COMFORT SYSTEMS USA INC
Form 10-Q
July 31, 2008

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

OR

o **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	**76-0526487**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

777 Post Oak Boulevard
Suite 500
Houston, Texas 77056
(Address of Principal Executive Offices) (Zip Code)

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

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

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

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 ý No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer o	Accelerated filer ý	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares outstanding of the issuer's common stock, as of July 29, 2008 was 39,624,466.

COMFORT SYSTEMS USA, INC.

INDEX TO FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2008

	Page
Part I Financial Information	
Item 1 Financial Statements	
COMFORT SYSTEMS USA, INC.	
Consolidated Balance Sheets	1
Consolidated Statements of Operations	2
Consolidated Statements of Stockholders' Equity	3
Consolidated Statements of Cash Flows	4
Condensed Notes to Consolidated Financial Statements.	5
Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3 Quantitative and Qualitative Disclosures about Market Risk	27
Item 4 Controls and Procedures	27
Part II Other Information	
Item 1 Legal Proceedings	29
Item 2 Unregistered Sales of Equity Securities and Use of Proceeds	29
Item 4 Submission of Matters to a Vote of Security Holders	30
Item 6 Exhibits	30
Signatures	31

Table of Contents

COMFORT SYSTEMS USA, INC.

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Amounts)

	December 31, 2007	June 30, 2008 (Unaudited)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 139,631	$ 101,508
Accounts receivable, less allowance for doubtful accounts of $3,807 and $3,541 respectively	261,402	297,762
Other receivables	7,255	5,908
Inventories	9,397	11,851
Prepaid expenses and other	14,475	15,816
Costs and estimated earnings in excess of billings	18,463	25,686
Total current assets	450,623	458,531
PROPERTY AND EQUIPMENT, net	21,442	32,632
GOODWILL	68,621	85,956
IDENTIFIABLE INTANGIBLE ASSETS, net	2,187	14,753
MARKETABLE SECURITIES		9,781
OTHER NONCURRENT ASSETS	4,194	2,677
Total assets	$ 547,067	$ 604,330
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$	$
Current maturities of notes to former owners	375	1,708
Accounts payable	90,866	104,910
Accrued compensation and benefits	42,768	40,603
Billings in excess of costs and estimated earnings	104,236	117,756
Income taxes payable	377	4,520
Accrued self-insurance expense	21,288	23,242
Other current liabilities	21,783	21,971
Total current liabilities	281,693	314,710
LONG-TERM DEBT, NET OF CURRENT MATURITIES		
NOTES TO FORMER OWNERS, NET OF CURRENT MATURITIES	1,125	11,125
OTHER LONG-TERM LIABILITIES	1,671	3,558
Total liabilities	284,489	329,393
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, 781,415 and 1,291,699 shares, respectively	(9,973)	(16,431)
Additional paid-in capital	336,996	332,521
Accumulated other comprehensive income (loss)		(142)
Retained earnings (deficit)	(64,856)	(41,422)
Total stockholders' equity	262,578	274,937

Total liabilities and stockholders' equity	$ 547,067	$ 604,330

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,	
	2007	2008	2007	2008
REVENUES	$280,520	$355,097	$530,160	$650,802
COST OF SERVICES	228,797	287,271	441,923	529,556
Gross profit	51,723	67,826	88,237	121,246
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	35,207	43,363	69,584	84,003
GAIN ON SALE OF ASSETS	(27)	(103)	(46)	(133)
Operating income	16,543	24,566	18,699	37,376
OTHER INCOME (EXPENSE):				
Interest income	674	552	1,389	1,488
Interest expense	(145)	(410)	(309)	(668)
Other	24	52	57	158
Other income (expense)	553	194	1,137	978
INCOME BEFORE INCOME TAXES	17,096	24,760	19,836	38,354
INCOME TAX EXPENSE	6,595	9,567	7,529	14,920
NET INCOME	$ 10,501	$ 15,193	$ 12,307	$ 23,434
INCOME PER SHARE:				
Basic	$ 0.26	$ 0.38	$ 0.30	$ 0.59
Diluted	$ 0.25	$ 0.38	$ 0.30	$ 0.58
SHARES USED IN COMPUTING INCOME PER SHARE:				
Basic	40,655	39,634	40,578	39,737
Diluted	41,407	40,359	41,355	40,422
DIVIDENDS PER SHARE	$ 0.035	$ 0.045	$ 0.070	$ 0.090

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	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
BALANCE AT DECEMBER 31, 2006	40,710,003	$ 407		$	$ 339,589	$	$ (97,282)	$ 242,714
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit	239,743	2	111,857	1,539	918			2,459
Issuance of restricted stock	173,619	2	2,246	32	(34)			
Shares received in lieu of tax withholding payment on vested restricted stock			(35,618)	(481)				(481)
Stock-based compensation expense					2,521			2,521
FIN 48 adoption							(40)	(40)
Tax benefit from vesting of restricted stock					127			127
Dividends					(6,125)			(6,125)
Share repurchase			(859,900)	(11,063)				(11,063)
Net income							32,466	32,466
BALANCE AT DECEMBER 31, 2007	41,123,365	411	(781,415)	(9,973)	336,996		(64,856)	262,578
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit (unaudited)			103,750	1,312	(558)			754
Issuance of restricted stock (unaudited)			201,309	2,485	(2,485)			
Shares received in lieu of tax withholding payment on vested restricted stock (unaudited)			(39,100)	(513)				(513)
Stock-based compensation expense (unaudited)					2,080			2,080
Dividends (unaudited)					(3,601)			(3,601)
Share repurchase (unaudited)			(776,243)	(9,742)				(9,742)
Net income (unaudited)							23,434	23,434
Tax benefit from vesting of restricted stock (unaudited)					89			89
						(142)		(142)

Unrealized loss on marketable securities (unaudited)									
BALANCE AT JUNE 30, 2008 (unaudited)	41,123,365	$ 411	(1,291,699)	$(16,431)	$ 332,521	$ (142)	$(41,422)	$	274,937

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,	
	2007	2008	2007	2008
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income	$ 10,501	$ 15,193	$ 12,307	$ 23,434
Adjustments to reconcile net income to net cash provided by operating activities:				
Amortization of identifiable intangible assets	220	1,135	341	1,843
Depreciation expense	1,459	2,206	2,882	4,038
Bad debt expense	469	297	1,290	376
Deferred tax expense	346	(19)	1,262	279
Amortization of debt financing costs	27	27	53	54
Gain on sale of assets	(27)	(103)	(46)	(133)
Stock-based compensation expense	771	1,441	1,259	2,080
Changes in operating assets and liabilities, net of effects of acquisitions:				
(Increase) decrease in:				
Receivables, net	(17,998)	(25,030)	(16,437)	(18,726)
Inventories	346	(737)	(1,116)	(763)
Prepaid expenses and other current assets	2,552	5,830	1,853	2,591
Costs and estimated earnings in excess of billings	(3,442)	(3,319)	(2,492)	(6,282)
Other noncurrent assets	(63)	(1,204)	139	1,191
Increase (decrease) in:				
Accounts payable and accrued liabilities	10,437	25,018	(6,047)	7,981
Billings in excess of costs and estimated earnings	15,626	7,209	13,148	7,548
Other long-term liabilities		(885)		502
Net cash provided by operating activities	21,224	27,059	8,396	26,013
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of property and equipment	(2,227)	(4,253)	(4,717)	(7,005)
Proceeds from sales of property and equipment	82	37	123	117
Proceeds from businesses sold	6	6	38	116
Sale (purchase) of marketable securities		7,575		(10,950)
Cash paid for acquisition and intangible assets, net of cash acquired	(5)	(4,667)	(4,460)	(27,885)
Net cash used in investing activities	(2,144)	(1,302)	(9,016)	(45,607)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Net borrowings on revolving line of credit				
Payments on other long-term debt		(5,233)	(252)	(5,233)
Debt financing costs			(312)	
Payments of dividends to shareholders	(1,437)	(1,798)	(2,863)	(3,601)
Share repurchase program and shares received in lieu of tax withholding	(184)	(6,414)	(184)	(10,255)
Excess benefit of stock-based compensation	672	93	909	89
Proceeds from exercise of options	763	467	968	471

Net cash used in financing activities	(186)	(12,885)	(1,734)	(18,529)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	18,894	12,872	(2,354)	(38,123)
CASH AND CASH EQUIVALENTS, beginning of year	69,038	88,636	90,286	139,631
CASH AND CASH EQUIVALENTS, end of year	$ 87,932	$ 101,508	$ 87,932	$ 101,508

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, 2008

(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 59% of our consolidated 2008 revenues to date are attributable to installation of systems in newly constructed facilities, with the remaining 41% attributable to maintenance, repair and replacement services. The following service activities account for our consolidated 2008 revenues to date: HVAC 77%, plumbing 16%, building automation control systems 3%, 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, 2007 (the "Form 10-K").

There were no significant changes in our accounting policies during the current period except for the adoption of Financial Accounting Standards Board ("FASB") Statement No. 157, "Fair Value Measurements" ("Statement 157"), as further discussed in Note 3. For a description of our significant accounting policies, refer to Note 2 of Notes to Consolidated Financial Statements of Comfort Systems included in 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.

Cash Flow Information

Cash paid for interest for the three months ended June 30, 2007 and 2008 was approximately $0.1 million and $0.4 million, respectively. Cash paid for income taxes for the three months ended June 30, 2007 and 2008 was approximately $1.8 million and $9.4 million, respectively. Cash paid for interest for the six months ended June 30, 2007 and 2008 was approximately $0.3 million and

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2008

(Unaudited)

2. Summary of Significant Accounting Policies (Continued)

$0.5 million, respectively. Cash paid for income taxes for the six months ended June 30, 2007 and 2008 was approximately $2.9 million and $10.1 million, respectively.

Segment Disclosure

Our activities are within the mechanical services industry which is the single industry segment we serve. Under Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures About Segments of an Enterprise and Related Information," each operating subsidiary represents an operating segment and these segments have been aggregated, as the operating units meet all of SFAS No. 131's aggregation criteria.

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, revenues 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, and the quantification of fair value for reporting units in connection with our goodwill impairment testing.

Income Taxes

We file a consolidated return for federal income tax purposes. Income taxes are provided for under the liability method in accordance with SFAS No. 109, "Accounting for Income Taxes," which takes into account differences between financial statement treatment and tax treatment of certain transactions. Deferred tax assets represent the tax effect of activity that has been reflected in the financial statements but which will not be deductible for tax purposes until future periods. Deferred tax liabilities represent the tax effect of activity that has been reflected in the financial statements but which will not be taxable until future periods.

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.

Our effective tax rate is generally higher than the federal statutory rate primarily due to state taxes.

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2008

(Unaudited)

2. Summary of Significant Accounting Policies (Continued)

Financial Instruments

We consider our marketable securities as available-for-sale as defined in SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). These investments are recorded at fair value and are classified as marketable securities in the accompanying consolidated balance sheet as of June 30, 2008. The changes in fair values, net of applicable taxes, are recorded as unrealized gains (losses) as a component of accumulated other comprehensive income in stockholders' equity.

New Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("Statement 157"), effective for fiscal years beginning after November 15, 2007. Statement 157 provides guidance for using fair value to measure assets and liabilities. The statement applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The statement does not expand the use of fair value in any new circumstances. On February 12, 2008, the FASB issued FASB Staff Position No. 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2") that amends Statement 157 to delay the effective date for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. FSP 157-2 defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008. We adopted Statement 157 on January 1, 2008 for financial assets and liabilities measured on a recurring basis. See Note 3.

In December 2007, the FASB issued Statement No. 141 (Revised 2007), "Business Combinations" ("Statement 141(R)"). Statement 141(R) requires an acquiring entity to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. Statement 141(R) also changes the accounting treatment for certain specific items. Statement 141(R) applies prospectively to business combinations for which the acquisition date is on or after the first annual reporting period beginning on or after December 15, 2008. We will adopt the provisions of Statement 141(R) for business combinations on January 1, 2009.

Reclassifications

Certain reclassifications have been made in prior period financial statements to conform to current period presentation. These reclassifications have not resulted in any changes to previously reported net income for any periods.

3. Fair Value Measurements

We adopted Statement 157 effective January 1, 2008 for financial assets and liabilities measured on a recurring basis. Statement 157 applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis. There was no impact upon adoption of Statement 157 to the consolidated financial statements.

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2008

(Unaudited)

3. Fair Value Measurements (Continued)

Statement 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. As of June 30, 2008, we held marketable securities that are required to be measured at fair value on a recurring basis. We had no investments in marketable securities as of December 31, 2007.

As of June 30, 2008, our marketable securities consisted of $10.7 million of auction rate securities, which are variable rate debt instruments, having long-term maturities, but whose interest rates are designed to reset through an auction process, at intervals ranging from seven to 35 days. All of our auction rate securities are high quality municipal obligations which have high investment grade ratings or otherwise are backed by high investment grade rated insurance agencies as of June 30, 2008. During the second quarter of 2008, we sold $7.6 million of these auction rate securities at face value. An additional $0.9 million has been called; this is included in "Prepaid Expenses and Other" in our consolidated balance sheet. The remaining $9.8 million has been classified as a noncurrent asset on the consolidated balance sheet as we have the intent and ability to hold these securities until the market for auction rate securities stabilizes or until the issuer refinances the underlying security.

Due to recent events in credit markets, the auction events for some of these instruments failed during the first half of 2008. As a result of the temporary declines in fair value for our auction rate securities, which we attribute to liquidity issues rather than credit issues, we recorded an unrealized loss of $0.1 million, net of tax, to accumulated other comprehensive income (loss). Our analysis of the fair values of these securities considered, among other items, the creditworthiness of the counterparty, the timing of expected future cash flows, and the possibility that a discount may be required if we choose to sell the securities in the absence of a successful auction. These securities were also compared, when possible, to other observable market data with similar characteristics.

As of June 30, 2008, we continue to collect interest when due on all of our auction rate securities. Any future fluctuation in fair value related to these instruments that we deem to be temporary, including any recoveries of previous write-downs, would be recorded to accumulated other comprehensive income (loss). If we determine that any future valuation adjustment was other than temporary, we would record a charge to earnings as appropriate.

The assets measured at fair value on a recurring basis subject to the disclosure requirements of Statement 157 at June 30, 2008 were as follows (in thousands):

		Fair Value Measurements at Reporting Date Using		
	Balance, June 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Auction rate securities	$ 10,731	$	$ 950	$ 9,781

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2008

(Unaudited)

4. Acquisitions

On October 1, 2007, we completed the acquisition of Air Systems Engineering, Inc., an HVAC company based in Tacoma, Washington. On February 29, 2008, we completed the acquisition of Riddleberger Brothers, a full service commercial HVAC company based in Mount Crawford, Virginia. On March 3, 2008, we completed the acquisition of Merit Mechanical Services, a full service commercial HVAC company based in Redmond, Washington. On April 1, 2008 we completed the acquisition of Conditioned Air Mechanical Services, a commercial HVAC company based in Phoenix, Arizona. We acquired these companies, which were not material individually or in the aggregate, for an aggregate purchase price of $53.0 million. Additional contingent purchase price ("earn-out"), capped at $14.1 million will be paid if certain acquisitions achieve predetermined profitability targets. Our consolidated balance sheets include preliminary allocations of the purchase price to the assets acquired and liabilities assumed based on estimates of fair value. The results of operations of these acquisitions are included in our consolidated financial statements from their respective acquisition dates.

As of June 30, 2008, we had $86.0 million and $14.8 million, respectively, of goodwill and net identifiable intangible assets (primarily based on the market values of contract backlog, customer relationships, non-competition agreements and trade names), primarily arising out of the acquisition of companies. As of December 31, 2007, goodwill and net identifiable intangible assets were $68.6 million and $2.2 million, respectively. The increases in goodwill and net identifiable intangible assets (net of accumulated amortization) since December 31, 2007 were related to the acquisitions of Riddleberger and Merit during the first quarter of 2008 and Conditioned Air during the second quarter of 2008, pending completion of final valuation and purchase price adjustments. As of June 30, 2008, we have accrued contingent payments of approximately $0.7 million related to prior acquisitions.

5. Long-Term Debt Obligations

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

	December 31, 2007	June 30, 2008
Revolving credit facility	$	$
Notes to former owners	1,500	12,833
Total debt	1,500	12,833
Less current maturities of notes to former owners	(375)	(1,708)
Total long-term portion of debt	$ 1,125	$ 11,125

We have a $100.0 million senior credit facility (the "Facility") provided by a syndicate of banks which is available for borrowings and letters of credit. The Facility expires in February 2012 and is secured by the capital stock of our current and future subsidiaries. As of June 30, 2008, the total of the Facility was $100.0 million, with no outstanding borrowings, $38.2 million in letters of credit outstanding, and $61.8 million of credit available.

We have a choice of two interest rate options for borrowings under the Facility; these rates are floating rates determined by the broad financial markets, meaning they can and do move up and down

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2008

(Unaudited)

5. Long-Term Debt Obligations (Continued)

from time to time. We estimate that the interest rate applicable to the borrowings under the Facility would be approximately 3.7% as of June 30, 2008. 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%-0.30% per annum, based on the ratio of debt 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. We are in compliance with all the financial covenants as of June 30, 2008.

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 $12.8 million, of which $1.7 million is current, as of June 30, 2008 and bear interest, payable annually, at a weighted average interest rate of 6.0%.

6. Commitments and Contingencies

Claims and Lawsuits

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 the accompanying consolidated financial statements. While we cannot predict the outcome of these proceedings, in management's opinion and based on reports of 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.

In addition to the matters described above, we have accrued $2.7 million for potential and asserted backcharges from several customers of our large multi-family operation based in Texas. The accrual is included in "Other Current Liabilities." We believe these accruals reflect a probable outcome with respect to such backcharges and potential backcharges, however, if we are not successful in resolving these disputes, we may in the future experience a material adverse effect on our operating results.

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.

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2008

(Unaudited)

6. Commitments and Contingencies (Continued)

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 30% of our business has required bonds. While we have enjoyed a longstanding relationship with our primary surety and have a second surety to further 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 revenues and profits to decline in the near term.

Self-Insurance

We are substantially self-insured for worker's 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 worker's compensation, auto liability and general liability, are reviewed by a third-party actuary quarterly.

Our self-insurance arrangements currently are as follows:

Worker's Compensation The per-incident deductible for worker's compensation is $250,000. The next layer, $250,000 in excess of $250,000, is covered by the corridor deductible policy explained below. Losses above $500,000 are determined by statutory rules on a state-by-state basis, and are fully covered by excess worker's compensation insurance.

Employer's Liability For employer's liability, the per incident deductible is $250,000. The next layer, $250,000, in excess of $250,000 is covered by the corridor deductible policy explained below. We are fully insured for the next $500,000 of each loss, then have a single, aggregate excess loss insurance policy that covers losses up to $50 million across both these risk areas (as well as auto liability noted below).

General Liability For general liability, the per incident deductible is $500,000. We are fully insured for the next $500,000 of each loss, then have a single, aggregate excess loss insurance policy that covers losses up to $50 million across both these risk areas (as well as auto liability noted below).

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2008

(Unaudited)

6. Commitments and Contingencies (Continued)

Auto Liability For auto liability, the per incident deductible is $250,000. The next layer, $250,000 in excess of $250,000, is covered by the corridor deductible policy explained below. We are fully insured for the next $1.5 million of each loss, then have a single, aggregate excess loss insurance policy that covers losses up to $50 million.

Corridor Deductible Policy Worker's compensation, employer's liability and auto liability claims that exceed $250,000 but are less than $500,000, are subject to the corridor deductible policy. This policy insures 100% of losses that fall in this layer, once aggregate retained losses within this layer reach $500,000.

Employee Medical We have two medical plans. The deductible for employee group health claims is $300,000 per person, per policy (calendar) year for one plan and $150,000 per person, per policy (calendar) year for the other plan. Insurance then covers any responsibility for medical claims in excess of the deductible amount.

Our $50 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 $50 million of excess loss coverage for each of general liability, employer's liability and auto liability.

7. 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 year. Diluted EPS is computed considering the dilutive effect of stock options and contingently issuable restricted stock.

Under EPS calculation methods established by generally accepted accounting principles, including the effect of options whose exercise price exceeds the average market price of the Common Stock for a given period would increase calculated EPS. This impact is called "anti-dilutive." Generally accepted accounting principles for determining EPS require that any options or other common stock equivalents whose inclusion in determining EPS would have an anti-dilutive effect be excluded. Accordingly, options to purchase 0.1 million shares of Common Stock at prices ranging from $13.51 to $21.125 per share which were outstanding for the three months ended June 30, 2007 and options to purchase approximately 2,000 shares at $15.03 per share which were outstanding for the three months ended June 30, 2008, were not included in the computation of diluted EPS because they were anti-dilutive. Options to purchase 0.1 million shares at prices ranging from $13.51 to $21.125 per share which were outstanding for the six months ended June 30, 2007, and options to purchase 0.2 million shares at prices ranging from $12.90 to $15.03 per share which were outstanding for the six months ended June 30, 2008, were not included in the computation of diluted EPS because they were anti-dilutive.

Table of Contents

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2008

(Unaudited)

7. Stockholders' Equity (Continued)

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,	
	2007	2008	2007	2008
Common shares outstanding, end of period(a)	40,782	41,123	40,782	41,123
Effect of using weighted average common shares outstanding	(127)	(1,489)	(204)	(1,386)
Shares used in computing earnings per share basic	40,655	39,634	40,578	39,737
Effect of shares issuable under stock option plans based on the treasury stock method	722	657	737	642
Effect of contingently issuable restricted stock	30	68	40	43
Shares used in computing earnings per share diluted	41,407	40,359	41,355	40,422

(a) Excludes 0.3 million and 0.3 million shares of unvested contingently issuable restricted stock outstanding as of June 30, 2007 and 2008, respectively.

Share Repurchase Program

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to one million shares of our outstanding common stock. On November 16, 2007, the Board approved an extension of our stock repurchase program to cover an additional 401,200 shares of our outstanding common stock. On February 27, 2008, the Board approved an extension of our stock repurchase program to cover an additional 712,083 shares of our outstanding common stock.

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 776,243 shares for the six months ended June 30, 2008. There were 477,140 shares remaining that may be repurchased under the program as of June 30, 2008.

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 thereto included elsewhere in this Form 10-Q and the Annual Report on Form 10-K as filed with the Securities and Exchange Commission for the year ended December 31, 2007 (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. Company 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. The services we provide address a very broad need, as air is circulated through almost all commercial, industrial and institutional buildings virtually year-round. 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 87% of our revenues are 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, 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.

As of June 30, 2008, we had 4,408 projects in process. Our average contract price remained constant at approximately $435,000, and our average project takes six to nine months to complete. 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. 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.

We also perform larger HVAC projects. As of June 30, 2008, we had seven projects in process with a contract price of between $15 and $30 million, 11 projects between $10 million and $15 million, 50 projects between $5 million and $10 million, and 242 projects between $1 million and $5 million. Taken together, projects with contract prices of $1 million or more totaled $1,186.1 million of aggregate contract value as of June 30, 2008, or approximately 62%, out of a total contract value for all projects in progress of $1,910.5 million. 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.

In addition to project work, approximately 13% of our revenues represent 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 agreements typically cover periods ranging from one to three years and are cancelable on 30 to 60 days notice.

A relatively small but growing portion of our revenues 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

Table of Contents

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 41 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 revenues 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 US, 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. Although nonresidential construction activity has demonstrated periods of both significant growth and decline, it has grown at a compound annual rate of approximately 4.2% over the last twenty-five years.

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 macroeconomic and geopolitical trends. We have experienced periods of time, such as after the terrorist incidents on September 11, 2001 in the US, and prior to and during the war in Iraq that occurred in early 2003, when uncertainty caused a significant slowdown in decisions to proceed with installation and replacement project work. We believe that the current economic environment remains favorable relative to the activity levels of recent years.

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 and has expanded moderately during 2004 and 2005, and was strong during 2006 and 2007. During the decline and through 2003, we responded to market challenges by pursuing work in sectors less affected by this 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. We have experienced notable improvements in both industry activity as well as our own results since 2004, as discussed further under "Results of Operations" below.

As a result of our sale of certain assets and our continued strong emphasis on cash flow, our debt outstanding under our revolving credit facility is now zero, and we have substantial uncommitted cash balances, as discussed further in "Liquidity and Capital Resources" below. On February 20, 2007, we put a new credit facility in place with considerably less restrictive terms than those of our previous facilities. In addition, we have a second surety to further 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 nine 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 increased activity levels in our industry since 2004. 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. However, our primary emphasis for 2008 will be on internal execution and margins, rather than on revenue growth. We plan to continue our involvement in multi-family work; however, we have decided to focus a portion of our resources away from this work and we expect that as a result, the portion of our work that is multi-family will diminish somewhat in the future. In addition to the work we have done on our underperforming units, we have increased our focus on project qualification, estimating, pricing and management, and on service performance. This focus includes significant increases in unit level training.

Critical Accounting Policies

In response to the Commission's Release No. 33-8040, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies," we identified our critical accounting policies 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. We have concluded that our most critical accounting policy is our revenue recognition policy. As discussed elsewhere in this report, 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 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 and the recoverability of goodwill and identifiable intangible assets. These accounting policies, as well as others, are described in Note 2 to the Consolidated Financial Statements included in our Form 10-K.

Table of Contents

Percentage of Completion Method of Accounting

Approximately 87% of our revenues were earned on a project basis and recognized through the percentage of completion method of accounting. Under this method as provided by American Institute of Certified Public Accountants Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," 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 such 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. Subcontract 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 cost consists 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.

Our 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 we incur costs. As a result, contract revenues 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 revenues 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 revenues 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, revenues. Such revisions are frequently based on further estimates and subjective assessments. We recognize these revisions in the period in which they are determined. If such revisions lead us to conclude that we will recognize a loss on a contract, the full amount of the estimated ultimate loss is recognized in the period we reach that conclusion, 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 revenues 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.

Table of Contents

Accounting for Allowance for Doubtful Accounts

We are required to estimate the collectibility of accounts receivable and provide an allowance for doubtful accounts for receivable amounts we believe we will not ultimately collect. This requires us to make certain judgments and estimates involving, among others, the creditworthiness of the customer, our prior collection history with the customer, ongoing relationships with the customer, 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 our contract. These estimates are re-evaluated and adjusted as additional information is received.

Accounting for Self-Insurance Liabilities

We are substantially self-insured for worker's 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 worker's 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.

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 differs from our estimates, we may not realize deferred tax assets to the extent we have estimated.

Recoverability of Goodwill and Identifiable Intangible Assets

In most businesses we have acquired, the value we paid to buy the business was greater than the value of specifically identifiable net assets in the business. Under generally accepted accounting principles, this excess is termed goodwill and is recognized as an asset at the time the business is acquired. It is generally expected that future net earnings from an acquired business will exceed the goodwill asset recognized at the time the business is acquired.

Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" requires us to assess our goodwill asset amounts for impairment each year, and more frequently if circumstances suggest an impairment may have occurred. Impairment must be reflected when the value of a given business unit in excess of its tangible net assets falls below the goodwill asset balance carried for that unit on our books. If other business units have had increases in the value of their respective goodwill balances, such increases may not be recorded under SFAS No. 142. Accordingly, such increases may not be netted against impairments at other business units. The requirements for assessing whether goodwill assets have 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. These reporting units are tested for impairment by comparing the unit's fair value to its carrying value. The fair value of each reporting unit is estimated using a discounted cash flow model combined with market valuation approaches. Significant estimates and assumptions are used in assessing the fair value of reporting units. These estimates and assumptions involve future cash flows, growth rates, discount rates, weighted average cost of capital and estimates of market valuations for each of the reporting units.

SFAS No. 142 also requires that identifiable intangible assets with finite lives be amortized over their useful lives. Changes in strategy and/or market condition, may result in adjustments to recorded intangible asset balances.

Results of Operations (in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2007	**%**	**2008**	**%**	**2007**	**%**	**2008**	**%**
Revenues	$280,520	100.0%	$355,097	100.0%	$530,160	100.0%	$650,802	100.0%
Cost of services	228,797	81.6%	287,271	80.9%	441,923	83.4%	529,556	81.4%
Gross profit	51,723	18.4%	67,826	19.1%	88,237	16.6%	121,246	18.6%
Selling, general and administrative expenses	35,207	12.6%	43,363	12.2%	69,584	13.1%	84,003	12.9%
Gain on sale of assets	(27)		(103)		(46)		(133)	
Operating income	16,543	5.9%	24,566	6.9%	18,699	3.5%	37,376	5.7%
Interest income, net	529	0.2%	142		1,080	0.2%	820	0.1%
Other income	24		52		57		158	
Income before income taxes	17,096	6.1%	24,760	7.0%	19,836	3.7%	38,354	5.9%
Income tax expense	6,595		9,567		7,529		14,920	
Net income	$ 10,501	3.7%	$ 15,193	4.3%	$ 12,307	2.3%	$ 23,434	3.6%

Revenues Revenues increased $74.6 million, or 26.6% to $355.1 million for the second quarter of 2008 compared to the same period in 2007. Approximately 13.6% of the increase in revenues related to internal growth and the remaining 13.0% resulted from the acquisitions of Air Systems, Riddleberger, Merit, and Conditioned Air. The internal revenue growth stemmed primarily from increased activity in the nonresidential markets throughout the United States especially in healthcare (approximately $10.9 million) and education facilities (approximately $9.3 million) as well as increased activity in lodging and entertainment (approximately $10.4 million). These increases were partially offset by decreased activity in the multi-family markets (approximately $11.7 million). We have seen increased activity, primarily in our Arizona, Alabama, and Southern Maryland operations, resulting from the start-up of several large projects partially offset by decreased activity at our Tennessee and Southern California operations.

Revenues for the first six months of 2008 increased $120.6 million, or 22.8%, to $650.8 million as compared to the same period in 2007. Approximately 13.6% of the increase in revenues related to internal growth and the remaining 9.2% resulted from acquisitions. The internal revenue growth stemmed primarily from increased activity in the nonresidential markets throughout the United States especially in government (approximately $23.4 million) and healthcare facilities (approximately $15.7 million) as well as increased activity in lodging and entertainment (approximately $20.0 million). These increases were partially offset by decreased activity in the multi-family markets (approximately

Table of Contents

$9.5 million). We have seen a broad based increase in activity across most of our operations, with the largest increases occuring in our Arizona, Alabama and Wisconsin operations.

Backlog reflects revenues still to be recognized under contracted or committed installation and replacement project work. Project work generally lasts less than one year. Service agreement revenues 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 revenues for any given future period, and it represents revenues that are likely to be reflected in our operating results over the next six 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, 2008 was $780.2 million a 3.8% decrease from March 31, 2008 backlog of $811.3 million. The decrease of 3.8% was primarily related to our large multi-family operation based in Texas and our Arizona, and Alabama operations. We plan to continue our involvement in multi-family work; however, we have decided to focus a portion of our resources away from this work and we expect that as a result, the portion of our work that is multi-family may diminish somewhat in the future.

On a same store basis, backlog as of June 30, 2008 was $701.1 million, as compared to $720.0 million on June 30, 2007. Same store backlog decreased $18.9 million, or 2.6% primarily related to the decrease of $36.6 million at our large multi-family operation based in Texas, partially offset by increases at our Colorado and Arkansas operations.

Following the three-year period of industry activity declines from 2001-2003 noted previously, we saw modest year-over-year revenue increases at our ongoing operations beginning in mid-2003 and continuing throughout 2007. Based on our backlog and industry forecasts, we expect that activity levels in our industry will remain solid throughout 2008 but may moderate in 2009.

Along with the indications noted above, there remain the following cautionary factors in the industry environment, each of which is discussed at greater length in the *Introduction* above. Since HVAC and related installation and replacement decisions are capital decisions usually involving some amount of discretion, they tend to be affected to a greater degree by macroeconomic or geopolitical uncertainty. Negative developments or events in these arenas, should they occur, will likely cause end users to defer HVAC and related spending decisions, thereby reducing our revenues.

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

While we believe industry activity will remain solid throughout 2008, in view of all of the foregoing factors, we may experience modest revenue growth or revenue declines in upcoming periods. In addition, if general economic activity in the U.S. slows significantly from current levels, we may realize decreases in revenue and lower operating margins.

Gross Profit Gross profit increased $16.1 million, or 31.1%, to $67.8 million for the second quarter of 2008 as compared to the same period in 2006. $9.1 million of the increase is due to internal growth and the remaining $7.0 million is due to the acquisitions of Air Systems, Riddleberger, Merit, and Conditioned Air. As a percentage of revenues, gross profit for 2008 was 19.1%, up from 18.4% in 2007. The increase in gross profit percentage resulted primarily from improved results at our large multi-family operation based in Texas (approximately $3.6 million), as well as from improved profitability at our Southern Maryland operation (approximately $0.9 million), and at our Alabama operation (approximately $0.6 million). These increases were partially offset by lower profitability margins at our Arizona operation (approximately $2.3 million) and job underperformance at our northern Maryland operation (approximately $1.1 million).

Table of Contents

Gross profit for the first six months of 2008 increased $33.0 million, or 37.4% to $121.2 million, as compared to the same period in 2007. $23.2 million of the increase is due to internal growth and the remaining $9.8 million is due to the acquisitions of Air Systems, Riddleberger, Merit, and Conditioned Air. As a percentage of revenues, historical gross profit for the first six months of 2008 was 18.6%, up from 16.6% for the first six months of 2007. The increase in gross profit percentage for the first six months of 2008 resulted primarily from improved results at our large multi-family operation based in Texas (approximately $8.8 million), as well as improved profitability at our Florida operation (approximately $0.9 million) and at our Alabama operation (approximately $0.9 million). These increases were partially offset by lower profitability margins at our Arizona operation (approximately $2.3 million) and at our Southern California operation (approximately $1.3 million).

As noted in the *Introduction* above, we are currently placing a greater emphasis on internal execution and margins than on revenue growth. This includes a strong focus on those of our units that have underperformed, along with increased training efforts on project qualification, estimating, pricing and management, and on service performance. While we believe these efforts will help us increase gross profits, we cannot assure that this will occur. Further, if we are successful in these efforts, we cannot assure that they will offset adverse industry trends, if such trends occur.

Selling, General and Administrative Expenses ("SG&A") SG&A increased $8.2 million, or 23.2% for the second quarter of 2008 as compared to the same period in 2007. This is primarily due to higher compensation accruals due to strong performance at a number of our operations, an increase in the number of selling and overhead personnel for new or expanded service operations and the acquisition and start-up of new operations. As a percentage of revenues, SG&A declined from 12.6% in 2007 to 12.2% in 2008. This decrease is consistent with our effort to control our SG&A expenses as we experience internal revenue growth. SG&A increased $14.4 million, or 20.7%, to $84.0 million for the first six months ended June 30, 2008 as compared to the same period in 2007. This increase is due to the factors noted above and our acquisitions of Air Systems, Riddleberger, Merit and Conditioned Air. As a percentage of revenues, SG&A declined from 13.1% for the first six months of 2007 to 12.9% for the first six months of 2008.

Interest Income, Net Interest income, net was $0.5 million and $0.1 million for the second quarter of 2007 and 2008, respectively. Interest income, net was $1.1 million and $0.8 million for the first six months of 2007 and 2008, respectively.

Income Tax Expense Our year to date effective tax rate for 2008 was 38.9%, as compared to 38.0% in 2007. The effective tax rate for the second quarter of 2007 is lower than 2008 due to a change in expected tax expense in certain jurisdictions. One component of the increase in the effective tax rate for 2008 is primarily due to an increase in tax reserves. Adjustments to 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 effective tax rate for 2008 will be between 38% and 40%.

Outlook Although there is uncertainty as to the overall economy for 2008, we believe that activity for our industry will continue to be at reasonably high levels in 2008 and we are encouraged by our current level of backlog. Our primary emphasis for 2008 will continue to be on margins rather than revenue growth. Our ongoing margin efforts include a focus on improving the results of units that incurred losses or subpar income in 2007 as well as on intensified project and service performance training at the unit level. Based on these margin improvement efforts (especially with our large multi-family operation based in Texas), our strong level of backlog as compared to prior year and on our perception regarding economic conditions for our industry over the coming year, we expect that our 2008 profitability will improve as compared to our 2007 results.

Table of Contents

Liquidity and Capital Resources*:*

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2008	2007	2008
	(in thousands)			
Cash provided by (used in):				
Operating activities	$21,224	$ 27,059	$ 8,396	$ 26,013
Investing activities	$ (2,144)	$ (1,302)	$(9,016)	$(45,607)
Financing activities	$ (186)	$(12,885)	$(1,734)	$(18,529)
Free cash flow:				
Cash used in operating activities	$21,224	$ 27,059	$ 8,396	$ 26,013
Purchases of property and equipment	(2,227)	(4,253)	(4,717)	(7,005)
Proceeds from sales of property and equipment	82	37	123	117
Free cash flow	$19,079	$ 22,843	$ 3,802	$ 19,125

Cash Flow We define free cash flow as cash provided by operating activities less customary capital expenditures, plus the proceeds from asset sales. Positive free cash flow represents funds available to invest in significant operating initiatives, to acquire other companies, or to reduce a company's outstanding debt or equity. If free cash flow is negative, additional debt or equity is generally required to fund the outflow of cash. Free cash flow may be defined differently by other companies.

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 customers pay 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. Accordingly, 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.

For the three months ended June 30, 2008, we had positive free cash flow of $22.8 million as compared to positive free cash flow of $19.1 million in 2007. For the six months ended June 30, 2008, we had positive free cash flow of $19.1 million, as compared to positive free cash flow of $3.8 million for the first six months of 2007. These increases are a result of increased earnings and improved working capital efficiency primarily due to lower revenue growth as compared to the prior year primarily in our multi-family operations.

As of June 30, 2008, our marketable securities consisted of $10.7 million of auction rate securities, which are variable rate debt instruments, having long-term maturities, but whose interest rates are designed to reset through an auction process, at intervals ranging from seven to 35 days. All of our auction rate securities are high quality direct municipal obligations which have high investment grade ratings or otherwise are backed by high investment grade rated insurance agencies as of June 30, 2008. In February 2008, liquidity issues in the global credit markets caused auctions representing some of the auction rate securities we hold to fail because the amount of securities offered for sale exceeded the

Table of Contents

bids. As a result, the liquidity of our remaining auction rate securities has diminished, and we expect that this decreased liquidity for our auction rate securities will continue as long as the present depressed global credit market environment persists, or until issuers refinance and replace these securities with other instruments. Despite the current auction market, we believe the credit quality of our auction rate securities remains high due to the creditworthiness of the issuers. We continue to collect interest when due and we expect to continue to do so going forward. Additionally, we expect we will fully realize the principal through either future successful auctions, sales of these securities outside the auction process, the issuers' establishment of different form of financing to replace these securities, or the maturing of the securities. During the second quarter of 2008, we sold $7.6 million of these auction rate securities at face value and an additional $0.9 million has been called.

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to one million shares of our outstanding common stock. On November 16, 2007, the Board approved an extension of our stock repurchase program to cover an additional 401,200 shares of our outstanding common stock. On February 27, 2008, the Board approved an extension of our stock repurchase program to cover an additional 712,083 shares of our outstanding common stock. We repurchased 776,243 shares for approximately $9.7 million under our share repurchase program for the six months ended June 30, 2008. There are 477,140 shares remaining that may be repurchased under the program as of June 30, 2008. The share repurchase is reflected as a financing outflow in our consolidated statements of cash flows.

Credit Facility We have a $100.0 million senior credit facility (the "Facility") provided by a syndicate of banks which is available for borrowings and letters of credit. The Facility will expire in February 2012 and is secured by the capital stock of our current and future subsidiaries. As of June 30, 2008, the total of the Facility was $100.0 million, with no outstanding borrowings, $38.2 million in letters of credit outstanding, and $61.8 million of credit available.

We have a choice of two interest rate options for borrowings under the Facility; these rates are floating rates determined by the broad financial markets, meaning they can and do move up and down from time to time. We estimate that the interest rate applicable to the borrowings under the Facility would be approximately 3.7% as of June 30, 2008. Commitment fees are payable on the portion of the capacity not in use for borrowings or letters of credit at any given time. These fees range from 0.20%-0.30% per annum, based on the ratio of debt to Credit Facility Adjusted EBITDA. The Facility contains financial covenants defining various financial measures and the levels of these measures with which we must comply. We are in compliance with all the financial covenants as of June 30, 2008.

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 $12.8 million, of which $1.7 million is current, as of June 30, 2008 and bear interest, payable annually, at a weighted average interest rate of 6.0%.

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.

Table of Contents

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 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 30% of our business has required bonds. While we have enjoyed a longstanding relationship with our primary surety and we have added another surety to further 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 revenues and profits to decline in the near term.

The following recaps the future maturities of our contractual obligations as of June 30, 2008 (in thousands):

	Twelve Months Ended June 30,						
	2009	2010	2011	2012	2013	Thereafter	Total
Liabilities Notes to former owners	$ 1,708	$5,375	$5,375	$ 375	$	$	$12,833
Operating lease obligations	$10,155	$6,562	$4,158	$3,129	$2,559	$ 6,697	$33,260

Absent any significant commitments of capital for items such as capital expenditures, acquisitions, dividends and share repurchases, it is reasonable to expect us to continue to maintain excess cash on our balance sheet. Therefore, we assumed that we would continue our current status of not utilizing any borrowings under our revolving credit facility.

Table of Contents

As of June 30, 2008 we also have $38.2 million letter of credit commitments, of which $37.5 million expire in 2008 and $0.7 million expire in 2009. The substantial majority of these letters of credit are posted with insurers who disburse funds on our behalf in connection with our worker's 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 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 2008, we expect nearly all of them, particularly those supporting our insurance programs, will be renewed annually.

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.

Outlook We have generated positive net free cash flow for the last nine calendar years, most of which occurred during challenging economic and industry conditions. We also expect to have significant borrowing capacity under our credit facility and substantial uncommitted cash balances. We believe these factors will provide us with sufficient liquidity to fund our operations for the foreseeable future.

Seasonality and Cyclicality

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 revenues and operating results generally will be lower in the first and fourth calendar quarters.

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.

New Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("Statement 157"), effective for fiscal years beginning after November 15, 2007. Statement 157 provides guidance for using fair value to measure assets and liabilities. The statement applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The statement does not expand the use of fair value in any new circumstances. On February 12, 2008, the FASB issued FASB Staff Position No. 157-2, "Effective Date of FASB Statement No. 157" ("FSP 157-2") that amends Statement 157 to delay the effective date for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. FSP 157-2 defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008. We adopted Statement 157 on January 1, 2008 for financial assets and liabilities measured on a recurring basis. There was no impact upon adoption of Statement 157 to the consolidated financial statements.

In December 2007, the FASB issued Statement No. 141 (Revised 2007), "Business Combinations" ("Statement 141(R)"). Statement 141(R) requires an acquiring entity to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. Statement 141(R) also changes the accounting treatment for certain specific items. Statement 141(R) applies prospectively to business combinations for which the acquisition date is on or

Table of Contents

after the first annual reporting period beginning on or after December 15, 2008. We will adopt the provisions of Statement 141(R) for business combinations on January 1, 2009.

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. We have a debt facility under which we may borrow funds in the future. We do not currently foresee any borrowing needs. 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, 2008:

	Twelve Months Ended June 30,						
	2009	2010	2011	2012	2013	Thereafter	Fair Value
Fixed Rate Debt	$1,708	$5,375	$5,375	$ 375	$	$	$12,833
Average Interest Rate	6.0%	6.0%	6.0%	6.0%			6.0%

As of June 30, 2008, our marketable securities consisted of $10.7 million of auction rate securities, which are variable rate debt instruments, having long-term maturities, but whose interest rates are designed to reset through an auction process, at intervals ranging from seven to 35 days. All of our auction rate securities are high quality direct municipal obligations which have high investment grade ratings or otherwise are backed by high investment grade rated insurance agencies as of June 30, 2008. In February 2008, liquidity issues in the global credit markets caused auctions representing some of the auction rate securities we hold to fail because the amount of securities offered for sale exceeded the bids. As a result, the liquidity of our remaining auction rate securities has diminished, and we expect that this decreased liquidity for our auction rate securities will continue as long as the present depressed global credit market environment persists, or until issuers refinance and replace these securities with other instruments. As a result of the current situation in the auction markets, our ability to liquidate our investment in auction rate securities and fully recover the carrying value of our investment in the near term may be limited or impossible. If in the future the issuers are unable to successfully close future auctions and their credit ratings deteriorate, we may be required to record an additional impairment charge on these investments. Because the tax exempt interest rates on these bonds are relatively attractive, we expect that we will be able to liquidate our investment without significant loss in the near future, however, it could take until the final maturity of the underlying notes (up to 26 years) to be repaid. Based on our expected operating cash flows, and our other sources of cash, we do not anticipate the potential lack of liquidity on these investments will affect our ability to execute our current business plan.

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 supervision and with the participation of our management, including our Chief Executive Officer and

Table of Contents

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 15(d)-15(f) under the Securities Exchange Act of 1934) during the three months ended June 30, 2008 that have materially affected, or is reasonably likely to materially affect, 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. While we cannot predict the outcome of these proceedings, in our opinion and based on reports of 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.

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 one million shares of our outstanding common stock. On November 16, 2007, the Board approved an extension of our stock repurchase program to cover an additional 401,200 shares of our outstanding common stock. On February 27, 2008, the Board approved an extension of our stock repurchase program to cover an additional 712,083 shares of our outstanding common stock. 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.

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	51,160	$ 13.30	1,248,543	864,740
May 1 May 31	220,700	$ 13.72	1,469,243	644,040
June 1 June 30	166,900	$ 13.42	1,636,143	477,140
	438,760	$ 13.56	1,636,143	477,140

In addition, under our 2006 Equity Incentive 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 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.

Table of Contents

During the quarter ended June 30, 2008, 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	13,297	$ 13.33
May 1 May 31	16,128	$ 13.74
June 1 June 30	4,960	$ 13.76
	34,385	$ 13.58

Item 4. ***Submission of Matters to a Vote of Security Holders***

The Company held its annual meeting of stockholders in Houston, Texas on May 16, 2008, which meeting was duly noticed in the Company's Proxy Statement dated April 9, 2008. All of the Company's incumbent directors were elected by a majority of the outstanding shares eligible to vote with respect to such election, each for a term expiring at the next annual meeting. Out of a potential of 40,006,252 shares of Common Stock outstanding, William F. Murdy had 36,282,892 shares voted in favor of election, with 1,069,531 withheld. Darcy G. Anderson had 37,219,621 shares voted in favor of election, with 132,802 shares withheld. Herman E. Bulls had 37,080,697 shares voted in favor of election, with 271,726 shares withheld. Alfred J. Giardinelli, Jr. had 37,219,721 shares voted in favor of election, with 132,702 shares withheld. Alan P. Krusi had 37,219,721 shares voted in favor of election, with 132,702 shares withheld. Franklin Myers had 37,080,792 shares voted in favor of election, with 271,631 shares withheld. James H. Schultz had 37,080,597 shares voted in favor of election, with 271,826 shares withheld. Robert D. Wagner, Jr. had 37,218,521 shares voted in favor of election, with 133,902 shares withheld.

The selection of Ernst & Young LLP as the Company's independent auditors for the year 2007 was ratified by the following vote: 37,287,402 votes for; 39,399 votes against; and 25,621 abstentions.

The Company's Amended and Restated 2006 Equity Compensation Plan for Non-employee Directors was approved by the following vote: 29,483,677 votes for; 4,049,047 votes against; and 330,344 abstentions.

The Company's 2008 Senior Management Annual Performance Plan was approved by the following vote: 29,597,856 votes for; 3,590,151 votes against; and 353,029 abstentions.

Item 6. ***Exhibits***

(a) Exhibits.

31.1	Rule 13a-14(a) Certification of William F. Murdy pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Rule 13a-14(a) Certification of William George pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Section 1350 Certification of William F. Murdy pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Section 1350 Certification of William George pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

COMFORT SYSTEMS USA, INC.

July 31, 2008 By: /s/ WILLIAM F. MURDY

William F. Murdy
Chairman of the Board and Chief Executive Officer

July 31, 2008 By: /s/ WILLIAM GEORGE

William George
Executive Vice President and Chief Financial Officer

July 31, 2008 By: /s/ JULIE S. SHAEFF

Julie S. Shaeff
Senior Vice President and Chief Accounting Officer