

COMFORT SYSTEMS USA INC  
Form 10-Q  
April 29, 2015

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

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

**For the quarterly period ended March 31, 2015**

**OR**

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

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

**COMFORT SYSTEMS USA, INC.**

(Exact name of registrant as specified in its charter)

**DELAWARE**

(State or other jurisdiction of  
Incorporation or Organization)

**76-0526487**

(I.R.S. Employer  
Identification No.)

**675 Bering Drive  
Suite 400**

**Houston, Texas 77057**

(Address of Principal Executive Offices) (Zip Code)

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

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

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

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a  
smaller reporting company)

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

The number of shares outstanding of the issuer's common stock as of April 24, 2015 was 37,391,203 (excluding treasury shares of 3,732,162).

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FOR THE QUARTER ENDED MARCH 31, 2015**

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

|                                                                                                | March 31,<br>2015 | December 31,<br>2014 |
|------------------------------------------------------------------------------------------------|-------------------|----------------------|
|                                                                                                | (Unaudited)       |                      |
| ASSETS                                                                                         |                   |                      |
| CURRENT ASSETS:                                                                                |                   |                      |
| Cash and cash equivalents                                                                      | \$ 38,892         | \$ 32,064            |
| Accounts receivable, less allowance for doubtful accounts of \$4,257 and \$4,379, respectively | 306,864           | 303,575              |
| Other receivables                                                                              | 8,983             | 15,520               |
| Inventories                                                                                    | 10,027            | 8,646                |
| Prepaid expenses and other                                                                     | 26,564            | 25,591               |
| Costs and estimated earnings in excess of billings                                             | 31,300            | 27,620               |
| Assets related to discontinued operations                                                      | 176               | 176                  |
| Total current assets                                                                           | 422,806           | 413,192              |
| PROPERTY AND EQUIPMENT, NET                                                                    | 55,640            | 55,759               |
| GOODWILL                                                                                       | 143,569           | 140,341              |
| IDENTIFIABLE INTANGIBLE ASSETS, NET                                                            | 46,012            | 45,666               |
| OTHER NONCURRENT ASSETS                                                                        | 10,777            | 10,792               |
| Total assets                                                                                   | \$ 678,804        | \$ 665,750           |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

|                                                                                                               |          |          |
|---------------------------------------------------------------------------------------------------------------|----------|----------|
| <b>CURRENT LIABILITIES:</b>                                                                                   |          |          |
| Current maturities of long-term debt                                                                          | \$       | \$       |
| Current maturities of long-term capital lease obligations                                                     | 299      | 317      |
| Accounts payable                                                                                              | 109,478  | 106,211  |
| Accrued compensation and benefits                                                                             | 45,992   | 44,683   |
| Billings in excess of costs and estimated earnings                                                            | 82,306   | 77,446   |
| Accrued self-insurance expense                                                                                | 29,427   | 28,903   |
| Other current liabilities                                                                                     | 25,056   | 24,814   |
| Liabilities related to discontinued operations                                                                | 263      | 263      |
| Total current liabilities                                                                                     | 292,821  | 282,637  |
| LONG-TERM DEBT                                                                                                | 37,000   | 39,500   |
| LONG-TERM CAPITAL LEASE OBLIGATIONS                                                                           | 463      | 529      |
| DEFERRED INCOME TAX LIABILITIES                                                                               | 10,204   | 10,817   |
| OTHER LONG-TERM LIABILITIES                                                                                   | 11,129   | 10,874   |
| Total liabilities                                                                                             | 351,617  | 344,357  |
| <b>COMMITMENTS AND CONTINGENCIES</b>                                                                          |          |          |
| <b>STOCKHOLDERS' EQUITY:</b>                                                                                  |          |          |
| Preferred stock, \$.01 par, 5,000,000 shares authorized, none issued and outstanding                          |          |          |
| Common stock, \$.01 par, 102,969,912 shares authorized, 41,123,365 and 41,123,365 shares issued, respectively | 411      | 411      |
| Treasury stock, at cost, 3,816,216 and 3,853,586 shares, respectively                                         | (43,175) | (43,598) |
| Additional paid-in capital                                                                                    | 320,844  | 320,084  |
| Retained earnings                                                                                             | 32,213   | 29,384   |

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|                                                |            |            |
|------------------------------------------------|------------|------------|
| Comfort Systems USA, Inc. stockholders' equity | 310,293    | 306,281    |
| Noncontrolling interests                       | 16,894     | 15,112     |
| Total stockholders' equity                     | 327,187    | 321,393    |
| Total liabilities and stockholders' equity     | \$ 678,804 | \$ 665,750 |

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

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**COMFORT SYSTEMS USA, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(In Thousands, Except Per Share Data)

(Unaudited)

|                                                                             | Three Months Ended<br>March 31, |            |
|-----------------------------------------------------------------------------|---------------------------------|------------|
|                                                                             | 2015                            | 2014       |
| REVENUE                                                                     | \$ 369,547                      | \$ 321,381 |
| COST OF SERVICES                                                            | 304,859                         | 269,232    |
| Gross profit                                                                | 64,688                          | 52,149     |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES                                | 53,696                          | 50,385     |
| GAIN ON SALE OF ASSETS                                                      | (176)                           | (133)      |
| Operating income                                                            | 11,168                          | 1,897      |
| OTHER INCOME (EXPENSE):                                                     |                                 |            |
| Interest income                                                             | 1                               | 11         |
| Interest expense                                                            | (505)                           | (336)      |
| Changes in the fair value of contingent earn-out obligations                |                                 | 130        |
| Other                                                                       | 18                              | 68         |
| Other income (expense)                                                      | (486)                           | (127)      |
| INCOME BEFORE INCOME TAXES                                                  | 10,682                          | 1,770      |
| INCOME TAX EXPENSE                                                          | 3,793                           | 692        |
| INCOME FROM CONTINUING OPERATIONS                                           | 6,889                           | 1,078      |
| Loss from discontinued operations, net of income tax benefit of \$ and \$10 |                                 | (15)       |
| NET INCOME INCLUDING NONCONTROLLING INTERESTS                               | 6,889                           | 1,063      |
| Less: Net income attributable to noncontrolling interests                   | 1,823                           | 688        |
| NET INCOME ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC.                        | \$ 5,066                        | \$ 375     |

INCOME PER SHARE ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC.:

|                                   |    |      |         |
|-----------------------------------|----|------|---------|
| Basic                             |    |      |         |
| Income from continuing operations | \$ | 0.14 | \$ 0.01 |
| Loss from discontinued operations |    |      |         |
| Net income                        | \$ | 0.14 | \$ 0.01 |
| Diluted                           |    |      |         |
| Income from continuing operations | \$ | 0.13 | \$ 0.01 |
| Loss from discontinued operations |    |      |         |
| Net income                        | \$ | 0.13 | \$ 0.01 |

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SHARES USED IN COMPUTING INCOME PER SHARE:

|       |        |        |
|-------|--------|--------|
| Basic | 37,281 | 37,582 |
|-------|--------|--------|

|         |        |        |
|---------|--------|--------|
| Diluted | 37,605 | 37,890 |
|---------|--------|--------|

|                     |          |          |
|---------------------|----------|----------|
| DIVIDENDS PER SHARE | \$ 0.060 | \$ 0.055 |
|---------------------|----------|----------|

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)**

|                                                                                              | <b>Common Stock</b> |               | <b>Treasury Stock</b> |               | <b>Additional<br/>Paid-In<br/>Capital</b> | <b>Retained<br/>Earnings</b> | <b>Non-<br/>Controlling<br/>Interests</b> | <b>Total<br/>Stockholders'<br/>Equity</b> |
|----------------------------------------------------------------------------------------------|---------------------|---------------|-----------------------|---------------|-------------------------------------------|------------------------------|-------------------------------------------|-------------------------------------------|
|                                                                                              | <b>Shares</b>       | <b>Amount</b> | <b>Shares</b>         | <b>Amount</b> |                                           |                              |                                           |                                           |
| BALANCE AT DECEMBER 31, 2013                                                                 | 41,123,365          | \$ 411        | (3,488,438)           | \$ (37,468)   | \$ 318,123                                | \$ 14,768                    | \$ 18,188                                 | \$ 314,022                                |
| Net income                                                                                   |                     |               |                       |               |                                           | 23,063                       | 5,536                                     | 28,599                                    |
| Issuance of Stock:                                                                           |                     |               |                       |               |                                           |                              |                                           |                                           |
| Issuance of shares for options exercised<br>including tax benefit                            |                     |               | 103,619               | 1,132         | 79                                        |                              |                                           | 1,211                                     |
| Issuance of restricted stock                                                                 |                     |               | 115,044               | 1,243         | (1,243)                                   |                              |                                           |                                           |
| Shares received in lieu of tax withholding<br>payment on vested restricted stock             |                     |               | (34,657)              | (531)         |                                           |                              |                                           | (531)                                     |
| Tax benefit from vesting of restricted stock                                                 |                     |               |                       |               | 133                                       |                              |                                           | 133                                       |
| Stock-based compensation                                                                     |                     |               |                       |               | 2,992                                     |                              |                                           | 2,992                                     |
| Dividends                                                                                    |                     |               |                       |               |                                           | (8,447)                      |                                           | (8,447)                                   |
| Distribution to noncontrolling interests                                                     |                     |               |                       |               |                                           |                              | (8,612)                                   | (8,612)                                   |
| Share repurchase                                                                             |                     |               | (549,154)             | (7,974)       |                                           |                              |                                           | (7,974)                                   |
| BALANCE AT DECEMBER 31, 2014                                                                 | 41,123,365          | 411           | (3,853,586)           | (43,598)      | 320,084                                   | 29,384                       | 15,112                                    | 321,393                                   |
| Net income (unaudited)                                                                       |                     |               |                       |               |                                           | 5,066                        | 1,823                                     | 6,889                                     |
| Issuance of Stock:                                                                           |                     |               |                       |               |                                           |                              |                                           |                                           |
| Issuance of shares for options exercised<br>including tax benefit (unaudited)                |                     |               | 37,370                | 423           | (36)                                      |                              |                                           | 387                                       |
| Issuance of restricted stock (unaudited)                                                     |                     |               |                       |               |                                           |                              |                                           |                                           |
| Shares received in lieu of tax withholding<br>payment on vested restricted stock (unaudited) |                     |               |                       |               |                                           |                              |                                           |                                           |
| Tax benefit from vesting of restricted stock<br>(unaudited)                                  |                     |               |                       |               |                                           |                              |                                           |                                           |
| Stock-based compensation (unaudited)                                                         |                     |               |                       |               | 796                                       |                              |                                           | 796                                       |
| Dividends (unaudited)                                                                        |                     |               |                       |               |                                           | (2,237)                      |                                           | (2,237)                                   |
| Distribution to noncontrolling interests<br>(unaudited)                                      |                     |               |                       |               |                                           |                              | (41)                                      | (41)                                      |
| Share repurchase (unaudited)                                                                 |                     |               |                       |               |                                           |                              |                                           |                                           |
| BALANCE AT MARCH 31, 2015 (unaudited)                                                        | 41,123,365          | \$ 411        | (3,816,216)           | \$ (43,175)   | \$ 320,844                                | \$ 32,213                    | \$ 16,894                                 | \$ 327,187                                |

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



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## COMFORT SYSTEMS USA, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

(Unaudited)

|                                                                                            | Three Months Ended<br>March 31, |          |
|--------------------------------------------------------------------------------------------|---------------------------------|----------|
|                                                                                            | 2015                            | 2014     |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                               |                                 |          |
| Net income including noncontrolling interests                                              | \$ 6,889                        | \$ 1,063 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities |                                 |          |
| Amortization of identifiable intangible assets                                             | 1,831                           | 1,604    |
| Depreciation expense                                                                       | 3,792                           | 3,050    |
| Bad debt expense                                                                           | 211                             | 33       |
| Deferred tax benefit                                                                       | (1,241)                         | (1,622)  |
| Amortization of debt financing costs                                                       | 93                              | 65       |
| Gain on sale of assets                                                                     | (176)                           | (133)    |
| Changes in the fair value of contingent earn-out obligations                               |                                 | (130)    |
| Stock-based compensation expense                                                           | 1,388                           | 1,431    |
| Changes in operating assets and liabilities, net of effects of acquisitions                |                                 |          |
| (Increase) decrease in                                                                     |                                 |          |
| Receivables, net                                                                           | 2,854                           | 7,330    |
| Inventories                                                                                | (1,263)                         | (393)    |
| Prepaid expenses and other current assets                                                  | 735                             | 824      |
| Costs and estimated earnings in excess of billings                                         | (3,592)                         | (4,443)  |
| Other noncurrent assets                                                                    | 278                             | 182      |
| Increase (decrease) in                                                                     |                                 |          |
| Accounts payable and accrued liabilities                                                   | 3,721                           | (11,169) |
| Billings in excess of costs and estimated earnings                                         | 4,817                           | (6,181)  |
| Other long-term liabilities                                                                | 78                              | (295)    |
| Net cash provided by (used in) operating activities                                        | 20,415                          | (8,784)  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                               |                                 |          |
| Purchases of property and equipment                                                        | (3,623)                         | (3,882)  |
| Proceeds from sales of property and equipment                                              | 206                             | 217      |
| Cash paid for acquisitions, net of cash acquired                                           | (5,350)                         | (4,000)  |
| Net cash used in investing activities                                                      | (8,767)                         | (7,665)  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                               |                                 |          |
| Proceeds from revolving line of credit                                                     | 14,500                          | 18,000   |
| Payments on revolving line of credit                                                       | (17,000)                        | (11,000) |
| Payments on capital lease obligations                                                      | (84)                            |          |
| Payments of dividends to shareholders                                                      | (2,237)                         | (2,067)  |
| Share repurchase program                                                                   |                                 | (416)    |
| Excess tax benefit of stock-based compensation                                             | 90                              | (14)     |
| Proceeds from exercise of options                                                          | 297                             | 542      |
| Distributions to noncontrolling interests                                                  | (41)                            |          |
| Payments for contingent consideration arrangements                                         | (345)                           |          |
| Net cash provided by (used in) financing activities                                        | (4,820)                         | 5,045    |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS                                       | 6,828                           | (11,404) |

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|                                                |           |           |
|------------------------------------------------|-----------|-----------|
| CASH AND CASH EQUIVALENTS, beginning of period | 32,064    | 52,054    |
| CASH AND CASH EQUIVALENTS, end of period       | \$ 38,892 | \$ 40,650 |

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

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**COMFORT SYSTEMS USA, INC.**

**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2015**

**(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 52% of our consolidated 2015 revenue is attributable to installation of systems in newly constructed facilities, with the remaining 48% attributable to maintenance, repair and replacement services. The following service activities account for our consolidated 2015 revenue: HVAC 76%, plumbing 15%, building automation control systems 5% 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, 2014 (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. Certain amounts in prior periods may have been reclassified to conform to the current year presentation. The effects of the reclassifications were not material to the unaudited consolidated financial statements. The results of operations for interim periods are not necessarily indicative of the results for the full fiscal year.

***Use of Estimates***

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

Table of Contents**COMFORT SYSTEMS USA, INC.****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****March 31, 2015****(Unaudited)****2. Summary of Significant Accounting Policies (Continued)*****Cash Flow Information***

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

Cash paid (in thousands) for:

|              | <b>Three Months<br/>Ended<br/>March 31,</b> |               |
|--------------|---------------------------------------------|---------------|
|              | <b>2015</b>                                 | <b>2014</b>   |
| Interest     | \$ 407                                      | \$ 261        |
| Income taxes | 590                                         | 519           |
| <b>Total</b> | <b>\$ 997</b>                               | <b>\$ 780</b> |

***Recent Accounting Pronouncements***

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 provides a framework that replaces the existing revenue recognition guidance. The guidance can be applied on a full retrospective or modified retrospective basis whereby the entity records a cumulative effect of initially applying this update at the date of initial application, and early adoption is not permitted. It is effective for annual periods beginning after December 15, 2016, including interim periods within that reporting period. We are currently evaluating the potential impact of this authoritative guidance on our consolidated financial statements.

***Income Taxes***

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

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

We regularly evaluate valuation allowances established for deferred tax assets for which future realization is uncertain. We perform this evaluation quarterly. In assessing the realizability of deferred tax assets, we must consider whether it is more likely than not that some portion, or all, of the deferred tax assets will not be realized. We consider all available evidence, both positive and negative, in determining whether a valuation allowance is required. Such evidence includes the scheduled reversal of deferred tax liabilities, projected future taxable income, taxable income in prior carryback years and



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**COMFORT SYSTEMS USA, INC.**

**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**March 31, 2015**

**(Unaudited)**

**2. Summary of Significant Accounting Policies (Continued)**

tax planning strategies in making this assessment, and judgment is required in considering the relative weight of negative and positive evidence.

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

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

For the three months ended March 31, 2015 our tax expense is \$3.8 million with an effective tax rate of 35.5% as compared to tax expense of \$0.7 million with an effective tax rate of 39.1% for the three months ended March 31, 2014. The effective rate for 2015 is higher than the federal statutory rate of 35.0% primarily due to state income taxes (3.9%) and non-deductible expenses (1.3%) partially offset by the impact of the noncontrolling interest of EAS which for tax purposes is treated as a partnership (2.7%) and the production activity deduction (1.8%). The effective rate for 2014 is higher than the federal statutory rate of 35.0% primarily due to state income taxes (4.0%). Tax reserves are analyzed and adjusted quarterly as events occur to warrant such changes. Adjustments to tax reserves are a component of the effective tax rate.

***Financial Instruments***

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

***Segment Disclosure***

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

**3. Fair Value Measurements**

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

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

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

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

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## COMFORT SYSTEMS USA, INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2015

(Unaudited)

**3. Fair Value Measurements (Continued)**

The following table summarizes the fair values, and levels within the fair value hierarchy in which the fair value measurements fall, for assets and liabilities measured on a recurring basis as of March 31, 2015 (in thousands):

|                                     | Balance<br>March 31, 2015 | Fair Value Measurements at<br>Reporting Date Using                         |                                                           |                                                    |
|-------------------------------------|---------------------------|----------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                     |                           | Quoted Prices In<br>Active Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Cash and cash equivalents           | \$ 38,892                 | \$ 38,892                                                                  | \$                                                        | \$                                                 |
| Life insurance cash surrender value | \$ 3,343                  | \$                                                                         | \$ 3,343                                                  | \$                                                 |
| Contingent earn-out obligations     | \$ 425                    | \$                                                                         | \$                                                        | \$ 425                                             |

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

One of our operations has life insurance policies covering 44 employees with a combined face value of \$41.7 million. The policy is invested in mutual funds and the fair value measurement of the cash surrender balance associated with these policies is determined using Level 2 inputs within the fair value hierarchy and will vary with investment performance. The cash surrender value of these policies is \$3.3 million as of March 31, 2015 and \$3.2 million as of December 31, 2014. These assets are included in "Other Noncurrent Assets" in our consolidated balance sheets.

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

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

|                              |        |
|------------------------------|--------|
| Balance at beginning of year | \$ 670 |
| Issuances                    | 100    |
| Settlements                  | (345)  |
| Adjustments to fair value    |        |
| Balance at end of period     | \$ 425 |

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

Table of Contents**COMFORT SYSTEMS USA, INC.****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****March 31, 2015****(Unaudited)****3. Fair Value Measurements (Continued)**

impairments, in the current quarter, on those assets required to be measured at fair value on a nonrecurring basis.

**4. Acquisitions***Acquisition of DynaTen*

On May 1, 2014, we closed a transaction to acquire DynaTen Corporation ("DynaTen") which reports as a separate operation location in Northern Texas. DynaTen is a regional mechanical contractor based in Fort Worth, Texas which engages in broad range of mechanical contracting projects, HVAC services and controls, in the Dallas/FortWorth metroplex and in surrounding areas. The total purchase price, which was finalized in the first quarter of 2015, was \$40.5 million, of which \$19.8 million was allocated to goodwill.

*Other Acquisitions*

We completed two acquisition in the first quarter of 2015 and one acquisition in the first quarter of 2014. These acquisitions were not material and were "tucked-in" with existing operations. The total purchase price for the "tucked-in" acquisitions, including earn-outs, was \$6.7 million and \$1.5 million in the first quarter of 2015 and 2014, respectively. Our consolidated balance sheet includes preliminary allocations of the purchase price to the assets acquired and liabilities assumed based on estimates of fair value, pending completion of final valuation and purchase price adjustments. The results of operations of acquisitions are included in our consolidated financial statements from their respective acquisition dates. Additional contingent purchase price ("earn-out") has been or will be paid if certain acquisitions achieve predetermined profitability targets.

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

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

|                              | <b>March 31,<br/>2015</b> | <b>December 31,<br/>2014</b> |
|------------------------------|---------------------------|------------------------------|
| Balance at beginning of year | \$ 140,341                | \$ 114,588                   |
| Additions                    | 3,228                     | 26,480                       |
| Impairment adjustment        |                           | (727)                        |
| Balance at end of period     | \$ 143,569                | \$ 140,341                   |



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## COMFORT SYSTEMS USA, INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2015

(Unaudited)

## 5. Goodwill and Identifiable Intangible Assets, Net (Continued)

*Identifiable Intangible Assets, Net*

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

|                        |                                       | March 31, 2015      |                             | December 31, 2014   |                             |
|------------------------|---------------------------------------|---------------------|-----------------------------|---------------------|-----------------------------|
|                        | Estimated<br>Useful Lives<br>in Years | Gross<br>Book Value | Accumulated<br>Amortization | Gross<br>Book Value | Accumulated<br>Amortization |
| Customer relationships | 2 - 15                                | \$ 52,617           | \$ (27,653)                 | \$ 50,440           | \$ (26,287)                 |
| Backlog                | 1 - 2                                 | 1,600               | (975)                       | 1,600               | (829)                       |
| Noncompete agreements  | 2 - 7                                 | 2,890               | (2,878)                     | 2,890               | (2,868)                     |
| Tradenames             | 2 - 25                                | 27,995              | (7,584)                     | 27,995              | (7,275)                     |
| Total                  |                                       | \$ 85,102           | \$ (39,090)                 | \$ 82,925           | \$ (37,259)                 |

## 6. Long-Term Debt Obligations

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

|                                 | March 31,<br>2015 | December 31,<br>2014 |
|---------------------------------|-------------------|----------------------|
| Revolving credit facility       | \$ 36,000         | \$ 38,500            |
| Notes to former owners          | 1,000             | 1,000                |
| Capital lease obligations       | 762               | 846                  |
| Total debt                      | 37,762            | 40,346               |
| Less current portion            | (299)             | (317)                |
| Total long-term portion of debt | \$ 37,463         | \$ 40,029            |

*Revolving Credit Facility*

We have a \$250.0 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 October 2019 and is secured by a first lien on substantially all of our personal property except for assets related to projects subject to surety bonds and assets held by certain unrestricted subsidiaries and a second lien on our assets related to projects subject to surety bonds. The Facility provides that availability under the Facility will be limited to the lesser of the face amount of \$250.0 million, or indebtedness less certain exclusions equal to 2.75 times trailing twelve month Credit Facility Adjusted EBITDA, which calculates to availability of \$248.5 million as of March 31, 2015. As of March 31, 2015, we had \$36.0 million of outstanding borrowings, \$48.0 million in letters of credit outstanding and \$164.5 million of credit available.

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

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## COMFORT SYSTEMS USA, INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2015

(Unaudited)

**6. Long-Term Debt Obligations (Continued)**

The following is a summary of the additional margins:

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

The weighted average interest rate applicable to the borrowings under the Facility was approximately 1.4% as of March 31, 2015.

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

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

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

The Facility's principal financial covenants include:

**Leverage Ratio** The Facility requires that the ratio of our Consolidated Total Indebtedness to our Credit Facility Adjusted EBITDA not exceed 2.75 through maturity. The leverage ratio as of March 31, 2015 was 0.51.

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

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**COMFORT SYSTEMS USA, INC.**

**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**March 31, 2015**

**(Unaudited)**

**6. Long-Term Debt Obligations (Continued)**

quarterly covenant compliance measurement date. The fixed charge coverage ratio as of March 31, 2015 was 20.47.

*Other Restrictions* The Facility permits acquisitions of up to \$25.0 million per transaction, provided that the aggregate purchase price of such an acquisition and of acquisitions in the same fiscal year does not exceed \$60.0 million. However, these limitations only apply when the Company's Net Leverage Ratio is equal to or greater than 2.00.

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

We are in compliance with all of our financial covenants as of March 31, 2015.

***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 \$1.0 million as of March 31, 2015 and bear interest, payable quarterly, at a weighted average interest rate of 2.5%. The principle is due in equal installments on October 2016 and 2017.

***Other Debt***

In conjunction with our acquisition of our northern Texas operation, we acquired capital lease obligations of \$0.7 million. Currently, \$0.8 million of capital lease obligations are outstanding, of which \$0.3 million is considered current.

Our majority owned subsidiary, EAS, has a revolving \$2.5 million credit line that is available for temporary working capital needs and expires July 31, 2015. As of March 31, 2015, we had no outstanding borrowings and, therefore, \$2.5 million of credit available. We estimate that the weighted average interest rate applicable to borrowings under this variable rate credit line would be approximately 2.7% as of March 31, 2015.

**7. Commitments and Contingencies**

***Claims and Lawsuits***

We are subject to certain legal and regulatory claims, including lawsuits arising in the normal course of business. We maintain various insurance coverages to minimize financial risk associated with these claims. We have estimated and provided accruals for probable losses and related legal fees associated with certain litigation in the accompanying consolidated financial statements. While we cannot predict the outcome of these proceedings, in management's opinion and based on reports of counsel, any liability arising from these matters individually and in the aggregate will not have a material effect on our operating results, cash flows or financial condition, after giving effect to provisions already recorded.

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**COMFORT SYSTEMS USA, INC.**

**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**March 31, 2015**

**(Unaudited)**

**7. Commitments and Contingencies (Continued)**

***Surety***

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

Surety market conditions are currently challenging as a result of significant losses incurred by many sureties in recent periods, both in the construction industry as well as in certain larger corporate bankruptcies. As a result, less bonding capacity is available in the market and terms have become more restrictive. Further, under standard terms in the surety market, sureties issue bonds on a project-by-project basis, and can decline to issue bonds at any time. Historically, approximately 25% to 35% of our business has required bonds. While we currently have strong surety relationships to support our bonding needs, future market conditions or 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 would enable us to ultimately respond effectively to an interruption in the availability of bonding capacity, such an interruption would likely cause our revenue and profits to decline in the near term.

***Self-Insurance***

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

**8. Stockholders' Equity**

***Earnings Per Share***

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

Table of Contents**COMFORT SYSTEMS USA, INC.****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****March 31, 2015****(Unaudited)****8. Stockholders' Equity (Continued)**

There were approximately 0.1 million anti-dilutive stock options excluded from the calculation of diluted EPS for the three months ended March 31, 2015 and no anti-dilutive stock options for the three months ended March 31, 2014.

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):

|                                                                                       | <b>Three Months<br/>Ended March 31,</b> |             |
|---------------------------------------------------------------------------------------|-----------------------------------------|-------------|
|                                                                                       | <b>2015</b>                             | <b>2014</b> |
| Common shares outstanding, end of period(a)                                           | 37,307                                  | 37,597      |
| Effect of using weighted average common shares outstanding                            | (26)                                    | (15)        |
| Shares used in computing earnings per share basic                                     | 37,281                                  | 37,582      |
| Effect of shares issuable under stock option plans based on the treasury stock method | 233                                     | 186         |
| Effect of contingently issuable restricted shares                                     | 91                                      | 122         |
| Shares used in computing earnings per share diluted                                   | 37,605                                  | 37,890      |

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(a) Excludes 0.1 million shares of unvested contingently issuable restricted stock outstanding as of March 31, 2014.

***Share Repurchase Program***

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from time to time approved extensions of the program to acquire additional shares. On October 24, 2014, the Board approved an extension to the program by increasing the shares authorized for repurchase by 1.0 million shares. Since the inception of the repurchase program, the Board has approved 7.6 million shares to be repurchased.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. No shares were repurchased during the current quarter. Since the inception of the program in 2007 and as of March 31, 2015, we have repurchased a cumulative total of 6.6 million shares at an average price of \$11.30 per share.

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

The following discussion and analysis should be read in conjunction with our historical Consolidated Financial Statements and related notes included elsewhere in this Form 10-Q and the Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2014 (the "Form 10-K"). This discussion contains "forward-looking statements" regarding our business and industry within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on our current plans and expectations and involve risks and uncertainties that could cause our actual future activities and results of operations to be materially different from those set forth in the forward-looking statements. Important factors that could cause actual results to differ include risks set forth in "Item 1A. Risk Factors" included in our Form 10-K. The terms "Comfort Systems," "we," "us," or "the Company," refer to Comfort Systems USA, Inc. or Comfort Systems USA, Inc. and its consolidated subsidiaries, as appropriate in the context.

***Introduction and Overview***

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

***Nature and Economics of Our Business***

Approximately 83% of our revenue is earned on a project basis for installation of HVAC systems in newly constructed facilities or for replacement of HVAC systems in existing facilities. Customers hire us to ensure such systems deliver specified or generally expected heating, cooling, conditioning and circulation of air in a facility. This entails installing core system equipment such as packaged heating and air conditioning units, or in the case of larger facilities, separate core components such as chillers, boilers, air handlers, and cooling towers. We also typically install connecting and distribution elements such as piping and ducting. Our responsibilities usually require conforming the systems to pre-established engineering drawings and equipment and performance specifications, which we frequently participate in establishing. Our project management responsibilities include staging equipment and materials to project sites, deploying labor to perform the work, and coordinating with other service providers on the project, including any subcontractors we might use to deliver our portion of the work.

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

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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 although such projects are sometimes subject to a guaranteed maximum cost. These margins are frequently less than fixed-price contract margins because there is less risk of unrecoverable cost overruns in cost-plus or time and materials work.

Our average project takes six to nine months to complete, with an average contract price of approximately \$490,000. We also perform larger HVAC projects. Generally, projects closer in size to \$1 million will be completed in one year or less. It is unusual for us to work on a project that exceeds two years in length. Our projects generally require working capital funding of equipment and labor costs. Customer payments on periodic billings generally do not recover these costs until late in the job. Our average project duration together with typical retention terms as discussed above generally allow us to complete the realization of revenue and earnings in cash within one year. We have what we believe is a well-diversified distribution of revenue across end-use sectors that we believe reduces our exposure to negative developments in any given sector. Because of the integral nature of HVAC and related controls systems to most buildings, we have the legal right in almost all cases to attach liens to buildings or related funding sources when we have not been fully paid for installing systems, except with respect to some government buildings. The service work that we do, which is discussed further below, usually does not give rise to lien rights.

A stratification of projects in progress as of March 31, 2015, by contract price, is as follows:

| <b>Contract Price of Project</b> | <b>No. of Projects</b> | <b>Aggregate Contract Price Value (millions)</b> |
|----------------------------------|------------------------|--------------------------------------------------|
| Under \$1 million                | 3,711                  | \$ 404.8                                         |
| \$1 million - \$5 million        | 293                    | 648.3                                            |
| \$5 million - \$10 million       | 64                     | 437.3                                            |
| \$10 million - \$15 million      | 16                     | 196.5                                            |
| Greater than \$15 million        | 16                     | 320.2                                            |
| <b>Total</b>                     | <b>4,100</b>           | <b>\$ 2,007.1</b>                                |

In addition to project work, approximately 17% of our revenue represents maintenance and repair service on already installed HVAC and controls systems. This kind of work usually takes from a few hours to a few days to perform. Prices to the customer are usually based on the equipment and materials used in the service as well as technician labor time. We usually bill the customer for service



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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 with thirty- to sixty-day cancellation notice periods.

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

***Profile and Management of Our Operations***

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

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

***Economic and Industry Factors***

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

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

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trends. We have experienced periods of time when economic weakness caused a significant slowdown in decisions to proceed with installation and replacement project work.

***Operating Environment and Management Emphasis***

Nonresidential building construction and renovation activity, as reported by the federal government, declined over the four year period from 2009 to 2012, and 2013 and 2014 activity levels have been relatively stable at the low levels of the preceding years. During these periods of decline, we responded to market challenges by pursuing work in sectors less affected by the downturn, such as government, educational, and healthcare facilities, and by establishing marketing initiatives that take advantage of our size and range of expertise. We also responded to declining gross profits over those years by reducing our selling, general, and administrative expenses. We believe our efforts in these areas partially offset the decline in our profitability over that period.

As a result of our continued strong emphasis on cash flow, we currently have modest indebtedness under our revolving credit facility and we have substantial uncommitted cash balances, as discussed further in "Liquidity and Capital Resources" below. We have a credit facility in place with considerably less restrictive terms than those of our previous facilities; this facility does not expire until October 2019. We have strong surety relationships to support our bonding needs, and we believe our relationships with the surety markets are strong and benefit from our solid current results and financial position. We have generated positive free cash flow in each of the last sixteen 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 expect price competition to continue as our customers and local and regional competitors respond cautiously to changing conditions. We will continue our efforts expand and improve our service business, to find the more active sectors in our markets, and to increase our regional and national account business. Our primary emphasis for the remainder of 2015 will be on execution and cost control, but we are beginning to seek growth based on our belief that industry conditions are beginning to improve, and we believe that activity levels will permit us to earn reasonable profits while preserving our core workforce. We have increased our focus on project qualification, estimating, pricing and management; and overall we are investing in service growth and improved performance.

***Cyclical and Seasonality***

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

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

***Critical Accounting Policies***

Our critical accounting policies are based upon the significance of the accounting policy to our overall financial statement presentation, as well as the complexity of the accounting policy and our use of estimates and subjective assessments. Our most critical accounting policy is revenue recognition. As

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discussed elsewhere in this quarterly report on Form 10-Q, our business has two service functions: (i) installation, which we account for under the percentage of completion method, and (ii) maintenance, repair and replacement, which we account for as the services are performed, or in the case of replacement, under the percentage of completion method. In addition, we identified other critical accounting policies related to our allowance for doubtful accounts receivable, the recording of our self-insurance liabilities, valuation of deferred tax assets, accounting for acquisitions and the recoverability of goodwill and identifiable intangible assets. These accounting policies, as well as others, are described as follows and in Note 2 to the Consolidated Financial Statements included elsewhere in this quarterly report on Form 10-Q.

*Percentage of Completion Method of Accounting*

Approximately 83% of our revenue was earned on a project basis and recognized through the percentage of completion method of accounting. Under this method contract revenue recognizable at any time during the life of a contract is determined by multiplying expected total contract revenue by the percentage of contract costs incurred at any time to total estimated contract costs. More specifically, as part of the negotiation and bidding process in connection with obtaining installation contracts, we estimate our contract costs, which include all direct materials (exclusive of rebates), labor and subcontract costs and indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. These contract costs are included in our results of operations under the caption "Cost of Services." Then, as we perform under those contracts, we measure costs incurred, compare them to total estimated costs to complete the contract, and recognize a corresponding proportion of contract revenue. Labor costs are considered to be incurred as the work is performed. Subcontractor labor is recognized as the work is performed, but is generally subjected to approval as to milestones or other evidence of completion. Non-labor project costs consist of purchased equipment, prefabricated materials and other materials. Purchased equipment on our projects is substantially produced to job specifications and is a value added element to our work. The costs are considered to be incurred when title is transferred to us, which typically is upon delivery to the worksite. Prefabricated materials, such as ductwork and piping, are generally performed at our shops and recognized as contract costs when fabricated for the unique specifications of the job. Other materials cost are not significant and are generally recorded when delivered to the worksite. This measurement and comparison process requires updates to the estimate of total costs to complete the contract, and these updates may include subjective assessments.

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

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

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The percentage of completion method of accounting is also affected by changes in job performance, job conditions, and final contract settlements. These factors may result in revisions to estimated costs and, therefore, revenue. Such revisions are frequently based on further estimates and subjective assessments. The effects of these revisions are recognized in the period in which revisions are determined. When such revisions lead to a conclusion that a loss will be recognized on a contract, the full amount of the estimated ultimate loss is recognized in the period such conclusion is reached, regardless of the percentage of completion of the contract.

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

*Accounting for Allowance for Doubtful Accounts*

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

*Accounting for Self-Insurance Liabilities*

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

Our self-insurance arrangements currently are as follows:

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

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

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

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

*Employee Medical* We have a national medical plan. The deductible for employee group health claims is \$350,000 per person, per policy (calendar) year for each plan. Insurance then covers any responsibility for medical claims in excess of the deductible amount.

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

*Accounting for Deferred Tax Assets*

We regularly evaluate valuation allowances established for deferred tax assets for which future realization is uncertain. We perform this evaluation quarterly. In assessing the realizability of deferred tax assets, we must consider whether it is more likely than not that some portion, or all, of the deferred tax assets will not be realized. We consider all available evidence, both positive and negative, in determining whether a valuation allowance is required. Such evidence includes the scheduled reversal of deferred tax liabilities, projected future taxable income, taxable income in prior carryback years and tax planning strategies in making this assessment, and judgment is required in considering the relative weight of negative and positive evidence.

*Acquisitions*

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

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

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

*Recoverability of Goodwill and Identifiable Intangible Assets*

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

When the carrying value of a given reporting unit exceeds its fair value, an impairment loss is recorded to the extent that the implied fair value of the goodwill of the reporting unit is less than its

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carrying value. If other reporting units have had increases in fair value, such increases may not be recorded. Accordingly, such increases may not be netted against impairments at other reporting units. The requirements for assessing whether goodwill has been impaired involve market-based information. This information, and its use in assessing goodwill, entails some degree of subjective assessment.

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

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

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

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

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

Table of Contents**Results of Operations (dollars in thousands):**

|                                                              | Three Months Ended<br>March 31, |        |            |        |
|--------------------------------------------------------------|---------------------------------|--------|------------|--------|
|                                                              | 2015                            | %      | 2014       | %      |
| Revenue                                                      | \$ 369,547                      | 100.0% | \$ 321,381 | 100.0% |
| Cost of services                                             | 304,859                         | 82.5%  | 269,232    | 83.8%  |
| Gross profit                                                 | 64,688                          | 17.5%  | 52,149     | 16.2%  |
| Selling, general and administrative expenses                 | 53,696                          | 14.5%  | 50,385     | 15.7%  |
| Gain on sale of assets                                       | (176)                           |        | (133)      |        |
| Operating income                                             | 11,168                          | 3.0%   | 1,897      | 0.6%   |
| Interest income                                              | 1                               |        | 11         |        |
| Interest expense                                             | (505)                           | (0.1)% | (336)      | (0.1)% |
| Changes in the fair value of contingent earn-out obligations |                                 |        | 130        |        |
| Other income (expense)                                       | 18                              |        | 68         |        |
| Income before income taxes                                   | 10,682                          | 2.9%   | 1,770      | 0.6%   |
| Income tax expense                                           | 3,793                           |        | 692        |        |
| Income from continuing operations                            | 6,889                           |        | 1,078      |        |
| Loss from discontinued operations, net of tax                |                                 |        | (15)       |        |
| Net income including noncontrolling interests                | 6,889                           | 1.9%   | 1,063      | 0.3%   |
| Less: Net income attributable to noncontrolling interests    | 1,823                           |        | 688        |        |
| Net income attributable to Comfort Systems USA, Inc.         | \$ 5,066                        |        | \$ 375     |        |

We had 37 operating locations as of December 31, 2014. We completed two acquisitions in the first quarter of 2015. These acquisitions were not material and were "tucked-in" with existing operations. In addition, we merged two operating locations during the current quarter. As of March 31, 2015, we had 36 operating locations. Acquisitions are included in our results of operations from the respective acquisition date. The same-store comparison from 2015 to 2014, as described below, excludes three months of results for our Northern Texas operation, which was acquired in May 2014. An operating location is included in the same-store comparison on the first day it has comparable prior year operating data. An operating location is excluded from the same-store comparison in the current year and comparable prior years when it is properly characterized as a discontinued operation under applicable accounting standards.

**Revenue** Revenue increased \$48.2 million, or 15.0%, to \$369.5 million for the first quarter of 2015 compared to the same period in 2014. The increase included a 10.2% increase in revenue related to same-store activity and a 4.8% increase related to the acquisition of our Northern Texas operation. The same-store revenue increase is primarily due to our EAS operation (\$23.4 million), our Arkansas operation (\$11.1 million) and our large operation headquartered in Virginia (\$7.2 million). These operations experienced increased project work compared to the prior year, specifically in the manufacturing sector.

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

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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 March 31, 2015 was \$718.0 million, a 5.2% decrease from December 31, 2014 backlog of \$757.8 million, and a 17.3% increase from March 31, 2014 backlog of \$612.3 million. Sequential backlog decreased primarily due to our EAS operation (\$21.1 million), our Arkansas operation (\$12.2 million) and our large operation headquartered in Virginia (\$10.4 million), with each completing a significant amount of project work during the quarter. The year-over-year backlog increase was primarily due to a same-store increase of 9.4% largely related to increased project bookings at one of our Maryland operations (\$23.9 million) and one of our Virginia operations (\$21.4 million). In addition, a 7.9% increase was due to the aforementioned acquisition of our Northern Texas operation (\$48.2 million) in the second quarter of last year.

We experienced significant industry activity declines in 2009 through 2012 with activity levels stabilizing in 2013 and 2014. Based on our backlog and forecasts from industry construction analysts, we expect that activity levels in our industry are likely to gradually improve over the next twelve months, particularly in the area of new construction.

**Gross Profit** Gross profit increased \$12.5 million, or 24.0%, to \$64.7 million for the first quarter of 2015 as compared to the same period in 2014. The increase included a \$2.0 million, or 3.9%, increase related to the acquisition of our Northern Texas operation and a \$10.5 million, or 20.1%, increase on a same-store basis. The same-store increase in gross profit was primarily due to improved project execution at our EAS operation (\$3.4 million) and job underperformance at our Southern California operation in 2014 which has turned around in the current quarter (\$2.7 million). As a percentage of revenue, gross profit increased from 16.2% in 2014 to 17.5% in 2015 primarily due to the factors discussed above.

**Selling, General and Administrative Expenses ("SG&A")** SG&A increased \$3.3 million, or 6.6%, to \$53.7 million for the first quarter of 2015 as compared to 2014. On a same-store basis, excluding amortization expense, SG&A increased \$1.8 million, or 3.7%. This increase is primarily due to expanded service activities at certain locations (approximately \$1.5 million). Amortization expense remained relatively flat during the period. As a percentage of revenue, SG&A decreased from 15.7% in 2014 to 14.5% in 2015 primarily due to an increase in large-project revenues at EAS which did not require an increase in SG&A.

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

|                                                 | <b>Three Months Ended</b> |             |
|-------------------------------------------------|---------------------------|-------------|
|                                                 | <b>March 31,</b>          |             |
|                                                 | <b>2015</b>               | <b>2014</b> |
|                                                 | <b>(in thousands)</b>     |             |
| SG&A                                            | \$ 53,696                 | \$ 50,385   |
| Less: SG&A from companies acquired              | (1,438)                   |             |
| Less: Amortization expense                      | (1,685)                   | (1,604)     |
| Same-store SG&A, excluding amortization expense | \$ 50,573                 | \$ 48,781   |



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*Interest Expense* Interest expense increased \$0.2 million, or 50.3%, to \$0.5 million for the first quarter of 2015 as compared to the same period in 2014. The increase is due to the increase in borrowings on the revolving credit facility.

*Changes in the Fair Value of Contingent Earn-out Obligations* The contingent earn-out obligations are measured at fair value each reporting period and changes in estimates of fair value are recognized in earnings. There was no income from changes in the fair value of contingent earn-out obligations for the first quarter of 2015 as compared to \$0.1 million in the prior year. Based on updated measurements of estimated future cash flows for our contingent obligations in the first quarter of 2015, no change in estimate was made to the remaining earn-out obligations.

*Income Tax Expense* We perform work throughout the United States in virtually all of the fifty states as well as in Puerto Rico. Our effective tax rate varies based upon our relative profitability, or lack of profitability, in states with varying state tax rates and rules. In addition, discrete events, judgments and legal structures can affect our effective tax rate. These items can include the tax treatment for impairment of goodwill and other intangible assets and changes in fair value of acquisition related assets and liabilities, tax reserves associated with regulatory audits, accounting for losses associated with underperforming operations and the partial ownership of consolidated entities.

For the three months ended March 31, 2015 our tax expense is \$3.8 million with an effective tax rate of 35.5% as compared to tax expense of \$0.7 million with an effective tax rate of 39.1% for the three months ended March 31, 2014. The effective rate for 2015 is higher than the federal statutory rate of 35.0% primarily due to state income taxes (3.9%) and non-deductible expenses (1.3%) partially offset by the impact of the noncontrolling interest of EAS which for tax purposes is treated as a partnership (2.7%) and the production activity deduction (1.8%). The effective rate for 2014 is higher than the federal statutory rate of 35.0% primarily due to state income taxes (4.0%). 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 2015 will be between 35% and 40%.

*Net Income Attributable to Noncontrolling Interests* Net income attributable to noncontrolling interests increased \$1.1 million to \$1.8 million for the first quarter of 2015 as compared to the same quarter in 2014. This increase reflects the impact of higher earnings at EAS, our non-wholly owned consolidated subsidiary, which was due primarily to increased revenues and margins on jobs performed in the current quarter.

***Outlook***

We expect that activity levels and the underlying environment for nonresidential construction activity will remain below prior peaks, but we believe that industry conditions will improve gradually through the remainder of 2015. Our backlog has recently begun to increase. Our emphasis for the remainder of 2015 will be on execution, including a focus on cost discipline and efficient project performance, labor force development, and investing in growth, particularly in service and small projects. Based on our backlog, and in light of economic conditions for our industry, we expect that revenue will be above the levels that we have experienced in recent years, and that 2015 profitability is likely to improve as compared to 2014.

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### Liquidity and Capital Resources (in thousands):

|                                                      | Three Months Ended<br>March 31, |             |
|------------------------------------------------------|---------------------------------|-------------|
|                                                      | 2015                            | 2014        |
| Cash provided by (used in):                          |                                 |             |
| Operating activities                                 | \$ 20,415                       | \$ (8,784)  |
| Investing activities                                 | (8,767)                         | (7,665)     |
| Financing activities                                 | (4,820)                         | 5,045       |
| Net increase (decrease) in cash and cash equivalents | \$ 6,828                        | \$ (11,404) |

### Free cash flow:

|                                                 |           |            |
|-------------------------------------------------|-----------|------------|
| Cash provided by (used in) operating activities | \$ 20,415 | \$ (8,784) |
| Purchases of property and equipment             | (3,623)   | (3,882)    |
| Proceeds from sales of property and equipment   | 206       | 217        |

Free cash flow \$ 16,998 \$ (12,449)

### Cash Flow

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

*Cash Provided by (Used in) Operating Activities* Cash flow from operations is primarily influenced by demand for our services and operating margins, but can also be influenced by working capital needs associated with the various types of services that we provide. In particular, working capital needs may increase when we commence large volumes of work under circumstances where project costs, primarily associated with labor, equipment and subcontractors, are required to be paid before the receivables resulting from the work performed are billed and collected. Working capital needs are generally higher during the late winter and spring months as we prepare and plan for the increased project demand when favorable weather conditions exist in the summer and fall months. Conversely, working capital assets are typically converted to cash during the late summer and fall months as project completion is underway. These seasonal trends are sometimes offset by changes in the timing of major projects which can be impacted by the weather, project delays or accelerations and other economic factors that may affect customer spending.

Cash provided by operating activities was \$20.4 million during the first quarter of 2015 compared with cash used of \$8.8 million during 2014. The \$29.2 million increase is primarily due to increases in accounts payable and billings in excess of costs and estimated earnings which had a positive impact of \$14.9 million and \$11.0 million, respectively. These increases are primarily due to timing of various project work at our EAS operation and our large operation headquartered in Virginia. These sources of operating cash flow were partially offset by a corresponding increase in receivables related to these projects. In addition, the increase was also impacted by higher net income in the first quarter of 2015 (\$6.9 million) compared to the first quarter of 2014 (\$1.1 million).

*Cash Used in Investing Activities* During the first quarter of 2015, cash used in investing activities was \$8.8 million compared to \$7.7 million during the first quarter of 2014. The \$1.1 million increase in cash used primarily relates to cash paid for acquisitions in 2015 (\$1.4 million).

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*Cash Provided by (Used in) Financing Activities* Cash used in financing activities was \$4.8 million for the first quarter of 2015 compared to cash provided by financing activities of \$5.0 million during the first quarter of 2014. The primary reason for the \$9.9 million increase in cash provided by financing activities is due to net payments to the revolving credit facility during the current quarter of \$2.5 million compared to net borrowings during the first quarter of 2014 of \$7.0 million.

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

***Share Repurchase Program***

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from time to time approved extensions of the program to acquire additional shares. On October 24, 2014, the Board approved an extension to the program by increasing the shares authorized for repurchase by 1.0 million shares. Since the inception of the repurchase program, the Board has approved 7.6 million shares to be repurchased.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. No shares were repurchased during the current quarter. Since the inception of the program in 2007 and as of March 31, 2015, we have repurchased a cumulative total of 6.6 million shares at an average price of \$11.30 per share.

***Debt***

***Credit Facility***

We have a \$250.0 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 October 2019 and is secured by a first lien on substantially all of our personal property except for assets related to projects subject to surety bonds and assets held by certain unrestricted subsidiaries and a second lien on our assets related to projects subject to surety bonds. The Facility provides that availability under the Facility will be limited to the lesser of the face amount of \$250.0 million, or indebtedness less certain exclusions equal to 2.75 times trailing twelve month Credit Facility Adjusted EBITDA, which calculates to availability of \$248.5 million as of March 31, 2015. As of March 31, 2015, we had \$36.0 million of outstanding borrowings, \$48.0 million in letters of credit outstanding and \$164.5 million of credit available.

There are two interest rate options for borrowings under the Facility, the Base Rate Loan Option and the Eurodollar Rate Loan Option. These rates are floating rates determined by the broad financial markets, meaning they can and do move up and down from time to time. Additional margins are then added to these two rates. The weighted average interest rate applicable to the borrowings under the Facility was approximately 1.4% as of March 31, 2015.

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

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

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

The Facility's principal financial covenants include:

**Leverage Ratio** The Facility requires that the ratio of our Consolidated Total Indebtedness to our Credit Facility Adjusted EBITDA not exceed 2.75 through maturity. The leverage ratio as of March 31, 2015 was 0.51.

**Fixed Charge Coverage Ratio** The Facility requires that the ratio of Credit Facility Adjusted EBITDA, less non-financed capital expenditures, tax provision, dividends and amounts used to repurchase stock to the sum of interest expense and scheduled principal payments of indebtedness be at least 2.00; provided that the calculation of the fixed charge coverage ratio excludes stock repurchases and the payment of dividends at any time that the Company's Net Leverage Ratio does not exceed 1.50. The Facility also allows the fixed charge coverage ratio not to be reduced for stock repurchases through September 30, 2015 in an aggregate amount not to exceed \$25 million if at the time of and after giving effect to such repurchase the Company's Net Leverage Ratio was less than or equal to 1.50. Capital expenditures, tax provision, dividends and stock repurchase payments are defined under the Facility for purposes of this covenant to be amounts for the four quarters ending as of any given quarterly covenant compliance measurement date. The fixed charge coverage ratio as of March 31, 2015 was 20.47.

**Other Restrictions** The Facility permits acquisitions of up to \$25.0 million per transaction, provided that the aggregate purchase price of such an acquisition and of acquisitions in the same fiscal year does not exceed \$60.0 million. However, these limitations only apply when the Company's Net Leverage Ratio is equal to or greater than 2.00.

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

We are in compliance with all of our financial covenants as of March 31, 2015.

**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 \$1.0 million as of March 31, 2015 and bear interest, payable quarterly, at a weighted average interest rate of 2.5%. The principle is due in equal installments on October 2016 and 2017.

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***Other Debt***

In conjunction with our acquisition of our northern Texas operation, we acquired capital lease obligations of \$0.7 million. Currently, \$0.8 million of capital lease obligations are outstanding, of which \$0.3 million is considered current.

Our majority owned subsidiary, EAS, has a revolving \$2.5 million credit line that is available for temporary working capital needs and expires July 31, 2015. As of March 31, 2015, we had no outstanding borrowings and, therefore, \$2.5 million of credit available. We estimate that the weighted average interest rate applicable to borrowings under this variable rate credit line would be approximately 2.7% as of March 31, 2015.

***Outlook***

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

**Off-Balance Sheet Arrangements and Other Commitments**

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

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

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

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We must reimburse the sureties for any expenses or outlays they incur. To date, we are not aware of any losses to our sureties in connection with bonds the sureties have posted on our behalf, and we do not expect such losses to be incurred in the foreseeable future.

Surety market conditions are currently challenging as a result of significant losses incurred by many sureties in recent periods, both in the construction industry as well as in certain larger corporate bankruptcies. As a result, less bonding capacity is available in the market and terms have become more restrictive. Further, under standard terms in the surety market, sureties issue bonds on a project-by-project basis, and can decline to issue bonds at any time. Historically, approximately 25% to 35% of our business has required bonds. While we currently have strong surety relationships to support our bonding needs, future market conditions or 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 would enable us to ultimately respond effectively to an interruption in the availability of bonding capacity, such an interruption would likely cause our revenue and profits to decline in the near term.

## Contractual Obligations

The following recaps the future maturities of our contractual obligations as of March 31, 2015 (in thousands):

|                             | Twelve Months Ended March 31, |           |           |          |           |            |           |
|-----------------------------|-------------------------------|-----------|-----------|----------|-----------|------------|-----------|
|                             | 2016                          | 2017      | 2018      | 2019     | 2020      | Thereafter | Total     |
| Revolving credit facility   | \$                            | \$        | \$        | \$       | \$ 36,000 | \$         | \$ 36,000 |
| Notes to former owners      |                               | 500       | 500       |          |           |            | 1,000     |
| Interest payable            | 529                           | 529       | 517       | 504      | 504       |            | 2,583     |
| Capital lease obligations   | 299                           | 245       | 141       | 61       | 16        |            | 762       |
| Operating lease obligations | 11,806                        | 10,459    | 9,497     | 7,930    | 5,221     | 5,994      | 50,907    |
| Total                       | \$ 12,634                     | \$ 11,733 | \$ 10,655 | \$ 8,495 | \$ 41,741 | \$ 5,994   | \$ 91,252 |

As of March 31, 2015, we have \$48.0 million in letter of credit commitments, of which \$23.8 million will expire in 2015 and \$24.2 million will expire in 2016. The substantial majority of these letters of credit are posted with insurers who disburse funds on our behalf in connection with our workers' compensation, auto liability and general liability insurance program. These letters of credit provide additional security to the insurers that sufficient financial resources will be available to fund claims on our behalf, many of which develop over long periods of time, should we ever encounter financial 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 2015, we expect nearly all of them, particularly those supporting our insurance programs, will be renewed annually.

Other than the operating and capital 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.

Table of Contents**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 exposure to changes in interest rates under our revolving credit facility and the EAS credit line. We have a modest level of indebtedness under our debt facility and our indebtedness could increase in the future. Our debt with fixed interest rates consists of notes to former owners of acquired companies.

The following table presents principal amounts (stated in thousands) and related average interest rates by year of maturity for our debt obligations and their indicated fair market value at March 31, 2015:

|                       | Twelve Months Ended March 31, |        |        |      |           |            | Fair Value |
|-----------------------|-------------------------------|--------|--------|------|-----------|------------|------------|
|                       | 2016                          | 2017   | 2018   | 2019 | 2020      | Thereafter |            |
| Fixed Rate Debt       | \$                            | \$ 500 | \$ 500 | \$   | \$        | \$         | \$ 1,000   |
| Average Interest Rate |                               | 2.5%   | 2.5%   |      |           |            | 2.5%       |
| Variable Rate Debt    | \$                            | \$     | \$     | \$   | \$ 36,000 | \$         | \$ 36,000  |

The weighted average interest rate applicable to borrowings under the Facility was approximately 1.4% as of March 31, 2015.

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

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

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

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

**Changes in Internal Control over Financial Reporting**

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the three months ended March 31, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**COMFORT SYSTEMS USA, INC.**  
**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

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

**Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part 1, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2014, which could materially affect our business, financial condition, or future results. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, or future results.

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

None.

**Issuer Purchases of Equity Securities**

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from time to time approved extensions of the program to acquire additional shares. On October 24, 2014, the Board approved an extension to the program by increasing the shares authorized for repurchase by 1.0 million shares. Since the inception of the repurchase program, the Board has approved 7.6 million shares to be repurchased.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. No shares were repurchased during the current quarter. Since the inception of the program in 2007 and as of March 31, 2015, we have repurchased a cumulative total of 6.6 million shares at an average price of \$11.30 per share.

During the quarter ended March 31, 2015, no share repurchases were made.

| Period                   | Total<br>Number<br>of Shares<br>Purchased | Average<br>Price Paid<br>Per Share | Total Number of<br>Shares Purchased<br>as Part of Publicly<br>Announced Plans<br>or Programs | Maximum Number of<br>Shares that May Yet<br>Be Purchased Under<br>the Plans or Programs |
|--------------------------|-------------------------------------------|------------------------------------|----------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------|
| January 1 - January 31   |                                           | \$                                 | 6,566,368                                                                                    | 994,815                                                                                 |
| February 1 - February 28 |                                           | \$                                 | 6,566,368                                                                                    | 994,815                                                                                 |
| March 1 - March 31       |                                           | \$                                 | 6,566,368                                                                                    | 994,815                                                                                 |
|                          |                                           | \$                                 | 6,566,368                                                                                    | 994,815                                                                                 |



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Under our restricted share plan, employees may elect to have us withhold common shares to satisfy minimum statutory federal, state and local tax withholding obligations arising on the vesting of restricted stock awards and exercise of options. When we withhold these shares, we are required to remit to the appropriate taxing authorities the market price of the shares withheld, which could be deemed a purchase of the common shares by us on the date of withholding.

### Item 6. *Exhibits*

| Exhibit<br>Number | Description of Exhibits                                                                            | Incorporated by Reference to the<br>Exhibit Indicated Below and to the<br>Filing with the Commission<br>Indicated Below |                            |
|-------------------|----------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------|----------------------------|
|                   |                                                                                                    | Exhibit<br>Number                                                                                                       | Filing or File Number      |
| 3.1               | Second Amended and Restated Certificate of Incorporation of the Registrant                         | 3.1                                                                                                                     | 333-24021                  |
| 3.2               | Certificate of Amendment dated May 21, 1998                                                        | 3.2                                                                                                                     | 1998 Form 10-K             |
| 3.3               | Certificate of Amendment dated July 9, 2003                                                        | 3.3                                                                                                                     | 2003 Form 10-K             |
| 3.4               | Amended and Restated Bylaws of Comfort Systems USA, Inc.                                           | 3.1                                                                                                                     | March 26, 2012<br>Form 8-K |
| *10.1             | Summary of 2015 Incentive Compensation Plan                                                        |                                                                                                                         | Filed Herewith             |
| *10.2             | Form of 2015 Restricted Stock Unit Agreement                                                       | 10.1                                                                                                                    | April 2, 2015<br>Form 8-K  |
| *10.3             | Form of 2015 Dollar-denominated Performance Vesting Restricted Stock Unit Agreement                | 10.2                                                                                                                    | April 2, 2015<br>Form 8-K  |
| 31.1              | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |                                                                                                                         | Filed Herewith             |
| 31.2              | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |                                                                                                                         | Filed Herewith             |
| 32.1              | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |                                                                                                                         | Furnished Herewith         |
| 32.2              | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |                                                                                                                         | Furnished Herewith         |
| 101.INS           | XBRL Instance Document                                                                             |                                                                                                                         | Filed Herewith             |
| 101.SCH           | XBRL Taxonomy Extension Schema Document                                                            |                                                                                                                         | Filed Herewith             |
| 101.CAL           | XBRL Taxonomy Extension Calculation Linkbase Document                                              |                                                                                                                         | Filed Herewith             |
| 101.DEF           | XBRL Taxonomy Extension Definition Linkbase Document                                               |                                                                                                                         | Filed Herewith             |
| 101.LAB           | XBRL Taxonomy Extension Label Linkbase Document                                                    |                                                                                                                         | Filed Herewith             |
| 101.PRE           | XBRL Taxonomy Extension Presentation Linkbase                                                      |                                                                                                                         | Filed Herewith             |

\*

Management contract or compensatory plan.

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**SIGNATURES**

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

COMFORT SYSTEMS USA, INC.

April 29, 2015

By: /s/ BRIAN E. LANE

Brian E. Lane  
*President, Chief Executive Officer and Director*

April 29, 2015

By: /s/ WILLIAM GEORGE

William George  
*Executive Vice President and Chief Financial Officer*

April 29, 2015

By: /s/ JULIE S. SHAEFF

Julie S. Shaeff  
*Senior Vice President and Chief Accounting Officer*