

COMFORT SYSTEMS USA INC
Form 10-Q
July 31, 2013

Use these links to rapidly review the document

[TABLE OF CONTENTS](#)

[Table of Contents](#)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2013

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

**For the transition period from _____ to _____
Commission file number: 1-13011**

COMFORT SYSTEMS USA, INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
Incorporation or Organization)

76-0526487
(I.R.S. Employer
Identification No.)

**675 Bering Drive
Suite 400
Houston, Texas 77057**
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: **(713) 830-9600**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Edgar Filing: COMFORT SYSTEMS USA INC - Form 10-Q

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a
smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes ☐ No ☒

The number of shares outstanding of the issuer's common stock as of July 23, 2013 was 37,327,193 (excluding treasury shares of 3,796,172).

Table of Contents

**COMFORT SYSTEMS USA, INC.
INDEX TO FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2013**

	Page
Part I Financial Information	
Item 1 Financial Statements	
<u>Consolidated Balance Sheets</u>	<u>1</u>
<u>Consolidated Statements of Operations</u>	<u>2</u>
<u>Consolidated Statements of Stockholders' Equity</u>	<u>3</u>
<u>Consolidated Statements of Cash Flows</u>	<u>4</u>
<u>Condensed Notes to Consolidated Financial Statements</u>	<u>5</u>
<u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>15</u>
<u>Item 3 Quantitative and Qualitative Disclosures about Market Risk</u>	<u>31</u>
<u>Item 4 Controls and Procedures</u>	<u>31</u>
Part II Other Information	
<u>Item 1 Legal Proceedings</u>	<u>33</u>
<u>Item 1A Risk Factors</u>	<u>33</u>
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>33</u>
<u>Item 6 Exhibits</u>	<u>35</u>
<u>Signatures</u>	<u>36</u>

Table of Contents

COMFORT SYSTEMS USA, INC.
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Amounts)

	June 30, 2013	December 31, 2012
	(Unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 23,346	\$ 40,757
Accounts receivable, less allowance for doubtful accounts of \$4,584 and \$6,333, respectively	291,828	256,959
Other receivables	8,775	12,376
Inventories	9,651	9,638
Prepaid expenses and other	25,714	25,037
Costs and estimated earnings in excess of billings	29,314	26,204
Assets related to discontinued operations	600	1,582
Total current assets	389,228	372,553
PROPERTY AND EQUIPMENT, NET	42,522	41,416
GOODWILL	114,588	114,588
IDENTIFIABLE INTANGIBLE ASSETS, NET	40,846	44,515
OTHER NONCURRENT ASSETS	8,062	7,682
Total assets	\$ 595,246	\$ 580,754
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 300	\$ 300
Accounts payable	101,248	100,641
Accrued compensation and benefits	39,547	36,892
Billings in excess of costs and estimated earnings	76,083	73,814
Accrued self-insurance expense	29,636	29,096
Other current liabilities	28,173	27,077
Liabilities related to discontinued operations	584	767
Total current liabilities	275,571	268,587
LONG-TERM DEBT, NET OF CURRENT MATURITIES	2,100	2,100
NOTES TO FORMER OWNERS	3,000	5,000
DEFERRED INCOME TAX LIABILITIES	8,267	7,954
OTHER LONG-TERM LIABILITIES	10,154	9,807
Total liabilities	299,092	293,448
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$.01 par, 5,000,000 shares authorized, none issued and outstanding		
Common stock, \$.01 par, 102,969,912 shares authorized, 41,123,365 and 41,123,365 shares issued, respectively	411	411
Treasury stock, at cost, 3,806,172 and 3,879,299 shares, respectively	(40,509)	(41,012)
Additional paid-in capital	316,727	317,534
Retained earnings (deficit)	1,909	(6,528)
Comfort Systems USA, Inc. stockholders' equity	278,538	270,405
Noncontrolling interests	17,616	16,901
Total stockholders' equity	296,154	287,306

Edgar Filing: COMFORT SYSTEMS USA INC - Form 10-Q

Total liabilities and stockholders' equity	\$	595,246	\$	580,754
--	----	---------	----	---------

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

COMFORT SYSTEMS USA, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands, Except Per Share Data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
REVENUE	\$ 351,053	\$ 353,172	\$ 676,943	\$ 680,074
COST OF SERVICES	291,086	299,076	565,509	583,047
Gross profit	59,967	54,096	111,434	97,027
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	45,699	46,877	92,219	92,928
GAIN ON SALE OF ASSETS	(111)	(222)	(250)	(339)
Operating income	14,379	7,441	19,465	4,438
OTHER INCOME (EXPENSE):				
Interest income	7	4	14	8
Interest expense	(347)	(428)	(685)	(825)
Changes in the fair value of contingent earn-out obligations	(27)	(37)	(54)	(67)
Other	37	18	101	69
Other income (expense)	(330)	(443)	(624)	(815)
INCOME BEFORE INCOME TAXES	14,049	6,998	18,841	3,623
INCOME TAX EXPENSE	5,735	3,049	7,778	2,105
INCOME FROM CONTINUING OPERATIONS	8,314	3,949	11,063	1,518
Income (loss) from discontinued operations, net of income tax expense (benefit) of \$, \$122, \$(39) and \$(40)		98	(54)	(139)
NET INCOME INCLUDING NONCONTROLLING INTERESTS	8,314	4,047	11,009	1,379
Less: Net income (loss) attributable to noncontrolling interests	552	(421)	715	(2,060)
NET INCOME ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC.	\$ 7,762	\$ 4,468	\$ 10,294	\$ 3,439
INCOME PER SHARE ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC.:				
Basic				
Income from continuing operations	\$ 0.21	\$ 0.12	\$ 0.28	\$ 0.09
Income from discontinued operations				
Net income	\$ 0.21	\$ 0.12	\$ 0.28	\$ 0.09
Diluted				
Income from continuing operations	\$ 0.21	\$ 0.12	\$ 0.28	\$ 0.09
Income from discontinued operations				
Net income	\$ 0.21	\$ 0.12	\$ 0.28	\$ 0.09
SHARES USED IN COMPUTING INCOME PER SHARE:				
Basic	37,190	37,166	37,128	37,111

Edgar Filing: COMFORT SYSTEMS USA INC - Form 10-Q

Diluted	37,365	37,247	37,349	37,232
DIVIDENDS PER SHARE	\$ 0.05	\$ 0.05	\$ 0.10	\$ 0.10

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In Thousands, Except Share Amounts)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings (Deficit)	Non- Controlling Interests	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
BALANCE AT DECEMBER 31, 2011	41,123,365	\$ 411	(3,714,506)	\$ (39,437)	\$ 323,608	\$ (19,991)	\$ 18,515	\$ 283,106
Net income (loss)						13,463	(1,614)	11,849
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit			102,750	1,087	(714)			373
Issuance of restricted stock			70,000	742	(742)			
Shares received in lieu of tax withholding payment on vested restricted stock			(51,507)	(544)				(544)
Tax benefit from vesting of restricted stock					56			56
Stock-based compensation					2,797			2,797
Dividends					(7,471)			(7,471)
Share repurchase			(286,036)	(2,860)				(2,860)
BALANCE AT DECEMBER 31, 2012	41,123,365	411	(3,879,299)	(41,012)	317,534	(6,528)	16,901	287,306
Net income (unaudited)						10,294	715	11,009
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit (unaudited)			45,568	484	(129)			355
Issuance of restricted stock (unaudited)			122,375	1,301	(1,301)			
Shares received in lieu of tax withholding payment on vested restricted stock (unaudited)			(44,384)	(622)				(622)
Tax benefit from vesting of restricted stock (unaudited)					172			172
Forfeiture of unvested restricted stock (unaudited)			(469)	(5)	5			
Stock-based compensation (unaudited)					2,308			2,308
Dividends (unaudited)					(1,862)	(1,857)		(3,719)
Share repurchase (unaudited)			(49,963)	(655)				(655)
BALANCE AT JUNE 30, 2013 (unaudited)	41,123,365	\$ 411	(3,806,172)	\$ (40,509)	\$ 316,727	\$ 1,909	\$ 17,616	\$ 296,154

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income including noncontrolling interests	\$ 8,314	\$ 4,047	\$ 11,009	\$ 1,379
Adjustments to reconcile net income to net cash provided by (used in) operating activities				
Amortization of identifiable intangible assets	1,740	2,066	3,669	4,146
Depreciation expense	2,799	2,946	5,645	6,003
Bad debt expense	(471)	1,745	(318)	2,486
Deferred tax expense (benefit)	1,598	676	476	(845)
Amortization of debt financing costs	58	58	115	115
Gain on sale of assets	(111)	(239)	(250)	(455)
Changes in the fair value of contingent earn-out obligations	27	37	54	67
Stock-based compensation expense	1,793	1,067	2,720	1,644
Changes in operating assets and liabilities, net of effects of acquisitions				
(Increase) decrease in				
Receivables, net	(18,928)	(19,001)	(30,920)	(19,906)
Inventories	(50)	436	(13)	368
Prepaid expenses and other current assets	(83)	1,434	111	579
Costs and estimated earnings in excess of billings	4,528	3,170	(3,110)	(3,239)
Other noncurrent assets	127	135	249	(1,942)
Increase (decrease) in				
Accounts payable and accrued liabilities	4,595	4,649	4,742	(5,700)
Billings in excess of costs and estimated earnings	799	3,269	2,269	1,648
Other long-term liabilities	(35)	298	(99)	629
Net cash provided by (used in) operating activities	6,700	6,793	(3,651)	(13,023)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of property and equipment	(4,029)	(4,494)	(7,237)	(6,588)
Proceeds from sales of property and equipment	325	342	502	762
Proceeds from businesses sold		39	43	78
Cash paid for acquisitions, earn-outs and intangible assets, net of cash acquired		(12,213)		(12,228)
Net cash used in investing activities	(3,704)	(16,326)	(6,692)	(17,976)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Net borrowings (payments) on revolving line of credit		18,000		18,000
Payments on other long-term debt	(2,000)	(4,000)	(2,000)	(4,100)
Debt financing costs	(552)		(552)	
Payments of dividends to shareholders	(1,913)	(1,929)	(3,766)	(3,782)
Share repurchase program	(510)	(912)	(655)	(912)
Shares received in lieu of tax withholding	(622)	(543)	(622)	(543)
Excess tax benefit of stock-based compensation	243	(145)	243	(126)
Proceeds from exercise of options	269		284	36
Net cash provided by (used in) financing activities	(5,085)	10,471	(7,068)	8,573

Edgar Filing: COMFORT SYSTEMS USA INC - Form 10-Q

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,089)	938	(17,411)	(22,426)
CASH AND CASH EQUIVALENTS, beginning of period	25,435	27,873	40,757	51,237
CASH AND CASH EQUIVALENTS, end of period	\$ 23,346	\$ 28,811	\$ 23,346	\$ 28,811

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2013

(Unaudited)

1. Business and Organization

Comfort Systems USA, Inc., a Delaware corporation, provides comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services within the mechanical services industry. We operate primarily in the commercial, industrial and institutional HVAC markets and perform most of our services within office buildings, retail centers, apartment complexes, manufacturing plants and healthcare, education and government facilities. In addition to standard HVAC services, we provide specialized applications such as building automation control systems, fire protection, process cooling, electronic monitoring and process piping. Certain locations also perform related activities such as electrical service and plumbing. Approximately 44% of our consolidated 2013 revenue is attributable to installation of systems in newly constructed facilities, with the remaining 56% attributable to maintenance, repair and replacement services. The following service activities account for our consolidated 2013 revenue: HVAC 75%, plumbing 15%, building automation control systems 6% and other 4%. These service activities are within the mechanical services industry which is the single industry segment we serve.

2. Summary of Significant Accounting Policies

Basis of Presentation

These interim statements should be read in conjunction with the historical consolidated financial statements and related notes of Comfort Systems included in the Annual Report on Form 10-K as filed with the Securities and Exchange Commission ("SEC") for the year ended December 31, 2012 (the "Form 10-K").

The accompanying unaudited consolidated financial statements were prepared using generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and applicable rules of Regulation S-X of the SEC. Accordingly, these financial statements do not include all the footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the Form 10-K. We believe all adjustments necessary for a fair presentation of these interim statements have been included and are of a normal and recurring nature. The results of operations for interim periods are not necessarily indicative of the results for the full fiscal year.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions by management in determining the reported amounts of assets and liabilities, revenue and expenses and disclosures regarding contingent assets and liabilities. Actual results could differ from those estimates. The most significant estimates used in our financial statements affect revenue and cost recognition for construction contracts, the allowance for doubtful accounts, self-insurance accruals, deferred tax assets, warranty accruals, fair value accounting for acquisitions and the quantification of fair value for reporting units in connection with our goodwill impairment testing.

Table of Contents**COMFORT SYSTEMS USA, INC.****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****June 30, 2013****(Unaudited)****2. Summary of Significant Accounting Policies (Continued)*****Cash Flow Information***

We consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Cash paid (in thousands) for:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Interest	\$ 509	\$ 617	\$ 520	\$ 664
Income taxes for continuing operations	2,525	222	3,123	1,529
Income taxes for discontinued operations				5
Total	\$ 3,034	\$ 839	\$ 3,643	\$ 2,198

Income Taxes

We are subject to income tax in the United States and Puerto Rico and we file a consolidated return for federal income tax purposes. Income taxes are provided for under the liability method, which takes into account differences between financial statement treatment and tax treatment of certain transactions.

Deferred income taxes are based on the difference between the financial reporting and tax basis of assets and liabilities. The deferred income tax provision represents the change during the reporting period in the deferred tax assets and deferred tax liabilities, net of the effect of acquisitions and dispositions. Deferred tax assets include tax loss and credit carry-forwards and are reduced by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

We regularly evaluate valuation allowances established for deferred tax assets for which future realization is uncertain. We perform this evaluation each quarter. Estimations of required valuation allowances include estimates of future taxable income. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the activity underlying these assets becomes deductible. We consider projected future taxable income and tax planning strategies in making this assessment. If actual future taxable income is less than the estimates, we may not realize all or a portion of the recorded deferred tax assets.

Significant judgment is required in assessing the timing and amounts of deductible and taxable items. We establish reserves when, despite our belief that our tax return positions are fully supportable, we believe that certain positions may be challenged and potentially disallowed. When facts and circumstances change, we adjust these reserves through our provision for income taxes.

To the extent interest and penalties may be assessed by taxing authorities on any underpayment of income tax, such amounts have been accrued and are classified as a component of income tax expense in our consolidated statements of operations.

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2013

(Unaudited)

2. Summary of Significant Accounting Policies (Continued)

For the six months ended June 30, 2013 our tax expense is \$7.8 million with an effective tax rate of 41.3% as compared to tax expense of \$2.1 million with an effective tax rate of 58.1% for the six months ended June 30, 2012. The effective rate for 2013 is higher than the federal statutory rate primarily due to the impact of the variability of rates and results among local jurisdictions. The effective tax rate in 2012 was higher than the federal statutory rate primarily due to the impact of increases in tax reserves. Tax reserves are analyzed and adjusted quarterly as events occur to warrant such changes. Adjustments to tax reserves are a component of the effective tax rate.

Financial Instruments

Our financial instruments consist of cash and cash equivalents, accounts receivable, other receivables, accounts payable, notes to former owners and a revolving credit facility. We believe that the carrying values of these instruments on the accompanying balance sheets approximate their fair values.

Segment Disclosure

Our activities are within the mechanical services industry which is the single industry segment we serve. Each operating subsidiary represents an operating segment and these segments have been aggregated, as the operating units meet all of the aggregation criteria.

Reclassifications

Certain reclassifications have been made in prior period financial statements to conform to current period presentation. These reclassifications are of a normal and recurring nature or are due to discontinued operations accounting related to the shutdown of our Delaware operation in 2012. Neither have resulted in any changes to previously reported net income for any periods.

3. Fair Value Measurements

We classify and disclose assets and liabilities carried at fair value in one of the following three categories:

Level 1 quoted prices in active markets for identical assets and liabilities;

Level 2 observable market based inputs or unobservable inputs that are corroborated by market data; and

Level 3 significant unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2013

(Unaudited)

3. Fair Value Measurements (Continued)

The following table summarizes the fair values and levels within the fair value hierarchy in which the fair value measurements fall for assets and liabilities measured on a recurring basis as of June 30, 2013 (in thousands):

	Total	Fair Value Measurements at Reporting Date Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 23,346	\$ 23,346	\$	\$
Life insurance cash surrender value	\$ 2,587	\$	\$ 2,587	\$
Contingent earn-out obligations	\$ 2,020	\$	\$	\$ 2,020

Cash and cash equivalents consist primarily of highly rated money market funds at a variety of well-known institutions with original maturities of three months or less. The original cost of these assets approximates fair value due to their short term maturity.

One of our operations has life insurance policies covering 39 employees with a combined face value of \$40.5 million. The policy is invested in mutual funds and the fair value measurement is determined using Level 2 inputs within the fair value hierarchy and will vary with investment performance. The cash surrender value of these policies is \$2.6 million as of June 30, 2013 and \$2.5 million as of December 31, 2012, respectively. These assets are included in "Other Noncurrent Assets" in our consolidated balance sheets.

The valuation of the Company's contingent earn-out obligations is determined using a probability weighted discounted cash flow method. This fair value measurement is based on significant unobservable inputs in the market and thus represents a Level 3 measurement within the fair value hierarchy. This analysis reflects the contractual terms of the purchase agreements (e.g., minimum and maximum payments, length of earn-out periods, manner of calculating any amounts due, etc.) and utilizes assumptions with regard to future cash flows, probabilities of achieving such future cash flows and a discount rate. The contingent earn-out obligations are measured at fair value each reporting period and changes in estimates of fair value are recognized in earnings.

The table below presents a reconciliation of the fair value of our contingent earn-out obligations that use significant unobservable inputs (Level 3) (in thousands).

Balance at beginning of year	\$ 1,966
Issuances	
Settlements	
Adjustments to fair value	54
Balance at end of period	\$ 2,020

We measure certain assets at fair value on a nonrecurring basis. These assets are recognized at fair value when they are deemed to be other-than-temporarily impaired. We did not recognize any impairments, in the current quarter, on those assets required to be measured at fair value on a nonrecurring basis.

Table of Contents**COMFORT SYSTEMS USA, INC.****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****June 30, 2013****(Unaudited)****4. Acquisitions**

No acquisitions were completed in the first six months of 2013. We completed one acquisition in the first quarter and one in the second quarter of 2012. These acquisitions were not material, individually or in the aggregate, and were "tucked-in" with existing operations. The results of operations of acquisitions are included in our consolidated financial statements from their respective acquisition dates. Additional contingent purchase price ("earn-out") has been or will be paid if certain acquisitions achieve predetermined profitability targets.

5. Discontinued Operations

During the fourth quarter of 2012, we substantially completed the shutdown of our operation located in Delaware. Discontinued operations were breakeven for the three months ended June 30, 2013. The after tax loss for the six months ended June 30, 2013 was \$0.1 million. The after tax income for the three months ended June 30, 2012 was \$0.1 million while the after tax loss for the six months ended June 30, 2012 was \$0.1 million. These results have been recorded in discontinued operations under "Income (loss) from discontinued operations, net of income tax expense (benefit)".

Our consolidated statements of operations and the related earnings per share amounts have been restated to reflect the effects of the discontinued operations. No interest expense is allocated to discontinued operations.

Revenue and pre-tax income (loss) related to discontinued operations are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenue	\$ 49	\$ 1,578	\$ 22	\$ 4,086
Pre-tax income (loss)	\$	\$ 220	\$ (93)	\$ (179)

6. Goodwill and Identifiable Intangible Assets, Net***Goodwill***

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

	June 30, 2013	December 31, 2012
Balance at beginning of year	\$ 114,588	\$ 107,093
Additions		7,495
Balance at end of period	\$ 114,588	\$ 114,588

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2013

(Unaudited)

6. Goodwill and Identifiable Intangible Assets, Net (Continued)

Identifiable Intangible Assets, Net

Identifiable intangible assets consist of the following (dollars in thousands):

		June 30, 2013		December 31, 2012	
	Estimated Useful Lives in Years	Gross Book Value	Accumulated Amortization	Gross Book Value	Accumulated Amortization
Customer relationships	1 - 15	\$ 40,404	\$ (18,287)	\$ 40,404	\$ (15,579)
Backlog	1 - 2	6,515	(6,515)	6,515	(6,375)
Noncompete agreements	2 - 7	2,890	(2,538)	2,890	(2,380)
Tradenames	2 - 25	23,695	(5,318)	23,695	(4,655)
Total		\$ 73,504	\$ (32,658)	\$ 73,504	\$ (28,989)

7. Long-Term Debt Obligations

Long-term debt obligations consist of the following (in thousands):

	June 30, 2013	December 31, 2012
Revolving credit facility	\$	\$
Other debt	2,400	2,400
Notes to former owners	3,000	5,000
Total debt	5,400	7,400
Less current portion	(300)	(300)
Total long-term portion of debt	\$ 5,100	\$ 7,100

Revolving Credit Facility

On June 25, 2013, we amended our senior credit facility (the "Facility") provided by a syndicate of banks increasing our borrowing capacity from \$125.0 million to \$175.0 million. The Facility, which is available for borrowings and letters of credit, now expires in July 2018 and is secured by a first lien on substantially all of the Company's personal property except for assets related to projects subject to surety bonds and assets held by certain unrestricted subsidiaries and a second lien on the Company's assets related to projects subject to surety bonds. We incurred approximately \$0.6 million in financing and professional costs in connection with the amendment to the Facility, which combined with the previous unamortized costs of \$0.7 million, will be amortized on a straight-line basis as a non-cash charge to interest expense over the remaining term of the Facility. As of June 30, 2013, we had no outstanding borrowings, \$53.2 million in letters of credit outstanding and \$121.8 million of credit available.

There are two interest rate options for borrowings under the Facility, the Base Rate Loan Option and the Eurodollar Rate Loan Option. These rates are floating rates determined by the broad financial

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2013

(Unaudited)

7. Long-Term Debt Obligations (Continued)

markets, meaning they can and do move up and down from time to time. Additional margins are then added to these two rates.

The following is a summary of the additional margins:

	Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA			
	Less than 0.75	0.75 to 1.50	1.50 to 2.25	2.25 or greater
Additional Per Annum Interest Margin Added Under:				
Base Rate Loan Option	0.25%	0.50%	0.75%	1.00%
Eurodollar Rate Loan Option	1.25%	1.50%	1.75%	2.00%

We estimate that the weighted average interest rate applicable to borrowings under the Facility would be approximately 1.7% as of June 30, 2013.

We have used letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. Our lenders issue such letters of credit through the Facility for a fee. We have never had a claim made against a letter of credit that resulted in payments by a lender or by us and believe such claims are unlikely in the foreseeable future. The letter of credit fees range from 1.25% to 2.00% per annum, based on the ratio of Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA, as defined in the credit agreement.

Commitment fees are payable on the portion of the revolving loan capacity not in use for borrowings or letters of credit at any given time. These fees range from 0.20% to 0.35% per annum, based on the ratio of Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA, as defined in the credit agreement.

The Facility contains financial covenants defining various financial measures and the levels of these measures with which we must comply. Covenant compliance is assessed as of each quarter end.

The Facility's principal financial covenants include:

Leverage Ratio The Facility requires that the ratio of our Consolidated Total Indebtedness to our Credit Facility Adjusted EBITDA not exceed 3.00 through December 31, 2014, 2.75 through December 31, 2015 and 2.50 through maturity. The leverage ratio as of June 30, 2013 was 0.09.

Fixed Charge Coverage Ratio The Facility requires that the ratio of Credit Facility Adjusted EBITDA, less non-financed capital expenditures, tax provision, dividends and amounts used to repurchase stock to the sum of interest expense and scheduled principal payments of indebtedness be at least 2.00; provided that the calculation of the fixed charge coverage ratio excludes stock repurchases and the payment of dividends at any time that the Company's Net Leverage Ratio does not exceed 1.50. The Facility also allows the fixed charge coverage ratio not to be reduced for stock repurchases through June 30, 2015 in an aggregate amount not to exceed \$25 million if at the time of and after giving effect to such repurchase the Company's Net Leverage Ratio was less than or equal to 1.50. Capital expenditures, tax provision, dividends and stock repurchase payments are defined under the Facility for purposes of this covenant to be amounts for the four quarters ending as of any given

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2013

(Unaudited)

7. Long-Term Debt Obligations (Continued)

quarterly covenant compliance measurement date. The fixed charge coverage ratio as of June 30, 2013 was 21.37.

Other Restrictions The Facility permits acquisitions of up to \$20.0 million per transaction, provided that the aggregate purchase price of such an acquisition and of acquisitions in the same fiscal year does not exceed \$50.0 million. However, these limitations only apply when the Company's Net Leverage Ratio is equal to or greater than 2.00.

While the Facility's financial covenants do not specifically govern capacity under the Facility, if our debt level under the Facility at a quarter-end covenant compliance measurement date were to cause us to violate the Facility's leverage ratio covenant, our borrowing capacity under the Facility and the favorable terms that we currently have could be negatively impacted by the lenders.

We are in compliance with all of our financial covenants as of June 30, 2013.

Notes to Former Owners

We issued subordinated notes to the former owners of acquired companies as part of the consideration used to acquire these companies. These notes had an outstanding balance of \$3.0 million as of June 30, 2013 and bear interest, payable annually, at a weighted average interest rate of 3.3%. The maturity date of the outstanding balance is July 2014. In July 2013, we paid \$1.0 million of this outstanding balance.

Other Debt

In conjunction with our acquisition of ColonialWebb in 2010, we acquired long-term debt related to an industrial revenue bond associated with its office building and warehouse. The outstanding balance as of June 30, 2013 was \$2.4 million, of which \$0.3 million is current. The weighted average interest rate on this variable rate debt as of June 30, 2013 was approximately 0.30%. In July 2013, we paid the outstanding balance of \$2.4 million.

In addition, our majority owned subsidiary, EAS, has a revolving \$2.5 million credit line that is available for temporary working capital needs and expires June 30, 2014. As of June 30, 2013, we had no outstanding borrowings and, therefore, \$2.5 million of credit available. We estimate that the weighted average interest rate applicable to borrowings under this variable rate credit line would be approximately 2.7% as of June 30, 2013.

8. Commitments and Contingencies

Claims and Lawsuits

We are subject to certain legal and regulatory claims, including lawsuits arising in the normal course of business. We maintain various insurance coverages to minimize financial risk associated with these claims. We have estimated and provided accruals for probable losses and related legal fees associated with certain litigation in the accompanying consolidated financial statements. While we cannot predict the outcome of these proceedings, in management's opinion and based on reports of

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2013

(Unaudited)

8. Commitments and Contingencies (Continued)

counsel, any liability arising from these matters individually and in the aggregate will not have a material effect on our operating results or financial condition, after giving effect to provisions already recorded.

Surety

Many customers, particularly in connection with new construction, require us to post performance and payment bonds issued by a financial institution known as a surety. If we fail to perform under the terms of a contract or to pay subcontractors and vendors who provided goods or services under a contract, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the surety for any expenses or outlays it incurs. To date, we are not aware of any losses to our sureties in connection with bonds the sureties have posted on our behalf, and do not expect such losses to be incurred in the foreseeable future.

Surety market conditions remain challenging as a result of significant losses incurred by many sureties in recent periods, both in the construction industry as well as in certain larger corporate bankruptcies. As a result, less bonding capacity is available in the market and terms have become more restrictive. Further, under standard terms in the surety market, sureties issue bonds on a project-by-project basis, and can decline to issue bonds at any time. Historically, approximately 25% to 35% of our business has required bonds. While we have strong surety relationships to support our bonding needs, current market conditions as well as changes in the sureties' assessment of our operating and financial risk could cause the sureties to decline to issue bonds for our work. If that were to occur, the alternatives include doing more business that does not require bonds, posting other forms of collateral for project performance such as letters of credit or cash, and seeking bonding capacity from other sureties. We would likely also encounter concerns from customers, suppliers and other market participants as to our creditworthiness. While we believe our general operating and financial characteristics, including a significant amount of cash on our balance sheet, would enable us to ultimately respond effectively to an interruption in the availability of bonding capacity, such an interruption would likely cause our revenue and profits to decline in the near term.

Self-Insurance

We are substantially self-insured for workers' compensation, employer's liability, auto liability, general liability and employee group health claims, in view of the relatively high per-incident deductibles we absorb under our insurance arrangements for these risks. Losses up to deductible amounts are estimated and accrued based upon known facts, historical trends and industry averages. Loss estimates associated with the larger and longer-developing risks, such as workers' compensation, auto liability and general liability, are reviewed by a third-party actuary quarterly.

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2013

(Unaudited)

9. Stockholders' Equity

Earnings Per Share

Basic earnings per share ("EPS") is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted EPS is computed considering the dilutive effect of stock options, contingently issuable restricted stock and restricted stock units.

There were approximately 0.3 million and 1.0 million of anti-dilutive stock options excluded from the calculation of diluted EPS for the three months ended June 30, 2013 and 2012, respectively. There were approximately 0.4 million and 1.0 million of anti-dilutive stock options excluded from the calculation of diluted EPS for the six months ended June 30, 2013 and 2012, respectively.

The following table reconciles the number of shares outstanding with the number of shares used in computing basic and diluted earnings per share for each of the periods presented (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Common shares outstanding, end of period(a)	37,257	37,163	37,257	37,163
Effect of using weighted average common shares outstanding	(67)	3	(129)	(52)
Shares used in computing earnings per share - basic	37,190	37,166	37,128	37,111
Effect of shares issuable under stock option plans based on the treasury stock method	121	81	107	92
Effect of contingently issuable restricted shares	54		114	29
Shares used in computing earnings per share - diluted	37,365	37,247	37,349	37,232

(a)

Excludes 0.1 million and 0.2 million shares of unvested contingently issuable restricted stock outstanding as of June 30, 2013 and 2012, respectively.

Share Repurchase Program

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from time to time approved extensions of the program to acquire additional shares. Since the inception of the repurchase program, the Board has approved 6.6 million shares to be repurchased.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. We repurchased less than 0.1 million shares during the six months ended June 30, 2013 at an average price of \$13.11 per share. Since the inception of the program in 2007 and as of June 30, 2013, we have repurchased a cumulative total of 5.9 million shares at an average price of \$10.95 per share.

Table of Contents

Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion should be read in conjunction with our historical Consolidated Financial Statements and related notes included elsewhere in this Form 10-Q and the Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2012 (the "Form 10-K"). This discussion contains "forward-looking statements" regarding our business and industry within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on our current plans and expectations and involve risks and uncertainties that could cause our actual future activities and results of operations to be materially different from those set forth in the forward-looking statements. Important factors that could cause actual results to differ include risks set forth in "Item 1A. Risk Factors" included in our Form 10-K. The terms "Comfort Systems," "we," "us," or "the Company," refer to Comfort Systems USA, Inc. or Comfort Systems USA, Inc. and its consolidated subsidiaries, as appropriate in the context.

Introduction and Overview

We are a national provider of comprehensive HVAC installation, maintenance, repair and replacement services within the mechanical services industry. We operate primarily in the commercial, industrial and institutional HVAC markets and perform most of our services within office buildings, retail centers, apartment complexes, manufacturing plants and healthcare, education and government facilities. In addition to standard HVAC services, we provide specialized applications such as building automation control systems, fire protection, process cooling, electronic monitoring and process piping. Certain locations also perform related activities such as electrical service and plumbing.

Nature and Economics of Our Business

Approximately 84% of our revenue is earned on a project basis for installation of HVAC systems in newly constructed facilities or for replacement of HVAC systems in existing facilities. Customers hire us to ensure such systems deliver specified or generally expected heating, cooling, conditioning and circulation of air in a facility. This entails installing core system equipment such as packaged heating and air conditioning units, or in the case of larger facilities, separate core components such as chillers, boilers, air handlers and cooling towers. We also typically install connecting and distribution elements such as piping and ducting. Our responsibilities usually require conforming the systems to pre-established engineering drawings and equipment and performance specifications, which we frequently participate in establishing. Our project management responsibilities include staging equipment and materials to project sites, deploying labor to perform the work and coordinating with other service providers on the project, including any subcontractors we might use to deliver our portion of the work.

When competing for project business, we usually estimate the costs we will incur on a project, and then propose a bid to the customer that includes a contract price and other performance and payment terms. Our bid price and terms are intended to cover our estimated costs on the project and provide a profit margin to us commensurate with the value of the installed system to the customer, the risk that project costs or duration will vary from estimate, the schedule on which we will be paid, the opportunities for other work that we might forego by committing capacity to this project, and other costs that we incur more broadly to support our operations but which are not specific to the project. Typically customers will seek bids from competitors for a given project. While the criteria on which customers select the winning bid vary widely and include factors such as quality, technical expertise, on-time performance, post-project support and service, and company history and financial strength, we believe that price is the most influential factor for most customers in choosing an HVAC installation and service provider.

Table of Contents

After a customer accepts our bid, we generally enter into a contract with the customer that specifies what we will deliver on the project, what our related responsibilities are, and how much and when we will be paid. Our overall price for the project is typically set at a fixed amount in the contract, although changes in project specifications or work conditions that result in unexpected additional work are usually subject to additional payment from the customer via what are commonly known as change orders. Project contracts typically provide for periodic billings to the customer as we meet progress milestones or incur cost on the project. Project contracts in our industry also frequently allow for a small portion of progress billings or contract price to be withheld by the customer until after we have completed the work, typically for six months. Amounts withheld under this practice are known as retention or retainage.

Labor and overhead costs account for the majority of our cost of service. Accordingly, labor management and utilization have the most impact on our project performance. Given the fixed price nature of much of our project work, if our initial estimate of project costs is wrong or we incur cost overruns that cannot be recovered in change orders, we can experience reduced profits or even significant losses on fixed price project work. We also perform some project work on a cost-plus or a time and materials basis, under which we are paid our costs incurred plus an agreed-upon profit margin. These margins are typically less than fixed-price contract margins because there is less risk of unrecoverable cost overruns in cost-plus or time and materials work.

Our average project takes six to nine months to complete, with an average contract price of approximately \$431,000. We also perform larger HVAC projects. Generally, projects closer in size to \$1 million will be completed in one year or less. It is unusual for us to work on a project that exceeds two years in length. Our projects generally require working capital funding of equipment and labor costs. Customer payments on periodic billings generally do not recover these costs until late in the job. Our average project duration together with typical retention terms as discussed above generally allow us to complete the realization of revenue and earnings in cash within one year. We have what we believe is a well-diversified distribution of revenue across end-use sectors that we believe reduces our exposure to negative developments in any given sector. Because of the integral nature of HVAC and related controls systems to most buildings, we have the legal right in almost all cases to attach liens to buildings or related funding sources when we have not been fully paid for installing systems, except with respect to some government buildings. The service work that we do, which is discussed further below, usually does not give rise to lien rights.

A stratification of projects in progress as of June 30, 2013, by contract price, is as follows:

Contract Price of Project	No. of Projects	Aggregate Contract Price Value (millions)
Under \$1 million	4,011	\$ 360.8
\$1 million - \$5 million	288	660.0
\$5 million - \$10 million	64	432.0
\$10 million - \$15 million	14	170.9
Greater than \$15 million	10	266.1
Total	4,387	\$ 1,889.8

In addition to project work, approximately 16% of our revenue represents maintenance and repair service on already-installed HVAC and controls systems. This kind of work usually takes from a few hours to a few days to perform. Prices to the customer are usually based on the equipment and materials used in the service as well as technician labor time. We usually bill the customer for service work when it is complete, typically with payment terms of up to thirty days. We also provide maintenance and repair service under ongoing contracts. Under these contracts, we are paid regular monthly or quarterly amounts and provide specified service based on customer requirements. These

Table of Contents

agreements typically cover periods ranging from one to three years with thirty- to sixty-day cancellation notice periods.

A relatively small portion of our revenue comes from national and regional account customers. These customers typically have multiple sites, and contract with us to perform maintenance and repair service. These contracts may also provide for us to perform new or replacement systems installation. We operate a national call center to dispatch technicians to sites requiring service. We perform the majority of this work with our own employees, with the balance being subcontracted to third parties that meet our performance qualifications. We will also typically use proprietary information systems to maintain information on the customer's sites and equipment, including performance and service records, and related cost data. These systems track the status of ongoing service and installation work, and may also monitor system performance data. Under these contractual relationships, we usually provide consolidated billing and credit payment terms to the customer.

Profile and Management of Our Operations

We manage our 36 operating units based on a variety of factors. Financial measures we emphasize include profitability, and use of capital as indicated by cash flow and by other measures of working capital principally involving project cost, billings and receivables. We also monitor selling, general, administrative and indirect project support expense, backlog, workforce size and mix, growth in revenue and profits, variation of actual project cost from original estimate, and overall financial performance in comparison to budget and updated forecasts. Operational factors we emphasize include project selection, estimating, pricing, management and execution practices, labor utilization, safety, training, and the make-up of both existing backlog as well as new business being pursued, in terms of project size, technical application and facility type, end-use customers and industries, and location of the work.

Most of our operations compete on a local or regional basis. Attracting and retaining effective operating unit managers is an important factor in our business, particularly in view of the relative uniqueness of each market and operation, the importance of relationships with customers and other market participants such as architects and consulting engineers, and the high degree of competition and low barriers to entry in most of our markets. Accordingly, we devote considerable attention to operating unit management quality, stability and contingency planning, including related considerations of compensation, and non-competition protection where applicable.

Economic and Industry Factors

As an HVAC and building controls services provider, we operate in the broader nonresidential construction services industry and are affected by trends in this sector. While we do not have operations in all major cities of the United States, we believe our national presence is sufficiently large that we experience trends in demand for and pricing of our services that are consistent with trends in the national nonresidential construction sector. As a result, we monitor the views of major construction sector forecasters along with macroeconomic factors they believe drive the sector, including trends in gross domestic product, interest rates, business investment, employment, demographics and the general fiscal condition of federal, state and local governments.

Spending decisions for building construction, renovation and system replacement are generally made on a project basis, usually with some degree of discretion as to when and if projects proceed. With larger amounts of capital, time and discretion involved, spending decisions are affected to a significant degree by uncertainty, particularly concerns about economic and financial conditions and trends. We have experienced periods of time when economic weakness caused a significant slowdown in decisions to proceed with installation and replacement project work.

Table of Contents

Operating Environment and Management Emphasis

Nonresidential building construction and renovation activity, as reported by the federal government, declined over the three year period of 2001 to 2003, expanded moderately during 2004 and 2005, and was strong over the three year period from 2006 to 2008. We experienced significant industry activity declines over the four year period from 2009 to 2012, which have continued in 2013. During the periods of decline, we responded to market challenges by pursuing work in sectors less affected by the downturn, such as government, educational and healthcare facilities, and by establishing marketing initiatives that take advantage of our size and range of expertise. We also responded to declining gross profits over those years by reducing our selling, general and administrative expenses, and our indirect project and service overhead costs. We believe our efforts in these areas partially offset the decline in our profitability over that period.

As a result of our continued strong emphasis on cash flow, our debt outstanding under our revolving credit facility is zero, and we have substantial uncommitted cash balances, as discussed further in "Liquidity and Capital Resources" below. We have a credit facility in place with considerably less restrictive terms than those of our previous facilities; this facility does not expire until July 2018. We have strong surety relationships to support our bonding needs, and we believe our relationships with the surety markets are positive in light of our strong current results and financial position. We have generated positive free cash flow in each of the last fourteen calendar years and will continue our emphasis in this area. We believe that the relative size and strength of our balance sheet and surety support as compared to most companies in our industry represent competitive advantages for us.

As discussed at greater length in "Results of Operations" below, we have seen declining activity levels in our industry since late 2008 and we expect price competition to continue to be strong, as local and regional competitors respond cautiously to changing conditions. We will continue our efforts to find the more active sectors in our markets, and to increase our regional and national account business. Our primary emphasis for the remainder of 2013 will be on execution and cost control, and on maintaining activity levels that will permit us to earn reasonable profits while preserving our core workforce. We have increased our focus on project qualification, estimating, pricing and management, and on service performance.

Cyclical and Seasonality

Historically, the construction industry has been highly cyclical. As a result, our volume of business may be adversely affected by declines in new installation and replacement projects in various geographic regions of the United States during periods of economic weakness.

The HVAC industry is subject to seasonal variations. Specifically, the demand for new installation and replacement is generally lower during the winter months (the first quarter of the year) due to reduced construction activity during inclement weather and less use of air conditioning during the colder months. Demand for HVAC services is generally higher in the second and third calendar quarters due to increased construction activity and increased use of air conditioning during the warmer months. Accordingly, we expect our revenue and operating results generally will be lower in the first and fourth calendar quarters.

Critical Accounting Policies

Our critical accounting policies are based upon the significance of the accounting policy to our overall financial statement presentation, as well as the complexity of the accounting policy and our use of estimates and subjective assessments. Our most critical accounting policy is revenue recognition. As discussed elsewhere in this quarterly report on Form 10-Q, our business has two service functions: (i) installation, which we account for under the percentage of completion method, and (ii) maintenance, repair and replacement, which we account for as the services are performed, or in the

Table of Contents

case of replacement, under the percentage of completion method. In addition, we identified other critical accounting policies related to our allowance for doubtful accounts receivable, the recording of our self-insurance liabilities, valuation of deferred tax assets, accounting for acquisitions and the recoverability of goodwill and identifiable intangible assets. These accounting policies, as well as others, are described as follows and in Note 2 to the Consolidated Financial Statements included elsewhere in this quarterly report on Form 10-Q.

Percentage of Completion Method of Accounting

Approximately 84% of our revenue was earned on a project basis and recognized through the percentage of completion method of accounting. Under this method contract revenue recognizable at any time during the life of a contract is determined by multiplying expected total contract revenue by the percentage of contract costs incurred at any time to total estimated contract costs. More specifically, as part of the negotiation and bidding process in which we engage in connection with obtaining installation contracts, we estimate our contract costs, which include all direct materials (exclusive of rebates), labor and subcontract costs and indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. These contract costs are included in our results of operations under the caption "Cost of Services." Then, as we perform under those contracts, we measure costs incurred, compare them to total estimated costs to complete the contract, and recognize a corresponding proportion of contract revenue. Labor costs are considered to be incurred as the work is performed. Subcontractor labor is recognized as the work is performed, but is generally subjected to approval as to milestones or other evidence of completion. Non-labor project costs consist of purchased equipment, prefabricated materials and other materials. Purchased equipment on our projects is substantially produced to job specifications and is a value added element to our work. The costs are considered to be incurred when title is transferred to us, which typically is upon delivery to the worksite. Prefabricated materials, such as ductwork and piping, are generally performed at our shops and recognized as contract costs when fabricated for the unique specifications of the job. Other materials cost are not significant and are generally recorded when delivered to the worksite. This measurement and comparison process requires updates to the estimate of total costs to complete the contract, and these updates may include subjective assessments.

We generally do not incur significant costs prior to receiving a contract, and therefore, these costs are expensed as incurred. In limited circumstances, when significant pre-contract costs are incurred, they are deferred if the costs can be directly associated with a specific contract and if their recoverability from the contract is probable. Upon receiving the contract, these costs are included in contract costs. Deferred costs associated with unsuccessful contract bids are written off in the period that we are informed that we will not be awarded the contract.

Project contracts typically provide for a schedule of billings or invoices to the customer based on reaching agreed-upon milestones or as we incur costs. The schedules for such billings usually do not precisely match the schedule on which costs are incurred. As a result, contract revenue recognized in the statement of operations can and usually do differ from amounts that can be billed or invoiced to the customer at any point during the contract. Amounts by which cumulative contract revenue recognized on a contract as of a given date exceed cumulative billings to the customer under the contract are reflected as a current asset in our balance sheet under the caption "Costs and estimated earnings in excess of billings." Amounts by which cumulative billings to the customer under a contract as of a given date exceed cumulative contract revenue recognized on the contract are reflected as a current liability in our balance sheet under the caption "Billings in excess of costs and estimated earnings."

The percentage of completion method of accounting is also affected by changes in job performance, job conditions and final contract settlements. These factors may result in revisions to estimated costs and, therefore, revenue. Such revisions are frequently based on further estimates and

Table of Contents

subjective assessments. The effects of these revisions are recognized in the period in which revisions are determined. When such revisions lead to a conclusion that a loss will be recognized on a contract, the full amount of the estimated ultimate loss is recognized in the period such conclusion is reached, regardless of the percentage of completion of the contract.

Revisions to project costs and conditions can give rise to change orders under which the customer agrees to pay additional contract price. Revisions can also result in claims we might make against the customer to recover project variances that have not been satisfactorily addressed through change orders with the customer. Except in certain circumstances, we do not recognize revenue or margin based on change orders or claims until they have been agreed upon with the customer. The amount of revenue associated with unapproved change orders and claims is currently immaterial. Variations from estimated project costs could have a significant impact on our operating results, depending on project size, and the recoverability of the variation via additional customer payments.

Accounting for Allowance for Doubtful Accounts

We are required to estimate the collectability of accounts receivable and provide an allowance for doubtful accounts for receivable amounts we believe it is probable we will not ultimately collect. This requires us to make certain judgments and estimates involving, among others, the creditworthiness of our customers, prior collection history with our customers, ongoing relationships with our customers, the aging of past due balances, our lien rights, if any, in the property where we performed the work, and the availability, if any, of payment bonds applicable to the contract. These estimates are evaluated and adjusted as needed when additional information is received.

Accounting for Self-Insurance Liabilities

We are substantially self-insured for workers' compensation, employer's liability, auto liability, general liability and employee group health claims in view of the relatively high per-incident deductibles we absorb under our insurance arrangements for these risks. Losses up to deductible amounts are estimated and accrued based upon known facts, historical trends and industry averages. Loss estimates associated with the larger and longer-developing risks workers' compensation, auto liability and general liability are reviewed by a third party actuary quarterly. We believe these accruals are adequate. However, insurance liabilities are difficult to estimate due to unknown factors, including the severity of an injury, the determination of our liability in proportion to other parties, timely reporting of occurrences, ongoing treatment or loss mitigation, general trends in litigation recovery outcomes and the effectiveness of safety and risk management programs. Therefore, if actual experience differs from the assumptions and estimates used for recording the liabilities, adjustments may be required and would be recorded in the period that such experience becomes known.

Our self-insurance arrangements currently are as follows:

Workers' Compensation The per-incident deductible for workers' compensation is \$500,000. Losses above \$500,000 are determined by statutory rules on a state-by-state basis, and are fully covered by excess workers' compensation insurance.

Employer's Liability For employer's liability, the per incident deductible is \$500,000. We are fully insured for the next \$500,000 of each loss, and then have several layers of excess loss insurance policies that cover losses up to \$100 million in aggregate across this risk area (as well as general liability and auto liability noted below).

General Liability For general liability, the per incident deductible is \$500,000. We are fully insured for the next \$1.5 million of each loss, and then have several layers of excess loss insurance policies that cover losses up to \$100 million in aggregate across this risk area (as well as employer's liability noted above and auto liability noted below).

Table of Contents

Auto Liability For auto liability, the per incident deductible is \$500,000. We are fully insured for the next \$1.5 million of each loss, and then have several layers of excess loss insurance policies that cover losses up to \$100 million in aggregate across this risk area (as well as employer's liability and general liability noted above).

Employee Medical We have two medical plans. The deductible for employee group health claims is \$300,000 per person, per policy (calendar) year for each plan. Insurance then covers any responsibility for medical claims in excess of the deductible amount.

Our \$100 million of aggregate excess loss coverage above applicable per-incident deductibles represents one policy limit that applies to all lines of risk; we do not have a separate \$100 million of excess loss coverage for each of general liability, employer's liability and auto liability.

Accounting for Deferred Tax Assets

We regularly evaluate valuation allowances established for deferred tax assets for which future realization is uncertain. We perform this evaluation quarterly. Estimations of required valuation allowances include estimates of future taxable income. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the activity underlying these assets becomes deductible. We consider projected future taxable income and tax planning strategies in making this assessment. If actual future taxable income is less than the estimates, we may not realize all or a portion of the recorded deferred tax assets.

Acquisitions

We recognize assets acquired and liabilities assumed in business combinations, including contingent assets and liabilities, based on fair value estimates as of the date of acquisition.

Contingent Consideration In certain acquisitions, we agree to pay additional amounts to sellers contingent upon achievement by the acquired businesses of certain predetermined profitability targets. We have recognized liabilities for these contingent obligations based on their estimated fair value at the date of acquisition with any differences between the acquisition date fair value and the ultimate settlement of the obligations being recognized in income from operations.

Contingent Assets and Liabilities Assets and liabilities arising from contingencies are recognized at their acquisition date fair value when their respective fair values can be determined. If the fair values of such contingencies cannot be determined, they are recognized at the acquisition date if the contingencies are probable and an amount can be reasonably estimated. Acquisition date fair value estimates are revised as necessary if, and when, additional information regarding these contingencies becomes available to further define and quantify assets acquired and liabilities assumed.

Recoverability of Goodwill and Identifiable Intangible Assets

Goodwill is the excess of purchase price over the fair value of the net assets of acquired businesses. We assess goodwill for impairment each year, and more frequently if circumstances suggest an impairment may have occurred.

When the carrying value of a given reporting unit exceeds its fair value, an impairment loss is recorded to the extent that the implied fair value of the goodwill of the reporting unit is less than its carrying value. If other reporting units have had increases in fair value, such increases may not be recorded. Accordingly, such increases may not be netted against impairments at other reporting units. The requirements for assessing whether goodwill has been impaired involve market-based information. This information, and its use in assessing goodwill, entails some degree of subjective assessment.

Table of Contents

We currently perform our annual impairment testing as of October 1 and any impairment charges resulting from this process are reported in the fourth quarter. We segregate our operations into reporting units based on the degree of operating and financial independence of each unit and our related management of them. We perform our annual goodwill impairment testing at the reporting unit level.

In the evaluation of goodwill for impairment, we have the option to first assess qualitative factors to determine whether the existence of events or circumstances lead to a determination that it is more likely than not that the fair value of one of our reporting units is greater than its carrying value. If, after completing such assessment, we determine it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then there is no need to perform any further testing. If we conclude otherwise, then we perform the first step of a two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying value of the reporting unit.

We estimate the fair value of the reporting unit based on two market approaches and an income approach, which utilizes discounted future cash flows. Assumptions critical to the fair value estimates under the discounted cash flow model include discount rates, cash flow projections, projected long-term growth rates and the determination of terminal values. The market approaches utilized market multiples of invested capital from comparable publicly traded companies ("public company approach") and comparable transactions ("transaction approach"). The market multiples from invested capital include revenue, book equity plus debt and earnings before interest, taxes, depreciation and amortization ("EBITDA").

There are significant inherent uncertainties and management judgment involved in estimating the fair value of each reporting unit. While we believe we have made reasonable estimates and assumptions to estimate the fair value of our reporting units, it is possible that a material change could occur. If actual results are not consistent with our current estimates and assumptions, or the current economic downturn worsens or the projected recovery is significantly delayed beyond our projections, goodwill impairment charges may be recorded in future periods.

We amortize identifiable intangible assets with finite lives over their useful lives. Changes in strategy and/or market condition may result in adjustments to recorded intangible asset balances or their useful lives.

Edgar Filing: COMFORT SYSTEMS USA INC - Form 10-Q

Table of Contents

Results of Operations (dollars in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013	%	2012	%	2013	%	2012	%
Revenue	\$ 351,053	100.0%	\$ 353,172	100.0%	\$ 676,943	100.0%	\$ 680,074	100.0%
Cost of services	291,086	82.9%	299,076	84.7%	565,509	83.5%	583,047	85.7%
Gross profit	59,967	17.1%	54,096	15.3%	111,434	16.5%	97,027	14.3%
Selling, general and administrative expenses	45,699	13.0%	46,877	13.3%	92,219	13.6%	92,928	13.7%
Gain on sale of assets	(111)		(222)	(0.1)%	(250)		(339)	
Operating income	14,379	4.1%	7,441	2.1%	19,465	2.9%	4,438	0.7%
Interest income	7		4		14		8	
Interest expense	(347)	(0.1)%	(428)	(0.1)%	(685)	(0.1)%	(825)	(0.1)%
Changes in the fair value of contingent earn-out obligations	(27)		(37)		(54)		(67)	
Other income (expense)	37		18		101		69	
Income before income taxes	14,049	4.0%	6,998	2.0%	18,841	2.8%	3,623	0.5%
Income tax expense	5,735		3,049		7,778		2,105	
Income from continuing operations	8,314		3,949		11,063		1,518	
Income (loss) from discontinued operations, net of tax			98		(54)		(139)	
Net income including noncontrolling interests	8,314	2.4%	4,047	1.1%	11,009	1.6%	1,379	0.2%
Less: Net income (loss) attributable to noncontrolling interests	552		(421)		715		(2,060)	
Net income attributable to Comfort Systems USA, Inc.	\$ 7,762		\$ 4,468		\$ 10,294		\$ 3,439	

We had 37 operating locations as of December 31, 2012. During the first quarter of 2013, we consolidated one company into other operations. As of June 30, 2013, we had 36 operating locations.

Revenue Revenue decreased \$2.1 million, or 0.6%, to \$351.1 million for the second quarter of 2013 compared to the same period in 2012. The decrease is primarily due to our large operation headquartered in Virginia (\$26.9 million) which had a fast-paced large data center project in the first six months of 2012. This decrease was partially offset by our EAS operation (\$21.8 million) which performed a significant amount of project work during the current quarter.

Revenue decreased \$3.1 million, or 0.5%, to \$676.9 million for the first six months of 2013 compared to the same period in 2012. The decrease is primarily due to our large operation headquartered in Virginia (\$48.0 million) which had a fast-paced large data center project in the first six months of 2012. This decrease was partially offset by our EAS operation (\$30.4 million) which performed a significant amount of project work during the first six months of 2013.

Backlog reflects revenue still to be recognized under contracted or committed installation and replacement project work. Project work generally lasts less than one year. Service agreement revenue and service work and short duration projects which are generally billed as performed do not flow through backlog. Accordingly, backlog represents only a portion of our revenue for any given future period, and it represents revenue that is likely to be reflected in our operating results over the next six

Table of Contents

to twelve months. As a result, we believe the predictive value of backlog information is limited to indications of general revenue direction over the near term, and should not be interpreted as indicative of ongoing revenue performance over several quarters.

Backlog as of June 30, 2013 was \$590.3 million, a 6.5% decrease from March 31, 2013 backlog of \$631.1 million, and a 4.4% decrease from June 30, 2012 backlog of \$617.2 million. Sequential backlog decreased primarily due to our EAS operation (\$27.9 million) which performed a significant amount of project work during the current quarter. Our year-over-year backlog decreased primarily due to one of our Tennessee operations (\$19.3 million) which has experienced lower project bookings in the current year.

Following the three year period of industry activity declines from 2001 through 2003 noted previously, we saw modest year-over-year revenue increases at our ongoing operations beginning in mid-2003 and continuing throughout 2008. We experienced significant industry activity declines in 2009 through 2012. Based on our backlog and forecasts from industry construction analysts, we expect that activity levels in our industry are likely to remain flat over the next twelve months, particularly in the area of new construction.

We continue to experience a noticeable amount of price competition in our markets, which restrains our ability to profitably increase revenue.

Gross Profit Gross profit increased \$5.9 million, or 10.9%, to \$60.0 million for the second quarter of 2013 as compared to the same period in 2012. The increase in gross profit was primarily due to improved profitability in 2013 at our EAS operation (approximately \$2.5 million) and job underperformance at our Maryland operations in 2012 (approximately \$1.7 million). As a percentage of revenue, gross profit increased from 15.3% in 2012 to 17.1% in 2013 primarily due to the factors discussed above. In addition, the gross profit percentage increased due to improved profitability at our large operation headquartered in Virginia despite lower revenues.

Gross profit increased \$14.4 million, or 14.8%, to \$111.4 million for the first six months of 2013 as compared to the same period in 2012. The increase in gross profit was primarily due to improved profitability in 2013 at our EAS operation (approximately \$4.9 million) and job underperformance at our Maryland operations in 2012 (approximately \$2.8 million). As a percentage of revenue, gross profit increased from 14.3% in 2012 to 16.5% in 2013 primarily due to the factors discussed above. In addition, the gross profit percentage increased due to improved profitability at our large operation headquartered in Virginia despite lower revenues, and included a claim settled during the first quarter of 2013 with the general contractor on a large data center project that had been accelerated by the owner on which we recognized approximately \$1.6 million of additional gross profit during the current year.

Selling, General and Administrative Expenses ("SG&A") SG&A decreased \$1.2 million, or 2.5%, to \$45.7 million for the second quarter of 2013 as compared to the same period in 2012. Excluding amortization expense, SG&A decreased \$1.1 million, or 2.4%. This decrease is primarily due to a decrease in bad debt expense (\$2.2 million) as a result of a receivable settlement in the current quarter for a gain of \$0.8 million, and higher than normal expense in the prior year due to specific collectability concerns on a couple of projects. This decrease was partially offset by higher compensation accruals (\$1.3 million) as a result of improved operating results. Amortization expense remained relatively flat during the period. As a percentage of revenue, SG&A decreased from 13.3% in 2012 to 13.0% in 2013 primarily due to the factors discussed above.

SG&A decreased \$0.7 million, or 0.8%, to \$92.2 million for the first six months of 2013 as compared to 2012. Excluding amortization expense, SG&A decreased \$0.5 million, or 0.6%. This decrease is primarily due to a decrease in bad debt expense (\$2.8 million) as a result of a receivable settlement in the current quarter for a gain of \$0.8 million, and higher than normal expense in the

Table of Contents

prior year due to specific collectability concerns on a couple of projects. This decrease was partially offset by higher compensation accruals (\$0.7 million) as a result of improved operating results. Amortization expense remained relatively flat during the period. As a percentage of revenue, SG&A decreased from 13.7% in 2012 to 13.6% in 2013 primarily due to the factors discussed above.

We have included SG&A, excluding amortization, because we believe it is an effective measure of comparative results of operations. However, SG&A, excluding amortization, is not considered under generally accepted accounting principles to be a primary measure of an entity's financial results, and accordingly, should not be considered an alternative to SG&A as shown in our consolidated statements of operations.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in thousands)			
SG&A	\$ 45,699	\$ 46,877	\$ 92,219	\$ 92,928
Less: Amortization expense	(1,740)	(1,856)	(3,529)	(3,740)
SG&A, excluding amortization expense	\$ 43,959	\$ 45,021	\$ 88,690	\$ 89,188

Income Tax Expense For the six months ended June 30, 2013 our tax expense is \$7.8 million with an effective tax rate of 41.3% as compared to tax expense of \$2.1 million with an effective tax rate of 58.1% for the six months ended June 30, 2012. The effective rate for 2013 is higher than the federal statutory rate primarily due to the impact of the variability of rates and results among local jurisdictions. The effective tax rate in 2012 was higher than the federal statutory rate primarily due to the impact of increases in tax reserves. Tax reserves are analyzed and adjusted quarterly as events occur to warrant such changes. Adjustments to tax reserves are a component of the effective tax rate. We currently estimate our annual effective tax rate for 2013 will be between 38% and 42%.

Discontinued Operations During the fourth quarter of 2012, we substantially completed the shutdown of our operation located in Delaware. Discontinued operations were breakeven for the three months ended June 30, 2013. The after tax loss for the six months ended June 30, 2013 was \$0.1 million. The after tax income for the three months ended June 30, 2012 was \$0.1 million while the after tax loss for the six months ended June 30, 2012 was \$0.1 million. These results have been recorded in discontinued operations under "Income (loss) from discontinued operations, net of income tax expense (benefit)".

Outlook

Weakness in the environment for nonresidential construction activity has persisted in 2013, and nonresidential construction activity has remained at subdued levels similar to recent years. We expect underlying weakness to continue to impact revenues for the remainder of 2013. Our backlog is lower than we have experienced in the past, although it is still at solid levels in light of industry conditions and we believe that overall our booked work and prospects are stable. Our primary emphasis for the remainder of 2013 will be on execution, including a focus on cost discipline and efficient project and service performance. Based on our backlog, and in light of weak economic conditions for our industry, we expect that revenues will continue at the lower levels that we have experienced in recent years while we expect that 2013 profitability will be somewhat improved from the levels that we experienced in 2012.

Table of Contents
Liquidity and Capital Resources (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Cash provided by (used in):				
Operating activities	\$ 6,700	\$ 6,793	\$ (3,651)	\$ (13,023)
Investing activities	(3,704)	(16,326)	(6,692)	(17,976)
Financing activities	(5,085)	10,471	(7,068)	8,573
Net increase (decrease) in cash and cash equivalents	\$ (2,089)	\$ 938	\$ (17,411)	\$ (22,426)
Free cash flow:				
Cash provided by (used in) operating activities	\$ 6,700	\$ 6,793	\$ (3,651)	\$ (13,023)
Purchases of property and equipment	(4,029)	(4,494)	(7,237)	(6,588)
Proceeds from sales of property and equipment	325	342	502	762
Free cash flow	\$ 2,996	\$ 2,641	\$ (10,386)	\$ (18,849)

Cash Flow

Our business does not require significant amounts of investment in long-term fixed assets. The substantial majority of the capital used in our business is working capital that funds our costs of labor and installed equipment deployed in project work until our customer pays us. Customary terms in our industry allow customers to withhold a small portion of the contract price until after we have completed the work, typically for six months. Amounts withheld under this practice are known as retention or retainage. Our average project duration together with typical retention terms generally allow us to complete the realization of revenue and earnings in cash within one year.

Cash Provided by (Used in) Operating Activities Cash provided by operating activities during the second quarter of 2013 was \$6.7 million compared with \$6.8 million during 2012. The \$0.1 million decrease in cash provided by operations is primarily due to increased investment in working capital offset by improved profitability in 2013 compared to 2012.

Cash used in operating activities during the first six months of 2013 was \$3.7 million compared with \$13.0 million of cash used in operating activities during 2012. The \$9.4 million decrease in cash used in operations primarily relates to higher profitability in 2013 compared to 2012.

Cash Used in Investing Activities During the second quarter of 2013, cash used in investing activities was \$3.7 million compared with the second quarter of 2012 at \$16.3 million. The \$12.6 million decrease in cash used primarily relates to cash paid for acquisitions in 2012.

Cash used in investing activities was \$6.7 million for the first six months of 2013 compared to \$18.0 million during 2012. The \$11.3 million decrease in cash used primarily relates to cash paid for acquisitions in 2012.

Cash Provided by (Used in) Financing Activities Cash used in financing activities was \$5.1 million for the second quarter of 2013 compared to cash provided by financing activities of \$10.5 million during 2012. The most significant item affecting the comparison of our financing cash flows for these periods primarily relates to borrowings on the revolving line of credit in 2012 with no outstanding borrowings in 2013.

Cash used in financing activities was \$7.1 million for the first six months of 2013 compared to cash provided by financing activities of \$8.6 million during 2012. The \$15.6 million decrease in cash provided by financing activities primarily relates to borrowings on the revolving line of credit in 2012 with no outstanding borrowings in 2013.

Table of Contents

Free Cash Flow We define free cash flow as cash provided by operating activities, less customary capital expenditures, plus the proceeds from asset sales. We believe free cash flow, by encompassing both profit margins and the use of working capital over our approximately one year working capital cycle, is an effective measure of operating effectiveness and efficiency. We have included free cash flow information here for this reason, and because we are often asked about it by third parties evaluating us. However, free cash flow is not considered under generally accepted accounting principles to be a primary measure of an entity's financial results, and accordingly free cash flow should not be considered an alternative to operating income, net income, or amounts shown in our consolidated statements of cash flows as determined under generally accepted accounting principles. Free cash flow may be defined differently by other companies.

Share Repurchase Program

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from time to time approved extensions of the program to acquire additional shares. Since the inception of the repurchase program, the Board has approved 6.6 million shares to be repurchased.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. We repurchased less than 0.1 million shares during the six months ended June 30, 2013. Since the inception of the program in 2007 and as of June 30, 2013, we have repurchased a cumulative total of 5.9 million shares at an average price of \$10.95 per share.

Debt

Revolving Credit Facility

On June 25, 2013, we amended our senior credit facility (the "Facility") provided by a syndicate of banks increasing our borrowing capacity from \$125.0 million to \$175.0 million. The Facility, which is available for borrowings and letters of credit, now expires in July 2018 and is secured by a first lien on substantially all of the Company's personal property except for assets related to projects subject to surety bonds and assets held by certain unrestricted subsidiaries and a second lien on the Company's assets related to projects subject to surety bonds. We incurred approximately \$0.6 million in financing and professional costs in connection with the amendment to the Facility, which combined with the previous unamortized costs of \$0.7 million, will be amortized on a straight-line basis as a non-cash charge to interest expense over the remaining term of the Facility. As of June 30, 2013, we had no outstanding borrowings, \$53.2 million in letters of credit outstanding and \$121.8 million of credit available.

There are two interest rate options for borrowings under the Facility, the Base Rate Loan Option and the Eurodollar Rate Loan Option. These rates are floating rates determined by the broad financial markets, meaning they can and do move up and down from time to time. Additional margins are then added to these two rates.

Table of Contents

The following is a summary of the additional margins:

	Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA			
	Less than 0.75	0.75 to 1.50	1.50 to 2.25	2.25 or greater
Additional Per Annum Interest Margin Added Under:				
Base Rate Loan Option	0.25%	0.50%	0.75%	1.00%
Eurodollar Rate Loan Option	1.25%	1.50%	1.75%	2.00%

We estimate that the weighted average interest rate applicable to the borrowings under the Facility would be approximately 1.7% as of June 30, 2013.

We have used letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. Our lenders issue such letters of credit through the Facility for a fee. We have never had a claim made against a letter of credit that resulted in payments by a lender or by us and believe such claims are unlikely in the foreseeable future. The letter of credit fees range from 1.25% to 2.00% per annum, based on the ratio of Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA, as defined in the credit agreement.

Commitment fees are payable on the portion of the revolving loan capacity not in use for borrowings or letters of credit at any given time. These fees range from 0.20% to 0.35% per annum, based on the ratio of Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA, as defined in the credit agreement.

The Facility contains financial covenants defining various financial measures and the levels of these measures with which we must comply. Covenant compliance is assessed as of each quarter end.

The Facility's principal financial covenants include:

Leverage Ratio The Facility requires that the ratio of our Consolidated Total Indebtedness to our Credit Facility Adjusted EBITDA not exceed 3.00 through December 31, 2014, 2.75 through December 31, 2015 and 2.50 through maturity. The leverage ratio as of June 30, 2013 was 0.09.

Fixed Charge Coverage Ratio The Facility requires that the ratio of Credit Facility Adjusted EBITDA, less non-financed capital expenditures, tax provision, dividends and amounts used to repurchase stock to the sum of interest expense and scheduled principal payments of indebtedness be at least 2.00; provided that the calculation of the fixed charge coverage ratio excludes stock repurchases and the payment of dividends at any time that the Company's Net Leverage Ratio does not exceed 1.50. The Facility also allows the fixed charge coverage ratio not to be reduced for stock repurchases through June 30, 2015 in an aggregate amount not to exceed \$25 million if at the time of and after giving effect to such repurchase the Company's Net Leverage Ratio was less than or equal to 1.50. Capital expenditures, tax provision, dividends and stock repurchase payments are defined under the Facility for purposes of this covenant to be amounts for the four quarters ending as of any given quarterly covenant compliance measurement date. The fixed charge coverage ratio as of June 30, 2013 was 21.37.

Other Restrictions The Facility permits acquisitions of up to \$20.0 million per transaction, provided that the aggregate purchase price of such an acquisition and of acquisitions in the same fiscal year does not exceed \$50.0 million. However, these limitations only apply when the Company's Net Leverage Ratio is equal to or greater than 2.00.

While the Facility's financial covenants do not specifically govern capacity under the Facility, if our debt level under the Facility at a quarter-end covenant compliance measurement date were to cause us

Table of Contents

to violate the Facility's leverage ratio covenant, our borrowing capacity under the Facility and the favorable terms that we currently have could be negatively impacted by the lenders.

We are in compliance with all of our financial covenants as of June 30, 2013.

Notes to Former Owners

We issued subordinated notes to the former owners of acquired companies as part of the consideration used to acquire these companies. These notes had an outstanding balance of \$3.0 million as of June 30, 2013 and bear interest, payable annually, at a weighted average interest rate of 3.3%. The maturity date of the outstanding balance is July 2014. In July 2013, we paid \$1.0 million of this outstanding balance.

Other Debt

In conjunction with our acquisition of ColonialWebb in 2010, we acquired long-term debt related to an industrial revenue bond associated with its office building and warehouse. The outstanding balance as of June 30, 2013 was \$2.4 million, of which \$0.3 million is current. The weighted average interest rate on this variable rate debt as of June 30, 2013 was approximately 0.30%. In July 2013, we paid the outstanding balance of \$2.4 million.

In addition, our majority owned subsidiary, EAS, has a revolving \$2.5 million credit line that is available for temporary working capital needs and expires June 30, 2014. As of June 30, 2013, we had no outstanding borrowings and, therefore, \$2.5 million of credit available. We estimate that the weighted average interest rate applicable to borrowings under this variable rate credit line would be approximately 2.7% as of June 30, 2013.

Outlook

We have generated positive net free cash flow for the last fourteen calendar years, much of which occurred during challenging economic and industry conditions. We also expect to have significant borrowing capacity under our credit facility and we currently have modest indebtedness. We believe these factors will provide us with sufficient liquidity to fund our operations for the foreseeable future.

Off-Balance Sheet Arrangements and Other Commitments

As is common in our industry, we have entered into certain off-balance sheet arrangements in the ordinary course of business that result in risks not directly reflected in our balance sheets. Our most significant off-balance sheet transactions include liabilities associated with noncancelable operating leases. We also have other off-balance sheet obligations involving letters of credit and surety guarantees.

We enter into noncancelable operating leases for many of our facility, vehicle and equipment needs. These leases allow us to conserve cash by paying a monthly lease rental fee for use of facilities, vehicles and equipment rather than purchasing them. At the end of the lease, we have no further obligation to the lessor. If we decide to cancel or terminate a lease before the end of its term, we would typically owe the lessor the remaining lease payments under the term of the lease.

Certain of our vendors require letters of credit to ensure reimbursement for amounts they are disbursing on our behalf, such as to beneficiaries under our self-funded insurance programs. We have also occasionally used letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. The letters of credit we provide are actually issued by our lenders through the Facility as described above. A letter of credit commits the lenders to pay specified amounts to the holder of the letter of credit if the holder demonstrates that we have failed to perform specified actions. If this were to occur, we would be required to reimburse the

Table of Contents

lenders. Depending on the circumstances of such a reimbursement, we may also have to record a charge to earnings for the reimbursement. Absent a claim, there is no payment or reserving of funds by us in connection with a letter of credit. However, because a claim on a letter of credit would require immediate reimbursement by us to our lenders, letters of credit are treated as a use of the Facility's capacity just the same as actual borrowings. Claims against letters of credit are rare in our industry. To date we have not had a claim made against a letter of credit that resulted in payments by a lender or by us. We believe that it is unlikely that we will have to fund claims under a letter of credit in the foreseeable future.

Many customers, particularly in connection with new construction, require us to post performance and payment bonds issued by a financial institution known as a surety. If we fail to perform under the terms of a contract or to pay subcontractors and vendors who provided goods or services under a contract, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the sureties for any expenses or outlays they incur. To date, we are not aware of any losses to our sureties in connection with bonds the sureties have posted on our behalf, and we do not expect such losses to be incurred in the foreseeable future.

Surety market conditions are currently challenging as a result of significant losses incurred by many sureties in recent periods, both in the construction industry as well as in certain larger corporate bankruptcies. As a result, less bonding capacity is available in the market and terms have become more restrictive. Further, under standard terms in the surety market, sureties issue bonds on a project-by-project basis, and can decline to issue bonds at any time. Historically, approximately 25% to 35% of our business has required bonds. While we have strong surety relationships to support our bonding needs, current market conditions as well as changes in our sureties' assessment of our operating and financial risk could cause our sureties to decline to issue bonds for our work. If that were to occur, our alternatives include doing more business that does not require bonds, posting other forms of collateral for project performance such as letters of credit or cash, and seeking bonding capacity from other sureties. We would likely also encounter concerns from customers, suppliers and other market participants as to our creditworthiness. While we believe our general operating and financial characteristics, including a significant amount of cash on our balance sheet, would enable us to ultimately respond effectively to an interruption in the availability of bonding capacity, such an interruption would likely cause our revenue and profits to decline in the near term.

Contractual Obligations

The following recaps the future maturities of our contractual obligations as of June 30, 2013 (in thousands):

	Twelve Months Ended June 30,						
	2014	2015	2016	2017	2018	Thereafter	Total
Notes to former owners	\$	\$ 3,000	\$	\$	\$	\$	\$ 3,000
Other debt	300	300	300	300	300	900	2,400
Interest payable	74	22	1	1	1	3	102
Operating lease obligations	10,232	8,368	6,942	5,478	4,699	7,336	43,055
Total	\$ 10,606	\$ 11,690	\$ 7,243	\$ 5,779	\$ 5,000	\$ 8,239	\$ 48,557

As of June 30, 2013, we have \$53.2 million in letter of credit commitments, of which \$36.4 million will expire in 2013 and \$16.8 million will expire in 2014. The substantial majority of these letters of credit are posted with insurers who disburse funds on our behalf in connection with our workers' compensation, auto liability and general liability insurance program. These letters of credit provide additional security to the insurers that sufficient financial resources will be available to fund claims on our behalf, many of which develop over long periods of time, should we ever encounter financial

Table of Contents

duress. Posting of letters of credit for this purpose is a common practice for entities that manage their self-insurance programs through third-party insurers as we do. While most of these letter of credit commitments expire in 2013, we expect nearly all of them, particularly those supporting our insurance programs, will be renewed annually.

In July 2013, we paid \$1.0 million in notes to former owners leaving an outstanding balance of \$2.0 million. Also in July 2013, we paid the outstanding balance of \$2.4 million associated with other debt related to an industrial revenue bond.

Other than the operating lease obligations noted above, we have no significant purchase or operating commitments outside of commitments to deliver equipment and provide labor in the ordinary course of performing project work.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk primarily related to potential adverse changes in interest rates as discussed below. We are actively involved in monitoring exposure to market risk and continue to develop and utilize appropriate risk management techniques. We are not exposed to any other significant financial market risks including commodity price risk, foreign currency exchange risk or interest rate risks from the use of derivative financial instruments. We do not use derivative financial instruments.

We have limited exposure to changes in interest rates under our revolving credit facility, the industrial revenue bond and the EAS credit line. We have a debt facility under which we may borrow additional funds in the future. Our debt with fixed interest rates consists of notes to former owners of acquired companies.

The following table presents principal amounts (stated in thousands) and related average interest rates by year of maturity for our debt obligations and their indicated fair market value at June 30, 2013:

	Twelve Months Ended June 30,						Fair Value
	2014	2015	2016	2017	2018	Thereafter	
Fixed Rate Debt	\$	\$ 3,000	\$	\$	\$	\$	\$ 3,000
Average Interest Rate		3.3%					3.3%
Variable Rate Debt	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300	\$ 900	\$ 2,400

The weighted average interest rate on the variable rate debt as of June 30, 2013 was approximately 0.30%.

We measure certain assets at fair value on a nonrecurring basis. These assets are recognized at fair value when they are deemed to be other-than-temporarily impaired. We did not recognize any impairments on those assets required to be measured at fair value on a nonrecurring basis.

The valuation of our contingent earn-out payments is determined using a probability weighted discounted cash flow method. This analysis reflects the contractual terms of the purchase agreements (e.g., minimum and maximum payment, length of earn-out periods, manner of calculating any amounts due, etc.) and utilizes assumptions with regard to future cash flows, probabilities of achieving such future cash flows and a discount rate.

Item 4. Controls and Procedures**Evaluation of Disclosure Controls and Procedures**

Our executive management is responsible for ensuring the effectiveness of the design and operation of our disclosure controls and procedures. We carried out an evaluation under the

Table of Contents

supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) are effective as of the end of the period covered by this report.

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the three months ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

COMFORT SYSTEMS USA, INC.
PART II OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to certain claims and lawsuits arising in the normal course of business. We maintain various insurance coverages to minimize financial risk associated with these claims. We have estimated and provided accruals for probable losses and related legal fees associated with certain of our litigation in our consolidated financial statements. Although management currently believes that resolving claims against us, individually or in aggregate, will not have a material adverse impact on our operating results or financial condition, these matters are subject to inherent uncertainties and management's view of these matters may change in the future.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part 1, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2012, which could materially affect our business, financial condition, or future results. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, or future results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**Recent Sales of Unregistered Securities**

None.

Issuer Purchases of Equity Securities

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board from time to time has approved extensions of the program to acquire additional shares. Since the inception of the repurchase program, the Board has approved 6.6 million shares to be repurchased.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. We repurchased less than 0.1 million shares during the six months ended June 30, 2013. Since the inception of the program in 2007 and as of June 30, 2013, we have repurchased a cumulative total of 5.9 million shares at an average price of \$10.95 per share.

During the quarter ended June 30, 2013, we purchased our common shares in the following amounts at the following average prices:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
April 1 - April 30	29,181	\$ 13.34	5,932,554	667,983
May 1 - May 31	9,082	\$ 13.30	5,941,636	658,901
June 1 - June 30		\$	5,941,636	658,901
	38,263	\$ 13.33	5,941,636	658,901

Under our restricted share plan, employees may elect to have us withhold common shares to satisfy minimum statutory federal, state and local tax withholding obligations arising on the vesting of

Edgar Filing: COMFORT SYSTEMS USA INC - Form 10-Q

Table of Contents

restricted stock awards and exercise of options. When we withhold these shares, we are required to remit to the appropriate taxing authorities the market price of the shares withheld, which could be deemed a purchase of the common shares by us on the date of withholding.

During the three months ended June 30, 2013, we withheld common shares to satisfy these tax withholding obligations as follows:

Period	Number of Shares Purchased	Average Price Paid Per Share
April 1 - April 30	44,079	\$ 13.84
May 1 - May 31		\$
June 1 - June 30	305	\$ 14.33
	44,384	\$ 13.84

Table of Contents

Item 6. Exhibits

10.1 Amendment No. 2 to Second Amended and Restated Credit Agreement and Amendment to Other Loan Documents.

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*101.INS XBRL Instance Document

*101.SCH XBRL Taxonomy Extension Schema Document

*101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

*101.DEF XBRL Taxonomy Extension Definition Linkbase Document

*101.LAB XBRL Taxonomy Extension Label Linkbase Document

*101.PRE XBRL Taxonomy Extension Presentation Linkbase

*

Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 and 12 of the Securities Act of 1933, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under those sections.

Table of Contents

SIGNATURES

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

COMFORT SYSTEMS USA, INC.

July 31, 2013

By: /s/ BRIAN E. LANE

Brian E. Lane
President, Chief Executive Officer and Director

July 31, 2013

By: /s/ WILLIAM GEORGE

William George
Executive Vice President and Chief Financial Officer

July 31, 2013

By: /s/ JULIE S. SHAEFF

Julie S. Shaeff
Senior Vice President and Chief Accounting Officer