

**WHAT DEFINES US**

**WATSCO 2022**

**ANNUAL REPORT**

## FINANCIAL HIGHLIGHTS

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(in thousands, except per share data)	2018	2019 <sup>(1)</sup>	2020	2021	2022
Revenues	\$ 4,546,653	\$ 4,770,362	\$ 5,054,928	\$ 6,280,192	<b>\$ 7,274,344</b>
Operating income	372,082	366,884	401,034	628,528	<b>831,578</b>
Adjusted operating income <sup>(2)</sup>	372,082	366,884	401,034	628,528	<b>835,214</b>
Net income attributable to Watsco, Inc.	242,932	245,950	269,579	418,945	<b>601,167</b>
Diluted earnings per share	6.49	6.50	7.01	10.78	<b>15.41</b>
Adjusted diluted earnings per share <sup>(2)</sup>	6.49	6.50	7.01	10.78	<b>14.20</b>
Dividends per share	5.60	6.40	6.925	7.625	<b>8.55</b>
Operating cash flow	170,557	335,771	534,379	349,566	<b>571,964</b>
Total assets	2,161,033	2,556,161	2,484,347	3,085,861	<b>3,488,214</b>
Borrowings under revolving credit agreement	135,200	155,700	—	89,000	<b>56,400</b>
Shareholders' equity	1,601,713	1,714,767	1,779,761	1,997,415	<b>2,248,278</b>

(1) Effective January 1, 2019, we adopted the provisions of accounting guidance related to leases. Amounts prior to January 1, 2019 have not been adjusted and remain as originally reported for such periods.

(2) Excludes the impact caused by the vesting of restricted stock on October 15, 2022.

How do we describe ourselves? Not in terms of what we do, but in terms of how we do it. How we approach business, how we think, how we partner with the OEMs and suppliers and why the OEMs and suppliers partner with us. What makes us the industry leader? It is our long-term focus, our entrepreneurial spirit, and our technological edge. Such characteristics may not sound bold or unique in the business world. What does stand out is what we've done with them, what we have accomplished for our shareholders, customers, and employees. Consistently.

**So then what defines us?**

# OUR RESULTS.

## TO OUR VALUED SHAREHOLDERS

Reflecting on 2022, we are proud to report a year marked by new records and accomplishments. Watsco achieved record sales and earnings while maintaining a strong balance sheet and generating healthy cash flow. Despite a moderating economy and ongoing supply chain challenges, our business leaders persevered, providing exceptional service to our customers and delivering outstanding results. I would like to personally thank our 7,200+ employees, who passionately support our customers every day.

Many factors influence a company's financial results, but the most important ingredient for Watsco's success is our *unique culture*. Often underestimated, culture is a powerful driver of performance and results.

Watsco's culture is defined by three core principles: trust in entrepreneurs and local leaders, relentless innovation, and an ownership mentality.

First, and most importantly, our entrepreneurial culture empowers leaders at all levels of the organization to make decisions that best serve our customers. Watsco was founded on the belief that entrepreneurs are the heart of every business and they deserve trust, confidence, respect, and opportunities for growth.

Localized decision-making and accountability are essential to our success as our 673 branches operate in diverse markets, which is why we encourage local leaders to tailor their approach to specific customer and product preferences.

At the same time, our local touch is supported by scale, access to capital, OEM and vendor relationships, and technology platforms that provide our business leaders with an edge in their markets. Our ability to combine local entrepreneurship with Watsco's robust resources is what truly sets us apart, establishing us as the industry pacesetter, redefining the way our customers do business.

Second, we continue to invest in the industry's leading digital ecosystem for HVAC/R contractors. In 2022, we invested nearly \$50 million in technology, bringing our total investment since 2018 to more than \$185 million. Our goal is to develop the industry's most robust, customer-friendly digital ecosystem that transforms the way distributors and contractors operate.

A few notable technology-related milestones in 2022 include more than 43,000 unique monthly users of our HVAC Pro+ mobile apps, \$2 billion in e-commerce sales, and approximately \$1 billion in gross merchandise value of sales through our OnCallAir digital selling platform.

The combination of higher customer adoption of our mobile apps and increased e-commerce has had two distinct results. Customers who are active users of our mobile apps and e-commerce platform grow meaningfully faster than non-users and those same customers experience lower attrition.

While we have made considerable progress, there is still much to do. We are committed to further expanding customer adoption, sustaining our technology investments, and delivering the best digital customer experience in our industry.

Last, but certainly not least, Watsco unique equity culture reinforces an ownership mentality through various equity programs, such as restricted stock for key corporate and operating leaders with cliff vesting at retirement age, stock options for emerging and high-potential talent, an employee stock purchase plan whereby employees can purchase Watsco stock at a discount, and 401(k) matching in Company stock.

We are immensely proud that Watsco employees are owners through these various equity plans. This equity culture promotes long-term thinking, retention of key leaders, and opportunities for employees to participate in the success of the business. We would have it no other way.

In 2022, we also celebrated a noteworthy milestone: Our Chairman and Chief Executive Officer (and my father), Albert H. Nahmad, marked his 50<sup>th</sup> anniversary with Watsco. From humble beginnings in 1972, Mr. Nahmad has transformed both our Company and the industry over his 50-year career. His drive, passion, and commitment to Watsco are unparalleled, and we celebrate his achievements.

Thank you for your trust and interest in our Company. Our ambitions remain limitless.



**Aaron (A.J.) Nahmad**  
**President**

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2012 / \$3,432B



2022 / \$7,274B

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# 112%

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## 10 YEAR REVENUE GROWTH

2012 - 2022

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## REVENUES

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OUR LONG-TERM FOCUS

## GROWTH

Watsco has established itself as the largest participant in the highly fragmented \$50 billion North American HVAC/R distribution market. Since entering this market in 1989, sales and operating income have grown at compounded annual growth rates (CAGRs) of 15% and 19%, respectively, reflecting strong, consistent performance across various macroeconomic and industry cycles.

2012 / \$3,432B

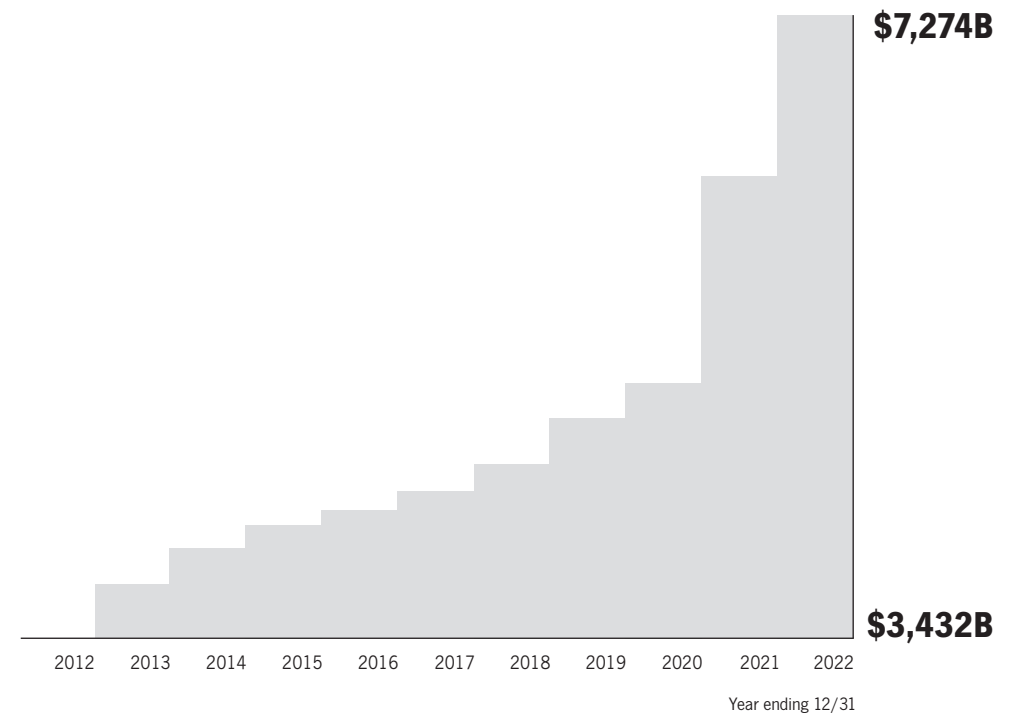


2022 / \$7,274B

# 112%

Watsco's scale, leading technology platforms, financial strength, entrepreneurial culture, and OEM relationships – along with the essential nature of HVAC/R products – are important competitive advantages that provide stability to our long-term performance.

## REVENUES



2012 / \$225M

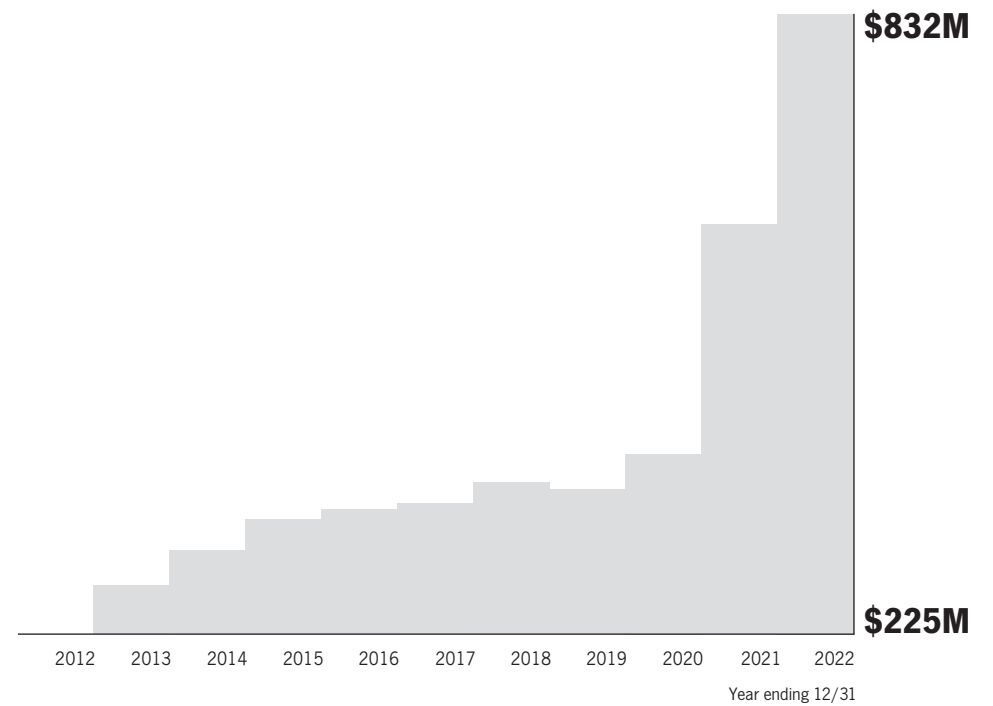


2022 / \$832M

# 270%

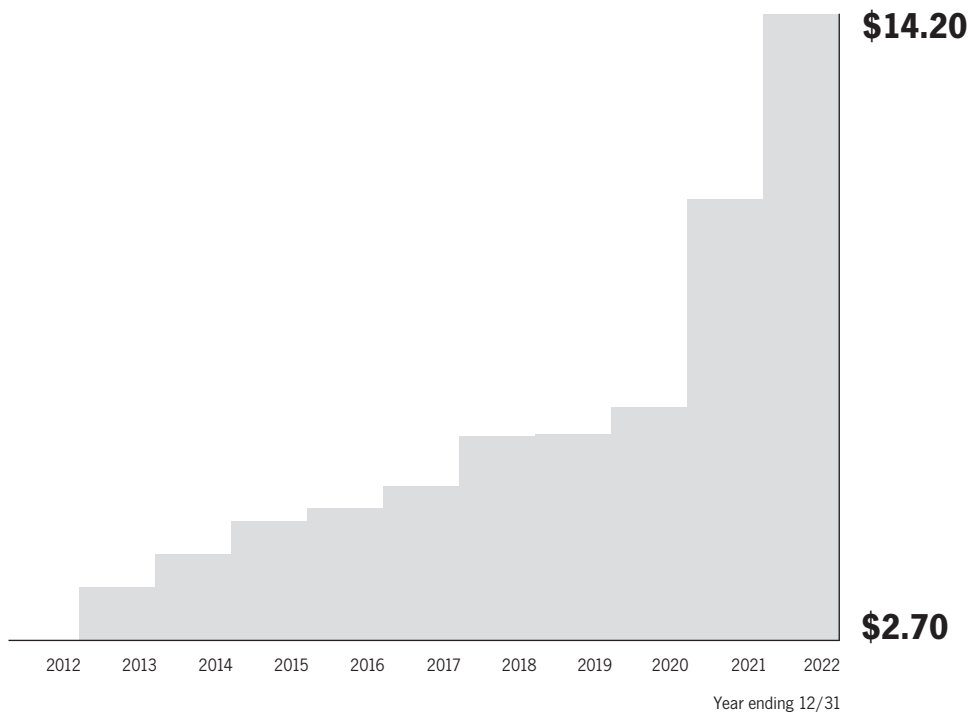
10 YEAR  
**OPERATING INCOME  
GROWTH**  
2012 - 2022

## OPERATING INCOME





## ADJUSTED DILUTED EPS



2012 / \$2.70

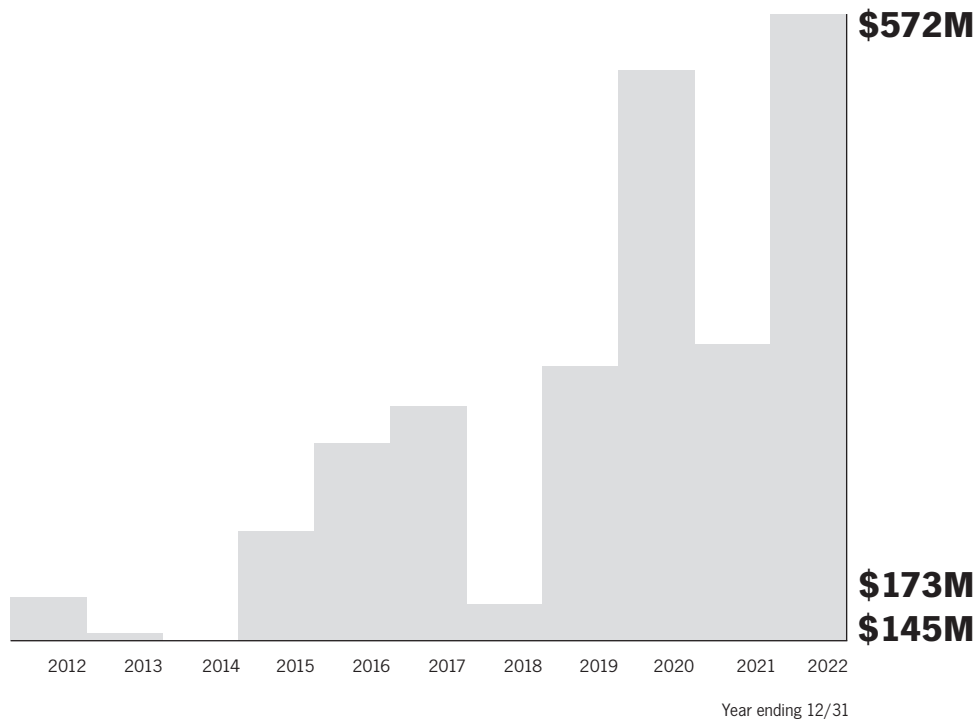


2022 / \$14.20

# 426%

10 YEAR  
**ADJUSTED DILUTED EPS  
GROWTH**  
2012 - 2022

## OPERATING CASH FLOW



2012 / \$173M



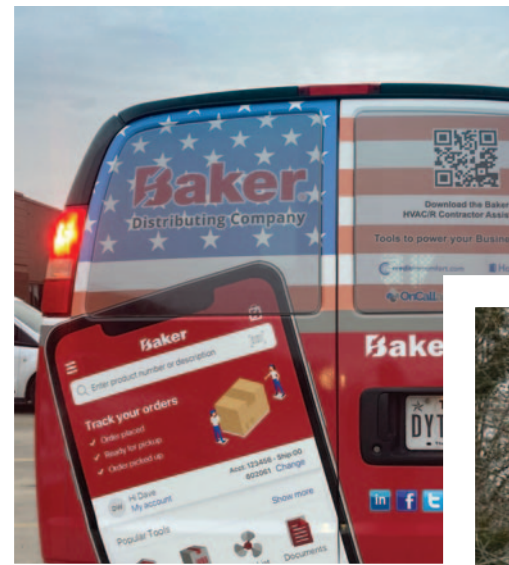
2022 / \$572M

# 230%

10 YEAR  
**OPERATING CASH FLOW  
 GROWTH**  
 2012 - 2022

## ACQUISITIONS

# 67



## OUR ENTREPRENEURIAL SPIRIT

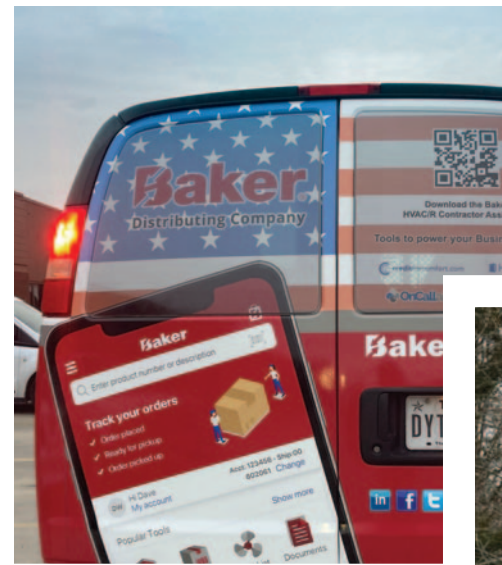
# CULTURE

We believe Watsco's success is the result of our entrepreneurial culture, which was established decades ago and continues to drive our performance today. We promote the core values of innovation, long-term growth, exceptional customer experience, and employee ownership. Our decentralized structure is designed to support the entrepreneurs and teams who run our operations. Across our footprint there are 673 business leaders who own their P&L and are empowered to make business decisions based on local dynamics, rather than corporate mandates.

## ACQUISITIONS

# 67

We have welcomed 67 businesses to the Watsco family over the last 33 years, most of which are successful, multi-generation, family-owned businesses. We are humbled and gratified to be entrusted with these families' legacies. In many instances, the rich legacies of those businesses are still alive and well within Watsco today.



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1989 / \$1M



2022 / \$332M

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21%

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33 YEAR  
**DIVIDENDS PAID  
COMPOUNDED ANNUAL  
GROWTH RATE**

1989 - 2022

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Watsco has paid dividends to shareholders for 49 consecutive years. Since 1989, Watsco's dividends have grown at a 21% CAGR. The Company's philosophy is to share increasing amounts of cash flow through higher dividends while maintaining a conservative balance sheet with continued capacity to build its distribution network.





1989 / \$2.70



2022 / \$249.40

# 21,739%

33 YEAR  
**CUMULATIVE TOTAL  
SHAREHOLDER RETURN**

1989 - 2022

## TOTAL SHAREHOLDER RETURN

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As of 12/31/22

10 YEAR

16.1%

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15 YEAR

17.8%

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20 YEAR

18.3%

25 YEAR

14.5%

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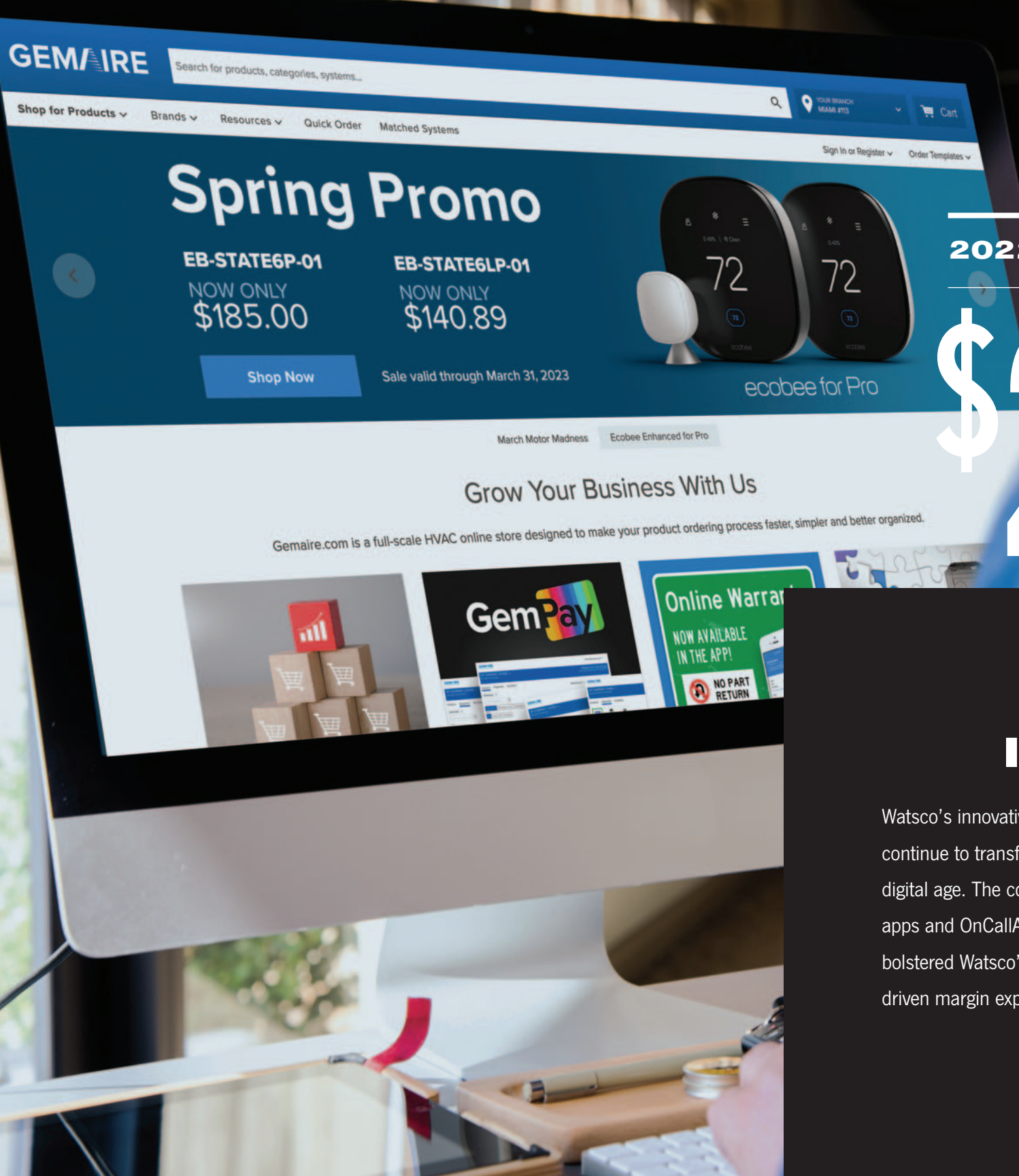
30 YEAR

18.0%

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33 YEAR

17.7%



## 2022 E-COMMERCE SALES

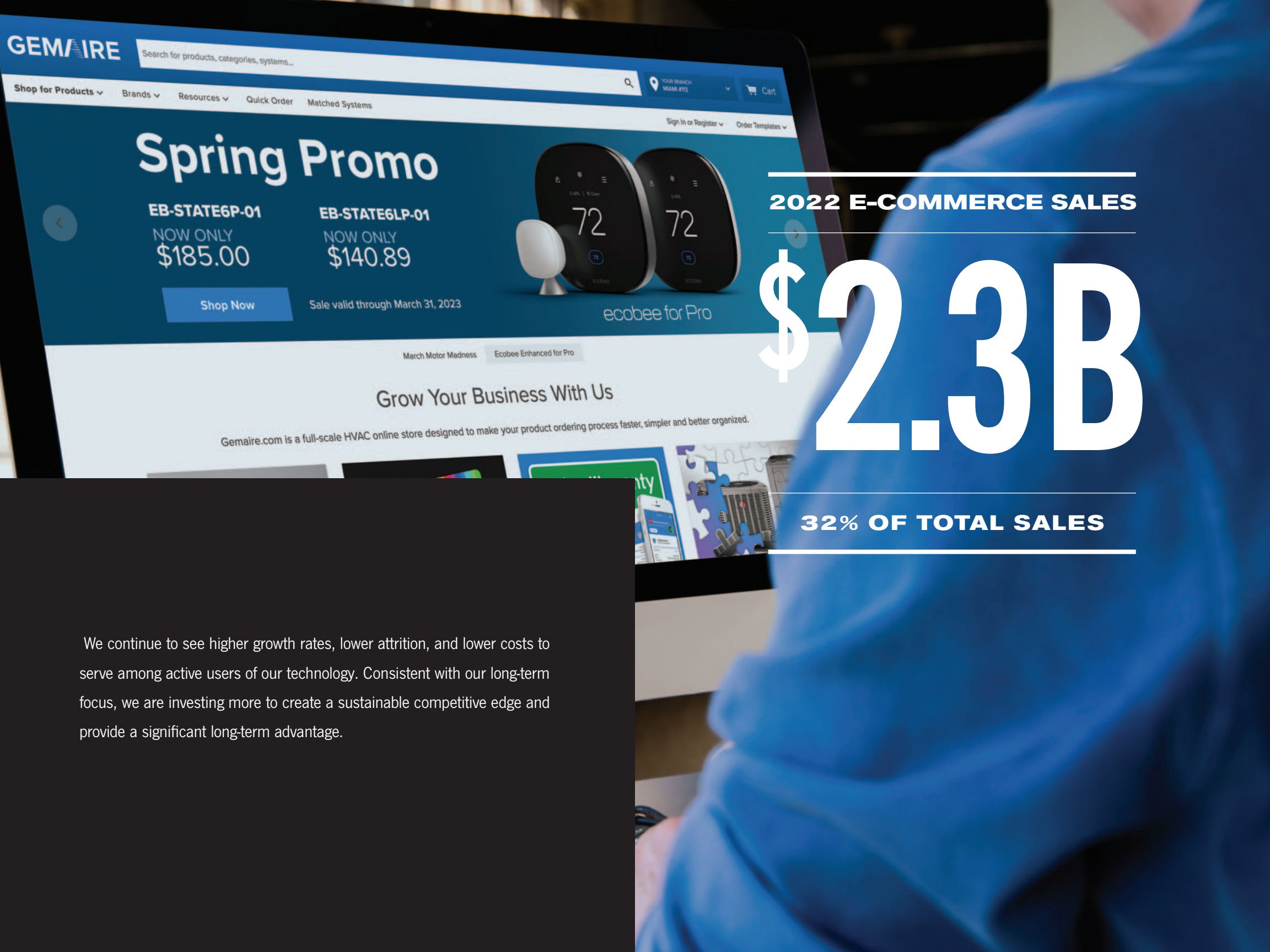
# \$2.3B

OUR TECHNOLOGICAL EDGE

## INNOVATION

Watsco's innovative technology tools, which are unique to the industry, continue to transform how our contractor customers do business in the digital age. The contractor-based platforms, like our HVAC Pro+ suite of apps and OnCallAir, combined with our internal-facing technologies, have bolstered Watsco's market share, energized new customer adoption, and driven margin expansion.





GEM/IRE

Search for products, categories, systems...



YOUR BRANCH  
MIAMI #113



Shop for Products ▾ Brands ▾ Resources ▾ Quick Order Matched Systems

Sign In or Register ▾ Order Templates ▾

# Spring Promo

EB-STATE6P-01  
NOW ONLY  
**\$185.00**

Shop Now

EB-STATE6LP-01  
NOW ONLY  
**\$140.89**

Sale valid through March 31, 2023



ecobee for Pro

March Motor Madness Ecobee Enhanced for Pro

## Grow Your Business With Us

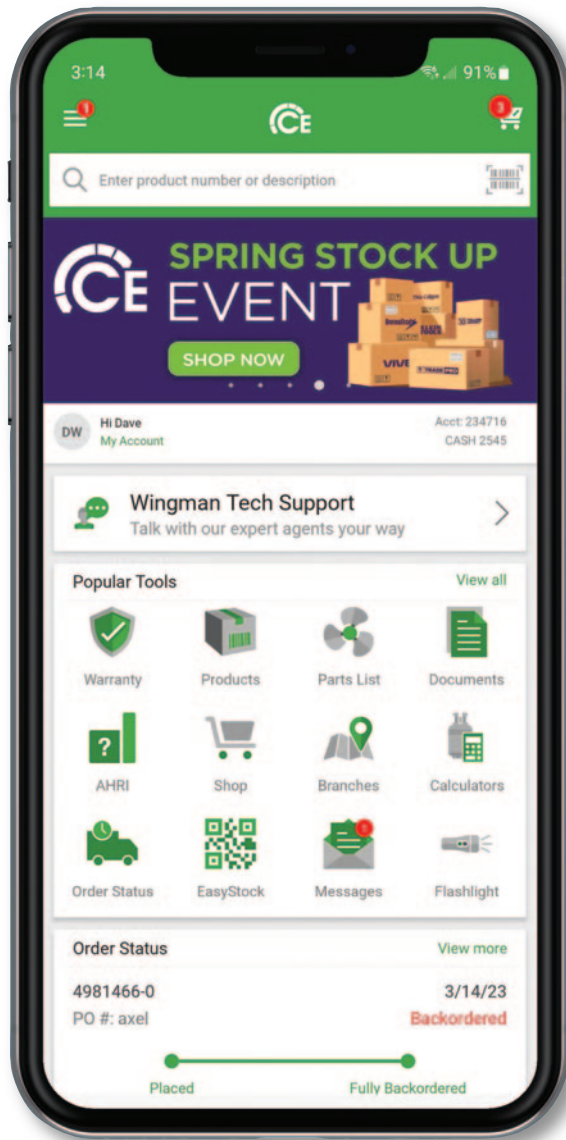
Gemaire.com is a full-scale HVAC online store designed to make your product ordering process faster, simpler and better organized.

**2022 E-COMMERCE SALES**

**\$2.3B**

**32% OF TOTAL SALES**

We continue to see higher growth rates, lower attrition, and lower costs to serve among active users of our technology. Consistent with our long-term focus, we are investing more to create a sustainable competitive edge and provide a significant long-term advantage.



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# 43,000

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## UNIQUE MONTHLY USERS OF OUR MOBILE APPS IN 2022

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Our proprietary apps provide customers real-time access to critical information that improves speed and productivity. This includes real time technical support, product detail, inventory availability, warranty look-up, system match ups, e-commerce and more.





# 1,000,000

**SKUs DELIVERED  
THROUGH OUR MOBILE  
APPS AND E-COMMERCE  
PLATFORM**

## **FINANCIAL REVIEW**

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## Management's Discussion and Analysis of Financial Condition and Results of Operations

### FORWARD-LOOKING STATEMENTS

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

- general economic conditions, both in the United States and in the international markets we serve;
- competitive factors within the HVAC/R industry;
- effects of supplier concentration, including conditions that impact the supply chain;
- fluctuations in certain commodity costs;
- consumer spending;
- consumer debt levels;
- the resurgence of the COVID-19 pandemic;
- new housing starts and completions;
- capital spending in the commercial construction market;
- access to liquidity needed for operations;
- seasonal nature of product sales;
- weather patterns and conditions;
- insurance coverage risks;
- federal, state, and local regulations impacting our industry and products;
- prevailing interest rates;
- the effect of inflation;
- foreign currency exchange rate fluctuations;
- international risk;
- cybersecurity risk; and
- the continued viability of our business strategy.

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

This discussion summarizes the significant factors affecting our consolidated operating results, financial condition and liquidity for the year ended December 31, 2022. This discussion should be read in conjunction with the information contained in Item 1A, "Risk Factors" and the consolidated financial statements, including the notes thereto, included in this Annual Report to Shareholders for the year ended December 31, 2022.

### COMPANY OVERVIEW

Watsco, Inc. was incorporated in Florida in 1956, and, together with its subsidiaries (collectively, "Watsco," or "we," "us," or "our") is the largest distributor of air conditioning, heating, and refrigeration equipment, and related parts and supplies ("HVAC/R") in the HVAC/R distribution industry in North America. At December 31, 2022, we operated from 673 locations in 42 U.S. States, Canada, Mexico, and Puerto Rico with additional market coverage on an export basis to portions of Latin America and the Caribbean.

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

Sales of residential central air conditioners, heating equipment, and parts and supplies are seasonal. Furthermore, profitability can be impacted favorably or unfavorably based on weather patterns, particularly during the Summer and Winter selling seasons. Demand related to the residential central air conditioning replacement market is typically highest in the second and third quarters, and demand for heating equipment is usually highest in the first and fourth quarters. Demand related to the new construction sectors throughout most of the markets we serve tends to be fairly evenly distributed throughout the year and depends largely on housing completions and related weather and economic conditions.

### IMPACT OF THE COVID-19 PANDEMIC AND ECONOMIC AND MARKETPLACE DYNAMICS

Since COVID-19 was declared a pandemic in March 2020, it has had, and could continue to have, widespread impacts on global financial markets and business practices. Although we learned to navigate COVID-19 while maintaining our operations in all material respects, the pandemic impacted our operations, and the operations of our customers and suppliers throughout 2020 and into 2021. However, as the effects of the pandemic have continued to lessen with the normalization of living with COVID-19 following the increase in accessibility to COVID-19 vaccines and antiviral treatments, the impact of the pandemic on our business has been more reflective of greater economic and marketplace dynamics, which include inflation, supply chain disruptions, and labor shortages, rather than pandemic-related issues, such as quarantines, location closures, mandated restrictions, employee illnesses, and travel restrictions.

Certain of our manufacturers and suppliers continue to experience some level of supply chain disruptions caused by component availability, labor shortages, transportation delays, and other logistical challenges, resulting in longer lead times and constrained availability of HVAC/R products. These supply chain disruptions impacted our ability to fulfill contractor demand at various points during 2022 and we estimate the impact was approximately 3% to 4% of lost revenues. We cannot reasonably estimate the future impact of supply chain disruptions to the extent that these disruptions become more pronounced than current conditions. Despite these disruptions, we experienced growth in sales during 2022.

We continue to take proactive steps to limit the impact of these disruptions and are working closely with our suppliers to ensure availability of products. Also, we continue to actively monitor the situation and may take further actions that alter our business.

### CLIMATE CHANGE AND REDUCTIONS IN CO<sub>2</sub>e EMISSIONS

We believe that our business plays an important and significant role in the drive to lower CO<sub>2</sub>e emissions. According to the Department of Energy, heating and air conditioning accounts for roughly half of household energy consumption in the United States. As such, replacing older, less efficient HVAC systems with higher efficiency systems is one of the most meaningful steps homeowners can take to reduce their electricity costs and carbon footprint.

The overwhelming majority of new HVAC systems that we sell replace systems that likely operate below current minimum efficiency standards in the United States and may use more harmful refrigerants that have been, or are being, phased-out. As consumers replace HVAC systems with new, higher-efficiency systems, homeowners will consume less energy, save costs, and reduce their carbon footprint.



The sale of high-efficiency systems has long been a focus of ours, and we have invested in tools and technology intended to capture an increasingly richer sales mix over time. In addition, regulatory mandates will periodically increase the required minimum SEER, thus providing a catalyst for greater sales of higher-efficiency systems. Recently enacted regulations increased the current minimum SEER beginning in 2023 (in general terms, to 14 SEER from 13 SEER in the Northern U.S. and to 15 SEER from 14 SEER for the Southern U.S.).

We offer a broad variety of systems that operate above the minimum SEER standards, ranging from base-level efficiency to systems that exceed 20 SEER. Our sales of higher-efficiency residential HVAC systems (those above base-level efficiency) grew 18% organically in 2022, outpacing the overall growth rate of 13% for residential HVAC equipment in the United States. Based on estimates validated by independent sources, we averted an estimated 15.8 million metric tons of CO<sub>2</sub>e emissions from January 1, 2020 to December 31, 2022 through the sale of replacement residential HVAC systems at higher-efficiency standards.

#### **Federal Tax Credits and State Incentives**

Demand for higher-efficiency products, such as variable-speed systems and heat pumps, is expected to benefit from the passage of the U.S. Inflation Reduction Act of 2022 (the "IRA") in August 2022. This legislation is intended, in part, to promote the replacement of existing systems in favor of high-efficiency heat pump systems that reduce greenhouse gas emissions, as compared to older systems, and thereby combat climate change. Programs under the IRA include enhanced tax credits for homeowners who install qualifying HVAC equipment and tax deductions for owners of commercial buildings that are upgraded to achieve defined energy savings. The IRA also sets aside \$4.3 billion for state-administered consumer rebate programs designed to promote energy savings for low and medium-income households, including HVAC systems. Further details, including qualifying products, specific programs, and other regulatory requirements contemplated by the IRA are being determined and are expected to be launched during 2023.

#### **JOINT VENTURES WITH CARRIER GLOBAL CORPORATION**

In 2009, we formed a joint venture with Carrier, which we refer to as Carrier Enterprise I, in which Carrier contributed company-owned locations in the Sun Belt states and Puerto Rico, and its export division in Miami, Florida, and we contributed certain locations that distributed Carrier products. We have an 80% controlling interest in Carrier Enterprise I, and Carrier has a 20% non-controlling interest. In 2019, Carrier Enterprise I acquired substantially all of the HVAC assets and assumed certain of the liabilities of Peirce-Phelps, Inc., an HVAC distributor operating in Pennsylvania, New Jersey, and Delaware. Carrier Enterprise I has a 38.1% ownership interest in Russell Sigler, Inc. ("RSI"), an HVAC distributor operating from 35 locations in the Western U.S.

The export division of Carrier Enterprise I, Carrier InterAmerica Corporation ("CIAC"), redomesticated from the U.S. Virgin Islands to Delaware in 2019, following which CIAC became a separate operating entity in which we have an 80% controlling interest and Carrier has a 20% non-controlling interest.

In 2011, we formed a second joint venture with Carrier, which we refer to as Carrier Enterprise II, in which Carrier contributed company-owned locations in the Northeast U.S., and we contributed certain locations operating as Homans Associates LLC ("Homans"), a Watsco subsidiary, in the Northeast U.S. Subsequently, Carrier Enterprise II purchased Carrier's distribution operations in Mexico. We have an 80% controlling interest in Carrier Enterprise II, and Carrier has a 20% non-controlling interest. In 2019, we repurchased the 20% ownership interest in Homans from Carrier Enterprise II and have since solely owned and operated Homans.

In 2012, we formed a third joint venture with Carrier, which we refer to as Carrier Enterprise III, to which Carrier contributed company-owned locations in Canada. We have a 60% controlling interest in Carrier Enterprise III, and Carrier has a 40% non-controlling interest.

In April 2021, we acquired certain assets and assumed certain liabilities comprising the HVAC distribution business of Temperature Equipment Corporation, an HVAC distributor operating from Illinois, Indiana, Kansas, Michigan, Minnesota, Missouri, and Wisconsin. We formed a new joint venture with Carrier, TEC Distribution LLC ("TEC"), that operates this business. We have an 80% controlling interest in TEC, and Carrier has a 20% non-controlling interest.

#### **CRITICAL ACCOUNTING ESTIMATES**

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

Our significant accounting policies are discussed in Note 1 to our audited consolidated financial statements included in this Annual Report to Shareholders. Management believes that the following accounting estimates include a higher degree of judgment and/or complexity and are reasonably likely to have a material impact on our financial condition or results of operations and, thus, are considered critical accounting estimates. Management has discussed the development and selection of critical accounting estimates with the Audit Committee of the Board of Directors and the Audit Committee has reviewed the disclosures relating to critical accounting estimates.

#### **Allowance for Doubtful Accounts**

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

The allowance for doubtful accounts was \$18.3 million and \$11.3 million at December 31, 2022 and 2021, respectively, an increase of \$7.0 million, which was primarily due to a single account delinquent in their payments at December 31, 2022. Accounts receivable balances greater than 90 days past due as a percent of accounts receivable at December 31, 2022 increased to 2.4% from 0.9% at December 31, 2021, which was primarily attributable to the account referenced.

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

### Inventory Valuation Reserves

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

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

The recoverability of goodwill is evaluated at least annually and when events or changes in circumstances indicate that the carrying amount may not be recoverable. We have one reporting unit that is subject to goodwill impairment testing. In performing the goodwill impairment test, we use a two-step approach. The first step compares the reporting unit's fair value to its carrying value. If the carrying value exceeds the fair value, a second step is performed to measure the amount of impairment loss. The identification and measurement of goodwill impairment involves the estimation of the fair value of our reporting unit and contains uncertainty because management must use judgment in determining appropriate assumptions to be used in the measurement of fair value. On January 1, 2023, we performed our annual evaluation of goodwill impairment and determined that the estimated fair value of our reporting unit exceeded its carrying value.

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

The estimates of fair value of our reporting unit, indefinite lived intangibles, and long-lived assets are based on the best information available as of the date of the assessment and incorporates management's assumptions about expected future cash flows and contemplates other valuation techniques. Future cash flows can be affected by changes in the industry, a declining economic environment, or market conditions. There have been no events or circumstances from the date of our assessments that would have had an impact on this conclusion. The carrying amounts of goodwill, intangibles, and long-lived assets were \$1,189.5 million and \$1,124.5 million at December 31, 2022 and 2021, respectively, an increase of \$65.0 million, primarily related to higher renewal lease rates of our warehouse facilities. Although no impairment losses have been recorded to date, there can be no assurance that impairments will not occur in the future. An adjustment to the carrying value of goodwill, intangibles, and long-lived assets could materially adversely impact the consolidated results of operations.

### Loss Contingencies

Accruals are recorded for various contingencies including self-insurance, legal proceedings, environmental matters, and other claims that arise in the normal course of business. The estimation process contains uncertainty because accruals are based on judgment, the probability of losses and, where applicable, the consideration of opinions of external legal counsel and actuarially determined estimates. Additionally, we record receivables from third party insurers when recovery has been determined to be probable.

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

estimates, additional reserves may be required and could materially impact the consolidated results of operations. The estimation process contains uncertainty since management must use judgment to estimate the ultimate cost that will be incurred to settle reported claims and unreported claims for incidents incurred but not reported as of the balance sheet date. Reserves in the amounts of \$12.3 million and \$7.3 million at December 31, 2022 and 2021, respectively, were established related to such insurance programs. The increase in self-insurance reserves was primarily due to the severity and frequency of claims reported during 2022.

### Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial reporting basis and the tax basis of assets and liabilities at enacted tax rates expected to be in effect when such amounts are recovered or settled. The use of estimates by management is required to determine income tax expense, deferred tax assets, and any related valuation allowance and deferred tax liabilities. A valuation allowance of \$8.2 million and \$5.1 million was recorded at December 31, 2022 and 2021, respectively. The increase was primarily attributable to the impact on U.S. deferred tax assets from share-based compensation deduction limitations related to the expansion of IRC Section 162(m). See Note 9 to our audited consolidated financial statements included in this Annual Report to Shareholders. The valuation allowance is based on several factors including, but not limited to, estimates of future taxable income by jurisdiction in which the deferred tax assets will be recoverable. These estimates can be affected by several factors, including changes to tax laws, or possible tax audits, or general economic conditions, or competitive pressures that could affect future taxable income. Although management believes that the estimates are reasonable, the deferred tax asset and any related valuation allowance will need to be adjusted if management's estimates of future taxable income differ from actual taxable income. An adjustment to the deferred tax asset and any related valuation allowance could materially impact the consolidated results of operations.

### NEW ACCOUNTING STANDARDS

There were no new accounting standards made effective during 2022 that have significance, or potential significance, to our consolidated financial statements.

### RESULTS OF OPERATIONS

The following table summarizes information derived from our audited consolidated statements of income, expressed as a percentage of revenues, for the years ended December 31, 2022, 2021, and 2020:

	2022	2021	2020
Revenues	100.0%	100.0%	100.0%
Cost of sales	72.1	73.4	75.8
Gross profit	27.9	26.6	24.2
Selling, general and administrative expenses	16.8	16.9	16.5
Other income	0.3	0.3	0.2
Operating income	11.4	10.0	7.9
Interest expense, net	0.0	0.0	0.0
Income before income taxes	11.4	10.0	7.9
Income taxes	1.7	2.1	1.5
Net income	9.7	7.9	6.4
Less: net income attributable to non-controlling interest	1.4	1.3	1.1
Net income attributable to Watsco, Inc.	8.3%	6.7%	5.3%

Note: Due to rounding, percentages may not total 100.

The following narratives reflect our acquisitions of Makdad Industrial Supply Co., Inc. (“MIS”) in August 2021, Acme Refrigeration of Baton Rouge LLC (“ACME”) in May 2021, and Temperature Equipment Corporation in April 2021. We did not acquire any businesses during 2022.

In the following narratives, computations and other information referring to “same-store basis” exclude the effects of locations closed, acquired, or locations opened, in each case during the immediately preceding 12 months, unless such locations are within close geographical proximity to existing locations. At December 31, 2022 and 2021, eight and four locations, respectively, that we opened during the immediately preceding 12 months were near existing locations and were therefore included in “same-store basis” information.

The table below summarizes the changes in our locations for 2022 and 2021:

	Number of Locations
December 31, 2020	600
Opened	24
Acquired	56
Closed	(9)
December 31, 2021	671
Opened	11
Closed	(9)
<b>December 31, 2022</b>	<b>673</b>

#### Tax Benefit from Fourth Quarter Vesting of Restricted Stock

Our 2022 results reflect the vesting of 975,622 shares of Class B restricted stock previously granted to our Chief Executive Officer (“CEO”) during the period from 1997 to 2011. The vesting occurred on October 15, 2022 and provided a \$49.0 million tax benefit and \$3.6 million in incremental selling, general and administrative expenses, primarily related to employment taxes. The net benefit to 2022 diluted earnings per share was \$1.21. Due to the infrequent nature of this event, certain key performance metrics in 2022 are presented on an “adjusted basis” to exclude the impact. Please see “Non-GAAP Financial Measures” below.

#### 2022 Compared to 2021

##### Revenues

(in millions)	Year Ended December 31,		Change	
	2022	2021		
Revenues	\$ 7,274.3	\$ 6,280.2	\$ 994.1	16%

The increase in revenues for 2022 included \$104.2 million attributable to new locations acquired and \$32.7 million from other locations opened during the preceding 12 months, offset by \$13.0 million from locations closed.

The following table presents our revenues by major product lines and related percentage change from the prior year:

	% of Sales		% Change	
	2022	2021	2022	2021
HVAC equipment	68%	69%	14%	23%
Other HVAC products	28%	28%	16%	22%
Commercial refrigeration products	4%	3%	24%	29%

(in millions)	Year Ended December 31,		Change	
	2022	2021		
Same-store sales	\$ 7,137.4	\$ 6,267.2	\$ 870.2	14%

The following table presents our revenues by major product lines on a same-store basis and related percentage change from the prior year:

	% of Same-Store Sales		% Change	
	2022	2021	2022	2021
HVAC equipment	68%	69%	13%	18%
Other HVAC products	28%	27%	15%	17%
Commercial refrigeration products	4%	4%	24%	29%

On a same-store basis, sales of HVAC equipment included a 12% increase in residential HVAC equipment (13% increase in U.S. markets and flat in international markets) and an 18% increase in sales of commercial HVAC equipment (18% increase in U.S. markets and a 17% increase in international markets).

For HVAC equipment, the increase in revenues was primarily due to the realization of price increases and a higher mix of high-efficiency air conditioning and heating systems, which sell at higher unit prices, resulting in a 13% increase in the average selling price and flat unit volume, as well as higher sales of commercial HVAC equipment.

#### Gross Profit

(in millions)	Year Ended December 31,		Change	
	2022	2021		
Gross profit	\$ 2,030.3	\$ 1,667.5	\$ 362.8	22%
Gross margin	27.9%	26.6%		

Gross profit for 2022 increased primarily as a result of increased revenues. Gross profit margin improved 130 basis-points primarily due to the impact of pricing and sales mix for residential HVAC equipment.



### Selling, General and Administrative Expenses

(in millions)	Year Ended December 31,		Change	
	2022	2021		
Selling, general and administrative expenses	\$ 1,221.4	\$ 1,058.3	\$ 163.1	15%
Selling, general and administrative expenses as a percentage of revenues	16.8%	\$ 16.9%		

Selling, general and administrative expenses for 2022 increased primarily due to increased revenues. On a same-store basis, selling, general and administrative expenses increased 13% as compared to 2021 and as a percentage of sales decreased to 16.7% versus 16.8% in 2021, primarily due to increased leverage on fixed costs driven by increased revenues.

### Other Income

Other income of \$22.7 million and \$19.3 million for 2022 and 2021, respectively, represented our share of the net income of RSI, in which we have a 38.1% equity interest.

### Operating Income

(in millions)	Year Ended December 31,		Change	
	2022	2021		
Operating income	\$ 831.6	\$ 628.5	\$ 203.1	32%
Operating margin	11.4%	\$ 10.0%		

On a same-store basis operating income grew 31% and operating margin was 11.5% in 2022 as compared to 10.0% in 2021.

### Interest Expense, Net

Interest expense, net for 2022 increased \$1.2 million, or 117%, to \$2.2 million, primarily as a result of an increase in average outstanding borrowings at a higher effective interest rate, in each case under our revolving credit facility, for the 2022 period as compared to the same period in 2021.

### Income Taxes

(in millions)	Year Ended December 31,		Change	
	2022	2021		
Income taxes	\$ 125.7	\$ 128.8	\$ (3.1)	(2%)
Effective income tax rate	17.2%	\$ 23.4%		

Income taxes represent a composite of the income taxes attributable to our wholly owned operations and income taxes attributable to the Carrier joint ventures, which are primarily taxed as partnerships for income tax purposes; therefore, Carrier is responsible for its proportionate share of income taxes attributable to its share of earnings from these joint ventures. The decrease in the effective income tax rate was primarily due to the increase in share-based compensation deduction resulting from the vesting of 975,622 shares of Class B restricted stock on October 15, 2022 and provided a \$49.0 million tax benefit that lowered our effective income tax rate. The share-based compensation deduction was partially offset by the addition of a valuation allowance on the deferred tax asset related to share-based compensation, and higher state income taxes in 2022 as compared to those related to the share-based compensation deduction in 2021.

### Net Income Attributable to Watsco, Inc.

Net income attributable to Watsco in 2022 increased \$182.2 million, or 43%, to \$601.2 million. The increase was primarily driven by higher revenues, expanded profit margins, and lower income taxes, partially offset by higher selling, general and administrative expenses and an increase in the net income attributable to the non-controlling interest.

Refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2021 for a discussion of results of operations for the year ended December 31, 2021 compared to the year ended December 31, 2020.

### NON-GAAP FINANCIAL MEASURES

We disclose operating income, operating margin, and diluted earnings per share on an adjusted, non-GAAP basis to exclude the impact caused by the vesting of restricted stock on October 15, 2022 as described above. We believe that these adjusted, non-GAAP financial measures provide greater comparability regarding our ongoing operating performance. These measures should not be considered an alternative to measurements required by U.S. GAAP.

The reconciliation of operating income, a GAAP measure, to operating income on an adjusted basis, a non-GAAP measure is as follows:

Year Ended December 31,	2022	2021
Operating income	\$ 831,578	\$ 628,528
Primarily employment taxes related to the vesting of restricted stock	3,636	—
Operating income on an adjusted basis	\$ 835,214	\$ 628,528
Operating margin on an adjusted basis	11.5%	10.0%

The reconciliation of diluted earnings per share for Common and Class B common stock, a GAAP measure, to diluted earnings per share for Common and Class B common stock on an adjusted basis, a non-GAAP measure is as follows:

Year Ended December 31,	2022	2021
Diluted earnings per share for Common and Class B common stock	\$ 15.41	\$ 10.78
Primarily employment taxes related to the vesting of restricted stock	0.08	—
Tax related benefit from the vesting of restricted stock	(1.29)	—
Diluted earnings per share for Common and Class B common stock on an adjusted basis	\$ 14.20	\$ 10.78

### LIQUIDITY AND CAPITAL RESOURCES

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

- cash needed to fund our business (primarily working capital requirements);
- borrowing capacity under our revolving credit facility;
- the ability to attract long-term capital with satisfactory terms;
- acquisitions, including joint ventures and investments in unconsolidated entities;
- dividend payments;
- capital expenditures; and
- the timing and extent of common stock repurchases.

### Sources and Uses of Cash

We rely on cash flows from operations and borrowing capacity under our revolving credit agreement to fund seasonal working capital needs and for other general corporate purposes in the short-term and the long-term, including dividend payments (if and as declared by our Board of Directors), capital expenditures, business acquisitions, and development of our long-term operating and technology strategies. Additionally, we may also generate cash through the issuance and sale of our Common stock.

As of December 31, 2022, we had \$147.5 million of cash and cash equivalents, of which \$124.9 million was held by foreign subsidiaries. The repatriation of cash balances from our foreign subsidiaries could have adverse tax impacts or be subject to capital controls; however, these balances are generally available to fund the ordinary business operations of our foreign subsidiaries without legal restrictions.

We believe that our operating cash flows, cash on hand, funds available for borrowing under our revolving credit agreement, and funds available from sales of our Common stock under our ATM Program (as defined below), each of which is described below, will be sufficient to meet our liquidity needs for the foreseeable future. However, there can be no assurance that our current sources of available funds will be sufficient to meet our cash requirements.

Our access to funds under our revolving credit agreement depends on the ability of the syndicate banks to meet their respective funding commitments. Disruptions in the credit and capital markets could adversely affect our ability to draw on our revolving credit agreement and may also adversely affect the determination of interest rates, particularly rates based on LIBOR, which is one of the base rates under our revolving credit agreement. On March 5, 2021, the United Kingdom Financial Conduct Authority, which regulates LIBOR, confirmed that LIBOR will either cease to be provided by any administrator or will no longer be representative after June 30, 2023 for USD LIBOR reference rates. The U.S. Federal Reserve has selected the Secured Overnight Funding Rate ("SOFR") as the preferred alternate rate to LIBOR. Our revolving credit agreement provides that it may be amended to replace LIBOR with an alternate benchmark rate including SOFR. SOFR is calculated differently from LIBOR and has inherent differences, including SOFR's limited historical data and that LIBOR is an unsecured lending rate while SOFR is a secured lending rate, which could give rise to uncertainties and volatility in the benchmark rates. While we continue to evaluate the potential impact of a transition to SOFR, these changes could result in interest obligations that are more than or do not otherwise correlate exactly over time with the payments that would have been made on such debt if LIBOR was available in its current form, including a potential increase in our overall interest expense. Additionally, disruptions in the credit and capital markets could also result in increased borrowing costs and/or reduced borrowing capacity under our revolving credit agreement.

### Working Capital

Working capital increased to \$1,392.2 million at December 31, 2022 from \$1,234.7 million at December 31, 2021, due to: (i) higher inventory balances primarily due to the general impact of inflation, greater inventory requirements in preparation for the required transition to higher minimum efficiency level for residential HVAC systems effective January 1, 2023, and more extensive inventories in response to various supply chain disruptions; and (ii) higher accounts receivable consistent with overall increased sales, which were offset by an increase in accounts payable and accrued liabilities and the reclassification of borrowings under our revolving credit agreement, which matures in December 2023, as current.

### Cash Flows

The following table summarizes our cash flow activity for 2022 and 2021 (in millions):

	2022	2021	Change
Cash flows provided by operating activities	\$ 572.0	\$ 349.6	\$ 222.4
Cash flows used in investing activities	\$ (33.8)	\$ (148.6)	\$ 114.8
Cash flows used in financing activities	\$ (504.0)	\$ (228.6)	\$ (275.4)

The individual items contributing to cash flow changes for the years presented are detailed in the audited consolidated statements of cash flows included in this Annual Report to Shareholders.

### Operating Activities

The increase in net cash provided by operating activities was primarily due to higher net income and accounts receivable collections, partially offset by increases in the level of inventory and timing of vendor payments in 2022 as compared to 2021.

### Investing Activities

Net cash used in investing activities was lower in 2022 primarily due to cash consideration paid for businesses acquired in 2021, whereas we acquired no businesses in 2022.

### Financing Activities

The increase in net cash used in financing activities was primarily attributable to an increase in dividends paid, the payment of withholding tax obligations primarily upon the vesting of restricted stock previously granted to our CEO, and higher borrowings under our revolving credit agreement in 2022, partially offset by proceeds from the non-controlling interest for its contribution to the acquisition of TEC in 2021.

### Revolving Credit Agreement

We maintain an unsecured, \$560.0 million syndicated multicurrency revolving credit agreement, which we use to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends (if and as declared by our Board of Directors), capital expenditures, stock repurchases and issuances of letters of credit. The credit facility has a seasonal component from October 1 to March 31, during which the borrowing capacity may be reduced to \$460.0 million at our discretion (which effectively reduces fees payable in respect of the unused portion of the commitment), and we effected this reduction in 2022. Included in the credit facility are a \$100.0 million swingline subfacility, a \$10.0 million letter of credit subfacility, a \$75.0 million alternative currency borrowing sublimit and an \$8.0 million Mexican borrowing sublimit.

The revolving credit agreement matures on December 5, 2023, and accordingly, borrowings outstanding under the revolving credit agreement are classified as current liabilities in our consolidated balance sheet at December 31, 2022. We believe that we will refinance the revolving credit agreement at or prior to its maturity on similar terms and subject to similar conditions.

Borrowings under the credit facility bear interest at either LIBOR-based rates plus a spread, which ranges from 87.5 to 150.0 basis-points (LIBOR plus 87.5 basis-points at December 31, 2022), depending on our ratio of total debt to EBITDA, or on rates based on the highest of the Federal Funds Effective Rate plus 0.5%, the Prime Rate or the Eurocurrency Rate plus 1.0%, in each case plus a spread which ranges from 0 to 50.0 basis-points (0 basis-points at December 31, 2022), depending on our ratio of total debt to EBITDA. We pay a variable commitment fee on the unused portion of the commitment under the revolving credit agreement, ranging from 7.5 to 20.0 basis-points (7.5 basis-points at December 31, 2022).

At December 31, 2022 and December 31, 2021, \$56.4 million and \$89.0 million, respectively, were outstanding under the revolving credit agreement. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at December 31, 2022.

### ***At-the-Market Offering Program***

On February 25, 2022, we entered into an amended and restated sales agreement with Robert W. Baird & Co. Inc. and Goldman Sachs & Co. LLC, which enables the Company to issue and sell shares of Common stock in one or more negotiated transactions or transactions that are deemed to be “at the market” offerings as defined in Rule 415 under the Securities Act of 1933, as amended (the “Securities Act”), for a maximum aggregate offering amount of up to \$300.0 million (the “ATM Program”). The offer and sale of our Common stock pursuant to the ATM Program has been registered under the Securities Act pursuant to our automatically effective shelf registration statement on Form S-3 (File No. 333-260758). As of December 31, 2022, no shares of Common stock had been sold under the ATM Program.

### ***Contractual Obligations***

At December 31, 2022, operating lease liabilities for real property, vehicles, and equipment totaled \$319.3 million and expire at various dates through 2032. Refer to Note 2 to our audited consolidated financial statements included in this Annual Report to Shareholders for information on our operating lease liabilities and related maturities.

Commercial obligations outstanding at December 31, 2022 under our revolving credit agreement consisted of borrowings totaling \$56.4 million with revolving maturities of 31 days.

At December 31, 2022, we were obligated under various non-cancelable purchase orders with our key suppliers for goods aggregating approximately \$69.0 million, of which approximately \$56.0 million is with Carrier and its affiliates. These purchase obligations represent commitments under purchase orders for goods in the ordinary course of business that are enforceable and legally binding with defined terms as to price, quantity, and delivery.

The total amount of unrecognized tax benefits (net of the federal benefit received from state positions) relating to various tax positions we have taken, the timing of which is uncertain, was \$6.5 million at December 31, 2022. Refer to Note 9 to our audited consolidated financial statements included in this Annual Report to Shareholders for additional information on our unrecognized tax benefits.

### ***Off-Balance Sheet Arrangements***

Refer to Note 15 to our audited consolidated financial statements included in this Annual Report to Shareholders, under the caption “Off-Balance Sheet Financial Instruments,” for a discussion of a standby letter of credit and performance bonds for which we were contingently liable at December 31, 2022.

### ***Investment in Unconsolidated Entity***

Carrier Enterprise I has a 38.1% ownership interest in RSI, an HVAC distributor operating from 35 locations in the Western U.S. Our proportionate share of the net income of RSI is included in other income in our consolidated statements of income.

Carrier Enterprise I is a party to a shareholders’ agreement (the “Shareholders’ Agreement”) with RSI and its shareholders, consisting of five family siblings, their children and affiliates related to them. Pursuant to the Shareholders’ Agreement, RSI’s shareholders have the right to sell, and Carrier Enterprise I has the obligation to purchase, their respective shares of RSI for a purchase price determined based on the higher of book value or a multiple of EBIT, the latter of which Carrier Enterprise I used to calculate the price for its 38.1% investment held in RSI. RSI’s shareholders may transfer their respective shares of RSI common stock only to members of the Sigler family or to Carrier Enterprise I, and, at any time from and after the date on which Carrier Enterprise I owns 85% or more of RSI’s outstanding common stock, it has the right, but not the obligation, to purchase from RSI’s shareholders the remaining outstanding shares of RSI common stock. At December 31, 2022, the estimated purchase amount we would be contingently liable for was approximately \$357.0 million. We believe that our operating cash flows, cash on hand, funds available for borrowing under our revolving credit agreement, or use of the ATM Program would be sufficient to purchase any additional ownership interests in RSI.

### ***Acquisitions***

On August 20, 2021, one of our wholly owned subsidiaries acquired MIS, a distributor of air conditioning and heating products operating from six locations in Pennsylvania. Consideration for the purchase consisted of \$3.2 million in cash and the issuance of 3,627 shares of Common stock having a fair value of \$1.0 million, net of cash acquired of \$0.2 million.

On May 7, 2021, we acquired certain assets and assumed certain liabilities of ACME, a distributor of air conditioning, heating, and refrigeration products, operating from 18 locations in Louisiana and Mississippi, for \$22.9 million less certain average revolving indebtedness. Consideration for the purchase consisted of \$18.1 million in cash, 8,492 shares of Common stock having a fair value of \$2.6 million, and \$3.1 million repayment of indebtedness, net of cash acquired of \$1.3 million.

On April 9, 2021, we acquired certain assets and assumed certain liabilities comprising the HVAC distribution business of Temperature Equipment Corporation, an HVAC distributor operating from 32 locations in Illinois, Indiana, Kansas, Michigan, Minnesota, Missouri, and Wisconsin. We formed a new, stand-alone joint venture with Carrier, TEC, which operates this business. We have an 80% controlling interest in TEC, and Carrier has a 20% non-controlling interest. Consideration for the purchase was paid in cash, consisting of \$105.2 million paid to Temperature Equipment Corporation (Carrier contributed \$21.0 million and we contributed \$84.2 million) and \$1.5 million for repayment of indebtedness.

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

### ***Common Stock Dividends***

We paid cash dividends of \$8.55, \$7.625, and \$6.925 per share of Common stock and Class B common stock in 2022, 2021, and 2020, respectively. On January 3, 2023, our Board of Directors declared a regular quarterly cash dividend of \$2.45 per share of both Common and Class B common stock that was paid on January 31, 2023 to shareholders of record as of January 17, 2023. Future dividends and/or changes in dividend rates are at the sole discretion of the Board of Directors and depend upon factors including, but not limited to, cash flow generated by operations, profitability, financial condition, cash requirements, and future prospects.

### ***Company Share Repurchase Program***

In September 1999, our Board of Directors authorized the repurchase, at management’s discretion, of up to 7,500,000 shares of common stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders’ equity. We last repurchased shares under this plan in 2008. In aggregate, 6,370,913 shares of Common and Class B common stock have been repurchased at a cost of \$114.4 million since the inception of the program. At December 31, 2022, there were 1,129,087 shares remaining authorized for repurchase under the program. The IRA includes, among other provisions, a 1% excise tax on corporate stock repurchases in tax years beginning after December 31, 2022. In consideration of any further stock repurchases under our repurchase program, we intend to evaluate the impact of the IRA’s 1% excise tax on stock repurchases in tax years beginning after December 31, 2022.

### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

### **Foreign Currency Exposure**

We are exposed to cash flow and earnings fluctuations resulting from currency exchange rate variations. These exposures are transactional and translational in nature. The foreign currency exchange rates to which we are exposed are the Canadian dollar and Mexican peso. Revenues in these markets accounted for 5% and 2%, respectively, of our total revenues for 2022.

Our transactional exposure primarily relates to purchases by our Canadian operations in currencies other than their local currency. To mitigate the impact of currency exchange rate movements on these purchases, we use foreign currency forward contracts. By entering into these foreign currency forward contracts, we lock in exchange rates that would otherwise cause losses should the U.S. dollar strengthen and gains should the U.S. dollar weaken, in each case against the Canadian dollar.

We have exposure related to the translation of financial statements of our Canadian operations into U.S. dollars, our functional currency. We do not currently hold any derivative contracts that hedge our foreign currency translational exposure. A 10% change in the Canadian dollar would have had an estimated \$5.1 million impact to our financial position and results of operations for 2022.

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

We had only one foreign exchange contract at December 31, 2022, the total notional value of which was \$3.3 million, and such contract expired during January 2023. For the year ended December 31, 2022, foreign currency transaction gains and losses did not have a material impact on our results of operations. See Note 16 to our audited consolidated financial statements included in this Annual Report to Shareholders for further information on our derivative instruments.

### **Interest Rate Exposure**

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

We have evaluated our exposure to interest rates assuming we are fully borrowed under our \$560.0 million revolving credit agreement and determined that a 100 basis-point change in interest rates would result in an impact to income before income taxes of approximately \$5.6 million. See Note 8 to our audited consolidated financial statements included in this Annual Report to Shareholders for further information about our debt.

## Management's Report on Internal Control Over Financial Reporting

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

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

Under the supervision and with the participation of our management, including our Chief Executive Officer, Executive Vice President and Chief Financial Officer, we conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2022. The assessment was based on criteria established in the framework *Internal Control — Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission. Based on this assessment under the COSO framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2022. The effectiveness of our internal control over financial reporting as of December 31, 2022 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report that is included herein.

## Report of Independent Registered Public Accounting Firm

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

### **Opinion on Internal Control Over Financial Reporting**

We have audited Watsco, Inc. and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2022, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2022, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2022 and 2021, the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2022, and the related notes (collectively, the consolidated financial statements), and our report dated February 24, 2023 expressed an unqualified opinion on those consolidated financial statements.

### **Basis for Opinion**

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

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

### **Definition and Limitations of Internal Control Over Financial Reporting**

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

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

Miami, Florida  
February 24, 2023

**KPMG LLP**  
KPMG LLP



## Report of Independent Registered Public Accounting Firm

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

### **Opinion on the Consolidated Financial Statements**

We have audited the accompanying consolidated balance sheets of Watsco, Inc. and subsidiaries (the Company) as of December 31, 2022 and 2021, the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2022, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2022, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2022, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 24, 2023 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

### **Basis for Opinion**

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

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

### **Critical Audit Matter**

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of a critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

#### *Evaluation of inventory net realizable value adjustments related to excess and slow-moving inventory*

As discussed in Note 1 to the consolidated financial statements, the Company values its inventory at the lower of cost using weighted-average cost basis and first-in, first-out methods, or net realizable value. The Company adjusts excess, slow-moving, and damaged inventory to their estimated net realizable value. As of December 31, 2022, the Company's inventory balance was \$1,370,173 thousand.

We identified the evaluation of inventory net realizable value adjustments related to excess and slow-moving inventory as a critical audit matter due to the amount of judgment required by the Company in making such estimates. As a result, there was a high degree of subjective auditor judgment in assessing such estimates, specifically as it related to the future salability of inventories.

The following are the primary procedures we performed to address this critical audit matter. We evaluated the design and tested the operating effectiveness of certain internal controls over the Company's process to estimate net realizable values related to excess and slow-moving inventory. This included controls related to the future salability of inventories, assumptions used for excess and slow-moving inventory, and the Company's review of inventory net realizable value adjustments. We compared a selection of inventory units to historical performance to assess possible write-down indications and future salability. We performed a sensitivity analysis under various scenarios and analyzed trends of total adjustments to net realizable values in relation to total inventory to test the Company's determination of the inventory valuation and adjustments related to excess and slow-moving inventory.

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

Miami, Florida  
February 24, 2023

**KPMG LLP**  
KPMG LLP

## CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

Years Ended December 31,	2022	2021	2020
Revenues	\$ 7,274,344	\$ 6,280,192	\$ 5,054,928
Cost of sales	5,244,055	4,612,647	3,832,107
Gross profit	2,030,289	1,667,545	1,222,821
Selling, general and administrative expenses	1,221,382	1,058,316	833,051
Other Income	22,671	19,299	11,264
Operating income	831,578	628,528	401,034
Interest expense, net	2,165	996	1,239
Income before income taxes	829,413	627,532	399,795
Income taxes	125,717	128,797	76,623
Net income	703,696	498,735	323,172
Less: net income attributable to non-controlling interest	102,529	79,790	53,593
Net income attributable to Watsco, Inc.	\$ 601,167	\$ 418,945	\$ 269,579
Earnings per share for Common and Class B common stock:			
Basic	\$ 15.46	\$ 10.83	\$ 7.03
Diluted	\$ 15.41	\$ 10.78	\$ 7.01

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

Years Ended December 31,	2022	2021	2020
Net income	\$ 703,696	\$ 498,735	\$ 323,172
Other comprehensive (loss) income, net of tax			
Foreign currency translation adjustment	(20,305)	936	6,272
Unrealized gain on cash flow hedging instruments	—	70	880
Reclassification of loss (gain) on cash flow hedging instruments into earnings	—	219	(418)
Other comprehensive (loss) income	(20,305)	1,225	6,734
Comprehensive income	683,391	499,960	329,906
Less: comprehensive income attributable to non-controlling interest	95,758	80,324	56,144
Comprehensive income attributable to Watsco, Inc.	\$ 587,633	\$ 419,636	\$ 273,762

See accompanying notes to consolidated financial statements.

## CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

December 31,	2022	2021
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 147,505	\$ 118,268
Accounts receivable, net	747,110	698,456
Inventories, net	1,370,173	1,115,469
Other current assets	33,951	29,207
Total current assets	2,298,739	1,961,400
Property and equipment, net	125,424	111,019
Operating lease right-of-use assets	317,314	268,528
Goodwill	430,711	434,019
Intangible assets, net	175,191	186,896
Investment in unconsolidated entity	132,802	114,808
Other assets	8,033	9,191
	\$ 3,488,214	\$ 3,085,861
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term obligations	\$ 90,597	\$ 84,501
Borrowings under revolving credit agreement (Note 8)	56,400	—
Accounts payable	456,128	364,185
Accrued expenses and other current liabilities	303,397	278,036
Total current liabilities	906,522	726,722
Long-term obligations:		
Borrowings under revolving credit agreement (Note 8)	—	89,000
Operating lease liabilities, net of current portion	232,144	187,024
Finance lease liabilities, net of current portion	11,388	9,189
Total long-term obligations	243,532	285,213
Deferred income taxes and other liabilities	89,882	76,511
Commitments and contingencies		
Watsco, Inc. shareholders' equity:		
Common stock, \$0.50 par value, 60,000,000 shares authorized; 38,108,752 and 37,881,247 shares outstanding at December 31, 2022 and 2021, respectively	19,054	18,941
Class B common stock, \$0.50 par value, 10,000,000 shares authorized; 5,513,386 and 5,790,636 shares outstanding at December 31, 2022 and 2021, respectively	2,757	2,895
Preferred stock, \$0.50 par value, 10,000,000 shares authorized; no shares issued	—	—
Paid-in capital	973,060	1,003,932
Accumulated other comprehensive loss, net of tax	(47,710)	(34,176)
Retained earnings	1,029,516	760,796
Treasury stock, at cost, 4,823,988 shares of Common stock and 48,263 shares of Class B common stock at both December 31, 2022 and 2021, respectively	(87,440)	(87,440)
Total Watsco, Inc. shareholders' equity	1,889,237	1,664,948
Non-controlling interest	359,041	332,467
Total shareholders' equity	2,248,278	1,997,415
	\$ 3,488,214	\$ 3,085,861

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In thousands, except share and per share data)

	Common Stock, Class B Common Stock and Preferred Stock Shares	Common Stock, Class B Common Stock and Preferred Stock Amount	Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Non-controlling Interest	Total
<b>Balance at December 31, 2019</b>	<b>38,194,056</b>	<b>\$21,533</b>	<b>\$907,877</b>	<b>\$(39,050)</b>	<b>\$632,507</b>	<b>\$(87,440)</b>	<b>\$279,340</b>	<b>\$1,714,767</b>
Net income					269,579		53,593	323,172
Other comprehensive gain				4,183			2,551	6,734
Issuances of restricted shares of common stock	184,265	92	(92)					—
Forfeitures of restricted shares of common stock	(3,589)	(2)	2					—
Common stock contribution to 401(k) plan	25,216	13	4,530					4,543
Stock issuances from exercise of stock options and employee stock purchase plan	144,894	72	21,528					21,600
Retirement of common stock	(23,148)	(11)	(4,631)					(4,642)
Share-based compensation			21,862					21,862
Cash dividends declared and paid on Common and Class B common stock, \$6.925 per share					(265,713)			(265,713)
Adjustment to fair value of Common stock issued for N&S Supply of Fishkill, Inc.			(161)					(161)
Distributions to non-controlling interest							(42,401)	(42,401)
<b>Balance at December 31, 2020</b>	<b>38,521,694</b>	<b>21,697</b>	<b>950,915</b>	<b>\$(34,867)</b>	<b>636,373</b>	<b>\$(87,440)</b>	<b>293,083</b>	<b>1,779,761</b>
Net income					418,945		79,790	498,735
Other comprehensive gain				691			534	1,225
Issuances of restricted shares of common stock	194,643	97	(97)					—
Forfeitures of restricted shares of common stock	(57,089)	(28)	28					—
Common stock contribution to 401(k) plan	22,752	11	5,143					5,154
Stock issuances from exercise of stock options and employee stock purchase plan	136,641	69	22,111					22,180
Retirement of common stock	(7,898)	(4)	(2,253)					(2,257)
Common stock released from escrow	(23,230)	(12)	12		522			522
Share-based compensation			24,531					24,531
Cash dividends declared and paid on Common and Class B common stock, \$7.625 per share					(295,044)			(295,044)
Common stock issued for Acme Refrigeration of Baton Rouge LLC	8,492	4	2,547					2,551
Common stock issued for Makdad Industrial Supply Co., Inc.	3,627	2	995					997
Investment in TEC Distribution LLC							21,040	21,040
Distributions to non-controlling interest							(61,980)	(61,980)
<b>Balance at December 31, 2021</b>	<b>38,799,632</b>	<b>21,836</b>	<b>1,003,932</b>	<b>\$(34,176)</b>	<b>760,796</b>	<b>\$(87,440)</b>	<b>332,467</b>	<b>1,997,415</b>
Net income					601,167		102,529	703,696
Other comprehensive loss				(13,534)			(6,771)	(20,305)
Issuances of restricted shares of common stock	143,059	72	(72)					—
Forfeitures of restricted shares of common stock	(13,000)	(7)	7					—
Common stock contribution to 401(k) plan	21,560	11	6,735					6,746
Stock issuances from exercise of stock options and employee stock purchase plan	120,696	60	20,742					20,802
Retirement of common stock	(322,060)	(161)	(87,327)					(87,488)
Share-based compensation			29,043					29,043
Cash dividends declared and paid on Common and Class B common stock, \$8.55 per share					(332,447)			(332,447)
Distributions to non-controlling interest							(69,184)	(69,184)
<b>Balance at December 31, 2022</b>	<b>38,749,887</b>	<b>\$21,811</b>	<b>\$973,060</b>	<b>\$(47,710)</b>	<b>\$1,029,516</b>	<b>\$(87,440)</b>	<b>\$359,041</b>	<b>\$2,248,278</b>

See accompanying notes to consolidated financial statements.



## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

Years Ended December 31,	2022	2021	2020
Cash flows from operating activities:			
Net income	\$ 703,696	\$ 498,735	\$ 323,172
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	31,683	28,127	25,908
Share-based compensation	28,821	25,365	22,129
Deferred income tax provision	13,466	5,939	40
Provision for doubtful accounts	8,539	6,888	2,688
Non-cash contribution to 401(k) plan	6,746	5,154	4,543
(Gain) loss on sale of property and equipment	(1,624)	350	17
Other income from investment in unconsolidated entity	(22,671)	(19,299)	(11,264)
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable, net	(60,154)	(130,414)	(3,559)
Inventories, net	(259,860)	(243,660)	139,929
Accounts payable and other liabilities	121,993	182,819	33,936
Other, net	1,329	(10,438)	(3,160)
Net cash provided by operating activities	571,964	349,566	534,379
Cash flows from investing activities:			
Capital expenditures	(35,652)	(25,464)	(16,436)
Business acquisitions, net of cash acquired	(47)	(129,462)	—
Proceeds from sale of equity securities	—	5,993	—
Other investment	—	(1,000)	—
Proceeds from sale of property and equipment	1,863	1,356	94
Net cash used in investing activities	(33,836)	(148,577)	(16,342)
Cash flows from financing activities:			
Dividends on Common and Class B common stock	(332,447)	(294,522)	(265,713)
Repurchases of common stock to satisfy employee withholding tax obligations	(87,107)	(1,092)	(2,299)
Distributions to non-controlling interest	(69,184)	(61,980)	(42,401)
Net (repayments) proceeds under revolving credit agreement	(32,600)	89,000	(155,700)
Net repayments of finance lease liabilities	(3,042)	(2,040)	(1,441)
Payment of fees related to revolving credit agreement	—	(22)	(196)
Proceeds from non-controlling interest for investment in TEC Distribution LLC	—	21,040	—
Net proceeds from issuances of common stock	20,422	21,014	19,257
Net cash used in financing activities	(503,958)	(228,602)	(448,493)
Effect of foreign exchange rate changes on cash and cash equivalents	(4,933)	(186)	2,069
Net increase (decrease) in cash and cash equivalents	29,237	(27,799)	71,613
Cash and cash equivalents at beginning of year	118,268	146,067	74,454
Cash and cash equivalents at end of year	\$ 147,505	\$ 118,268	\$ 146,067

### Supplemental cash flow information (Note 21)

See accompanying notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

(In thousands, except share and per share data)

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Organization, Consolidation and Presentation

Watsco, Inc. (collectively with its subsidiaries, “Watsco,” “we,” “us,” or “our”) was incorporated in Florida in 1956 and is the largest distributor of air conditioning, heating and refrigeration equipment and related parts and supplies (“HVAC/R”) in the HVAC/R distribution industry in North America. At December 31, 2022, we operated from 673 locations in 42 U.S. states, Canada, Mexico, and Puerto Rico with additional market coverage on an export basis to portions of Latin America and the Caribbean.

The consolidated financial statements include the accounts of Watsco, all of its wholly owned subsidiaries, the accounts of four joint ventures with Carrier Global Corporation, which we refer to as Carrier, the accounts of Carrier InterAmerica Corporation, of which we have an 80% controlling interest and Carrier has a 20% non-controlling interest, and our 38.1% investment in Russell Sigler, Inc. (“RSI”), which is accounted for under the equity method of accounting. All significant intercompany balances and transactions have been eliminated in consolidation.

#### Impact of the COVID-19 Pandemic and Economic and Marketplace Dynamics

Since COVID-19 was declared a pandemic in March 2020, it has had widespread impacts on global financial markets and business practices. Although we learned to navigate COVID-19 while maintaining our operations in all material respects, the pandemic impacted our operations, and the operations of our customers and suppliers, throughout 2020 and into 2021. As the effects of the pandemic have continued to lessen with the normalization of living with COVID-19 following the increase in accessibility to COVID-19 vaccines and antiviral treatments, the impact of the pandemic on our business has been more reflective of greater economic and marketplace dynamics, which include inflation, supply chain disruptions, and labor shortages, rather than pandemic-related issues, such as quarantines, location closures, mandated restrictions, employee illnesses, and travel restrictions. The extent to which these macro-economic and marketplace dynamics impact our business, results of operations, and financial condition will depend on future developments, which are highly uncertain and cannot be predicted, therefore, we cannot reasonably estimate the future impact of such dynamics at this time.

#### Foreign Currency Translation and Transactions

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

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

#### Equity Method Investments

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

### Use of Estimates

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

### Cash Equivalents

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

### Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable primarily consist of trade receivables due from customers and are stated at the invoiced amount less an allowance for doubtful accounts. An allowance for doubtful accounts is maintained for estimated losses resulting from the inability of customers to make required payments. When preparing these estimates, we consider a number of factors, including the aging of a customer's account, past transactions with customers, creditworthiness of specific customers, historical trends, and other information, including potential impacts of business and economic conditions. Upon determination that an account is uncollectible, the receivable balance is written off. At December 31, 2022 and 2021, the allowance for doubtful accounts totaled \$18,345 and \$11,315, respectively.

### Inventories

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

### Vendor Rebates and Purchase Discounts

We have arrangements with several vendors that provide rebates payable to us when we achieve defined measures, generally related to the volume level of purchases. We account for such rebates as a reduction of inventory until we sell the product, at which time such rebates are reflected as a reduction of cost of sales in our consolidated statements of income. Throughout the year, we estimate rebates based on our estimate of purchases to date relative to the purchase levels that mark our progress toward earning the rebates. We continually revise our estimates of earned vendor rebates based on actual purchase levels. At December 31, 2022 and 2021, we had \$22,961 and \$22,692, respectively, of rebates recorded as a reduction of inventories. Substantially all vendor rebate receivables are collected within three months following the end of the year. Vendor rebates that are earned based on products sold are credited directly to cost of sales in our consolidated statements of income.

We also have vendors that offer a cash discount when we pay their invoice within a specified period of time. We account for such cash discounts as a reduction of inventories until we sell the product at which time such cash discounts are reflected as a reduction of cost of sales in our consolidated statements of income. At December 31, 2022 and 2021, we had \$19,158 and \$17,893, respectively, of cash discounts recorded as a reduction of inventories.

### Equity Securities

Investments in equity securities are recorded at fair value using the specific identification method and are included in other assets in our consolidated balance sheets. Changes in the fair value of equity securities and dividend income are recognized in our consolidated statements of income.

### Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization of property and equipment is computed using the straight-line method. Buildings and improvements are depreciated or amortized over estimated useful lives ranging from 3-40 years. Leasehold improvements are amortized over the shorter of the respective lease terms or estimated useful lives. Machinery, vehicles, and equipment are depreciated over estimated useful lives ranging from 3-10 years. Computer hardware and software are depreciated over estimated useful lives ranging from 3-10 years. Furniture and fixtures are depreciated over estimated useful lives ranging from 5-7 years.

### Operating and Finance Leases

We have operating leases for real property, vehicles and equipment, and finance leases primarily for vehicles. Operating leases are included in operating lease right-of-use ("ROU") assets, current portion of long-term obligations, and operating lease liabilities, net of current portion in our consolidated balance sheets. Finance leases are not considered significant to our consolidated balance sheets or consolidated statements of income. Finance lease ROU assets at December 31, 2022 and 2021, of \$14,480 and \$11,489, respectively, are included in property and equipment, net in our consolidated balance sheets. Finance lease liabilities at December 31, 2022 and 2021, of \$14,865 and \$11,762, respectively, are included in current portion of long-term obligations and finance lease liabilities, net of current portion in our consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term, and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at the applicable commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit interest rate, we use our incremental borrowing rate based on the information available at the commencement dates of the respective leases in determining the present value of the applicable lease payments.

Operating lease ROU assets also include any lease pre-payments made and exclude lease incentives. Certain of our leases include variable payments, which are excluded from lease ROU assets and lease liabilities and expensed as incurred. Our leases have remaining lease terms of 1-10 years, some of which include options to extend the leases for up to five years. The exercise of lease renewal options is at our sole discretion, and our lease ROU assets and liabilities reflect only the options we are reasonably certain that we will exercise. Certain real property lease agreements have lease and non-lease components, which are generally accounted for as a single lease component. Lease expense for lease payments is recognized on a straight-line basis over the lease term. Lease payments for short-term leases, which are 12 months or less without a purchase option that is likely to be exercised, are recognized as lease cost on a straight-line basis over the lease term.

### Practical Expedients

We elected the practical expedients related to short-term leases and separating lease components from non-lease components for all underlying asset classes.

### Goodwill and Intangible Assets

Goodwill is recorded when the purchase price paid for an acquisition of a business exceeds the fair value of the net identified tangible and intangible assets acquired. We evaluate goodwill for impairment annually or more frequently when an event occurs or circumstances change that indicate that the carrying value may not be recoverable. We test goodwill for impairment by comparing the fair value of our reporting unit to its carrying value. If the fair value is determined to be less than the carrying value, an impairment charge would be recognized. On January 1, 2023, we performed our annual evaluation of goodwill impairment and determined that the estimated fair value of our reporting unit exceeded its carrying value.

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

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

#### **Long-Lived Assets**

Long-lived assets, other than goodwill and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Recoverability is evaluated by determining whether the amortization of the balance over its remaining life can be recovered through undiscounted future operating cash flows. We measure the impairment loss based on projected discounted cash flows using a discount rate reflecting the average cost of funds and compared to the asset's carrying value. As of December 31, 2022, there were no such events or circumstances.

#### **Fair Value Measurements**

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

- Level 1 Quoted prices in active markets for identical assets or liabilities. An active market for an asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 Observable inputs other than Level 1 prices such as quoted prices in active markets for similar assets or liabilities; quoted prices in markets that are not active; or model-driven valuations or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Unobservable inputs for the asset or liability. These inputs reflect our own assumptions about the assumptions a market participant would use in pricing the asset or liability.

#### **Revenue Recognition**

Revenue primarily consists of sales of air conditioning, heating and refrigeration equipment, and related parts and supplies. We generate our revenue primarily from the sale of finished products to customers; therefore, the significant majority of our contracts are short-term in nature and have only a single performance obligation to deliver products. The performance obligation under such contracts is satisfied when we transfer control of the product to the customer. Some contracts contain a combination of product sales and services, the latter of which is distinct and accounted for as a separate performance obligation. We satisfy our performance obligations for services when we render the services within the agreed-upon service period. Total service revenue is not material and accounted for less than 1% of our consolidated revenues for all periods presented.

Revenue is recognized when control transfers to our customers when products are picked up, or via shipment of products or delivery of services. We measure revenue as the amount of consideration we expect to be entitled to receive in exchange for those goods or services, net of any variable considerations (e.g., rights to return product, sales incentives, others) and any taxes collected from customers and subsequently remitted to governmental authorities. Revenue for shipping and handling charges is recognized when products are delivered to the customer.

#### **Product Returns**

We estimate product returns based on historical experience and record them on a gross basis on our balance sheets. Substantially all customer returns relate to products that are returned under manufacturers' warranty obligations. Accrued sales returns at December 31, 2022 and 2021 of \$21,023 and \$16,707, respectively, were included in accrued expenses and other current liabilities in our consolidated balance sheets.

#### **Sales Incentives**

We estimate sales incentives expected to be paid over the terms of the programs based on the most likely amounts. Sales incentives are accounted for as a reduction in the transaction price and are generally paid on an annual basis.

#### **Practical Expedients**

We generally expense sales commissions when incurred because the amortization period is one year or less. These costs are recorded within selling, general and administrative expenses. We do not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less.

#### **Advertising Costs**

Advertising costs are expensed as incurred. Advertising expense for the years ended December 31, 2022, 2021, and 2020, were \$25,884, \$21,552, and \$12,588, respectively.

#### **Shipping and Handling**

Shipping and handling costs associated with inbound freight are capitalized to inventories and relieved through cost of sales as inventories are sold. Shipping and handling costs associated with the delivery of products are included in selling, general and administrative expenses. Shipping and handling costs for the years ended December 31, 2022, 2021 and 2020, were \$86,620, \$70,453, and \$55,019, respectively.

#### **Share-Based Compensation**

The fair value of stock option and restricted stock awards are expensed net of estimated forfeitures on a straight-line basis over the vesting period of the awards. Share-based compensation expense is included in selling, general and administrative expenses in our consolidated statements of income. Tax benefits resulting from tax deductions in excess of share-based compensation expense are recognized in our provision for income taxes in our consolidated statements of income.

#### **Income Taxes**

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

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

## Earnings per Share

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

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

## Derivative Instruments and Hedging Activity

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

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

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

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

See Note 16 for additional information pertaining to derivative instruments.

## Loss Contingencies

Accruals are recorded for various contingencies including self-insurance, legal proceedings, environmental matters, and other claims that arise in the normal course of business. The estimation process contains uncertainty because accruals are based on judgment, the probability of losses and, where applicable, the consideration of opinions of external legal counsel and actuarially determined estimates. Additionally, we record receivables from third party insurers when recovery has been determined to be probable.

## 2. LEASES

The components of operating lease expense were as follows:

Years Ended December 31,	2022	2021	2020
Lease cost	\$ 101,578	\$ 90,742	\$ 82,543
Short-term lease cost	10,226	9,598	6,317
Variable lease cost	1,840	1,868	942
Sublease income	(373)	(332)	(228)
	\$ 113,271	\$ 101,876	\$ 89,574

Supplemental balance sheet information related to operating leases were as follows:

December 31,	2022	2021
ROU assets	\$ 317,314	\$ 268,528
Current portion of operating lease liabilities	\$ 87,120	\$ 81,928
Operating lease liabilities	232,144	187,024
Total operating lease liabilities	\$ 319,264	\$ 268,952
Weighted Average Remaining Lease Term (in years)	4.8 years	4.4 years
Weighted Average Discount Rate	3.85%	3.29%

Supplemental cash flow information related to operating leases were as follows:

Years Ended December 31,	2022	2021	2020
Operating cash flows for the measurement of operating lease liabilities	\$ 100,092	\$ 91,063	\$ 80,921
Operating lease ROU assets obtained in exchange for operating lease obligations	\$ 140,704	\$ 141,198	\$ 59,093

At December 31, 2022, maturities of operating lease liabilities over each of the next five years and thereafter were as follows:

2023	\$ 97,727
2024	76,563
2025	59,363
2026	44,035
2027	25,273
Thereafter	50,491
Total lease payments	353,452
Less imputed interest	34,188
Total lease liability	\$ 319,264

At December 31, 2022, we had additional operating leases, primarily for real property, that had not yet commenced. Such leases had estimated future minimum rental commitments of approximately \$19,200. These operating leases are expected to commence in 2023 with lease terms of 4-8 years. These undiscounted amounts are not included in the table above.



### 3. REVENUES

#### Disaggregation of Revenues

The following table presents our revenues disaggregated by primary geographical regions and major product lines within our single reporting segment:

Years Ended December 31,	2022	2021	2020
<b>Primary Geographical Regions:</b>			
United States	\$ 6,578,897	\$ 5,636,929	\$ 4,535,262
Canada	389,119	386,780	301,727
Latin America and the Caribbean	306,328	256,483	217,939
	\$ 7,274,344	\$ 6,280,192	\$ 5,054,928
<b>Major Product Lines:</b>			
HVAC equipment	68%	69%	69%
Other HVAC products	28%	28%	28%
Commercial refrigeration products	4%	3%	3%
	100%	100%	100%

### 4. EARNINGS PER SHARE

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

Years Ended December 31,	2022	2021	2020
<b>Basic Earnings per Share:</b>			
Net income attributable to Watsco, Inc. shareholders	\$ 601,167	\$ 418,945	\$ 269,579
Less: distributed and undistributed earnings allocated to restricted common stock	51,365	37,273	23,140
Earnings allocated to Watsco, Inc. shareholders	\$ 549,802	\$ 381,672	\$ 246,439
Weighted-average common shares outstanding - Basic	35,564,203	35,244,230	35,069,516
Basic earnings per share for Common and Class B common stock	\$ 15.46	\$ 10.83	\$ 7.03
<b>Allocation of earnings for Basic:</b>			
Common stock	\$ 499,792	\$ 353,873	\$ 228,361
Class B common stock	50,010	27,799	18,078
	\$ 549,802	\$ 381,672	\$ 246,439
<b>Diluted Earnings per Share:</b>			
Net income attributable to Watsco, Inc. shareholders	\$ 601,167	\$ 418,945	\$ 269,579
Less: distributed and undistributed earnings allocated to restricted common stock	51,294	37,222	23,140
Earnings allocated to Watsco, Inc. shareholders	\$ 549,873	\$ 381,723	\$ 246,439
Weighted-average common shares outstanding - Basic	35,564,203	35,244,230	35,069,516
Effect of dilutive stock options	119,431	179,608	81,055
Weighted-average common shares outstanding - Diluted	35,683,634	35,423,838	35,150,571
Diluted earnings per share for Common and Class B common stock	\$ 15.41	\$ 10.78	\$ 7.01

Diluted earnings per share for our Common stock assumes the conversion of all our Class B common stock into Common stock as of the beginning of the fiscal year; therefore, no allocation of earnings to Class B common stock is required. At December 31, 2022, 2021, and 2020, our outstanding Class B common stock was convertible into 3,234,939, 2,566,990, and 2,572,536 shares of our Common stock, respectively.

Diluted earnings per share excluded 190,462, 40,529, and 19,722 shares for the years ended December 31, 2022, 2021, and 2020, respectively, related to stock options with an exercise price per share greater than the average market value, resulting in an anti-dilutive effect on diluted earnings per share.

### 5. OTHER COMPREHENSIVE (LOSS) INCOME

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

Years Ended December 31,	2022	2021	2020
Foreign currency translation adjustment	\$ (20,305)	\$ 936	\$ 6,272
Unrealized gain on cash flow hedging instruments	—	97	1,205
Income tax expense	—	(27)	(325)
Unrealized gain on cash flow hedging instruments, net of tax	—	70	880
Reclassification of loss (gain) on cash flow hedging instruments into earnings	—	305	(574)
Income tax (benefit) expense	—	(86)	156
Reclassification of loss (gain) on cash flow hedging instruments into earnings, net of tax	—	219	(418)
Other comprehensive (loss) income	\$ (20,305)	\$ 1,225	\$ 6,734

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

Years Ended December 31,	2022	2021	2020
<b>Foreign currency translation adjustment:</b>			
Beginning balance	\$ (34,176)	\$ (34,694)	\$ (38,599)
Current period other comprehensive (loss) income	(13,534)	518	3,905
Ending balance	(47,710)	(34,176)	(34,694)
<b>Cash flow hedging instruments:</b>			
Beginning balance	—	(173)	(451)
Current period other comprehensive income	—	43	528
Reclassification adjustment	—	130	(250)
Ending balance	—	—	(173)
Accumulated other comprehensive loss, net of tax	\$ (47,710)	\$ (34,176)	\$ (34,867)

## 6. SUPPLIER CONCENTRATION

Purchases from our top ten suppliers comprised 84%, 83%, and 85% of all purchases made in 2022, 2021, and 2020, respectively. Our largest supplier, Carrier and its affiliates, accounted for 60%, 61%, and 63% of all purchases made in 2022, 2021, and 2020, respectively. See Note 19. A significant interruption by Carrier, or any of our other key suppliers, in the delivery of products could impair our ability to maintain current inventory levels and could materially impact our consolidated results of operations and consolidated financial position.

At December 31, 2022, \$92,402 was recorded as a reduction of inventories related to pricing claim advances, of which \$69,814 was provided by Carrier and its affiliates. At December 31, 2021, \$78,454 was recorded related to pricing claim advances, of which \$59,644 was provided by Carrier and its affiliates.

## 7. PROPERTY AND EQUIPMENT

Property and equipment, net, consists of:

December 31,	2022	2021
Land	\$ 676	\$ 676
Buildings and improvements	93,033	85,857
Machinery, vehicles, and equipment	120,811	108,110
Computer hardware and software	83,354	68,762
Furniture and fixtures	24,029	21,404
	321,903	284,809
Accumulated depreciation and amortization	(196,479)	(173,790)
	\$ 125,424	\$ 111,019

Depreciation and amortization expense related to property and equipment included in selling, general and administrative expenses for the years ended December 31, 2022, 2021, and 2020, were \$26,974, \$22,566, and \$19,963, respectively.

## 8. DEBT

We maintain an unsecured, \$560,000 syndicated multicurrency revolving credit agreement, which we use to fund seasonal working capital needs and for other general corporate purposes, including acquisitions, dividends (if and as declared by our Board of Directors), capital expenditures, stock repurchases, and issuances of letters of credit. The credit facility has a seasonal component from October 1 to March 31, during which the borrowing capacity may be reduced to \$460,000 at our discretion (which effectively reduces fees payable in respect of the unused portion of the commitment), and we effected this reduction in 2022. Included in the credit facility are a \$100,000 swingline subfacility, a \$10,000 letter of credit subfacility, a \$75,000 alternative currency borrowing sublimit and an \$8,000 Mexican borrowing sublimit.

The revolving credit agreement matures on December 5, 2023, and accordingly, borrowings outstanding under the revolving credit agreement are classified as current liabilities in our consolidated balance sheet at December 31, 2022. We believe that we will refinance the revolving credit agreement at or prior to its maturity on similar terms and subject to similar conditions.

Borrowings under the credit facility bear interest at either LIBOR-based rates plus a spread, which ranges from 87.5 to 150.0 basis-points (LIBOR plus 87.5 basis-points at December 31, 2022), depending on our ratio of total debt to EBITDA, or on rates based on the highest of the Federal Funds Effective Rate plus 0.5%, the Prime Rate or the Eurocurrency Rate plus 1.0%, in each case plus a spread which ranges from 0 to 50.0 basis-points (0 basis-points at December 31, 2022), depending on our ratio of total debt to EBITDA. We pay a variable commitment fee on the unused portion of the commitment under the revolving credit agreement, ranging from 7.5 to 20.0 basis-points (7.5 basis-points at December 31,

2022). During 2021, we paid fees of \$22 in connection with the increase in the aggregate borrowing capacity of our revolving credit agreement, which are being amortized ratably through the maturity of the facility in December 2023.

At December 31, 2022 and December 31, 2021, \$56,400 and \$89,000, respectively, were outstanding under the revolving credit agreement. The revolving credit agreement contains customary affirmative and negative covenants, including financial covenants with respect to consolidated leverage and interest coverage ratios, and other customary restrictions. We believe we were in compliance with all covenants at December 31, 2022.

## 9. INCOME TAXES

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

Years Ended December 31,	2022	2021	2020
Current:			
U.S. Federal	\$ 71,475	\$ 91,162	\$ 58,895
State	27,202	20,703	12,909
Foreign	13,574	10,993	4,779
	112,251	122,858	76,583
Deferred:			
U.S. Federal	10,766	6,434	218
State	3,695	1,374	21
Foreign	(995)	(1,869)	(199)
	13,466	5,939	40
Income tax expense	\$ 125,717	\$ 128,797	\$ 76,623

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

Following is a reconciliation of the effective income tax rate:

Years Ended December 31,	2022	2021	2020
U.S. federal statutory rate	21.0%	21.0%	21.0%
State income taxes, net of federal benefit and other	4.6	3.5	3.3
Excess tax benefits from share-based compensation	(8.6)	(1.7)	(2.1)
Tax effects on foreign income	0.3	0.4	0.3
FDII	(0.1)	(0.1)	—
Change in valuation allowance	0.4	0.8	—
Tax credits and other	(0.4)	(0.5)	(0.5)
Effective income tax rate attributable to Watsco, Inc.	17.2	23.4	22.0
Taxes attributable to non-controlling interest	(2.0)	(2.9)	(2.8)
Effective income tax rate	15.2%	20.5%	19.2%

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

December 31,	2022	2021
<b>Deferred tax assets:</b>		
Share-based compensation	\$ 27,037	\$ 30,854
Capitalized inventory costs and inventory adjustments	4,366	3,449
Allowance for doubtful accounts	3,326	1,328
Self-insurance reserves	1,975	1,027
Other	8,711	6,081
Net operating loss carryforwards	3,899	3,959
	<b>49,314</b>	<b>46,698</b>
Valuation allowance	(8,171)	(5,107)
<b>Total deferred tax assets</b>	<b>41,143</b>	<b>41,591</b>
<b>Deferred tax liabilities:</b>		
Deductible goodwill	(88,316)	(82,704)
Depreciation	(23,806)	(18,744)
Unremitted earnings of domestic affiliates	(6,618)	(5,175)
Other	(3,761)	(3,619)
	<b>(122,501)</b>	<b>(110,242)</b>
<b>Net deferred tax liabilities (1)</b>	<b>\$ (81,358)</b>	<b>\$ (68,651)</b>

(1) Net deferred tax liabilities have been included in the consolidated balance sheets in deferred income taxes and other liabilities.

Provisions of the Tax Cuts and Jobs Act of 2017 (the "TCJA") such as the one-time repatriation transition tax and the global intangible low-taxed income ("GILTI") for years beginning in 2018, effectively taxed the undistributed earnings previously deferred from U.S. federal and certain state income taxes and eliminated any additional U.S. taxation resulting from repatriation of earnings on non-US subsidiaries. GILTI is a tax on foreign income in excess of a deemed return on tangible assets of foreign corporations. We have elected to provide for the tax expense related to GILTI in the year the tax was incurred as a period expense. As of December 31, 2022, we have accumulated undistributed earnings generated by our foreign subsidiaries of approximately \$148,000. Any additional taxes due with respect to such previously taxed earnings, if repatriated, would generally be limited to certain state income taxes and foreign withholding. Deferred taxes have been recorded for foreign withholding taxes on certain earnings of our foreign consolidated subsidiaries expected to be repatriated. We do not intend to distribute the remaining previously taxed foreign earnings and therefore have not recorded deferred taxes for certain state income taxes and foreign withholding on such earnings. The amount of certain state income taxes and foreign withholding that might be payable on the remaining amounts at December 31, 2022 is not practicable to estimate.

On March 11, 2021, the America Rescue Plan Act of 2021 (the "ARPA") was enacted. The ARPA expanded IRC Section 162(m) to include five additional most highly compensated individuals. The expansion of Section 162(m) coverage is effective for tax years beginning after December 31, 2026. Unlike the employees subject to Section 162(m) by virtue of being the Chief Executive Officer ("CEO"), Chief Financial Officer, or three most highly compensated named executive officers, an employee who is identified as one of the "additional" five employees is not considered to be a covered employee indefinitely. The five additional employees will be subject to the annual \$1,000 cap on compensation, and will be determined annually.

On August 16, 2022, the Inflation Reduction Act (the "IRA") was enacted, which introduces a new 15% corporate minimum tax based on adjusted financial statement income and a 1% excise tax on stock repurchases, effective January 1, 2023, and provisions intended to mitigate climate change, including tax credit incentives for investments that reduce greenhouse gas emissions. Based on our current analysis of the provisions, this legislation will not have a material impact on our consolidated financial statements.

Valuation allowances are provided to reduce the related deferred income tax assets to an amount which will, more likely than not, be realized. The valuation allowance was \$8,171 and \$5,107 at December 31, 2022 and 2021, respectively. The increase was primarily attributable to the impact on U.S. deferred tax assets from share-based compensation deduction limitations related to the expansion of IRC Section 162(m).

At December 31, 2022, there were state net operating loss carryforwards of \$165,951, some of which expire in 2026, with the majority having an indefinite carryforward period. At December 31, 2022, there were foreign net operating loss carryforwards of \$14,916, which expire in varying amounts from 2036 through 2042. These amounts are available to offset future taxable income. There were no federal net operating loss carryforwards at December 31, 2022.

We are subject to U.S. federal income tax, income tax of multiple state jurisdictions and foreign income tax. We are subject to tax audits in the various jurisdictions until the respective statutes of limitations expire. We are currently under examination by the Internal Revenue Service for the 2019 tax year. We are no longer subject to U.S. federal tax examinations for tax years prior to 2019. For the majority of states and foreign jurisdictions, we are no longer subject to tax examinations for tax years prior to 2018. In addition, we are no longer subject to U.S. Virgin Islands federal tax examinations for tax years prior to 2015.

At December 31, 2022 and 2021, the total amount of gross unrecognized tax benefits (excluding the federal benefit received from state positions) was \$7,752 and \$6,727, respectively. Of these totals, \$6,457 and \$5,636, respectively, (net of the federal benefit received from state positions) represent the amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate. Our policy is to recognize penalties within selling, general and administrative expenses and interest related to income tax matters in income tax expense in the consolidated statements of income. At December 31, 2022 and 2021, the cumulative amount of estimated accrued interest and penalties resulting from such unrecognized tax benefits was \$1,343 and \$1,211, respectively, and is included in deferred income taxes and other current liabilities in the accompanying consolidated balance sheets.

The changes in gross unrecognized tax benefits were as follows:

Balance at December 31, 2019	\$ 5,367
Additions based on tax positions related to the current year	1,911
Reductions due to lapse of applicable statute of limitations	(773)
<b>Balance at December 31, 2020</b>	<b>6,505</b>
Additions based on tax positions related to the current year	1,143
Reductions due to lapse of applicable statute of limitations	(921)
<b>Balance at December 31, 2021</b>	<b>6,727</b>
Additions based on tax positions related to the current year	1,867
Reductions due to lapse of applicable statute of limitations	(842)
<b>Balance at December 31, 2022</b>	<b>\$ 7,752</b>

## 10. SHARE-BASED COMPENSATION AND BENEFIT PLANS

### Share-Based Compensation Plans

We have two share-based compensation plans for employees. The 2021 Incentive Compensation Plan (the "2021 Plan") provides for the award of a broad variety of share-based compensation alternatives such as restricted stock, non-qualified stock options, incentive stock options, performance awards, dividend equivalents, and stock appreciation rights at no less than 100% of the market price on the date the award is granted. To date, awards under the 2021 Plan consist of non-qualified stock options and restricted stock.

Under the 2021 Plan, the number of shares of Common and Class B common stock available for issuance is (i) 2,500,000, plus (ii) 7,327 shares of Common stock or Class B common stock that remained available for grant in connection with awards under the Watsco, Inc. 2014 Incentive Compensation Plan (the "2014 Plan") on the date on which our shareholders approved the 2021 Plan, plus (iii) shares underlying currently outstanding awards issued under the 2014 Plan, which shares become reissuable under the 2021 Plan to the extent that such underlying shares are not issued due to their forfeiture, expiration, termination or otherwise. A total of 4,361 shares of Common and Class B common stock, net of cancellations, had been awarded under the 2021 Plan as of December 31, 2022. As of December 31, 2022, 2,502,966 shares of common stock were reserved for future grants under the 2021 Plan. Options under the 2021 Plan vest over two to four years of service and have contractual terms of five years. Awards of restricted stock, which are granted at no cost to the employee, vest upon attainment of a specified age, generally toward the end of an employee's career at age 62 or older. Vesting may be accelerated in certain circumstances prior to the original vesting date.

The 2014 Plan expired in 2021; therefore, no additional options may be granted. There were 361,075 options to exercise common stock outstanding under the 2014 Plan at December 31, 2022. Options under the 2014 Plan vest over two to four years of service and have contractual terms of five years.

The following is a summary of stock option activity under the 2021 Plan and the 2014 Plan as of and for the year ended December 31, 2022:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at December 31, 2021	602,488	\$ 205.30		
Granted	104,500	274.38		
Exercised	(113,230)	166.08		
Forfeited	(24,467)	242.32		
Expired	(9,666)	176.80		
Options outstanding at December 31, 2022	<b>559,625</b>	<b>\$ 225.01</b>	<b>2.74</b>	<b>\$ 20,555</b>
Options exercisable at December 31, 2022	<b>130,213</b>	<b>\$ 174.30</b>	<b>1.50</b>	<b>\$ 9,930</b>

The following is a summary of restricted stock activity as of and for the year ended December 31, 2022:

	Shares	Weighted-Average Grant Date Fair Value
Restricted stock outstanding at December 31, 2021	3,459,661	\$ 83.94
Granted	143,059	290.55
Vested	(1,000,459)	37.66
Forfeited	(13,000)	207.83
Restricted stock outstanding at December 31, 2022	<b>2,589,261</b>	<b>\$ 112.53</b>

The weighted-average grant date fair value of restricted stock granted during 2022, 2021, and 2020 was \$290.55, \$254.73, and \$193.89, respectively. The fair value of restricted stock that vested during 2022, 2021, and 2020 was \$271,781, \$3,646, and \$7,354, respectively.

During 2022, 320,468 shares of Class B common stock, which include the 311,408 surrendered shares referenced below, with an aggregate fair market value of \$87,049 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of restricted stock. During 2021, 3,858 shares of Class B common stock with an aggregate fair market value of \$1,078 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of restricted stock. During 2020, 11,693 shares of Common and Class B common stock with an aggregate fair market value of \$2,299 were withheld as payment in lieu of cash to satisfy tax withholding obligations in connection with the vesting of restricted stock. These shares were retired upon delivery.

### Vesting of Restricted Stock Held by our CEO

On October 15, 2022, 975,622 shares of Class B restricted stock previously granted to our CEO during the period from 1997 to 2011 under various performance-based incentive plans vested. The vested shares had a value of \$265,106 based on the closing price of our Class B common stock as of that date, which is deductible in our 2022 income tax return. The vesting of shares provided a cash benefit of approximately \$67,000 in 2022 and reduced our provision for income taxes in 2022 by approximately \$49,000. This vested value constitutes taxable compensation to our CEO for income tax purposes and was subject to statutory withholding. Upon vesting, we funded \$104,319 in statutory withholding, which, in turn, was satisfied by the CEO through a cash payment to us of \$19,700 and by the surrendering of 311,408 shares of Class B common stock. Accordingly, 664,214 shares of Class B common stock were retained by the CEO, and we retired the surrendered shares.

### Share-Based Compensation Fair Value Assumptions

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

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

Years Ended December 31,	2022	2021	2020
Expected term in years	<b>4.25</b>	4.25	4.25
Risk-free interest rate	<b>3.04%</b>	0.79%	0.26%
Expected volatility	<b>23.10%</b>	21.85%	20.89%
Expected dividend yield	<b>2.84%</b>	2.97%	3.69%
Grant date fair value	<b>\$46.60</b>	\$34.79	\$20.76

### Exercise of Stock Options

The total intrinsic value of stock options exercised during 2022, 2021, and 2020 was \$13,046, \$16,903, and \$8,753, respectively. Cash received from the exercise of stock options during 2022, 2021, and 2020 was \$18,425, \$19,338, and \$17,608, respectively. The tax benefit from stock option exercises during 2022, 2021, and 2020 was \$2,658, \$3,595, and \$1,586, respectively. During 2022, 2021, and 2020, 1,592 shares of Common stock with an aggregate fair market value of \$438, 4,040 shares of Common stock with an aggregate fair market value of \$1,179 and 11,455 shares of Common stock with an aggregate fair market value of \$2,343, respectively, were withheld as payment in lieu of cash for stock option exercises and related tax withholdings. These shares were retired upon delivery.



## Share-Based Compensation Expense

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

Years Ended December 31,	2022	2021	2020
Stock options	\$ 3,856	\$ 2,908	\$ 2,447
Restricted stock	24,965	22,457	19,682
Share-based compensation expense	\$ 28,821	\$ 25,365	\$ 22,129

At December 31, 2022, there was \$8,390 of unrecognized pre-tax compensation expense related to stock options granted under the 2021 Plan, which is expected to be recognized over a weighted-average period of approximately 1.9 years. The total fair value of stock options that vested during 2022, 2021, and 2020 was \$2,721, \$2,621, and \$2,177, respectively.

At December 31, 2022, there was \$193,089 of unrecognized pre-tax compensation expense related to restricted stock, which is expected to be recognized over a weighted-average period of approximately 11.7 years. Of this amount, approximately \$54,000 is related to awards granted to our CEO, of which approximately \$21,000, \$24,000, and \$9,000 vest in approximately 4, 6, and 7 years upon his attainment of age 86, 88, and 89, respectively, and approximately \$40,000 is related to awards granted to our President, of which approximately \$39,000 and \$1,000 vest in approximately 21 and 23 years upon his attainment of age 62 and 64, respectively. In the event that vesting is accelerated for any circumstance, as defined in the related agreements, the remaining unrecognized share-based compensation expense would be immediately recognized as a charge to earnings with a corresponding tax benefit. At December 31, 2022, we were obligated to issue 39,602 shares of restricted stock to our CEO that vest in 7 years, 38,930 shares of restricted stock to our President that vest in 21 years, and an estimated 15,000 shares of restricted stock to various key leaders that vest in 5-13 years in connection with 2022's performance-based incentive compensation program. On February 7, 2023, our President received a short-term incentive of \$200,000 payable in 632 shares of Class B common stock in connection with his 2022 performance-based incentive program.

## Employee Stock Purchase Plan

The Watsco, Inc. Fourth Amended and Restated 1996 Qualified Employee Stock Purchase Plan (the "ESPP") provides for up to 1,500,000 shares of Common stock to be available for purchase by our full-time employees with at least 90 days of service. The ESPP allows participating employees to purchase shares of Common stock at a 5% discount to the fair market value at specified times. During 2022, 2021, and 2020, employees purchased 4,101, 3,501, and 5,121 shares of Common stock at an average price of \$262.57, \$239.11, and \$171.89 per share, respectively. Cash dividends received by the ESPP were reinvested in Common stock and resulted in the issuance of 3,365, 2,962, and 3,964 additional shares during 2022, 2021, and 2020, respectively. We received net proceeds of \$1,997, \$1,676, and \$1,649, respectively, during 2022, 2021, and 2020, for shares of our Common stock purchased under the ESPP. At December 31, 2022, 443,479 shares remained available for purchase under the ESPP.

## 401(k) Plan

We have a profit sharing retirement plan for our employees that is qualified under Section 401(k) of the Internal Revenue Code. Annual matching contributions are made based on a percentage of eligible employee compensation deferrals. The contribution has historically been made with the issuance of Common stock to the plan on behalf of our employees. For the years ended December 31, 2022, 2021, and 2020, we issued 21,560, 22,752, and 25,216 shares of Common stock, respectively, to the plan, representing the Common stock discretionary matching contribution of \$6,746, \$5,154, and \$4,543, respectively.

## 11. INVESTMENT IN UNCONSOLIDATED ENTITY

Our first joint venture with Carrier, Carrier Enterprise, LLC, which we refer to as Carrier Enterprise I, has a 38.1% ownership interest in Russell Sigler, Inc. ("RSI"), an HVAC distributor operating from 35 locations in the Western U.S. Our proportionate share of the net income of RSI is included in other income in our consolidated statements of income.

Carrier Enterprise I is a party to a shareholders' agreement (the "Shareholders' Agreement") with RSI and its shareholders, consisting of five family siblings, their children, and affiliates related to them. Pursuant to the Shareholders' Agreement, RSI's shareholders have the right to sell, and Carrier Enterprise I has the obligation to purchase, their respective shares of RSI for a purchase price determined based on the higher of book value or a multiple of EBIT, the latter of which Carrier Enterprise I used to calculate the price for its 38.1% investment held in RSI. RSI's shareholders may transfer their respective shares of RSI common stock only to members of the Sigler family or to Carrier Enterprise I, and, at any time from and after the date on which Carrier Enterprise I owns 85% or more of RSI's outstanding common stock, it has the right, but not the obligation, to purchase from RSI's shareholders the remaining outstanding shares of RSI common stock. Additionally, Carrier Enterprise I has the right to appoint two of RSI's six board members. Given Carrier Enterprise I's 38.1% equity interest in RSI and its right to appoint two out of RSI's six board members, this investment in RSI is accounted for under the equity method.

## 12. ACQUISITIONS

### Makdad Industrial Supply Co., Inc.

On August 20, 2021, one of our wholly owned subsidiaries acquired Makdad Industrial Supply Co., Inc. ("MIS"), a distributor of air conditioning and heating products operating from six locations in Pennsylvania. Consideration for the purchase consisted of \$3,164 in cash and the issuance of 3,627 shares of Common stock having a fair value of \$997, net of cash acquired of \$204. The purchase price resulted in the recognition of \$1,041 in goodwill and intangibles. The fair value of the identified intangible assets was \$596 and consisted of \$423 in trade names and distribution rights, and \$173 in customer relationships to be amortized over an 18-year period. The tax basis of such goodwill is deductible for income tax purposes over 15 years.

### Acme Refrigeration of Baton Rouge LLC

On May 7, 2021, we acquired certain assets and assumed certain liabilities of Acme Refrigeration of Baton Rouge LLC ("ACME"), a distributor of air conditioning, heating, and refrigeration products, operating from 18 locations in Louisiana and Mississippi, for \$22,855 less certain average revolving indebtedness. We formed a new, wholly owned subsidiary, Acme Refrigeration LLC, which operates this business. Consideration for the purchase consisted of \$18,051 in cash, 8,492 shares of Common stock having a fair value of \$2,551, and \$3,141 for repayment of indebtedness, net of cash acquired of \$1,340. The purchase price resulted in the recognition of \$3,710 in goodwill and intangibles. The fair value of the identified intangible assets was \$2,124 and consisted of \$1,508 in trade names and distribution rights, and \$616 in customer relationships to be amortized over an 18-year period. The tax basis of such goodwill is deductible for income tax purposes over 15 years.

### Temperature Equipment Corporation

On April 9, 2021, we acquired certain assets and assumed certain liabilities comprising the HVAC distribution business of Temperature Equipment Corporation, an HVAC distributor operating from 32 locations in Illinois, Indiana, Kansas, Michigan, Minnesota, Missouri, and Wisconsin. We formed a new, stand-alone joint venture with Carrier, TEC Distribution LLC ("TEC"), that operates this business. We have an 80% controlling interest in TEC, and Carrier has a 20% non-controlling interest. Consideration for the purchase was paid in cash, consisting of \$105,200 paid to Temperature Equipment Corporation (Carrier contributed \$21,040 and we contributed \$84,160) and \$1,497 for repayment of indebtedness.

The purchase price resulted in the recognition of \$38,624 in goodwill and intangibles. The fair value of the identified intangible assets was \$19,900 and consisted of \$15,700 in trade names and distribution rights, and \$4,200 in customer relationships to be amortized over an 18-year period. The tax basis of such goodwill is deductible for income tax purposes over 15 years.

The table below presents the allocation of the total consideration to tangible and intangible assets acquired and liabilities assumed from the acquisition of our 80% controlling interest in TEC based on their respective fair values as of April 9, 2021:

Accounts receivable	\$ 33,315
Inventories	71,325
Other current assets	962
Property and equipment	2,590
Operating lease ROU assets	53,829
Goodwill	18,724
Intangibles	19,900
Accounts payable	(25,393)
Accrued expenses and other current liabilities	(20,509)
Operating lease liabilities, net of current portion	(48,046)
<b>Total</b>	<b>\$ 106,697</b>

The results of operations of these acquisitions have been included in the consolidated financial statements from their respective dates of acquisition. The pro forma effect of these acquisitions was not deemed significant to the consolidated financial statements.

### 13. GOODWILL AND INTANGIBLE ASSETS

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

Balance at December 31, 2020	\$ 412,486
Acquired goodwill	21,291
Foreign currency translation adjustment	242
<b>Balance at December 31, 2021</b>	<b>434,019</b>
Acquired goodwill	60
Allocation to intangible assets related to 2021 acquisition	(596)
Foreign currency translation adjustment	(2,772)
<b>Balance at December 31, 2022</b>	<b>\$ 430,711</b>

Intangible assets are comprised of the following:

December 31,	Estimated Useful Lives	2022	2021
Indefinite lived intangible assets -			
Trade names, trademarks, and distribution rights		\$ 154,086	\$ 158,389
Finite lived intangible assets:			
Customer relationships	7-18 years	83,943	86,526
Patented and unpatented technology	7 years	1,611	1,721
Trade name	10 years	1,150	1,150
Accumulated amortization		(65,599)	(60,890)
<b>Finite lived intangible assets, net</b>		<b>21,105</b>	<b>28,507</b>
		<b>\$ 175,191</b>	<b>\$ 186,896</b>

Amortization expense related to finite lived intangible assets included in selling, general and administrative expenses for the years ended December 31, 2022, 2021, and 2020, were \$4,709, \$5,561, and \$5,945, respectively.

Based on the finite lived intangible assets recorded at December 31, 2022, annual amortization for the next five years is expected to approximate the following:

2023	\$ 3,200
2024	\$ 3,000
2025	\$ 3,000
2026	\$ 2,800
2027	\$ 1,500

### 14. SHAREHOLDERS' EQUITY

#### Common Stock

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

#### Preferred Stock

We are authorized to issue preferred stock with such designation, rights and preferences as may be determined from time to time by our Board of Directors. Accordingly, the Board of Directors is empowered, without shareholder approval, to issue preferred stock with dividend, liquidation, conversion, voting or other rights which could adversely affect the voting power or other rights of the holders of our Common stock and Class B common stock and, in certain instances, could adversely affect the market price of this stock. We had no preferred stock outstanding at December 31, 2022 or 2021.

#### At-the-Market Offering Program

On February 25, 2022, we entered into an amended and restated sales agreement with Robert W. Baird & Co. Inc. and Goldman Sachs & Co. LLC, which enables the Company to issue and sell shares of Common stock in one or more negotiated transactions or transactions that are deemed to be "at the market" offerings as defined in Rule 415 under the Securities Act of 1933, as amended (the "Securities Act"), for a maximum aggregate offering amount of up to \$300,000 (the "ATM Program"). The offer and sale of our Common stock pursuant to the ATM Program has been registered under the Securities Act pursuant to our automatically effective shelf registration statement on Form S-3 (File No. 333-260758). As of December 31, 2022, no shares of Common stock had been sold under the ATM Program.

#### Stock Repurchase Plan

In September 1999, our Board of Directors authorized the repurchase, at management's discretion, of up to 7,500,000 shares of common stock in the open market or via private transactions. Shares repurchased under the program are accounted for using the cost method and result in a reduction of shareholders' equity. No shares were repurchased during 2022, 2021 or 2020. We last repurchased shares under this plan during 2008. In aggregate, 6,322,650 shares of Common stock and 48,263 shares of Class B common stock have been repurchased at a cost of \$114,425 since the inception of the program. At December 31, 2022, there were 1,129,087 shares remaining authorized for repurchase under the program. The IRA includes, among other provisions, a 1% excise tax on corporate stock repurchases in tax years beginning after December 31, 2022. In consideration of any further stock repurchases under our repurchase program, we intend to evaluate the impact of the IRA's 1% excise tax on stock repurchases in tax years beginning after December 31, 2022.

### Common Stock Released from Escrow

On August 23, 2018 we issued 23,230 shares of Common stock into escrow as contingent consideration in connection with the acquisition of Alert Labs, Inc. The shares were subject to certain performance metrics within a three-year measurement period. On November 12, 2021, the shares, and related cash dividends paid during the three-year period, were released to us from escrow as the performance metrics were not met. These shares were retired upon delivery.

## 15. FINANCIAL INSTRUMENTS

### Recorded Financial Instruments

Recorded financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, the current portion of long-term obligations, and borrowings under our revolving credit agreement. At December 31, 2022 and 2021, the fair values of cash and cash equivalents, accounts receivable, accounts payable, and the current portion of long-term obligations approximated their carrying values due to the short-term nature of these instruments.

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

### Off-Balance Sheet Financial Instruments

At both December 31, 2022 and 2021, we were contingently liable under a standby letter of credit for \$150, which was required by a lease for real property. Additionally, at December 31, 2022 and 2021, we were contingently liable under various performance bonds aggregating approximately \$13,700 and \$7,900, respectively, which are used as collateral to cover any contingencies related to our nonperformance under agreements with certain customers. We do not expect that any material losses or obligations will result from the issuance of the standby letter of credit or performance bonds because we expect to meet our obligations under our lease for real property and to certain customers in the ordinary course of business.

### Concentrations of Credit Risk

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

## 16. DERIVATIVES

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

### Cash Flow Hedging Instruments

We enter into foreign currency forward contracts that are designated as cash flow hedges. The settlement of these derivatives results in reclassifications from accumulated other comprehensive loss to earnings for the period in which the settlement of these instruments occurs. The maximum period for which we hedge our cash flow using these instruments is 12 months. At December 31, 2022, no foreign currency forward contracts were designated as cash flow hedges.

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

Years Ended December 31,	2022	2021
Gain recorded in accumulated other comprehensive loss	\$ —	\$ 97
Loss reclassified from accumulated other comprehensive loss into earnings	\$ —	\$ 305

### Derivatives Not Designated as Hedging Instruments

We have also entered into foreign currency forward and option contracts that are either not designated as hedges or did not qualify for hedge accounting. These derivative instruments were effective economic hedges for all of the periods presented. The fair value gains and losses on these contracts are recognized in earnings as a component of selling, general and administrative expenses. We had only one foreign currency exchange contract not designated as a hedging instrument at December 31, 2022, the total notional value of which was \$3,300. Such contract expired in January 2023.

We recognized losses of \$917, \$237, and \$490 from foreign currency forward and option contracts not designated as hedging instruments in our consolidated statements of income for 2022, 2021, and 2020, respectively.

The following table summarizes the fair value of derivative instruments, which consist solely of foreign exchange contracts, included in accrued expenses and other current liabilities in our consolidated balance sheets. See Note 17.

December 31,	Asset Derivatives		Liability Derivatives	
	2022	2021	2022	2021
Derivatives designated as hedging instruments	\$ —	\$ —	\$ —	\$ —
Derivatives not designated as hedging instruments	—	—	—	5
<b>Total derivative instruments</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 5</b>

## 17. FAIR VALUE MEASUREMENTS

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

	Balance Sheet Location	Total	Fair Value Measurements at December 31, 2022 Using		
			Level 1	Level 2	Level 3
Assets:					
Equity securities	Other assets	\$ 678	\$ 678	—	—
Private equities	Other assets	\$ 1,000	—	—	\$ 1,000

	Balance Sheet Location	Total	Fair Value Measurements at December 31, 2021 Using		
			Level 1	Level 2	Level 3
Assets:					
Equity securities	Other assets	\$ 1,790	\$ 1,790	—	—
Private securities	Other assets	\$ 1,000	—	—	\$ 1,000
Liabilities:					
Derivative financial instruments	Accrued expenses and other current liabilities	\$ 5	—	\$ 5	—

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

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

*Private equities* – other investment in which fair value inputs are unobservable.

*Derivative financial instruments* – these derivatives are foreign currency forward and option contracts. See Note 16. Fair value is based on observable market inputs, such as forward rates in active markets; therefore, we classify these derivatives within Level 2 of the valuation hierarchy.

## 18. COMMITMENTS AND CONTINGENCIES

### Litigation, Claims, and Assessments

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

### Self-Insurance

Self-insurance reserves are maintained relative to company-wide casualty insurance and health benefit programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the self-insurance liabilities and related reserves, management considers several factors, which include historical claims experience, demographic factors, severity factors, and valuations provided by independent third-party actuaries. Management reviews its assumptions with its independent third-party actuaries to evaluate whether the self-insurance reserves are adequate. If actual claims or adverse development of loss reserves occur and exceed these estimates, additional reserves may be required. Reserves in the amounts of \$12,256 and \$7,253 at December 31, 2022 and 2021, respectively, were established related to such programs and are included in accrued expenses and other current liabilities in our consolidated balance sheets.

### Variable Interest Entity

As of December 31, 2022, in conjunction with our casualty insurance programs, limited equity interests are held in a captive insurance entity. The programs permit us to self-insure a portion of losses, to gain access to a wide array of safety-related services, to pool insurance risks and resources in order to obtain more competitive pricing for administration and reinsurance and to limit risk of loss in any particular year. The entity meets the definition of Variable Interest Entity (“VIE”); however, we do not meet the requirements to include this entity in the consolidated financial statements. At December 31, 2022, the maximum exposure to loss related to our involvement with this entity is limited to approximately \$6,700 and we have a cash deposit of approximately \$3,000 with them as collateral to cover any contingency related to additional risk assessments pertaining to our self-insurance programs. See “Self-Insurance” above for further information on commitments associated with the insurance programs. At December 31, 2022, there were no other entities that met the definition of a VIE.

### Purchase Obligations

At December 31, 2022, we were obligated under various non-cancelable purchase orders with our key suppliers for goods aggregating approximately \$69,000, of which approximately \$56,000 is with Carrier and its affiliates.

## 19. RELATED PARTY TRANSACTIONS

Purchases from Carrier and its affiliates comprised 60%, 61%, and 63% of all inventory purchases made during 2022, 2021, and 2020, respectively. At December 31, 2022 and 2021, approximately \$88,000 and \$90,000, respectively, was payable to Carrier and its affiliates, net of receivables. We also sell HVAC products to Carrier and its affiliates. Revenues in our consolidated statements of income for 2022, 2021, and 2020 included approximately \$97,000, \$108,000, and \$103,000, respectively, of sales to Carrier and its affiliates. We believe these transactions are conducted on terms equivalent to an arm’s-length basis in the ordinary course of business.

A member of our Board of Directors is the Senior Chairman of Greenberg Traurig, P.A., which serves as our principal outside counsel for compliance and acquisition-related legal services. During 2022, 2021, and 2020, fees for services performed were \$186, \$225, and \$156, respectively, and \$1 and \$34 was payable at December 31, 2022 and 2021, respectively.

## 20. INFORMATION ABOUT GEOGRAPHIC AREAS

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

Years Ended December 31,	2022	2021	2020
<b>Revenues:</b>			
United States	\$ 6,578,897	\$ 5,636,929	\$ 4,535,262
Canada	389,119	386,780	301,727
Latin America and the Caribbean	306,328	256,483	217,939
<b>Total revenues</b>	<b>\$ 7,274,344</b>	<b>\$ 6,280,192</b>	<b>\$ 5,054,928</b>
<b>Long-Lived Assets:</b>			
United States	\$ 1,009,188	\$ 931,170	
Canada	164,284	175,864	
Latin America and the Caribbean	16,003	17,427	
<b>Total long-lived assets</b>	<b>\$ 1,189,475</b>	<b>\$ 1,124,461</b>	

Revenues are attributed to countries based on the location of the store from which the sale occurred.

Long-lived assets consist primarily of goodwill and intangible assets, operating lease ROU assets, property and equipment, and our investment in an unconsolidated entity.

## 21. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information was as follows:

Years Ended December 31,	2022	2021	2020
Interest paid	\$ 3,505	\$ 913	\$ 1,844
Income taxes net of refunds	\$ 105,736	\$ 124,984	\$ 70,889
Common stock issued for MIS	—	\$ 997	—
Common stock issued for ACME	—	\$ 2,551	—
Common stock issued for N&S	—	—	\$ (161)

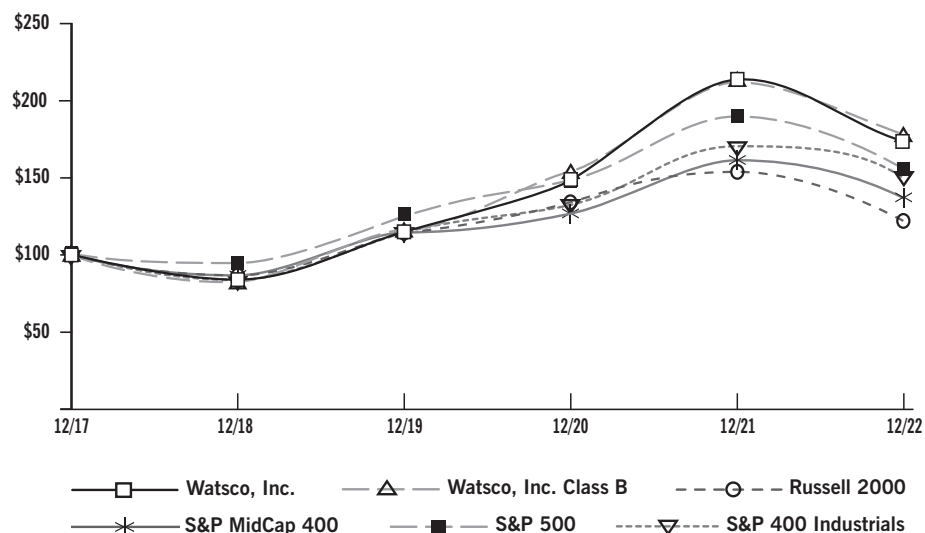


## SHAREHOLDER RETURN PERFORMANCE (UNAUDITED)

The following graph compares the cumulative five-year total shareholder return attained by holders of our Common stock and Class B common stock relative to the cumulative total returns of the Russell 2000 index, the S&P MidCap 400 index, the S&P 500 index, and the S&P 400 Industrials index. Given our position as the largest distributor of HVAC/R equipment, parts and supplies in North America, our unique, sole line of business, the nature of our customers (air conditioning and heating contractors), and the products and markets we serve, we cannot reasonably identify an appropriate peer group; therefore, we have included in the graph below the performance of certain major market indices, which contain companies with market capitalizations similar to our own. We have determined to add the S&P 400 Industrials index in the graph below because it more closely relates to the industry in which we operate. The graph tracks the performance of a \$100 investment in our common stock and in each index (with the reinvestment of all dividends) from December 31, 2017 to December 31, 2022.

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

**COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN\***  
Among Watsco, Inc., the Russell 2000 Index, the S&P Midcap 400 Index, the S&P 500 Index and the S&P 400 Industrials Index



\*\$100 invested on 12/31/17 in stock or index, including reinvestment of dividends. Fiscal year ending December 31.  
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	12/31/17	12/31/18	12/31/19	12/31/20	12/31/21	12/31/22
Watsco, Inc.	100.00	84.48	114.00	148.79	211.38	173.93
Watsco, Inc. Class B	100.00	82.60	115.56	154.05	208.80	177.20
Russell 2000 Index	100.00	88.99	111.70	134.00	153.85	122.41
S&P MidCap 400 Index	100.00	88.92	112.21	127.54	159.12	138.34
S&P 500 Index	100.00	95.62	125.72	148.85	191.58	156.89
S&P 400 Industrials Index	100.00	85.11	113.67	132.41	170.07	150.52

## Shareholder Information

### CORPORATE OFFICE

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www.watsco.com

### EXECUTIVE OFFICERS

**Albert H. Nahmad** Chief Executive Officer  
**Aaron J. Nahmad** President  
**Barry S. Logan** Executive Vice President & Secretary  
**Ana M. Menendez** Chief Financial Officer & Treasurer

### BOARD OF DIRECTORS

**Albert H. Nahmad**<sup>(4)</sup> Chairman of the Board and Chief Executive Officer  
**Cesar L. Alvarez**<sup>(4)</sup> Senior Chairman, Greenberg Traurig, P.A.  
**J. Michael Custer**<sup>(1,3)</sup> Principal, Kaufman Rossin  
**John A. Macdonald**<sup>(1,2)</sup> Chairman of the Board, Parity, Inc.  
**Denise Dickins**<sup>(1,2,3)</sup> Professor Emeritus, East Carolina University  
**Bob L. Moss** Chairman and Chief Executive Officer, Moss & Associates LLC  
**Aaron J. Nahmad**<sup>(4)</sup> President  
**Steven (Slava) Rubin**<sup>(2,3)</sup> Managing Partner, humbition

(1) Audit Committee (2) Compensation Committee (3) Nominating & Governance Committee (4) Strategy Committee

### STOCK INFORMATION

Common stock: New York Stock Exchange. Ticker Symbol: WSO  
Class B common stock: New York Stock Exchange. Ticker Symbol: WSOB

### TRANSFER AGENT AND REGISTRAR

American Stock Transfer & Trust Company is the transfer agent, registrar and dividend disbursing agent for Watsco's common stock. Questions and communications from registered shareholders regarding address changes, dividend checks, account consolidation, registration changes, lost stock certificates and other shareholder inquiries, should be directed to:

American Stock Transfer & Trust Company 6201 15<sup>th</sup> Avenue, Brooklyn, NY 11219  
Toll-Free: (800) 937-5449, International: (718) 921-8124  
Internet Site: astfinancial.com  
Email: help@astfinancial.com

### PUBLICATIONS

Our Annual Report on Form 10-K and Quarterly Reports on Form 10-Q are available free of charge upon request to our corporate office.

### INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

KPMG LLP 78 SW 7th Street, Suite 1200 Miami, FL 33130

Strict guidelines were adhered to in the production of the paper used in this annual report, both in the forest and in the mills. In doing so, the cause for renewable forests, preservation of natural resources, wildlife protection, and pollution and energy reduction are advanced.

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watsco

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