COMFORT SYSTEMS USA INC
Form 10-Q
August 01, 2012

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

OR

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

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

COMFORT SYSTEMS USA, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**76-0526487**
(State or other jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

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 ý No o

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 ý No o

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

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

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

The number of shares outstanding of the issuer's common stock as of July 25, 2012 was 37,341,400 (excluding treasury shares of 3,781,965).

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COMFORT SYSTEMS USA, INC.

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Amounts)

	June 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 28,811	$ 51,237
Accounts receivable, less allowance for doubtful accounts of $7,271 and $5,341, respectively	285,333	267,060
Other receivables	5,981	6,527
Inventories	10,465	10,631
Prepaid expenses and other	28,572	24,664
Costs and estimated earnings in excess of billings	31,079	27,163
Total current assets	390,241	387,282
PROPERTY AND EQUIPMENT, NET	42,251	42,013
GOODWILL	114,593	107,093
IDENTIFIABLE INTANGIBLE ASSETS, NET	49,206	48,349
OTHER NONCURRENT ASSETS	8,330	6,329
Total assets	$ 604,621	$ 591,066
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 300	$ 300
Current maturities of notes to former owners	332	332
Accounts payable	109,833	114,255
Accrued compensation and benefits	36,623	36,474
Billings in excess of costs and estimated earnings	73,686	71,730
Accrued self-insurance expense	27,293	27,408
Other current liabilities	27,779	27,472
Total current liabilities	275,846	277,971
LONG-TERM DEBT, NET OF CURRENT MATURITIES	20,400	2,400
NOTES TO FORMER OWNERS, NET OF CURRENT MATURITIES	8,249	12,349
DEFERRED INCOME TAX LIABILITIES	6,485	4,541
OTHER LONG-TERM LIABILITIES	12,796	10,699
Total liabilities	323,776	307,960
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, $.01 par, 5,000,000 shares authorized, none issued and outstanding		
Common stock, $.01 par, 102,969,912 shares authorized, 41,123,365 and 41,123,365 shares issued, respectively	411	411
Treasury stock, at cost, 3,781,965 and 3,714,506 shares, respectively	(40,054)	(39,437)
Additional paid-in capital	320,585	323,608
Retained earnings (deficit)	(16,552)	(19,991)
Comfort Systems USA, Inc. stockholders' equity	264,390	264,591
Noncontrolling interests	16,455	18,515
Total stockholders' equity	280,845	283,106

Total liabilities and stockholders' equity	$ 604,621	$ 591,066

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 June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
REVENUE	$ 354,750	$ 312,148	$ 684,160	$ 594,207
COST OF SERVICES	300,238	264,638	586,904	512,488
Gross profit	54,512	47,510	97,256	81,719
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	47,090	41,928	93,453	84,550
GAIN ON SALE OF ASSETS	(239)	(19)	(455)	(104)
Operating income (loss)	7,661	5,601	4,258	(2,727)
OTHER INCOME (EXPENSE):				
Interest income	4	23	8	49
Interest expense	(428)	(466)	(825)	(953)
Changes in the fair value of contingent earn-out obligations	(37)	584	(67)	489
Other	18	(67)	70	(52)
Other income (expense)	(443)	74	(814)	(467)
INCOME (LOSS) BEFORE INCOME TAXES	7,218	5,675	3,444	(3,194)
INCOME TAX EXPENSE (BENEFIT)	3,171	2,513	2,065	(1,186)
NET INCOME (LOSS) INCLUDING NONCONTROLLING INTERESTS	4,047	3,162	1,379	(2,008)
Less: Net loss attributable to noncontrolling interests	(421)		(2,060)	
NET INCOME (LOSS) ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC.	$ 4,468	$ 3,162	$ 3,439	$ (2,008)
INCOME (LOSS) PER SHARE ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC.:				
Basic	$ 0.12	$ 0.08	$ 0.09	$ (0.05)
Diluted	$ 0.12	$ 0.08	$ 0.09	$ (0.05)
SHARES USED IN COMPUTING INCOME (LOSS) PER SHARE:				
Basic	37,166	37,630	37,111	37,584
Diluted	37,247	37,742	37,232	37,584
DIVIDENDS PER SHARE	$ 0.05	$ 0.05	$ 0.10	$ 0.10

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

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COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In Thousands, Except Share Amounts)

	Common Stock		Treasury Stock		Additional Paid-In	Retained Earnings	Non-Controlling	Total Stockholders'
	Shares	Amount	Shares	Amount	Capital	(Deficit)	Interests	Equity
BALANCE AT DECEMBER 31, 2010	41,123,365	$ 411	(3,221,775)	$ (34,714)	$ 326,467	$ 20,620	$	$ 312,784
Net income (loss)						(36,830)	338	(36,492)
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit			65,950	707	(258)			449
Issuance of restricted stock			230,702	2,488	(2,488)			
Shares received in lieu of tax withholding payment on vested restricted stock			(50,793)	(662)				(662)
Tax benefit from vesting of restricted stock					54			54
Stock-based compensation expense					3,604			3,604
Dividends					(3,771)	(3,781)		(7,552)
Share repurchase			(738,590)	(7,256)				(7,256)
Acquisition of EAS							17,377	17,377
Contribution from noncontrolling interest							800	800
BALANCE AT DECEMBER 31, 2011	41,123,365	411	(3,714,506)	(39,437)	323,608	(19,991)	18,515	283,106
Net income (loss) (unaudited)						3,439	(2,060)	1,379
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit (unaudited)			9,000	96	(41)			55
Issuance of restricted stock (unaudited)			70,000	742	(742)			
Shares received in lieu of tax withholding payment on vested restricted stock (unaudited)			(50,625)	(543)				(543)
Tax benefit from vesting of restricted stock (unaudited)					(145)			(145)
Stock-based compensation expense (unaudited)					1,644			1,644
Dividends (unaudited)					(3,739)			(3,739)
Share repurchase (unaudited)			(95,834)	(912)				(912)
BALANCE AT JUNE 30, 2012 (unaudited)	41,123,365	$ 411	(3,781,965)	$ (40,054)	$ 320,585	$ (16,552)	$ 16,455	$ 280,845

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 June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income (loss) including noncontrolling interests	$ 4,047	$ 3,162	$ 1,379	$ (2,008)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities				
Amortization of identifiable intangible assets	2,066	1,700	4,146	3,358
Depreciation expense	2,946	3,013	6,003	6,174
Bad debt expense	1,745	(128)	2,486	711
Deferred tax expense (benefit)	676	794	(845)	(1,316)
Amortization of debt financing costs	58	56	115	112
Gain on sale of assets	(239)	(19)	(455)	(104)
Changes in the fair value of contingent earn-out obligations	37	(584)	67	(489)
Stock-based compensation expense	1,067	1,094	1,644	2,332
Changes in operating assets and liabilities, net of effects of acquisitions				
(Increase) decrease in				
Receivables, net	(19,001)	(20,835)	(19,906)	(22,555)
Inventories	436	(322)	368	(519)
Prepaid expenses and other current assets	1,434	972	579	2,203
Costs and estimated earnings in excess of billings	3,170	(724)	(3,239)	225
Other noncurrent assets	135	(1,533)	(1,942)	(2,323)
Increase (decrease) in				
Accounts payable and accrued liabilities	4,649	9,546	(5,700)	(7,846)
Billings in excess of costs and estimated earnings	3,269	(908)	1,648	(1,864)
Other long-term liabilities	298	339	629	466
Net cash provided by (used in) operating activities	6,793	(4,377)	(13,023)	(23,443)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of property and equipment	(4,494)	(1,544)	(6,588)	(3,904)
Proceeds from sales of property and equipment	342	134	762	381
Proceeds from businesses sold	39	39	78	78
Sale of marketable securities				2,000
Cash paid for acquisitions, earn-outs and intangible assets, net of cash acquired	(12,213)	(521)	(12,228)	(2,321)
Net cash used in investing activities	(16,326)	(1,892)	(17,976)	(3,766)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Net borrowings on revolving line of credit	18,000		18,000	
Payments on other long-term debt	(4,000)	(1,289)	(4,100)	(1,289)
Payments of dividends to shareholders	(1,929)	(1,923)	(3,782)	(3,803)
Share repurchase program	(912)	(3,712)	(912)	(3,712)
Shares received in lieu of tax withholding	(543)	(654)	(543)	(654)
Excess tax benefit of stock-based compensation	(145)	217	(126)	204
Proceeds from exercise of options		95	36	218
Net cash provided by (used in) financing activities	10,471	(7,266)	8,573	(9,036)

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	938	(13,535)	(22,426)	(36,245)
CASH AND CASH EQUIVALENTS, beginning of period	27,873	63,636	51,237	86,346
CASH AND CASH EQUIVALENTS, end of period	$ 28,811	$ 50,101	$ 28,811	$ 50,101

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

June 30, 2012

(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 49% of our consolidated 2012 revenue is attributable to installation of systems in newly constructed facilities, with the remaining 51% attributable to maintenance, repair and replacement services. The following service activities account for our consolidated 2012 revenue: HVAC 74%, plumbing 18%, building automation control systems 5% and other 3%. 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, 2011 (the "Form 10-K").

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

Use of Estimates

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

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COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2012

(Unaudited)

2. Summary of Significant Accounting Policies (Continued)

Cash Flow Information

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

Cash paid (in thousands) for:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Interest	$ 617	$ 411	$ 664	$ 810
Income taxes	222	344	1,534	998
Total	$ 839	$ 755	$ 2,198	$ 1,808

Income Taxes

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

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

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

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

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

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COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2012

(Unaudited)

2. Summary of Significant Accounting Policies (Continued)

For the six months ended June 30, 2012 our tax expense is $2.1 million with an effective tax rate of 60.0% as compared to tax benefit of $1.2 million with an effective tax rate of 37.1% for the six months ended June 30, 2011. The increase in the effective rate for 2012 is primarily due to the impact of increases in tax reserves. Tax reserves are analyzed and adjusted quarterly as events occur to warrant such changes. Adjustments to tax reserves are a component of the effective tax rate.

Financial Instruments

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

Segment Disclosure

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

Reclassifications

Certain reclassifications have been made in prior period financial statements to conform to current period presentation. These reclassifications are of a normal and recurring nature and have not resulted in any changes to previously reported net income for any periods.

3. Fair Value Measurements

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

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

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

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

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COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2012

(Unaudited)

3. Fair Value Measurements (Continued)

The following table summarizes the fair values and levels within the fair value hierarchy in which the fair value measurements fall for assets and liabilities measured on a recurring basis as of June 30, 2012 (in thousands):

		Fair Value Measurements at Reporting Date Using		
	Total	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 28,811	$ 28,811	$	$
Contingent earn-out obligations	$ 2,695	$	$	$ 2,695

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.

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

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

Balance at beginning of year	$ 2,488
Issuances	140
Settlements	
Adjustments to fair value	67
Balance at end of period	$ 2,695

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.

4. Acquisitions

Acquisition of EAS

On November 2, 2011, we acquired a 60% majority interest in Environmental Air Systems, LLC ("EAS"). EAS is a regional mechanical contractor with principal offices in Greensboro and Raleigh,

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COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2012

(Unaudited)

4. Acquisitions (Continued)

North Carolina. EAS engages in a broad range of mechanical contracting projects, HVAC service and controls, and sophisticated prefabrication of mechanical systems, in North Carolina, South Carolina and throughout the Atlantic region. The acquisition date fair value of consideration transferred was $30.4 million, of which $15.7 million was allocated to goodwill. See Note 5 "Goodwill and Identifiable Intangible Assets, Net." Our consolidated balance sheets include 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.

Other Acquisitions

We completed two acquisitions in the second quarter of 2012 and one acquisition in the first quarter of 2012. In 2011, during the same period, we completed one acquisition in the first quarter. These acquisitions were not material, individually or in the aggregate, and were "tucked-in" with existing operations. 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):

	June 30, 2012	December 31, 2011
Balance at beginning of year	$ 107,093	$ 147,818
Additions	7,500	16,629
Impairment adjustment		(57,354)
Balance at end of period	$ 114,593	$ 107,093

The November 2011 EAS acquisition resulted in goodwill of approximately $15.7 million. We recorded a goodwill impairment charge of $55.1 million during the third quarter of 2011 and an impairment charge for $2.2 million in the fourth quarter of 2011. Based on market activity declines and write-downs incurred on several jobs, we determined that the operating environment, conditions and performance at four reporting units serving the Virginia, Maryland and North Carolina markets could no longer support the related goodwill balance. When the carrying value of a given reporting unit exceeds its fair value, an impairment loss is recorded to the extent that the implied fair value of the goodwill of the reporting unit is less than its carrying value. The fair value was estimated using a discounted cash flow model combined with market valuation approaches.

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COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2012

(Unaudited)

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

Identifiable Intangible Assets, Net

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

		June 30, 2012		December 31, 2011	
	Estimated Useful Lives in Years	Gross Book Value	Accumulated Amortization	Gross Book Value	Accumulated Amortization
Customer relationships	1 - 15	$ 40,404	$ (12,715)	$ 36,351	$ (9,880)
Backlog	1 - 2	6,515	(5,430)	5,890	(4,999)
Noncompete agreements	2 - 7	2,890	(2,159)	2,890	(1,932)
Tradenames	2 - 25	23,695	(3,994)	23,370	(3,341)
Total		$ 73,504	$ (24,298)	$ 68,501	$ (20,152)

6. Long-Term Debt Obligations

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

	June 30, 2012	December 31, 2011
Revolving credit facility	$ 18,000	$
Other debt	2,700	2,700
Notes to former owners	8,581	12,681
Total debt	29,281	15,381
Less current portion	(632)	(632)
Total long-term portion of debt	$ 28,649	$ 14,749

Revolving Credit Facility

On September 23, 2011, we amended our $125.0 million senior credit facility (the "Facility") provided by a syndicate of banks. The Facility, which is available for borrowings and letters of credit, expires in September 2016 and is secured by the capital stock of our current and future subsidiaries. As of June 30, 2012, we had $18.0 million in outstanding borrowings, $45.5 million in letters of credit outstanding and $61.5 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.

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COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2012

(Unaudited)

6. Long-Term Debt Obligations (Continued)

The following is a summary of the additional margins:

	Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA				
	Less than 0.75	**0.75 to 1.25**	**1.25 to 2.00**	**2.00 to 2.50**	**2.50 or greater**
Additional Per Annum Interest Margin Added Under:					
Base Rate Loan Option	0.75%	1.00%	1.25%	1.50%	1.75%
Eurodollar Rate Loan Option	1.75%	2.00%	2.25%	2.50%	2.75%

The weighted average interest rate applicable to the borrowings under the Facility was approximately 2.0% as of June 30, 2012.

We have used letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. Our lenders issue such letters of credit through the Facility for a fee. We have never had a claim made against a letter of credit that resulted in payments by a lender or by us and believe such claims are unlikely in the foreseeable future. The letter of credit fees range from 1.30% to 2.10% 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 0.25% to 0.50% per annum, based on the ratio of Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA, as defined in the credit agreement.

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

The Facility's principal financial covenants include:

Leverage Ratio The Facility requires that the ratio of our Consolidated Total Indebtedness to our Credit Facility Adjusted EBITDA not exceed 3.00 through December 31, 2013, 2.75 through June 30, 2014 and 2.50 through maturity. The leverage ratio as of June 30, 2012 was 0.49.

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 2.00 through December 31, 2013, 1.50 through June 30, 2014 and 1.00 through maturity. Capital expenditures, tax provision, dividends and stock repurchase payments are defined under the Facility for purposes of this covenant to be amounts for the four quarters ending as of any given quarterly covenant compliance measurement date. The fixed charge coverage ratio as of June 30, 2012 was 19.28.

Other Restrictions The Facility permits acquisitions of up to $15.0 million per transaction, provided that the aggregate purchase price of such an acquisition and of acquisitions in the preceding

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COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2012

(Unaudited)

6. Long-Term Debt Obligations (Continued)

12 month period does not exceed $30.0 million. However, these limitations only apply when the Company's Net Leverage Ratio is equal to or greater than 2.00.

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

We are in compliance with all of our financial covenants as of June 30, 2012.

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 $8.6 million as of June 30, 2012, of which $0.3 million is current, and bear interest, payable annually, at a weighted average interest rate of 3.23%.

Other Debt

In conjunction with our acquisition of ColonialWebb in 2010, we acquired long-term debt related to an industrial revenue bond associated with its office building and warehouse. The outstanding balance as of June 30, 2012 was $2.7 million, of which $0.3 million is current. The weighted average interest rate on this variable rate debt as of June 30, 2012 was approximately 0.29%.

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 or financial condition, after giving effect to provisions already recorded.

In December 2011, we received a letter from Ferguson Enterprises, Inc. ("Ferguson"), a distributor of plumbing supplies and pipe, in which Ferguson stated that it had unintentionally supplied us with gaskets that were mislabeled by a former supplier as being non-asbestos. Ferguson currently states that we bought approximately 29,000 gaskets that might have been mislabeled. Ferguson further disclosed that four Ferguson customers had found asbestos in gaskets above the 1% level at which they can be classified as non-asbestos. No reasonable estimate of liability, if any, is possible at this time.

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COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2012

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

Self-Insurance

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

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 and contingently issuable restricted stock.

There were approximately 1.0 million and 0.7 million of anti-dilutive stock options excluded from the calculation of diluted EPS for the three months ended June 30, 2012 and 2011, respectively. There

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COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

June 30, 2012

(Unaudited)

8. Stockholders' Equity (Continued)

were approximately 1.0 million of anti-dilutive stock options that were excluded from the calculation of diluted EPS for the six months ended June 30, 2012. Assuming dilution, there were approximately 0.5 million anti-dilutive stock options excluded from the calculation of diluted EPS for the six months ended June 30, 2011. The effect of 0.3 million of common stock equivalents have been excluded from the calculation of diluted EPS for the six months ended June 30, 2011, due to our net loss position during that period.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Common shares outstanding, end of period(a)	37,163	37,414	37,163	37,414
Effect of using weighted average common shares outstanding	3	216	(52)	170
Shares used in computing earnings per share basic	37,166	37,630	37,111	37,584
Effect of shares issuable under stock option plans based on the treasury stock method	81	110	92	
Effect of contingently issuable restricted stock		2	29	
Shares used in computing earnings per share diluted	37,247	37,742	37,232	37,584

(a) Excludes 0.2 million and 0.4 million shares of unvested contingently issuable restricted stock outstanding as of June 30, 2012 and 2011, respectively.

Share Repurchase Program

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. As of June 30, 2012, the Board approved extensions of the program to acquire up to 6.6 million shares.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. We repurchased 0.1 million shares during the six months ended June 30, 2012 at an average price of $9.51 per share. Since the inception of the program in 2007 and as of June 30, 2012, we have repurchased a cumulative total of 5.7 million shares at an average price of $10.95 per share.

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

The following discussion should be read in conjunction with our historical Consolidated Financial Statements and related notes included elsewhere in this Form 10-Q and the Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2011 (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 85% 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. These margins are typically less than fixed-price contract margins because there is less risk of unrecoverable cost overruns in cost-plus or time and materials work.

Our average project takes six to nine months to complete, with an average contract price of approximately $422,000. We also perform larger HVAC projects. Generally, projects closer in size to $1 million will be completed in one year or less. It is unusual for us to work on a project that exceeds two years in length. Our projects generally require working capital funding of equipment and labor costs. Customer payments on periodic billings generally do not recover these costs until late in the job. Our average project duration together with typical retention terms as discussed above generally allow us to complete the realization of revenue and earnings in cash within one year. We have what we believe is a well-diversified distribution of revenue across end-use sectors that we believe reduces our exposure to negative developments in any given sector. Because of the integral nature of HVAC and related controls systems to most buildings, we have the legal right in almost all cases to attach liens to buildings or related funding sources when we have not been fully paid for installing systems, except with respect to some government buildings. The service work that we do, which is discussed further below, usually does not give rise to lien rights.

A stratification of projects in progress as of June 30, 2012, by contract price, is as follows:

Contract Price of Project	No. of Projects	Aggregate Contract Price Value (millions)
Under $1 million	4,278	$ 353.0
$1 million - $5 million	286	682.7
$5 million - $10 million	55	392.5
$10 million - $15 million	17	206.4
Greater than $15 million	13	327.1
Total	4,649	$ 1,961.7

In addition to project work, approximately 15% of our revenue represents maintenance and repair service on already-installed HVAC and controls systems. This kind of work usually takes from a few hours to a few days to perform. Prices to the customer are usually based on the equipment and materials used in the service as well as technician labor time. We usually bill the customer for service work when it is complete, typically with payment terms of up to thirty days. We also provide

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

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

Economic and Industry Factors

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

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

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Operating Environment and Management Emphasis

Nonresidential building construction and renovation activity, as reported by the federal government, declined over the three year period of 2001 to 2003, expanded moderately during 2004 and 2005, and was strong over the three year period from 2006 to 2008. We experienced significant industry activity declines over the three year period from 2009 to 2011, which have continued in 2012. During the periods of decline, we responded to market challenges by pursuing work in sectors less affected by the downturn, such as government, educational, and healthcare facilities, and by establishing marketing initiatives that take advantage of our size and range of expertise. We also responded to declining gross profits over those years by reducing our selling, general, and administrative expenses, and our indirect project and service overhead costs. We believe our efforts in these areas partially offset the decline in our profitability over that period.

As a result of our continued strong emphasis on cash flow, we currently have modest indebtedness and significant 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 September 2016. We have strong surety relationships to support our bonding needs, and we believe our relationships with the surety markets are positive in light of our strong current results and financial position. We have generated positive free cash flow in each of the last thirteen calendar years and will continue our emphasis in this area. We believe that the relative size and strength of our balance sheet and surety support as compared to most companies in our industry represent competitive advantages for us.

As discussed at greater length in "Results of Operations" below, we have seen declining activity levels in our industry since late 2008 and we expect price competition to continue to be strong, as local and regional competitors respond cautiously to changing conditions. We will continue our efforts to find the more active sectors in our markets, and to increase our regional and national account business. Our primary emphasis for 2012 will be on execution and cost control, and on maintaining activity levels that will permit us to earn reasonable profits while preserving our core workforce. We have increased our focus on project qualification, estimating, pricing and management, and on service performance.

Cyclicality and Seasonality

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

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

Critical Accounting Policies

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

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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 85% of our revenue was earned on a project basis and recognized through the percentage of completion method of accounting. Under this method contract revenue recognizable at any time during the life of a contract is determined by multiplying expected total contract revenue by the percentage of contract costs incurred at any time to total estimated contract costs. More specifically, as part of the negotiation and bidding process in which we engage in connection with obtaining installation contracts, we estimate our contract costs, which include all direct materials (exclusive of rebates), labor and subcontract costs and indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. These contract costs are included in our results of operations under the caption "Cost of Services." Then, as we perform under those contracts, we measure costs incurred, compare them to total estimated costs to complete the contract, and recognize a corresponding proportion of contract revenue. Labor costs are considered to be incurred as the work is performed. Subcontractor labor is recognized as the work is performed, but is generally subjected to approval as to milestones or other evidence of completion. Non-labor project costs consist of purchased equipment, prefabricated materials and other materials. Purchased equipment on our projects is substantially produced to job specifications and is a value added element to our work. The costs are considered to be incurred when title is transferred to us, which typically is upon delivery to the worksite. Prefabricated materials, such as ductwork and piping, are generally performed at our shops and recognized as contract costs when fabricated for the unique specifications of the job. Other materials cost are not significant and are generally recorded when delivered to the worksite. This measurement and comparison process requires updates to the estimate of total costs to complete the contract, and these updates may include subjective assessments.

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

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

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

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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).

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 and auto liability noted below).

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

Employee Medical We have two medical plans. The deductible for employee group health claims is $300,000 per person, per policy (calendar) year for one plan and $200,000 per person, per policy (calendar) year for the other plan. Insurance then covers any responsibility for medical claims in excess of the deductible amount.

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

Accounting for Deferred Tax Assets

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

Acquisitions

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

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

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

Recoverability of Goodwill and Identifiable Intangible Assets

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

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

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

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

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

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

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

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Results of Operations (dollars in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2012	%	2011	%	2012	%	2011	%
Revenue	$ 354,750	100.0%	$ 312,148	100.0%	$ 684,160	100.0%	$ 594,207	100.0%
Cost of services	300,238	84.6%	264,638	84.8%	586,904	85.8%	512,488	86.2%
Gross profit	54,512	15.4%	47,510	15.2%	97,256	14.2%	81,719	13.8%
Selling, general and administrative expenses	47,090	13.3%	41,928	13.4%	93,453	13.7%	84,550	14.2%
Gain on sale of assets	(239)	(0.1)%	(19)		(455)	(0.1)%	(104)	
Operating income (loss)	7,661	2.2%	5,601	1.8%	4,258	0.6%	(2,727)	(0.5)%
Interest income	4		23		8		49	
Interest expense	(428)	(0.1)%	(466)	(0.1)%	(825)	(0.1)%	(953)	(0.2)%
Changes in the fair value of contingent earn-out obligations	(37)		584	0.2%	(67)		489	0.1%
Other income (expense)	18		(67)		70		(52)	
Income (loss) before income taxes	7,218	2.0%	5,675	1.8%	3,444	0.5%	(3,194)	(0.5)%
Income tax expense (benefit)	3,171		2,513		2,065		(1,186)	
Net income (loss) including noncontrolling interests	4,047	1.1%	3,162	1.0%	1,379	0.2%	(2,008)	(0.3)%
Less: Net loss attributable to noncontrolling interests	(421)				(2,060)			
Net income (loss) attributable to Comfort Systems USA, Inc.	$ 4,468		$ 3,162		$ 3,439		$ (2,008)	

We had 38 operating locations as of December 31, 2011. During the first quarter of 2012, we consolidated one company into other operations. As of June 30, 2012, we had 37 operating locations. Acquisitions are included in our results of operations from the respective acquisition date. The same-store comparison from 2012 to 2011, as described below, excludes the results of EAS, in which we acquired a 60% interest in November 2011, for the three and six months ended June 30, 2012.

Revenue Revenue increased $42.6 million, or 13.6%, to $354.8 million for the second quarter of 2012 compared to the same period in 2011. The increase included a 6.0% increase in revenue related to same-store activity as well as a 7.6% increase from the acquisition of EAS. The same-store revenue increase is primarily from the manufacturing sector (approximately $31.5 million) including a large, short duration data center project at ColonialWebb. This increase was partially offset by a decrease in the healthcare sector (approximately $17.6 million). During the second quarter of 2012, EAS contributed revenue of approximately $23.8 million.

Revenue increased $90.0 million, or 15.1%, to $684.2 million for the first six months of 2012 compared to the same period in 2011. The increase included a 7.4% increase in revenue related to the same-store activity as well as a 7.7% increase from the acquisition of EAS. The same-store revenue increase is primarily from the manufacturing sector (approximately $69.8 million) primarily as a result of the ColonialWebb project discussed previously. This increase was partially offset by a decrease in the healthcare sector (approximately $30.3 million). During the first six months of 2012, EAS contributed revenue of approximately $45.9 million.

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 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.

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Backlog as of June 30, 2012 was $617.7 million, a 0.7% decrease from March 31, 2012 backlog of $622.0 million, and a 0.6% decrease from June 30, 2011 backlog of $621.2 million. Sequential backlog decreased primarily related to the revenue increase at ColonialWebb as previously discussed. The year-over-year increase due to the EAS acquisition was 8.7%. This increase was offset by a same-store backlog decrease of 9.3% primarily due to the revenue increase at ColonialWebb as previously discussed.

Following the three-year period of industry activity declines from 2001-2003 noted previously, we saw modest year-over-year revenue increases at our ongoing operations beginning in mid-2003 and continuing throughout 2008. We experienced significant industry activity declines in 2009 through 2011, which have continued in 2012. Based on our backlog and forecasts from industry construction analysts, we expect that activity levels in our industry are likely to remain flat over the next twelve months, particularly in the area of new construction.

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

Gross Profit Gross profit increased $7.0 million, or 14.7%, to $54.5 million for the second quarter of 2012 as compared to the same period in 2011. The increase included a $6.2 million, or 13.2%, increase in gross profit on a same-store basis and a $0.8 million, or 1.5%, increase related to the acquisition of EAS. As a percentage of revenue, gross profit was relatively flat at 15.2% in 2011 and 15.4% in 2012.

Gross profit increased $15.5 million, or 19.0%, to $97.3 million for the first six months of 2012 as compared to the same period in 2011. The increase included a $14.9 million, or 18.2%, increase in gross profit on a same-store basis and a $0.6 million, or 0.8%, increase related to the acquisition of EAS. The year-over-year increase in gross profit resulted primarily from job underperformance at our Southern Alabama operations in the prior year (approximately $4.0 million). This was partially offset by a job write-down that we recorded in the first quarter of 2012 on a project that had been accelerated by the owner. The additional costs associated with this acceleration exceeded $3 million but no additional contract price has been considered although we are pursuing a claim. As a percentage of revenue, gross profit increased from 13.8% in 2011 to 14.2% in 2012 primarily due to the factors discussed above.

Selling, General and Administrative Expenses ("SG&A") SG&A increased $5.2 million, or 12.3%, to $47.1 million for the second quarter of 2012 as compared to 2011. On a same-store basis, excluding amortization expense, SG&A increased $3.7 million, or 9.2%. The increase is primarily due to higher compensation accruals and an increase in bad debt expense ($1.9 million). Amortization expense increased $0.3 million due to the EAS acquisition in late 2011. As a percentage of revenue, SG&A decreased from 13.4% in 2011 to 13.3% in 2012.

SG&A increased $8.9 million, or 10.5%, to $93.5 million for the first six months of 2012 as compared to 2011. On a same-store basis, excluding amortization expense, SG&A increased $5.8 million, or 7.2%. The increase is primarily due to higher compensation accruals and an increase in bad debt expense ($1.8 million). Amortization expense increased $0.6 million, or 20.6%, primarily related to the EAS acquisition in 2011. As a percentage of revenue, SG&A decreased from 14.2% in 2011 to 13.7% in 2012.

We have included SG&A on a same-store basis, excluding amortization, because we believe it is an effective measure of comparative results of operations prior to factoring in charges incurred for recent acquisitions. However, SG&A, excluding amortization, is not considered under generally accepted

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accounting principles to be a primary measure of an entity's financial results, and accordingly, should not be considered an alternative to SG&A as shown in our consolidated statements of operations.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(in thousands)			
SG&A	$ 47,090	$ 41,928	$ 93,453	$ 84,550
Less: SG&A from companies acquired	(1,209)		(2,426)	
Less: Amortization expense	(1,856)	(1,606)	(3,740)	(3,101)
Same-store SG&A, excluding amortization expense	$ 44,025	$ 40,322	$ 87,287	$ 81,449

Income Tax Expense For the six months ended June 30, 2012 our tax expense is $2.1 million with an effective tax rate of 60.0% as compared to tax benefit of $1.2 million with an effective tax rate of 37.1% for the six months ended June 30, 2011. The increase in the effective rate for 2012 is primarily due to the impact of increases in tax reserves. Tax reserves are analyzed and adjusted quarterly as events occur to warrant such changes. Adjustments to tax reserves are a component of the effective tax rate. We currently estimate our annual effective tax rate for 2012 will be between 38% and 48%.

Outlook

We expect that weakness in the underlying environment for nonresidential construction activity will continue to adversely impact activity levels in our industry during the remainder of 2012. Our backlog, while still at solid levels by historical standards, declined substantially through early 2010 and has been relatively stable since early 2011. Our primary emphasis for the remainder of 2012 will be on execution, including a focus on cost controls and efficient project and service performance at the unit level. Based on our backlog, and despite weak economic conditions for our industry, we currently expect modest levels of profitability for the remainder of 2012.

Liquidity and Capital Resources (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Cash provided by (used in):				
Operating activities	$ 6,793	$ (4,377)	$ (13,023)	$ (23,443)
Investing activities	(16,326)	(1,892)	(17,976)	(3,766)
Financing activities	10,471	(7,266)	8,573	(9,036)
Net increase (decrease) in cash and cash equivalents	$ 938	$ (13,535)	$ (22,426)	$ (36,245)
Free cash flow:				
Cash provided by (used in) operating activities	$ 6,793	$ (4,377)	$ (13,023)	$ (23,443)
Purchases of property and equipment	(4,494)	(1,544)	(6,588)	(3,904)
Proceeds from sales of property and equipment	342	134	762	381
Free cash flow	$ 2,641	$ (5,787)	$ (18,849)	$ (26,966)

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

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completed the work, typically for six months. Amounts withheld under this practice are known as retention or retainage. Our average project duration together with typical retention terms generally allow us to complete the realization of revenue and earnings in cash within one year.

Cash Provided by (Used in) Operating Activities Cash provided by operating activities during the second quarter of 2012 was $6.8 million compared with $4.4 million of cash used in operating activities during 2011. The $11.2 million increase in cash provided by operations primarily relates to a decrease in cash outflow from working capital and by higher profitability in 2012 compared to 2011.

Cash used for operating activities during the first six months of 2012 was $13.0 million compared with $23.4 million during 2011. The $10.4 million decrease in cash used is primarily due to higher profitability in 2012 compared to 2011.

Cash Used in Investing Activities During the second quarter of 2012, cash used for investing activities was $16.3 million compared with the second quarter of 2011 at $1.9 million. The $14.4 million increase in cash used primarily relates to cash paid for acquisitions in 2012.

Cash used in investing activities was $18.0 million for the first six months of 2012 compared to $3.8 million during 2011. The most significant item affecting the comparison of our investing cash flows for these periods primarily relates to cash paid for acquisitions in 2012.

Cash Provided by (Used in) Financing Activities Cash provided by financing activities was $10.5 million for the second quarter of 2012 compared to $7.3 million of cash used in financing activities during 2011. The most significant item affecting the comparison of our financing cash flows for these quarters primarily relates to an increase in borrowings on the revolving line of credit.

Cash provided by financing activities was $8.6 million for the first six months of 2012 compared to $9.0 million of cash used in financing activities during 2011. The $17.6 million increase in cash provided primarily relates to an increase in borrowings on the revolving line of credit.

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. As of June 30, 2012, the Board approved extensions of the program to acquire up to 6.6 million shares.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. We repurchased 0.1 million shares during the six months ended June 30, 2012. Since the inception of the program in 2007 and as of June 30, 2012, we have repurchased a cumulative total of 5.7 million shares at an average price of $10.95 per share.

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Debt

Credit Facility

On September 23, 2011, we amended our $125.0 million senior credit facility (the "Facility") provided by a syndicate of banks. The Facility, which is available for borrowings and letters of credit, expires in September 2016 and is secured by the capital stock of our current and future subsidiaries. As of June 30, 2012, we had $18.0 million in outstanding borrowings, $45.5 million in letters of credit outstanding and $61.5 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 following is a summary of the additional margins:

	Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA				
	Less than 0.75	**0.75 to 1.25**	**1.25 to 2.00**	**2.00 to 2.50**	**2.50 or greater**
Additional Per Annum Interest Margin Added Under:					
Base Rate Loan Option	0.75%	1.00%	1.25%	1.50%	1.75%
Eurodollar Rate Loan Option	1.75%	2.00%	2.25%	2.50%	2.75%

The weighted average interest rate applicable to the borrowings under the Facility was approximately 2.0% as of June 30, 2012.

We have used letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. Our lenders issue such letters of credit through the Facility for a fee. We have never had a claim made against a letter of credit that resulted in payments by a lender or by us and believe such claims are unlikely in the foreseeable future. The letter of credit fees range from 1.30% to 2.10% 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 0.25% to 0.50% per annum, based on the ratio of Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA, as defined in the credit agreement.

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

The Facility's principal financial covenants include:

Leverage Ratio The Facility requires that the ratio of our Consolidated Total Indebtedness to our Credit Facility Adjusted EBITDA not exceed 3.00 through December 31, 2013, 2.75 through June 30, 2014 and 2.50 through maturity. The leverage ratio as of June 30, 2012 was 0.49.

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 our Net Leverage Ratio does not exceed 2.00 through December 31, 2013, 1.50 through June 30, 2014 and 1.00 through maturity. Capital expenditures, tax provision, dividends and stock repurchase payments are defined under the Facility for purposes of this

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covenant to be amounts for the four quarters ending as of any given quarterly covenant compliance measurement date. The fixed charge coverage ratio as of June 30, 2012 was 19.28.

Other Restrictions The Facility permits acquisitions of up to $15.0 million per transaction, provided that the aggregate purchase price of such an acquisition and of acquisitions in the preceding 12 month period does not exceed $30.0 million. However, these limitations only apply when our Net Leverage Ratio is equal to or greater than 2.00.

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

We are in compliance with all of our financial covenants as of June 30, 2012.

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 $8.6 million as of June 30, 2012, of which $0.3 million is current, and bear interest, payable annually, at a weighted average interest rate of 3.23%.

Other Debt

In conjunction with our acquisition of ColonialWebb in 2010, we acquired long-term debt related to an industrial revenue bond associated with its office building and warehouse. The outstanding balance as of June 30, 2012 was $2.7 million, of which $0.3 million is current. The weighted average interest rate on this variable rate debt as of June 30, 2012 was approximately 0.29%.

Outlook

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

Off-Balance Sheet Arrangements and Other Commitments

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

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

Certain of our vendors require letters of credit to ensure reimbursement for amounts they are disbursing on our behalf, such as to beneficiaries under our self-funded insurance programs. We have also occasionally used letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. The letters of credit we provide are actually issued by our lenders through the Facility as described above. A letter of credit commits the

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

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

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

Contractual Obligations

The following recaps the future maturities of our contractual obligations as of June 30, 2012 (in thousands):

	Twelve Months Ended June 30,						
	2013	**2014**	**2015**	**2016**	**2017**	**Thereafter**	**Total**
Notes to former owners	$ 332	$ 300	$ 7,949	$	$	$	$ 8,581
Other debt	300	300	300	300	18,300	1,200	20,700
Interest payable	479	507	324	241	61	4	1,616
Operating lease obligations	10,509	8,077	5,829	4,268	2,917	6,230	37,830
Total	$ 11,620	$ 9,184	$ 14,402	$ 4,809	$ 21,278	$ 7,434	$ 68,727

As of June 30, 2012, we have $45.5 million in letter of credit commitments, of which $40.3 million will expire in 2012 and $5.2 million will expire in 2013. 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

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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 2012, we expect nearly all of them, particularly those supporting our insurance programs, will be renewed annually.

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

Item 3. ***Quantitative and Qualitative Disclosures about Market Risk***

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

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

The following table presents principal amounts (stated in thousands) and related average interest rates by year of maturity for our debt obligations and their indicated fair market value at June 30, 2012:

	Twelve Months Ended June 30,						
	2013	**2014**	**2015**	**2016**	**2017**	**Thereafter**	**Fair Value**
Fixed Rate Debt	$ 332	$ 300	$ 7,949	$	$	$	$ 8,581
Average Interest Rate	3.0%	3.0%	3.3%				3.23%
Variable Rate Debt	$ 300	$ 300	$ 300	$ 300	$ 18,300	$ 1,200	$ 20,700

The weighted average interest rates on the variable rate debt as of June 30, 2012 were approximately 2.0% for borrowings under the Facility and 0.29% for the industrial revenue bond.

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

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

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the three months ended June 30, 2012 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 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. Company Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011, 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. As of June 30, 2012, the Board has approved extensions of the program to acquire up to 6.6 million shares.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. We repurchased 0.1 million shares during the six months ended June 30, 2012. Since the inception of the program in 2007 and as of June 30, 2012, we have repurchased a cumulative total of 5.7 million shares at an average price of $10.95 per share.

During the quarter ended June 30, 2012, we purchased our common shares in the following amounts at the following average prices:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
April 1 - April 30		$	5,605,637	994,900
May 1 - May 31	70,031	$ 9.63	5,675,668	924,869
June 1 - June 30	25,803	$ 9.18	5,701,471	899,066
	95,834	$ 9.51	5,701,471	899,066

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

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

During the three months ended June 30, 2012, we withheld common shares to satisfy these tax withholding obligations as follows:

Period	Number of Shares Purchased	Average Price Paid Per Share
April 1 - April 30	34,851	$ 11.21
May 1 - May 31	15,774	$ 9.69
June 1 - June 30		$
	50,625	$ 10.73

Item 6. ***Exhibits***

31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*101.INS	XBRL Instance Document
*101.SCH	XBRL Taxonomy Extension Schema Document
*101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
*101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
*101.LAB	XBRL Taxonomy Extension Label Linkbase Document
*101.PRE	XBRL Taxonomy Extension Presentation Linkbase

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

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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.

August 1, 2012 By: /s/ BRIAN E. LANE

Brian E. Lane
President, Chief Executive Officer and Director

August 1, 2012 By: /s/ WILLIAM GEORGE

William George
Executive Vice President and Chief Financial Officer

August 1, 2012 By: /s/ JULIE S. SHAEFF

Julie S. Shaeff
Senior Vice President and Chief Accounting Officer