

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR
15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 1999
Commission file number: 1-13011

COMFORT SYSTEMS USA, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE
(STATE OR OTHER JURISDICTION
OF INCORPORATION OR ORGANIZATION)

76-0526487
(I.R.S. EMPLOYER
IDENTIFICATION NO.)

777 POST OAK BLVD.
SUITE 500
HOUSTON, TEXAS 77056
(713) 830-9600

(ADDRESS AND TELEPHONE NUMBER OF PRINCIPAL EXECUTIVE OFFICES)

Securities registered pursuant to Section 12(b) of the Act:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Common Stock, \$.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

As of March 13, 2000, the aggregate market value of the 28,777,072 shares of the registrant's common stock held by non-affiliates of the registrant was \$226,619,442 based on the \$7.875 last sale price of the registrant's common stock on the New York Stock Exchange on that date.

As of March 13, 2000, 37,450,576 shares of the registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: The information required by Part III (other than the required information regarding executive officers) is incorporated by reference from the registrant's definitive proxy statement, which will be filed with the Commission not later than 120 days following December 31, 1999.

FORWARD-LOOKING STATEMENTS

This report contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended ("Securities Act") and Section 21E of the Exchange Act. Such forward-looking statements are made only as of the date of this report and involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of the Company, or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Such risks, uncertainties and other important factors include, among others, risks associated with fluctuations in operating results because of acquisitions and changes in economic factors that reduce demand for Company services, difficulty in maintaining key personnel, changes in government regulations, competition, and risks entailed in the operations and growth of the newly acquired businesses. Important factors that could cause actual results to differ are discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Factors Which May Affect Future Results."

PART I

ITEM 1. BUSINESS

Comfort Systems USA(Registered Trademark), Inc., a Delaware corporation ("Comfort Systems" and collectively with its subsidiaries, the "Company"), is a leading national provider of comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services. Founded in December 1996, the Company is composed of companies within the commercial and industrial HVAC markets, and performs most of its services within manufacturing plants, office buildings, retail centers, apartment

complexes, and healthcare, education and government facilities. In addition to standard HVAC services, the Company also provides specialized applications such as process cooling, control systems, electronic monitoring and process piping. Certain locations also perform related services such as electrical and plumbing. Approximately 97% of the Company's consolidated 1999 revenues were derived from commercial and industrial customers with approximately 60% of the revenues attributable to installation services and 40% attributable to maintenance, repair and replacement services.

On July 2, 1997, Comfort Systems completed the initial public offering (the "IPO") of its common stock (the "Common Stock") and simultaneously acquired 12 companies (collectively referred to as the "Founding Companies") engaged in providing HVAC services. The Founding Companies had 18 operating locations in 10 states. Subsequent to the IPO, and through December 31, 1999, the Company acquired 107 HVAC and complementary businesses (collectively with the Founding Companies, the "Acquired Companies"). The companies acquired subsequent to the IPO added 108 operating locations in 21 additional states. These acquisitions included 26 "tuck-in" operations that have been or are currently being integrated with existing Company operations.

INDUSTRY OVERVIEW

The HVAC industry as a whole is estimated to generate annual revenues in excess of \$75 billion, over \$40 billion of which is in the commercial and industrial markets. HVAC systems are a necessity in virtually all commercial and industrial buildings as well as homes. Because most commercial buildings are sealed, HVAC systems provide the primary method of circulating fresh air in such buildings. Older commercial and industrial facilities often have poor air quality as well as inadequate air conditioning, and older HVAC systems result in significantly higher energy costs than do modern systems. In many instances, the replacement of an aging system with a modern, energy-efficient system will significantly reduce a building's operating costs while also improving air quality and the effectiveness of the HVAC system. These factors cause many facility owners to consider early replacement of older systems.

Growth in the HVAC industry is positively affected by a number of factors, particularly (i) the aging of the installed base, (ii) the increasing efficiency, sophistication and complexity of HVAC systems, (iii) the increasing opportunities associated with utility deregulation and (iv) the increasing standards relating to indoor air quality, and the reduction or elimination of the refrigerants commonly used in older HVAC

systems. These factors are expected to increase demand for the reconfiguration or replacement of existing HVAC systems. The Company believes that these factors may also mitigate to some extent the effect on the HVAC industry of the cyclical nature inherent in the traditional construction industry.

The HVAC industry can be broadly divided into installation services and maintenance, repair and replacement services.

INSTALLATION SERVICES. Installation services consist of "design and build" and "plan and spec" projects. In "design and build" projects, the commercial HVAC firm is responsible for designing, engineering and installing a cost-effective, energy-efficient system customized to the specific needs of the building owner. Costs and other project terms are normally negotiated between the building owner or its representative and the HVAC firm. Firms which specialize in "design and build" projects generally have specially-trained HVAC engineers, CAD/CAM design systems and in-house sheet metal and prefabrication capabilities. These firms utilize a consultative approach with customers and tend to develop long-term relationships with building owners and developers, general contractors, architects and property managers. "Plan and spec" installation refers to projects where a third party architect or consulting engineer designs the HVAC systems and the installation project is "put out for bid." The Company believes that "plan and spec" projects usually take longer to complete than "design and build" projects because the preparation of the system design by a third party and resulting bid process may often take months to complete. Furthermore, in "plan and spec" projects, the HVAC firm is not responsible for project design and any changes must be approved by other parties, thereby increasing overall project time and cost. Approximately 60% of the Company's consolidated 1999 revenues related to installation services and the majority of the revenues from installation projects was performed on a "design and build/negotiated" basis.

MAINTENANCE, REPAIR AND REPLACEMENT SERVICES. These services include the maintenance, repair, replacement, reconfiguration and monitoring of previously installed HVAC systems and controls. The growth and aging of the installed base of HVAC systems and the increasing demand for more efficient, sophisticated and complex systems and controls have fueled growth in this service line. The increasing sophistication and complexity of these HVAC systems is leading many commercial and industrial building owners and property managers to increase attention to maintenance and to outsource maintenance and repair, often through service agreements with HVAC service providers. In addition, increasing restrictions are being placed on the use of certain types of refrigerants used in HVAC systems, which, along with indoor air quality concerns, may increase demand for the reconfiguration and replacement of existing HVAC systems. State-of-the-art control and monitoring systems feature electronic sensors and microprocessors. These systems require specialized training to install, maintain and repair, and the typical building engineer has not received this training. Increasingly, HVAC systems in commercial and industrial buildings are being remotely monitored through PC-based communications systems to improve energy efficiency and expedite problem diagnosis and correction. Approximately 40% of the Company's consolidated 1999 revenues related to maintenance, repair and replacement services.

STRATEGY

The Company has implemented an operating strategy that emphasizes strengthening operating competencies and continued internal growth.

OPERATING STRATEGY. The key elements of the Company's operating strategy are:

FOCUS ON COMMERCIAL AND INDUSTRIAL MARKETS. The Company primarily focuses on the commercial and industrial markets with particular emphasis on "design and build" installation services and maintenance, repair and replacement services. The Company believes that the commercial and industrial HVAC markets are attractive because of their growth opportunities, diverse customer base, reduced weather exposure as compared to residential markets, attractive margins and potential for long-term relationships with building owners, property managers, general contractors and architects. Approximately 97% of the Company's consolidated 1999 revenues were derived from commercial and industrial customers.

ACHIEVE EXCELLENCE IN CORE COMPETENCIES. The Company has identified six core competencies, which it believes are critical to attracting and retaining customers, increasing revenue and creating additional employment opportunities. The six core competencies are: (i) customer cultivation and intimacy, (ii) design and build expertise, (iii) estimating, (iv) job costing and job measurements, (v) safety and (vi) service capability.

ACHIEVE OPERATING EFFICIENCIES. The Company believes there are opportunities to achieve operating efficiencies and cost savings through purchasing economies, the adoption of "best practices" operating programs and a focus on job management to deliver services in a cost-effective and efficient manner. The Company has begun and will continue to use its growing purchasing power to gain volume discounts on products and services such as HVAC components, raw materials, service vehicles, advertising, bonding, insurance and benefits.

ATTRACT AND RETAIN QUALITY EMPLOYEES. The Company seeks to attract and retain quality employees by providing them (i) an enhanced career path from working for a larger public company, (ii) additional training, education and apprenticeships to allow talented employees to advance to higher-paying positions, (iii) the opportunity to realize a more stable income and (iv) attractive benefits packages.

GROWTH. A key component of the Company's strategy is to nurture growth at the Company's subsidiaries. The key elements of the Company's internal growth strategy are:

EXPAND NATIONAL SERVICE CAPABILITIES. The Company believes that significant demand exists from large regional and national companies to utilize the services of a single HVAC service company capable of providing commercial and industrial services on a regional or national basis. The Company has significantly increased its ability to handle multi-location service opportunities by internally developing a National Service Organization to facilitate these activities and through the acquisition of Outbound Services in November 1999. Outbound Services is an Internet based technology platform and call center designed to manage HVAC and related service along with the information needs of multi-location customers including asset data management, warranty tracking capability, real-time status of services performed and automated invoicing.

EXPAND ALLIANCES WITH ENERGY PROVIDERS. The Company believes that there is significant potential for mutually beneficial relationships with companies that market energy and energy services. The Company is currently working with several companies in the utility industry through cooperative marketing of the Company's services and is seeking to provide utilities the opportunity to profit and to benefit from the Company's own customer relationships. The Company believes it can expand these relationships as it gains experience with successful programs and as its geographic presence increases.

CAPITALIZE ON SPECIALIZED TECHNICAL AND MARKETING STRENGTHS. The Company believes it will be able to continue to expand the services it offers in its markets by leveraging the specialized technical and marketing strengths of individual companies. The Company also believes its geographical coverage will enable it to serve existing customers' needs in new regions that may have been beyond the service area of the Company's operations that originated the existing customer relationship.

ENTER NEW GEOGRAPHIC MARKETS. From time to time, the Company expects to opportunistically target leading local or regional companies providing HVAC and related services with a solid customer base, technical skills and infrastructure. The Company seeks businesses that are located in attractive markets, have a significant service and replacement component, are financially stable, are experienced in the industry and have a strong management team. The Company also enters new markets from time to time by opening new or branch offices, particularly where the Company has established customer opportunities.

OPERATIONS SERVICES PROVIDED

The Company provides a wide range of installation, maintenance, repair and replacement services for HVAC and related systems in commercial and industrial properties. The Company manages its locations on

a decentralized basis, with local management maintaining responsibility for day-to-day operating decisions. In addition to senior management, local personnel generally include design engineers, sales personnel, customer service personnel, installation service technicians, sheet metal and prefabrication technicians, estimators and administrative personnel. The Company has centralized certain administrative functions such as insurance, employee benefits, safety programs and cash management to enable the management of its locations to focus on pursuing new business opportunities and improving operating efficiencies. The Company is centralizing training programs, project financing programs, national sales and purchasing programs and joint marketing programs.

INSTALLATION SERVICES. The Company's installation business, which comprised approximately 60% of the Company's 1999 consolidated revenues, involves the design, engineering, integration, installation and start-up of HVAC and related systems. The commercial and industrial installation services performed by the Company consist of "design and build" and under some circumstances, "plan and spec" services for manufacturing plants, office buildings, retail centers, apartment complexes, health care, education and government facilities and other commercial and industrial facilities. In a "design and build" project, the customer typically has an overall design for the facility prepared by an architect or a consulting engineer who then enlists the Company's engineering personnel to prepare a specific design for the HVAC system. The Company determines the needed capacity, energy efficiency and type of controls that best suit the proposed facility. The Company's engineer then estimates the amount of time, labor, materials and equipment needed to build the specified system. The final design, terms, price and timing of the project are then negotiated with the customer or its representatives, after which any necessary modifications are made to the system. In "plan and spec" installation the Company participates in a bid process to provide labor, materials and installation based on plans and engineering provided by a customer or a general contractor.

Once an agreement has been reached, the Company orders the necessary materials and equipment for delivery to meet the project schedule. In most instances, the Company fabricates in its own facilities, the ductwork and piping and assembles certain components for the system based on the mechanical drawing specifications, eliminating the need to subcontract ductwork or piping fabrication. The Company installs the system at the project site, working closely with the general contractor. Most commercial and industrial installation projects last from two weeks to one year and generate revenues from \$50,000 to \$3,000,000 per project. These projects are generally billed periodically as costs are incurred and, in most cases, with retainage of up to 10% held back until completion and successful start-up of the HVAC system.

The Company also installs process cooling systems, building automation controls and monitoring systems and industrial process piping. Process cooling systems are utilized primarily in industrial facilities to provide heating and/or cooling to precise temperature and climate standards for products being manufactured and for the manufacturing equipment. Control systems are used in HVAC and process cooling systems to maintain pre-established temperature or climate standards for commercial or industrial facilities. Building automation control systems are capable not only of controlling a facility's entire HVAC system, often on a room-by-room basis, but can be programmed to integrate energy management, security, fire, card key access, lighting and overall facility monitoring. This monitoring can be performed on-site or remotely through a PC-based communications system. The monitoring system will communicate an exception when an operating system is operating outside pre-established parameters. Diagnosis of potential problems can be performed from the computer terminal which often can remotely adjust the control system. Industrial process piping is utilized in manufacturing facilities to convey required raw material, support utilities and finished products.

MAINTENANCE, REPAIR AND REPLACEMENT SERVICES. The Company's maintenance, repair and replacement services comprised approximately 40% of the Company's 1999 consolidated revenues, and include the maintenance, repair, replacement, reconfiguration and monitoring of HVAC systems and industrial process piping. Over two-thirds of the Company's maintenance, repair and replacement revenues were derived from reconfiguring existing HVAC systems for commercial and industrial customers. Reconfiguration often utilizes consultative expertise similar to that provided in the "design and build" installation market. The Company believes that the reconfiguration of an existing system results in a more cost-effective, energy-

efficient system that better meets the specific needs of the building owner. The reconfiguration also enables the Company to utilize its design and engineering personnel as well as its sheet metal and pre-fabrication facilities.

Maintenance and repair services are provided either in response to service calls or pursuant to a service agreement. Service calls are coordinated by customer service representatives or dispatchers that use computer and communication technology to process orders, arrange service calls, communicate with customers, dispatch technicians and invoice customers. Service technicians work from service vehicles equipped with commonly used parts, supplies and tools to complete a variety of jobs.

Commercial and industrial service agreements usually have terms of one to three years, with automatic annual renewals. The Company also provides remote monitoring of temperature, pressure, humidity and air flow for HVAC systems. If the system is not operating within the specifications set forth by the customer and cannot be remotely adjusted, a service crew is dispatched to analyze and repair the system.

SOURCES OF SUPPLY

The raw materials and components used by the Company include HVAC system components, ductwork, steel, sheet metal and copper tubing and piping. These raw materials and components are generally available from a variety of domestic or foreign suppliers at competitive prices. Delivery times are typically short for most raw materials and standard components, but during periods of peak demand, may extend to a month or more. Chillers for large units typically have the longest delivery time and generally have lead times of up to six months. The major components of commercial HVAC systems are compressors and chillers that are manufactured primarily by York Heating and Air Conditioning Corporation ("York"), Carrier Corporation and Trane Air Conditioning Company. The major suppliers of building automation control systems are Honeywell Inc., Johnson Controls Inc., York, Automated Logic, Novar and Andover Control Corporation. The Company does not have any significant contracts guaranteeing the Company a supply of raw materials or components.

SALES AND MARKETING

The Company has a diverse customer base, with no single customer accounting for more than 2% of consolidated 1999 revenues. Management and a dedicated sales force have been responsible for developing and maintaining successful long-term relationships with key customers. Customers generally include building owners and developers and property managers, as well as general contractors, architects and consulting engineers. The Company intends to continue its emphasis on developing and maintaining long-term relationships with its customers by providing superior, high-quality service in a professional manner. Moreover, the dedicated sales force receives technical and sales training to enhance the comprehensive selling skills necessary to serve the HVAC needs of their customers.

The Company has a national sales team to capitalize on cross-marketing and business development opportunities that management believes are available to the Company as a regional or national provider of comprehensive commercial and industrial HVAC and related services. Management believes that it can increasingly leverage the diverse technical and marketing strengths at individual locations to expand the services offered in other local markets.

EMPLOYEES

As of December 31, 1999, the Company had 10,853 employees, including 593 management personnel, 8,829 engineers, service and installation technicians, 313 sales personnel and 1,118 administrative personnel. As it executes its growth strategy, the Company expects the number of employees to increase. Certain of the Company's subsidiaries have collective bargaining agreements that cover, in the aggregate, approximately 2,690 employees. The Company has not experienced any significant strikes or work stoppages and believes its relations with employees covered by collective bargaining agreements are good.

RECRUITING, TRAINING AND SAFETY

The Company's continued future success will depend, in part, on its ability to continue to attract, retain and motivate qualified service technicians, field supervisors and project managers. The Company believes that its success in retaining qualified employees will be based on the quality of its recruiting, training, compensation, employee benefits programs and opportunities for advancement. The Company has a national recruiting network and also recruits via the internet and at local technical schools and community colleges where students focus on learning basic industry skills. Additionally, Comfort Systems provides on-the-job training, technical training, apprenticeship programs, attractive benefit packages, steady employment and career advancement opportunities within the Company.

The Company is working to establish "best practices" safety programs throughout its operations to ensure that all technicians comply with safety standards established by the Company and federal, state and local laws and regulations. Additionally, the Company has implemented a "best practices" safety program throughout its operations, which provides employees with incentives to improve safety performance and decrease workplace accidents. Regional safety directors establish safety programs and benchmarking to improve safety within their region. The Company's employment screening process seeks to determine that prospective employees have the requisite skills, sufficient background references and acceptable driving records, if applicable.

RISK MANAGEMENT, INSURANCE AND LITIGATION

The primary risks in the Company's operations are bodily injury, property damage and injured workers' compensation. The Company maintains liability insurance for bodily injury, third party property damage and workers' compensation which it considers sufficient to insure against these risks, subject to self-insured amounts.

The Company is subject to certain claims and lawsuits arising in the normal course of business and maintains various insurance coverages to minimize financial risk associated with these claims. The Company has provided accruals for probable losses and legal fees associated with certain of these actions in its consolidated financial statements. In the opinion of management, uninsured losses, if any, resulting from the ultimate resolution of these matters will not have a material adverse effect on the Company's financial position or results of operations.

The Company's subsidiaries typically warrant labor for the first year after installation on new HVAC systems and pass through to the customer manufacturers' warranties on equipment. The Company's subsidiaries generally warrant labor for 30 days after servicing of existing HVAC systems. The Company does not expect warranty claims to have a material adverse effect on its financial position or results of operations.

COMPETITION

The HVAC industry is highly competitive. The Company believes that purchasing decisions in the commercial and industrial markets are based on (i) long-term customer relationships, (ii) quality, timeliness and reliability of services provided, (iii) competitive price, (iv) range of services provided and (v) scale of operation. The Company's strategy of focusing on both the highly consultative "design and build" installation market and the maintenance, repair and replacement market promotes the development and strengthening of long-term customer relationships. In addition, the Company's ability to provide multi-location coverage, project financing and specialized technical skills for facilities owners gives it a strategic advantage over smaller competitors who may be unable to provide these services to customers at a competitive price.

Many of the Company's competitors are small, owner-operated companies that typically operate in a limited geographic area. There are also public companies, divisions of utility companies and equipment manufacturers that are focused on providing HVAC services in some of the same service lines provided by the Company. Certain of the Company's competitors and potential competitors may have greater financial

resources than the Company to finance acquisition and development opportunities, to pay higher prices for the same opportunities or to develop and support their own operations.

FACILITIES AND VEHICLES

The Company leases the majority of its facilities. In most instances these leases are with the former owners who are now employed by the Company. Leased premises range in size from 1,500 square feet to over 100,000 square feet. The Company believes that its facilities are sufficient for its current needs.

The Company operates a fleet of various owned or leased service trucks, vans and support vehicles. The Company believes that these vehicles generally are well-maintained and adequate for its current operations.

GOVERNMENTAL REGULATION AND ENVIRONMENTAL MATTERS

The Company's operations are subject to various federal, state and local laws and regulations, including: (i) licensing requirements applicable to service technicians, (ii) building and HVAC codes and zoning ordinances, (iii) regulations relating to consumer protection, including those governing residential service agreements and (iv) regulations relating to worker safety and protection of the environment. The Company believes it has all required licenses to conduct its operations and is in substantial compliance with applicable regulatory requirements. Failure of the Company to comply with applicable regulations could result in substantial fines or revocation of the Company's operating licenses.

Many state and local regulations governing the HVAC services trades require permits and licenses to be held by individuals. In some cases, a required permit or license held by a single individual may be sufficient to authorize specified activities for all of the Company's service technicians who work in the state or county that issued the permit or license. The Company is implementing a policy to ensure that, where possible, any such permits or licenses that may be material to the Company's operations in a particular geographic region are held by at least two Company employees within that region.

The Company's operations are subject to the federal Clean Air Act, as amended (the "Clean Air Act"), which governs air emissions and imposes specific requirements on the use and handling of chlorofluorocarbons ("CFCs") and certain other refrigerants. Clean Air Act regulations require the certification of service technicians involved in the service or repair of equipment containing these refrigerants and also regulate the containment and recycling of these refrigerants. These requirements have increased the Company's training expenses and expenditures for containment and recycling equipment. The Clean Air Act is intended ultimately to eliminate the use of CFCs in the United States and to require alternative refrigerants to be used in replacement HVAC systems.

EXECUTIVE OFFICERS

The Company has five executive officers.

Fred M. Ferreira, age 57, has served as Chairman of the Board, Chief Executive Officer and President of Comfort Systems since January 1997. Mr. Ferreira was responsible for introducing the consolidation opportunity in the commercial and industrial HVAC industry to Notre Capital Ventures II, L.L.C. ("Notre") and was primarily responsible for the organization of the Company. From 1995 through 1996, Mr. Ferreira was a private investor. He served as Chief Operating Officer and a director of Allwaste, Inc., a publicly-traded environmental services company ("Allwaste"), from 1994 to 1995, and was President of Allwaste Environmental Services, Inc., the largest division of Allwaste, from 1991 to 1994. From 1989 to 1990, Mr. Ferreira served as President of Allied Waste Industries, Inc., an environmental services company. Prior to that time, Mr. Ferreira served as Vice President -- Southern District and in various other positions with Waste Management, Inc., an environmental services company.

J. Gordon Beittenmiller, age 41, has served as Executive Vice President, Chief Financial Officer and a director of Comfort Systems since May 1998, and was Senior Vice President, Chief Financial Officer and a director of Comfort Systems from February 1997 to April 1998. From 1994 to February 1997, Mr. Beittenmiller was Corporate Controller of Keystone International, Inc. ("Keystone"), a publicly-traded

manufacturer of industrial valves and actuators, and served Keystone in other financial positions from 1991 to 1994. From 1987 to 1991, he was Vice President -- Finance of Critical Industries, Inc., a publicly-traded manufacturer and distributor of specialized safety equipment. From 1982 to 1987, he held various positions with Arthur Andersen LLP. Mr. Beittenmiller is a Certified Public Accountant.

Gary E. Hess, age 52, has served as Chief Operating Officer and Executive Vice President of Comfort Systems since June 1999 and prior to this he was the Senior Vice President -- Operations from February 1999 to May 1999. In March 2000, the Board of Directors unanimously elected Mr. Hess as a director of Comfort Systems. He served Comfort Systems as director of its Northeast region from August 1998 to January 1999. Prior to that, he was employed by Hess Mechanical Corporation, a wholly owned subsidiary of the Company, since 1980, serving as Chairman and Chief Executive Officer. Mr. Hess was President of Associated Builders and Contractors during 1996 and was selected as their 1997 Contractor of the Year. He is a decorated Vietnam veteran.

Reagan S. Busbee, age 36, has served as Senior Vice President of Comfort Systems since January 1997. From 1992 through 1996, Mr. Busbee served as Vice President of Chas. P. Young Co., a financial printer and a wholly-owned subsidiary of Consolidated Graphics Inc., a publicly-traded consolidator of the printing industry. From August 1986 to May 1992, he held various positions and was a Certified Public Accountant with Arthur Andersen LLP.

William George, III, age 35, has served as Senior Vice President, General Counsel and Secretary of Comfort Systems since May 1998, and was Vice President, General Counsel and Secretary of Comfort Systems from March 1997 to April 1998. From October 1995 to February 1997, Mr. George was Vice President and General Counsel of American Medical Response, Inc., a publicly traded consolidator of the healthcare transportation industry. From September 1992 to September 1995, Mr. George practiced corporate and antitrust law at Ropes & Gray, a Boston, Massachusetts law firm.

ITEM 2. PROPERTIES

Most of the Company's subsidiaries lease the real property and buildings from which they operate. The Company's facilities consist of offices, shops, maintenance and warehouse facilities. Generally, leases range from five to ten years and are on terms the Company believes to be commercially reasonable. Certain of these facilities are leased from related parties. In order to maximize available capital, the Company generally intends to continue to lease the majority of its properties. The Company believes that its facilities are adequate for its current needs.

The Company leases its executive and administrative offices in Houston, Texas.

ITEM 3. LEGAL PROCEEDINGS

The Company is party to litigation in the ordinary course of business. There are currently no pending legal proceedings that, in management's opinion, will have a material adverse effect on the Company's consolidated operating results or financial condition.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The following table sets forth the reported high and low sales prices of the Common Stock for the quarters indicated as traded at the New York Stock Exchange. The Common Stock is traded under the symbol FIX.

	HIGH	LOW
	-----	-----
First Quarter, 1998.....	\$ 22.25	\$ 18.125
Second Quarter, 1998.....	\$ 24.75	\$ 19.125
Third Quarter, 1998.....	\$ 26.625	\$ 15.25
Fourth Quarter, 1998.....	\$ 20.50	\$ 14.1875
First Quarter, 1999.....	\$ 18.50	\$ 11.375
Second Quarter, 1999.....	\$ 18.5625	\$ 13.125
Third Quarter, 1999.....	\$ 18.625	\$ 11.25
Fourth Quarter, 1999.....	\$ 12.00	\$ 6.4375
January 1 - March 13, 2000.....	\$ 9.375	\$ 6.75

As of March 13, 2000, there were approximately 1,458 stockholders of record of the Company's Common Stock, and the last reported sale price on that date was \$7.875 per share.

The Company has never declared or paid a dividend on its Common Stock. The Company currently expects to retain future earnings in order to repay debt, repurchase shares of the Company's Common Stock and finance growth and, consequently, does not intend to declare any dividend on the Common Stock for the foreseeable future. In addition, the Company's revolving credit agreement restricts the ability of the Company to pay dividends without the lenders' consent. The Company's Restricted Voting Common Stock converts to Common Stock upon sale and under certain other conditions.

RECENT SALES OF UNREGISTERED SECURITIES

During 1999, the Company issued a total of 256,363 unregistered shares of its Common Stock in connection with the acquisition of four HVAC businesses, none of which was material. In each case, the shares were issued without registration under the Securities Act in reliance on the exemption provided by Section 4(2), no public offering being involved.

ITEM 6. SELECTED FINANCIAL DATA

Comfort Systems acquired the 12 Founding Companies in connection with the IPO on July 2, 1997. Subsequent to the IPO and through December 31, 1999, the Company completed 107 acquisitions, 17 of which were accounted for as poolings-of-interests (the "Pooled Companies") and 90 of which were accounted for as purchases (the "Purchased Companies"). The following selected historical financial data has been derived from the audited financial statements of the Company for each of the four years ended December 31, 1996, 1997, 1998, and 1999. The remaining selected historical financial data of the Company has been derived from unaudited financial statements of the Company. These unaudited financial statements have been prepared on the same basis as the audited financial statements of the Company, and in the opinion of the Company, reflect all adjustments necessary for a fair presentation of that historical information. The historical financial statement data reflects the acquisitions of the Founding Companies and Purchased Companies as of their respective acquisition dates and reflects 15 of the Pooled Companies (the "Restated Companies") for all periods presented. Two of the Pooled Companies are considered immaterial poolings based upon criteria set forth by the Securities and Exchange Commission and have not been

restated for all periods presented. The selected historical financial data below should be read in conjunction with the historical Consolidated Financial Statements and related notes.

	YEAR ENDED DECEMBER 31,				
	1995	1996	1997	1998	1999
(IN THOUSANDS)					
STATEMENT OF OPERATIONS DATA:					
Revenues.....	\$ 126,794	\$ 161,419	\$ 297,646	\$ 853,961	\$ 1,370,035
Operating income.....	\$ 4,011	\$ 6,575	\$ 5,699	\$ 68,497	\$ 93,204
Net income (loss).....	\$ 3,137	\$ 4,589	\$ (2,064)	\$ 35,013	\$ 42,322
BALANCE SHEET DATA:					
Working capital.....	\$ 10,110	\$ 13,971	\$ 63,137	\$ 133,390	\$ 172,566
Total assets.....	\$ 42,035	\$ 50,366	\$ 308,779	\$ 789,293	\$ 943,272
Total debt, including current portion.....	\$ 9,076	\$ 8,376	\$ 24,726	\$ 236,446	\$ 305,833
Stockholders' equity.....	\$ 10,731	\$ 15,429	\$ 217,635	\$ 379,932	\$ 418,965

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

The following discussion should be read in conjunction with the consolidated historical financial statements of the Company and related notes thereto. This discussion contains forward-looking statements regarding the business and industry of Comfort Systems within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on the current plans and expectations of the Company and involve risks and uncertainties that could cause 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 are discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Factors Which May Affect Future Results."

Comfort Systems was founded in December 1996 to become a leading national provider of HVAC services, primarily focusing on commercial and industrial markets. On July 2, 1997, Comfort Systems completed the IPO and simultaneously acquired the 12 Founding Companies, which are engaged in providing HVAC services. Subsequent to the IPO, and through December 31, 1999, the Company acquired 107 additional HVAC and complementary businesses. Of these additional acquisitions, 17 acquisitions were accounted for as poolings-of-interests and are referred to herein as the Pooled Companies, and the remaining 90 acquisitions were accounted for as purchases and are referred to herein as the Purchased Companies. The consolidated historical financial statements of the Company have been retroactively restated to give effect to the operations of 15 of the Pooled Companies. Two of the Pooled Companies are considered immaterial poolings based upon criteria set forth by the Securities and Exchange Commission and have not been restated for all periods presented.

Historical results are not necessarily indicative of future results of the Company because, among other things, the Acquired Companies were not under common control or management prior to their acquisition. The results of the Company have historically been subject to seasonal fluctuations. The timing and magnitude of acquisitions, assimilation costs and the seasonal nature of the HVAC industry may materially affect operating results. Accordingly, the operating results for any period are not necessarily indicative of the results that may be achieved for any subsequent period. These historical statements of operations should be read in conjunction with the historical Consolidated Financial Statements and related notes of Comfort Systems, filed herewith.

RESULTS OF OPERATIONS -- HISTORICAL

The following historical consolidated financial information represents the operations of the Restated Companies for all periods presented and the Founding Companies and Purchased Companies from their respective dates of acquisition. Historical selling, general, and administrative expenses for the periods presented in the consolidated financial statements of the Company reflect compensation and related benefits

the owners of those businesses received prior to acquisition. The following historical financial information for 1997 includes the non-recurring, non-cash compensation charge of \$11.6 million recorded by Comfort Systems in the first quarter of 1997, non-recurring acquisition-related costs and reflects normal recurring corporate costs of Comfort Systems subsequent to the IPO. This compensation charge is not deductible for federal and state income taxes. This historical consolidated information has been derived from the audited consolidated financial statements of the Company.

	YEAR ENDED DECEMBER 31,					
	1997		1998		1999	
	(IN THOUSANDS)					
Revenues.....	\$ 297,646	100.0%	\$ 853,961	100.0%	\$ 1,370,035	100.0%
Cost of services.....	220,419	74.1	647,512	75.8	1,077,329	78.6
Gross profit.....	77,227	25.9	206,449	24.2	292,706	21.4
Selling, general and administrative expenses.....	69,677	23.4	130,820	15.3	187,771	13.7
Goodwill amortization.....	1,851	0.6	7,132	0.8	11,731	0.9
Operating income.....	5,699	1.9	68,497	8.1	93,204	6.8
Other income (expense).....	(161)	--	(6,435)	(0.8)	(19,144)	(1.4)
Income before taxes.....	5,538	1.9	62,062	7.3	74,060	5.4
Provision for income taxes.....	7,602	--	27,049	--	31,738	--
Net income (loss).....	\$ (2,064)	(0.7)%	\$ 35,013	4.1%	\$ 42,322	3.1%

1999 COMPARED TO 1998

REVENUES -- Revenues increased \$516.1 million, or 60.4%, to \$1.4 billion in 1999 compared to 1998. The increase in revenues over the prior year is primarily due to the acquisition of Purchased Companies in 1998 and 1999, however, the Company has experienced lower internal revenue growth in the latter part of fiscal 1999 as compared to previous periods. The Company believes that this is primarily attributable to a slowing in the growth of the construction industry due to shortages in both labor and specialty building materials, which in turn impacted HVAC installations.

GROSS PROFIT -- Gross profit increased \$86.3 million, or 41.8%, to \$292.7 million in 1999 compared to 1998. The increase in gross profit is primarily due to the acquisitions described above. As a percentage of revenues, gross profit decreased from 24.2% in 1998 to 21.4% in 1999. This decrease primarily resulted from the change in classification of certain costs from selling, general and administrative expenses to cost of services. These costs relate to activities that directly support project or service work. Management believes this revised presentation better aligns the presentation of cost of services and selling, general and administrative expenses across all of our acquired operations. Excluding the effect of this change in classification for 1999 of approximately \$37.2 million, gross profit as a percentage of revenues remained relatively unchanged at 24.1% in 1999 versus 24.2% in 1998. During 1999, the Company experienced increased gross profit margins from strong performances in commercial and industrial markets in the Northeast, Phoenix and Orlando as well as operating synergies achieved between its western Michigan companies. However, in the latter part of fiscal 1999 the Company has experienced lower internal revenue growth as a result of construction industry capacity issues as discussed above. In addition, there has been a shift in the mix of installation projects to higher labor-intensive projects with lower gross profit percentages, pricing competition in certain markets and execution shortfalls and inefficiencies as the Company sought stronger revenue growth levels.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES -- SG&A increased \$57.0 million, or 43.5%, to \$187.8 million in 1999 compared to 1998. Most of this increase was related to Purchased Companies along with an increase in corporate personnel and corporate office expenses commensurate with the increase in the number of Acquired Companies. As a percentage of revenues, selling, general and administrative expenses decreased from 15.3% in 1998 to 13.7% in 1999. This decrease is primarily attributable to the change in classification of certain costs as described above. Excluding the effect of this change in classification for 1999 of approximately \$37.2 million, SG&A expenses as a percentage of revenues increased from 15.3% for 1998 to 16.4% for 1999. This increase in SG&A as a percentage of revenues resulted primarily from lower internal revenue growth as discussed above and increased healthcare costs under the Company's self-insured medical plan. SG&A for 1998 includes \$1.8 million of salaries

and benefits paid to the former owners of the Pooled Companies which the former owners contractually agreed would not continue following their acquisition by Comfort Systems.

OPERATING INCOME -- Operating income increased \$24.7 million, or 36.1%, to \$93.2 million in 1999 compared to 1998 primarily due to the addition of Purchased Companies. As a percentage of revenues, operating income decreased from 8.1% in 1998 to 6.8% in 1999. The decrease in operating income as a percentage of revenues resulted from issues discussed above.

OTHER INCOME (EXPENSE) -- Other expense, net, increased \$12.7 million, or 197.5%, to \$19.1 million in 1999 compared to 1998 primarily due to the increase in interest expense related to the acquisition of the Purchased Companies.

1998 COMPARED TO 1997

REVENUES -- Revenues increased \$556.3 million, or 186.9%, to \$854.0 million in 1998 compared to 1997. The increase in revenues over the prior year was primarily due to the acquisition of the Founding Companies and Purchased Companies coupled with broad growth in certain of its Pooled Companies located in the Cincinnati, Syracuse and Kansas City, Kansas markets.

GROSS PROFIT -- Gross profit increased \$129.2 million, or 167.3%, to \$206.4 million in 1998 compared to 1997. The increase in gross profit was primarily due to the acquisitions described above. As a percentage of revenues, gross profit decreased from 25.9% in 1997 to 24.2% in 1998. This decline resulted primarily from the acquisition of the Purchased Companies, which, taken as a whole, have gross margins that are lower than the Company's historical average.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES -- SG&A, excluding goodwill amortization, in 1997 and 1998 includes \$10.3 million and \$1.8 million, respectively, of Compensation Differential and acquisition related costs which will be eliminated prospectively. Additionally, the Company recorded the non-recurring, non-cash compensation charge of \$11.6 million in the first quarter of 1997. Excluding the Compensation Differential, the compensation charge, and goodwill amortization, SG&A increased \$81.3 million to \$129.1 million in 1998. Most of this increase was related to the Founding Companies and Purchased Companies acquired since the IPO, along with corporate office and management expenses associated with the Company's establishment as a public company.

OPERATING INCOME -- Operating income increased \$62.8 million, or 1,101.9% to \$68.5 million in 1998 compared to 1997 primarily due to increased revenues at the Founding Companies, the addition of the Purchased Companies and incremental increases in volume at some of the Pooled Companies. As a percentage of revenues, operating income increased from 1.9% in 1997 to 8.1% in 1998. As discussed above, this increase primarily resulted from the Compensation Differential and the compensation charge recorded in 1997.

OTHER INCOME (EXPENSE) -- Other expense, net, increased to \$6.4 million in 1998 compared to 1997 primarily due to the increase in interest expense related to the acquisition of the Purchased Companies acquired subsequent to the IPO and through the end of 1998.

LIQUIDITY AND CAPITAL RESOURCES

For the year ended December 31, 1999, net cash provided by operating activities was \$18.4 million, or an increase of \$23.9 million over the prior year. This increase was primarily due to an increase in accounts payable and accrued liabilities which were partially offset by an increase in accounts receivable. Cash used in operations for 1998 was \$5.5 million and cash provided from operations in 1997 was \$1.0 million.

Cash used in investing activities was \$46.5 million for the year ended December 31, 1999, primarily in connection with the acquisition of Purchased Companies for \$31.4 million, net of cash acquired. Cash flows used in investing activities for 1998 and 1997 were \$143.1 million and \$57.6 million, respectively. The uses

of cash in 1998 and 1997 were primarily for the acquisition of the Founding Companies and Purchased Companies, net of cash acquired.

Cash provided by financing activities for the year ended December 31, 1999 was \$24.7 million primarily from net borrowings of long-term debt which were primarily used to fund acquisitions. Net cash provided by financing activities in 1998 was \$137.5 million and was primarily attributable to the \$16.7 million received from the second public offering (the "Second Public Offering") and net borrowings of long-term debt of \$124.2 million, which were primarily used to fund acquisitions. Net cash provided by financing activities in 1997 was \$66.6 million and was primarily attributable to the \$79.9 million from the IPO, which was partially offset by a net reduction in outstanding debt.

On July 2, 1997, Comfort Systems completed the offering of 6,100,000 shares of Common Stock to the public at \$13.00 per share. The net proceeds to Comfort Systems from the IPO (after deducting underwriting commissions and offering expenses) were \$68.8 million. Of this amount, \$45.3 million was used to pay the cash portion of the purchase prices of the Founding Companies. In connection with the IPO, the Company granted its underwriters an option to sell an additional 915,000 shares at \$13.00 per share. On July 9, 1997, the underwriters exercised this option. Net proceeds to the Company from this sale of shares were \$11.1 million after deducting underwriting commissions.

On June 16, 1998, the Company completed a Second Public Offering of 400,000 shares of its Common Stock to the public at \$20.00 per share. The net proceeds from this offering of \$7.6 million, after deducting underwriting commissions and offering expenses, were used to repay debt. In connection with the Second Public Offering, the Company granted its underwriters an option to sell additional shares at \$20.00 per share. On July 21, 1998, the underwriters exercised this option. An additional 461,479 shares of Common Stock were sold and the net proceeds of \$8.8 million, after deducting underwriting commissions, were used to repay debt.

In July 1997, the Company entered into a credit agreement with Bank One, Texas, N.A. (the "Credit Facility"). The Credit Facility was amended and restated in September 1997 primarily to provide for additional banks to lend to the Company under the Credit Facility. At that time, the Credit Facility provided the Company with an unsecured revolving line of credit of \$75 million. The Credit Facility was further amended in April 1998 and again in December 1998 in order to increase borrowing capacity and to provide for additional banks to lend to the Company under the Credit Facility. The Credit Facility currently provides the Company with a revolving line of credit of up to \$300 million secured by accounts receivable, inventory and the shares of capital stock of the Company's subsidiaries. The Company currently has a choice of two interest rate options when borrowing under the Credit Facility. Under one option, the interest rate is determined based on the higher of the Federal Funds Rate plus 0.5% or the bank's prime rate. An additional margin of zero to 1.25% is then added to the higher of these two rates. Under the other interest rate option, borrowings bear interest based on designated short-term Eurodollar rates (which generally approximate LIBOR) plus 1.0% to 2.5%. The additional margin for both options depends on the ratio of the Company's debt to EBITDA. Commitment fees of 0.25% to 0.5% per annum, also depending on the ratio of debt to EBITDA, are payable on the unused portion of the facility. The Credit Facility prohibits the payment of dividends by the Company without the lenders' approval and requires the Company to comply with certain financial covenants. The amended Credit Facility expires on November 1, 2001, at which time all amounts outstanding under the Credit Facility are due.

As of December 31, 1999, the Company had borrowed \$225.2 million under the Credit Facility at an average interest rate of approximately 7.4% for the year ended December 31, 1999. The Company's unused committed borrowing capacity under the Credit Facility was \$72.9 million at December 31, 1999. As of March 13, 2000, \$249.2 million was outstanding under this Facility.

On October 5, 1999, the Company announced that its Board of Directors had approved a share repurchase program authorizing the Company to buy up to 4 million shares of its Common Stock. As of December 31, 1999, the Company purchased approximately 1.8 million shares at a cost of approximately \$12.9 million. Subsequent to yearend, the Company has purchased approximately 0.1 million additional shares at a cost of approximately \$0.8 million through March 13, 2000.

The Company anticipates that available borrowings under its Credit Facility and cash flow from operations will be sufficient to meet the Company's normal working capital and capital expenditure needs, debt service requirements and additional acquisition opportunities. Should the Company accelerate or revise its acquisition program, the Company may need to seek additional financing through the public or private sale of equity or debt securities or increase its Credit Facility. There can be no assurance that the Company will secure such financing if and when it is needed, or that such financing will be available on terms that the Company deems acceptable.

YEAR 2000

Computers, software, and other equipment utilizing embedded technology that use only two digits to identify a year in a date field may be unable to accurately process certain date-based information at or after the year 2000. This is commonly referred to as the "Year 2000 issue." The Company implemented a Year 2000 program and used both internal and external resources to assess and replace or reprogram computers, software and other equipment as needed. Key areas of the Company's operations that were addressed included external customers, external suppliers and internal computers, software and potential back-up and contingency plans. To date, the Company has not experienced any significant Year 2000 issues.

The Company's initial assessment identified Year 2000 issues within the Company's operating systems. The total cost of Year 2000 enhancements was approximately \$800,000 and was funded from operating cash flows. The majority of such costs was for the acquisition of hardware and software and were capitalized. The remaining costs were expensed as incurred and did not have a material effect on the results of operations.

The ability of third parties with which the Company transacts business to adequately address remaining Year 2000 issues is outside of the Company's control. There can be no assurance that the failure of the Company, or such third parties, to adequately address their respective remaining Year 2000 issues will not have a material adverse effect on the Company's financial condition or results of operations. Accordingly, as part of the Year 2000 program, contingency plans were developed to respond to any failures. At this time, the Company does not expect that any failure of the Company or third parties to achieve Year 2000 compliance will adversely affect the Company.

SEASONALITY AND CYCLICALITY

The HVAC industry is subject to seasonal variations. Specifically, the demand for new installation and replacement is generally lower during the winter months 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, the Company expects its revenues and operating results generally will be lower in the first and fourth calendar quarters.

Historically, the construction industry has been highly cyclical. As a result, the Company's volume of business may be adversely affected by declines in new installation projects in various geographic regions of the United States.

FACTORS WHICH MAY AFFECT FUTURE RESULTS

The Company's future operating results are difficult to predict and may be affected by a number of factors, including the lack of a combined operating history and the difficulty of integrating acquired businesses, a downturn in construction, shortages of labor and specialty building materials, cyclical and seasonal fluctuations in the demand for HVAC systems, the use of incorrect estimates for bidding a fixed price contract, difficulties in implementing its acquisition strategy and the availability of acquisition financing. As a result of these and other factors, there can be no assurance that the Company will not experience material fluctuations in future operating results on a quarterly or annual basis.

The Company's success depends in part on its ability to integrate the companies it has acquired. The businesses operated as separate, independent entities prior to their affiliation with the Company, and there

can be no assurance that the Company will be able to integrate the operations of these businesses successfully or institute the necessary systems and procedures, including accounting and financial reporting systems, to effectively manage the combined enterprise on a profitable basis. The historical results are not necessarily indicative of future results of the Company because, among other things, the Acquired Companies were not under common control or management prior to their acquisition.

Key elements of the Company's strategy are to both maintain and improve the profitability of the individual businesses and to continue to expand the revenues of such businesses. The Company's level of success in this strategy, if any, will be affected by demand for new or replacement HVAC systems. In part, such demand will be contingent upon factors outside the Company's control, such as the level of new construction or the potential for slower replacement based upon the overall level of activity in the economy. The HVAC industry is subject to both seasonal and cyclical variations, meaning that temperate weather and downturns in the domestic or regional economies will negatively affect overall demand for the Company's services.

The Company has grown significantly through the acquisition of additional HVAC and complementary businesses and intends to continue acquisition activity in the future, albeit more opportunistically. However, the Company could face difficulties in continuing to acquire select companies. The HVAC industry continues to undergo consolidation on both a national and a regional level by the Company and by other companies that have acquisition objectives that are similar to the Company's objectives. Additionally, HVAC equipment manufacturers and certain public utilities are beginning to provide maintenance, repair and replacement services within the HVAC industry. These companies generally are better capitalized, have greater name recognition and may be able to provide these services at a lower cost.

Recently acquired businesses also involve a number of special risks, including failure of the acquired business to achieve expected results, diversion of management's attention and failure to retain key personnel of the acquired business. There are also risks associated with unanticipated events or liabilities resulting from the acquired businesses' operations prior to their acquisition. Any of these risks, or a combination of them, could have a material adverse effect on the Company's business, financial condition and results of operations.

The timely provision of high-quality installation service and maintenance, repair and replacement of HVAC systems by the Company requires an adequate supply of skilled HVAC technicians. In addition, the Company depends on the senior management of the businesses it acquires and regional and corporate management to remain committed to the success of the Company. Accordingly, the Company's ability to maintain and increase its productivity and profitability is also affected by its ability to employ, train and retain the skilled technicians necessary to meet the Company's service requirements, and to retain senior management in acquired businesses and at the corporate and regional level.

HVAC systems are also subject to various environmental statutes and regulations, including the Clean Air Act and those regulating the production, servicing and disposal of certain ozone depleting refrigerants used in HVAC systems. There can be no assurance that the regulatory environment in which the Company operates will not change significantly in the future. The Company's failure to comply, or the costs of compliance, with such laws and regulations could adversely affect the Company's future results.

Because of these and other factors, past financial performance should not necessarily be considered an indicator of future performance. Investors should not rely solely on historical trends to anticipate future results and should be aware that the trading price of the Company's Common Stock may be subject to wide fluctuations in response to quarter-to-quarter variations in operating results, general conditions in the HVAC industry, the increasing supply of tradable stock, changes in analysts' earnings estimates, recommendations by analysts, or other events.

ITEM 7-A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk primarily related to potential adverse changes in interest rates as discussed below. Management is actively involved in monitoring exposure to market risk and continues to develop and utilize appropriate risk management techniques. The Company is 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. Management does not use derivative financial instruments for trading or to speculate on changes in interest rates or commodity prices.

The Company's exposure to changes in interest rates primarily results from its short-term and long-term debt with both fixed and floating interest rates. The Company's debt with fixed interest rates consists of capital leases, convertible subordinated notes, subordinated notes and various other notes payable. The Company's debt with variable interest rates consists entirely of its revolving Credit Facility. The following table presents principal amounts (stated in thousands) and related average interest rates by year of maturity for the Company's debt obligations and their indicated fair market value at December 31, 1999:

	2000	2001	2002	2003	2004	THEREAFTER	FAIR VALUE
Liabilities -- Long-Term Debt:							
Variable Rate Debt.....	\$ --	\$ 225,215	\$ --	\$ --	\$ --	\$--	\$225,215
Average Interest Rate.....	-- %	7.4%	-- %	-- %	-- %	-- %	7.4%
Fixed Rate Debt.....	\$ 27,889	\$ 29,274	\$ 22,072	\$ 1,383	\$ --	\$--	\$ 80,618
Average Interest Rate.....	5.8%	5.8%	5.7%	5.5%	-- %	-- %	5.8%

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Comfort Systems USA, Inc.:

We have audited the accompanying consolidated balance sheets of Comfort Systems USA, Inc. (a Delaware corporation) and subsidiaries as of December 31, 1998 and 1999, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Comfort Systems USA, Inc., and subsidiaries as of December 31, 1998 and 1999, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP
Houston, Texas
February 22, 2000

COMFORT SYSTEMS USA, INC.
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	DECEMBER 31,	
	1998	1999
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents.....	\$ 6,985	\$ 3,664
Accounts receivable.....	241,332	314,599
Less -- Allowance.....	4,758	5,568
	-----	-----
Accounts receivable, net.....	236,574	309,031
Other receivables.....	2,733	4,575
Inventories.....	14,768	20,907
Prepaid expenses and other.....	14,264	19,891
Costs and estimated earnings in excess of billings.....	37,228	54,575
	-----	-----
Total current assets.....	312,552	412,643
PROPERTY AND EQUIPMENT, net.....	34,413	41,964
GOODWILL, net.....	430,526	474,529
OTHER NONCURRENT ASSETS.....	11,802	14,136
	-----	-----
Total assets.....	\$ 789,293	\$ 943,272
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt.....	\$ 1,568	\$ 3,353
Current maturities of notes to affiliates and former owners.....	7,509	24,536
Accounts payable.....	74,161	96,032
Accrued compensation and benefits.....	25,869	36,187
Billings in excess of costs and estimated earnings.....	43,968	52,170
Income taxes payable.....	1,299	--
Other current liabilities.....	24,788	27,799
	-----	-----
Total current liabilities.....	179,162	240,077
DEFERRED INCOME TAXES.....	1,124	4,547
LONG-TERM DEBT, NET OF CURRENT MATURITIES.....	171,039	225,471
NOTES TO AFFILIATES AND FORMER OWNERS, NET OF CURRENT MATURITIES.....	56,330	52,473
OTHER LONG-TERM LIABILITIES.....	1,706	1,739
	-----	-----
Total liabilities.....	409,361	524,307
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, 38,141,180 and 39,258,913 shares issued, respectively.....	381	393
Treasury stock, at cost, 1,695,524 shares at December 31, 1999.....	--	(11,978)
Additional paid-in capital.....	333,978	342,655
Retained earnings.....	45,573	87,895
	-----	-----
Total stockholders' equity.....	379,932	418,965
	-----	-----
Total liabilities and stockholders' equity.....	\$ 789,293	\$ 943,272
	=====	=====

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

COMFORT SYSTEMS USA, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	YEAR ENDED DECEMBER 31,		
	1997	1998	1999
REVENUES.....	\$ 297,646	\$ 853,961	\$ 1,370,035
COST OF SERVICES.....	220,419	647,512	1,077,329
Gross profit.....	77,227	206,449	292,706
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES.....	69,102	130,370	187,771
GOODWILL AND OTHER AMORTIZATION.....	1,851	7,132	11,731
ACQUISITION RELATED EXPENSES.....	575	450	--
Operating income.....	5,699	68,497	93,204
OTHER INCOME (EXPENSE):			
Interest income.....	1,187	957	841
Interest expense.....	(1,331)	(7,633)	(20,033)
Other.....	(17)	241	48
Other income (expense).....	(161)	(6,435)	(19,144)
INCOME BEFORE INCOME TAXES.....	5,538	62,062	74,060
PROVISION FOR INCOME TAXES.....	7,602	27,049	31,738
NET INCOME (LOSS).....	\$ (2,064)	\$ 35,013	\$ 42,322
NET INCOME (LOSS) PER SHARE:			
Basic.....	\$ (0.11)	\$ 1.06	\$ 1.10
Diluted.....	\$ (0.11)	\$ 1.04	\$ 1.09
SHARES USED IN COMPUTING NET INCOME (LOSS) PER SHARE:			
Basic.....	18,954	32,962	38,561
Diluted.....	18,954	34,329	39,699

Reflects a 121.1387-for-one stock split effective on March 19, 1997

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

COMFORT SYSTEMS USA, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	COMMON STOCK		TREASURY STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TOTAL STOCKHOLDERS' EQUITY
	SHARES	AMOUNT	SHARES	AMOUNT			
BALANCE AT DECEMBER 31, 1996.....	6,066,312	\$ 60	--	\$ --	\$ 216	\$15,153	\$ 15,429
Issuance of Common Stock:							
Initial Public Offering.....	7,015,000	70	--	--	79,805	--	79,875
Acquisition of Founding Companies.....	9,720,927	98	--	--	100,999	--	101,097
Issuance of management shares...	4,118,708	41	--	--	11,556	--	11,597
Acquisition of Purchased Companies.....	1,092,489	11	--	--	13,253	--	13,264
S Corporation distributions made by certain Pooled Companies.....	--	--	--	--	--	(2,191)	(2,191)
Adjustments to conform fiscal year-ends of Pooled Companies....	--	--	--	--	--	727	727
Net loss.....	--	--	--	--	--	(2,064)	(2,064)
Other.....	--	--	--	--	--	(99)	(99)
BALANCE AT DECEMBER 31, 1997.....	28,013,436	280	--	--	205,829	11,526	217,635
Issuance of Common Stock:							
Second Public Offering.....	861,479	9	--	--	15,892	--	15,901
Acquisition of Purchased Companies.....	9,212,573	92	--	--	111,456	--	111,548
Issuance of Employee Stock Purchase Plan shares.....	29,362	--	--	--	482	--	482
Issuance of shares for options exercised.....	24,330	--	--	--	319	--	319
S Corporation distributions made by certain Pooled Companies.....	--	--	--	--	--	(966)	(966)
Net income.....	--	--	--	--	--	35,013	35,013
BALANCE AT DECEMBER 31, 1998.....	38,141,180	381	--	--	333,978	45,573	379,932
Issuance of Common Stock:							
Acquisition of Purchased Companies.....	958,533	10	125,197	885	6,164	--	7,059
Issuance of Employee Stock Purchase Plan shares.....	142,276	2	--	--	2,036	--	2,038
Issuance of shares for options exercised.....	16,924	--	--	--	477	--	477
Common Stock repurchases.....	--	--	(1,820,721)	(12,863)	--	--	(12,863)
Net income.....	--	--	--	--	--	42,322	42,322
BALANCE AT DECEMBER 31, 1999.....	39,258,913	\$393	(1,695,524)	\$(11,978)	\$342,655	\$87,895	\$ 418,965

Reflects a 121.1387-for-one stock split effective on March 19, 1997

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

COMFORT SYSTEMS USA, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	YEAR ENDED DECEMBER 31,		
	1997	1998	1999
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss).....	\$ (2,064)	\$ 35,013	\$ 42,322
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities			
Depreciation and amortization expense.....	4,786	14,001	23,055
Bad debt expense.....	583	1,253	1,650
Compensation expense related to issuance of management shares....	11,556	--	--
Deferred tax expense (benefit)....	(630)	960	1,339
Gain on sale of property and equipment.....	(95)	(274)	(260)
Adjustment to conform year-end of certain Pooled Companies.....	727	--	--
Changes in operating assets and liabilities, net of effects of acquisitions of Founding and Purchased Companies --			
(Increase) decrease in --			
Receivables, net.....	(12,066)	(34,915)	(58,096)
Inventories.....	1,008	(788)	(4,822)
Prepaid expenses and other current assets.....	503	2,437	3,213
Cost and estimated earnings in excess of billings.....	(5,167)	(7,926)	(15,433)
Other noncurrent assets.....	65	113	(293)
Increase (decrease) in --			
Accounts payable and accrued liabilities...	1,170	(14,991)	20,166
Billings in excess of costs and estimated earnings.....	546	208	6,080
Other, net.....	31	(616)	(507)
Net cash provided by (used in) operating activities.....	953	(5,525)	18,414
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment.....	(4,501)	(11,137)	(16,054)
Proceeds from sales of property and equipment.....	936	1,369	1,507
Cash paid for Founding Companies, net of cash acquired.....	(42,295)	--	--
Cash paid for Purchased Companies, net of cash acquired.....	(11,781)	(133,338)	(31,417)
Other.....	--	--	(500)
Net cash used in investing activities.....	(57,641)	(143,106)	(46,464)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payments on long-term debt.....	(38,157)	(109,508)	(236,372)
Borrowings of long-term debt.....	27,107	233,684	271,706
S Corporation distributions paid by certain Pooled Companies.....	(2,090)	(966)	--
Proceeds from issuance of common stock, net of offering costs....	79,916	16,702	2,258
Repurchases of common stock.....	--	--	(12,863)
Other.....	(189)	(2,393)	--
Net cash provided by financing activities.....	66,587	137,519	24,729
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS.....	9,899	(11,112)	(3,321)
CASH AND CASH EQUIVALENTS, beginning of year.....	8,198	18,097	6,985
CASH AND CASH EQUIVALENTS, end of year.....	<u>\$ 18,097</u>	<u>\$ 6,985</u>	<u>\$ 3,664</u>

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

COMFORT SYSTEMS USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 1999

1. BUSINESS AND ORGANIZATION:

Comfort Systems USA, Inc., a Delaware corporation ("Comfort Systems" and collectively with its subsidiaries, the "Company"), is a leading national provider of comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services. Founded in December 1996, the Company is composed of companies within the commercial and industrial HVAC markets, and performs most of its services within manufacturing plants, office buildings, retail centers, apartment complexes, and healthcare, education and government facilities. In addition to standard HVAC services, the Company also provides specialized applications such as process cooling, control systems, electronic monitoring and process piping. Certain locations also perform related services such as electrical and plumbing.

On July 2, 1997, Comfort Systems completed the initial public offering (the "IPO") of its common stock (the "Common Stock") and simultaneously acquired 12 companies (collectively referred to as the "Founding Companies") engaged in providing HVAC services. The Founding Companies had 18 operating locations in 10 states. Subsequent to the IPO, and through December 31, 1999, the Company acquired 107 additional HVAC and complementary businesses (collectively with the Founding Companies, the "Acquired Companies"). The companies acquired subsequent to the IPO added 108 operating locations in 21 additional states. These acquisitions included 26 "tuck-in" operations that have been or are currently being integrated with existing Company operations.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

BASIS OF PRESENTATION

For financial statement purposes, Comfort Systems has been identified as the accounting acquirer. Accordingly, the historical financial statements include those of Comfort Systems since December 1996. Of the 107 acquisitions noted above, 17 were accounted for as poolings-of-interests (the "Pooled Companies") and 90 were accounted for as purchases (the "Purchased Companies"). These consolidated financial statements reflect the acquisitions of the Founding Companies and Purchased Companies as of their respective acquisition dates and reflects 15 of the Pooled Companies (the "Restated Companies") for all periods presented. Two of the Pooled Companies are considered immaterial poolings based upon criteria set forth by the Securities and Exchange Commission and have not been restated for all periods presented. The acquisitions of the Founding and Purchased Companies were accounted for using the purchase method of accounting. The allocations of the purchase prices to the assets acquired and liabilities assumed of certain of these companies have been recorded based on preliminary estimates of fair value and may be changed as additional information becomes available.

Prior to their acquisition by Comfort Systems, seven of the Pooled Companies reported annual results based on fiscal year-ends other than December 31. An adjustment to conform the year-ends of five of these companies to December 31 year-ends was made in 1996. An adjustment to conform the year-ends of two of these companies to December 31 year-ends was made in 1997 resulting in an increase of approximately \$727,000 to retained earnings and cash flows for 1997.

PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of Comfort Systems and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

CASH FLOW INFORMATION

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Cash paid for interest in 1997, 1998 and 1999 was approximately \$0.7 million, \$6.6 million and \$17.8 million, respectively. Cash paid for income taxes in 1997, 1998 and 1999 was approximately \$1.0 million, \$33.3 million and \$33.6 million, respectively.

INVENTORIES

Inventories consist of parts and supplies held for use in the ordinary course of business and are stated at the lower of cost or market using the first-in, first-out method.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost, and depreciation is computed using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are capitalized and amortized over the lesser of the expected life of the lease or the estimated useful life of the asset.

Expenditures for repairs and maintenance are charged to expense when incurred. Expenditures for major renewals and betterments, which extend the useful lives of existing equipment, are capitalized and depreciated over the remaining useful life of the equipment. Upon retirement or disposition of property and equipment, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in the statement of operations.

GOODWILL

Goodwill represents the excess of the aggregate purchase price paid by the Company in acquisitions accounted for as purchases over the fair value of the net tangible assets acquired. Goodwill is amortized on a straight-line basis over periods not exceeding 40 years.

As of December 31, 1998 and 1999, accumulated amortization of goodwill was approximately \$9.1 million and \$20.7 million, respectively.

LONG-LIVED ASSETS

Long-lived assets are comprised principally of goodwill and property and equipment. The Company periodically evaluates whether events and circumstances have occurred that indicate that the remaining balances of these assets may not be recoverable. The Company uses an estimate of future income from operations and cash flows, as well as other economic and business factors as a measure of recoverability of these assets.

REVENUE RECOGNITION

The Company recognizes revenue when services are performed except when work is being performed under a construction contract. Revenues from construction contracts are recognized on the percentage-of-completion method measured by the percentage of costs incurred to total estimated costs for each contract. Contract costs include all direct material (net of estimated rebates), labor and subcontract costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. Provisions for the total estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, estimated profitability and final contract settlements may result in revisions to costs and revenues, and their effects are recognized in the period in which the revisions are determined.

Receivable balances billed but not paid by customers pursuant to retainage provisions in construction contracts are due upon completion of the contracts and acceptance by the customer. Based on the Company's experience with similar contracts in recent years, the retention balance is billed and collected in the upcoming fiscal year. The retainage balances at December 31, 1998 and 1999 are \$45.3 million and \$58.2 million, respectively.

WARRANTY COSTS

The Company typically warrants labor for the first year after installation on new air conditioning and heating systems. The Company generally warrants labor for 30 days after servicing of existing air conditioning and heating systems. A reserve for warranty costs is recorded based upon the historical level of warranty claims and management's estimate of future costs.

INCOME TAXES

The Company files 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 tax assets represent the tax effect of activity that has been reflected in the financial statements but which will not be deductible for tax purposes until future periods. Deferred tax liabilities represent the tax effect of activity that has been reflected in the financial statements but which will not be taxable until future periods.

Certain of the Pooled Companies were S Corporations for income tax purposes and, accordingly, any income tax liabilities for the periods prior to the acquisition date are the responsibility of the respective stockholders. All acquired entities are subject to corporate income taxes subsequent to their acquisition.

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 revenues, expenses, assets, liabilities and contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

CONCENTRATIONS OF CREDIT RISK

The Company provides services to a broad range of geographical regions. The Company's credit risk primarily consists of receivables from a variety of customers including general contractors, property owners and developers, and commercial and industrial companies. The Company reviews its accounts receivable and provides allowances as deemed necessary.

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, receivables from related parties, other receivables, accounts payable, a line of credit, notes payable, notes payable to related parties and long-term debt. The Company believes that the carrying value of these instruments on the accompanying balance sheets approximates their fair value.

CHANGE IN CLASSIFICATION OF CERTAIN COSTS

During 1999, the Company began presenting certain costs in cost of services that related to activities that directly support project or service work. These costs were previously presented in selling, general and administrative expenses (SG&A). Management believes this revised presentation better aligns cost of services and SG&A across all acquired operations. The change in classification in 1999 resulted in approximately \$37.2 million of costs included in cost of services which would have been included in SG&A under the prior presentation. Exclusive of this change in classification, gross profit in 1999 would have been approximately \$329.9 million. Prior periods have not been restated.

3. BUSINESS COMBINATIONS:

POOLINGS

During 1997 and 1998, the Company acquired all of the outstanding stock of the Pooled Companies in exchange for 4,507,406 and 1,437,767 shares of Common Stock, respectively. These acquisitions have been accounted for as poolings-of-interests as described in Note 2. These companies provide HVAC and related services. The historical financial statements for 1997 and 1998 reflect the operations of the Restated Companies prior to their acquisition by the Company.

PURCHASES

Subsequent to the IPO, and through December 31, 1997, Comfort Systems acquired 13 of the Purchased Companies. These companies provide HVAC and related services. The aggregate consideration paid in these transactions was \$14.5 million in cash, 1,092,489 shares of the Company's stock with a market value at the date of acquisition totaling \$13.3 million and \$5.0 million in the form of convertible subordinated notes. Subsequent to the issuance of certain of the convertible subordinated notes, the Company entered into agreements with certain of the convertible noteholders to modify the terms of \$4.7 million of these notes in order to eliminate the provisions relating to convertibility into the Company's Common Stock. The remaining convertible subordinated notes have subsequently been paid.

During 1998, the Company acquired 52 of the Purchased Companies. These companies provide HVAC and related services. The aggregate consideration paid in these transactions was \$161.2 million in cash, 9,212,573 shares of the Company's stock with a market value at the date of acquisition totaling \$111.5 million, \$57.4 million in the form of convertible subordinated notes and \$3.1 million in the form of subordinated notes (collectively the "Notes"). Subsequent to the issuance of certain of the convertible subordinated notes, the Company entered into agreements with certain of the convertible noteholders to modify the terms of \$49.3 million of these notes in order to eliminate the provisions relating to convertibility into the Company's Common Stock. The remaining convertible subordinated notes are convertible at various dates in 2000 into 74,975 shares of Common Stock.

During 1999, the Company acquired 25 of the Purchased Companies. These companies provide HVAC and related services. The aggregate consideration paid in these transactions was \$38.0 million in cash, 1,151,907 shares of the Company's stock with a market value at the date of acquisition totaling \$8.5 million, \$2.2 million in the form of convertible subordinated notes and \$21.3 million in the form of subordinated notes. In addition, the Company received 68,177 shares from a former owner related to a prior year acquisition. Subsequent to the issuance of certain of the convertible subordinated notes, the Company entered into agreements with certain of the convertible noteholders to modify the terms of \$2.1 million of these notes in order to eliminate the provisions relating to convertibility into the Company's Common Stock. The remaining convertible subordinated notes are convertible at various dates in 2000 into 5,133 shares of Common Stock.

The accompanying balance sheet as of December 31, 1999 includes allocations of the respective purchase prices to the assets acquired and liabilities assumed based on preliminary estimates of fair value and is subject to final adjustment. The allocations in 1998 and 1999 resulted in \$277.4 million and \$55.7 million in goodwill, respectively, which represents the excess of the purchase price over the estimated fair

COMFORT SYSTEMS USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

value of the net assets acquired for the Purchased Companies. In conjunction with the acquisitions, goodwill was determined as follows (in thousands):

	1998	1999
	-----	-----
Fair value of assets acquired, net of cash acquired.....	\$ (261,754)	\$ (27,806)
Liabilities assumed.....	233,669	20,138
Cash paid, net of cash acquired.....	133,338	31,417
Estimated market value of stock consideration.....	111,681	8,463
Issuance of Notes.....	60,482	23,473
	-----	-----
Goodwill.....	\$ 277,416	\$ 55,685
	=====	=====

The unaudited pro forma data presented below consists of the income statement data presented in these consolidated financial statements plus income statement data for the Purchased Companies as if the acquisitions were effective on January 1, 1998 through the respective dates of acquisitions (in thousands, except per share data):

	YEAR ENDED DECEMBER 31,	
	-----	-----
	1998	1999
	-----	-----
	(UNAUDITED)	
Revenues.....	\$ 1,355,733	\$ 1,421,118
Net income.....	\$ 40,657	\$ 41,992
Net income per share -- diluted.....	\$ 1.03	\$ 1.06
Shares used in computing net income per share -- diluted.....	40,113	40,156

Pro forma adjustments included in the preceding table regarding the Purchased Companies primarily relate to (a) certain reductions in salaries and benefits to the former owners (the "Compensation Differential") of the Pooled Companies and Purchased Companies which the former owners agreed would take effect as of the acquisition date, (b) elimination of merger costs in connection with the acquisition of the Pooled Companies, (c) amortization of goodwill related to the Purchased Companies, (d) interest expense on borrowings of \$11.8 million that would have been necessary to fund certain S Corporation distributions if they had occurred at the beginning of each period presented, (e) interest expense on borrowings of \$197.6 million related to the purchase price of the Purchased Companies acquired during 1998 and 1999 and (f) interest expense related to the subordinated notes issued in connection with the acquisition of certain Acquired Companies. In addition, an incremental tax provision has been recorded as if all applicable Purchased Companies and Pooled Companies which were C Corporations had been subject to federal and state income taxes.

The pro forma results presented above are not necessarily indicative of actual results which might have occurred had the operations and management teams of the Company, the Purchased Companies and Pooled Companies been combined at the beginning of the periods presented.

COMFORT SYSTEMS USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

4. PROPERTY AND EQUIPMENT:

Property and equipment consist of the following (dollars in thousands):

	ESTIMATED USEFUL LIVES IN YEARS	DECEMBER 31,	
		1998	1999
Land.....	N/A	\$ 124	\$ 178
Transportation equipment.....	3-10	31,776	32,781
Machinery and equipment.....	3-15	23,002	27,542
Computer and telephone equipment.....	3-7	10,168	15,942
Buildings and leasehold improvements.....	3-39	8,564	12,079
Furniture and fixtures.....	3-10	8,082	8,815
		81,716	97,337
Less -- Accumulated depreciation.....		47,303	55,373
Property and equipment, net.....		\$ 34,413	\$ 41,964

5. DETAIL OF CERTAIN BALANCE SHEET ACCOUNTS:

Activity in the Company's allowance for doubtful accounts consists of the following (in thousands):

	DECEMBER 31,		
	1997	1998	1999
Balance at beginning of year.....	\$ 994	\$ 1,698	\$ 4,758
Additions for bad debt expense.....	583	1,253	1,650
Deductions for recoveries and for uncollectible receivables written off.....	(488)	(909)	(1,940)
Allowance for doubtful accounts of Founding and Purchased Companies at date of acquisition.....	609	2,716	1,100
Balance at end of year.....	\$ 1,698	\$ 4,758	\$ 5,568

Other current liabilities consist of the following (in thousands):

	DECEMBER 31,	
	1998	1999
Accrued warranty costs.....	\$ 4,596	\$ 4,587
Accrued insurance expense.....	4,851	6,835
Deferred income taxes.....	4,940	4,195
Deferred revenue.....	525	2,210
Other current liabilities.....	9,876	9,972
	\$ 24,788	\$ 27,799

Installation contracts in progress are as follows (in thousands):

	DECEMBER 31,	
	1998	1999
Costs incurred on contracts in progress.....	\$ 748,542	\$ 895,662
Estimated earnings, net of losses....	151,792	209,887
Less -- Billings to date.....	(907,074)	(1,103,144)
	\$ (6,740)	\$ 2,405
Costs and estimated earnings in excess of billings on uncompleted contracts.....	\$ 37,228	\$ 54,575
Billings in excess of costs and estimated earnings on uncompleted contracts.....	(43,968)	(52,170)
	\$ (6,740)	\$ 2,405

6. LONG-TERM DEBT OBLIGATIONS:

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

	DECEMBER 31,	
	1998	1999
Revolving credit facility.....	\$ 170,700	\$ 225,215
Notes to affiliates and former owners.....	63,839	77,009
Other.....	1,907	3,609
Total debt.....	236,446	305,833
Less: current maturities.....	9,077	27,889
	\$ 227,369	\$ 277,944

At December 31, 1999, future principal payments of long-term debt are as follows (in thousands):

YEAR ENDING DECEMBER 31 --	
2000.....	\$ 27,889
2001.....	254,489
2002.....	22,072
2003.....	1,383
	\$ 305,833

REVOLVING CREDIT FACILITY

In July 1997, the Company entered into a credit agreement with Bank One, Texas, N.A. (the "Credit Facility"). The Credit Facility was amended and restated in September 1997 primarily to provide for additional banks to lend to the Company under the Credit Facility. At that time, the Credit Facility provided the Company with an unsecured revolving line of credit of \$75 million. The Credit Facility was further amended in April 1998 and again in December 1998 in order to increase borrowing capacity and to provide for additional banks to lend to the Company under the Credit Facility. The Credit Facility currently provides the Company with a revolving line of credit of up to \$300 million secured by accounts receivable, inventory and the shares of capital stock of the Company's subsidiaries. The Company currently has a choice of two interest rate options when borrowing under the Credit Facility. Under one option, the interest rate is determined based on the higher of the Federal Funds Rate plus 0.5% or the bank's prime rate. An additional margin of zero to 1.25% is then added to the higher of these two rates. Under the other interest rate option,

COMFORT SYSTEMS USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

borrowings bear interest based on designated short-term Eurodollar rates (which generally approximate LIBOR) plus 1.0% to 2.5%. The additional margin for both options depends on the ratio of the Company's debt to EBITDA. Commitment fees of 0.25% to 0.5% per annum, also depending on the ratio of debt to EBITDA, are payable on the unused portion of the facility. The Credit Facility prohibits the payment of dividends by the Company without the lenders' approval and requires the Company to comply with certain financial covenants. The amended Credit Facility expires on November 1, 2001, at which time all amounts outstanding under the Credit Facility are due.

As of December 31, 1999, the Company had borrowed \$225.2 million under the Credit Facility at an average interest rate of approximately 7.4% for the year ended December 31, 1999. The Company's unused committed borrowing capacity under the Credit Facility was \$72.9 million at December 31, 1999. As of March 13, 2000, \$249.2 million (unaudited) was outstanding under this facility.

NOTES TO AFFILIATES AND FORMER OWNERS

The Notes in the amount of \$77.0 million referred to above were issued to former owners of certain Purchased Companies as partial consideration of the acquisition purchase price. Of these Notes, \$76.4 million bear interest, payable quarterly, at a weighted average interest rate of 5.84% and \$2.0 million of these Notes are convertible by the holder into shares of the Company's Common Stock at a weighted average price of \$25.66 per share. The remaining Notes in the amount of \$0.6 million are non-interest bearing and require \$0.2 million of principal payments in 2000 and \$0.4 million of principal payments in equal annual installments in 2001, 2002, and 2003. The terms of the convertible subordinated notes require \$0.4 million of principal payments in 2000, \$0.6 million of principal payments in 2001, \$0.6 million of principal payments in 2002, and \$0.4 million of principal payments in 2003. The terms of the nonconvertible interest bearing subordinated notes require \$23.9 million of principal payments in 2000, \$28.3 million of principal payments in 2001, \$21.3 million of principal payments in 2002, and \$0.9 million of principal payments in 2003.

The Company estimates the fair value of long-term debt as of December 31, 1998 and 1999 to be approximately the same as the recorded value.

7. INCOME TAXES:

The Company has implemented SFAS No. 109, "Accounting for Income Taxes," which provides for a liability approach to accounting for income taxes. The provision for income taxes consists of the following (in thousands):

	YEAR ENDED DECEMBER 31,		
	1997	1998	1999
<hr/>			
Current --			
Federal.....	\$ 6,469	\$ 21,650	\$ 25,622
State and Puerto Rico.....	1,763	4,439	4,777
	<hr/>	<hr/>	<hr/>
	8,232	26,089	30,399
	<hr/>	<hr/>	<hr/>
Deferred --			
Federal.....	(688)	907	2,067
State and Puerto Rico.....	58	53	(728)
	<hr/>	<hr/>	<hr/>
	(630)	960	1,339
	<hr/>	<hr/>	<hr/>
	\$ 7,602	\$ 27,049	\$ 31,738
	<hr/>	<hr/>	<hr/>

COMFORT SYSTEMS USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The difference in income taxes provided for and the amounts determined by applying the federal statutory tax rate to income before income taxes result from the following (in thousands):

	YEAR ENDED DECEMBER 31,		
	1997	1998	1999
Income tax expense at the statutory rate.....	\$ 1,937	\$ 21,713	\$ 25,921
Increase (decrease) resulting from --			
State income taxes, net of			
federal tax effect.....	1,245	3,148	2,567
Non-deductible expenses.....	428	364	492
Non-recurring, non-cash compensation charge.....	4,045	--	--
Effect of S Corporation income previously taxed to the former owners.....	(1,089)	(308)	--
Non-deductible goodwill amortization.....	633	2,047	2,730
Non-deductible acquisition costs related to Pooled Companies...	201	157	--
Provision (benefit) recognized upon termination of Subchapter S election.....	100	(101)	--
Other.....	102	29	28
	-----	-----	-----
	\$ 7,602	\$ 27,049	\$ 31,738
	=====	=====	=====

Deferred income tax provisions result from current period activity that has been reflected in the financial statements but which is not includable in determining the Company's tax liabilities until future periods. Deferred tax assets and liabilities reflect the tax effect in future periods of all such activity to date that has been reflected in the financial statements but which is not includable in determining the Company's tax liabilities until future periods.

	DECEMBER 31,	
	1998	1999
	-----	-----
	(IN THOUSANDS)	
Deferred income tax assets --		
Accounts receivable and allowance for doubtful accounts.....	\$ 1,699	\$ 1,854
Accrued liabilities and expenses.....	6,038	7,206
Net operating loss.....	126	1,343
Other.....	344	630
	-----	-----
Total deferred income tax assets.....	8,207	11,033
	-----	-----
Deferred income tax liabilities --		
Property and equipment.....	(873)	(1,113)
Long-term installation contracts.....	(4,716)	(3,821)
Goodwill.....	(31)	(3,180)
Other.....	(444)	(628)
	-----	-----
Total deferred income tax liabilities.....	(6,064)	(8,742)
	-----	-----
Net deferred income tax assets.....	\$ 2,143	\$ 2,291
	=====	=====

COMFORT SYSTEMS USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The deferred tax assets and liabilities reflected above are included in the consolidated balance sheets as follows (in thousands):

	DECEMBER 31,	
	----- 1998	1999 -----
Deferred income tax assets --		
Prepaid expenses and other.....	\$ 7,778	\$ 9,403
Other non-current assets.....	429	1,630
Deferred income tax liabilities --		
Other current liabilities.....	(4,940)	(4,195)
Deferred income taxes.....	(1,124)	(4,547)
Net deferred income tax assets.....	\$ 2,143	\$ 2,291
	=====	=====

8. EMPLOYEE BENEFIT PLANS:

Certain of the Company's subsidiaries sponsor various retirement plans for most full-time and some part-time employees. These plans consist of defined contribution plans and multi-employer pension plans and cover employees at substantially all of the Company's operating locations. The defined contribution plans provide for contributions ranging from 2% to 6% of covered employees' salaries or wages and totaled \$1.8 million for 1997, \$3.6 million for 1998 and \$5.4 million for 1999. Of these amounts, approximately \$2.2 million and \$2.5 million was payable to the plans at December 31, 1998 and 1999, respectively.

Certain of the Company's subsidiaries also participate in several multi-employer pension plans for the benefit of their employees who are union members. Company contributions to these plans were approximately \$2.1 million for 1997, \$8.1 million for 1998 and \$14.6 million for 1999. The data available from administrators of the multi-employer pension plans is not sufficient to determine the accumulated benefit obligations, nor the net assets attributable to the multi-employer plans in which Company employees participate.

9. COMMITMENTS AND CONTINGENCIES:

LEASES

The Company leases certain facilities and equipment under noncancelable operating leases. Rent expense for the years ended December 31, 1997, 1998, and 1999 was \$2.2 million, \$6.7 million and \$17.5 million, respectively. Concurrent with the acquisitions of certain Acquired Companies, the Company entered into various agreements with previous owners to lease land and buildings used in the Company's operations. The terms of these leases range from five years to ten years and provide for certain escalations in the rental expenses each year. Included in the 1997, 1998 and 1999 rent expense above is approximately \$1.2 million, \$3.9 million and \$6.1 million of rent paid to these related parties, respectively. The following represents future minimum rental payments under noncancelable operating leases (in thousands):

Year ending December 31 --	
2000.....	\$ 13,403
2001.....	12,000
2002.....	10,500
2003.....	7,629
2004.....	5,445
Thereafter.....	13,132

	\$ 62,109
	=====

CLAIMS AND LAWSUITS

The Company is party to litigation in the ordinary course of business. There are currently no pending legal proceedings that, in management's opinion, would have a material adverse effect on the Company's operating results or financial condition. The Company maintains various insurance coverages in order to minimize financial risk associated with certain claims. The Company has provided accruals for probable losses and legal fees associated with certain of these actions in the accompanying consolidated financial statements. A wholly-owned insurance company subsidiary reinsures a portion of the risk associated with surety bonds issued by a third party insurance company. Because no claims have been made against these financial instruments in the past, management does not expect these instruments will have a material effect on the Company's consolidated financial statements.

10. STOCKHOLDERS' EQUITY:

COMMON STOCK AND PREFERRED STOCK

Comfort Systems effected a 121.1387-for-one stock split on March 19, 1997 for each share of Common Stock of the Company then outstanding. During 1998, the Company increased the number of shares of Common Stock authorized to 102,969,912.

In December 1996, in connection with the organization and initial capitalization of Comfort Systems, the Company issued 121,139 shares of Common Stock at \$.01 per share to Notre Capital Ventures II, L.L.C. ("Notre"). In January 1997, the Company issued 2,848,773 additional shares to Notre for \$.01 per share. In January and February 1997, the Company issued a total of 1,269,935 shares of Common Stock to management of and consultants to the Company at a price of \$.01 per share. As a result, the Company recorded a non-recurring, non-cash compensation charge of \$11.6 million in the first quarter of 1997, representing the difference between the amount paid for the shares and the estimated fair value of the shares on the date of sale.

On July 2, 1997, Comfort Systems completed the offering of 6,100,000 shares of Common Stock to the public at \$13.00 per share. The net proceeds to Comfort Systems from the IPO (after deducting underwriting commissions and offering expenses) were \$68.8 million. Of this amount, \$45.3 million was used to pay the cash portion of the purchase prices of the Founding Companies. In connection with the IPO, the Company granted its underwriters an option to sell an additional 915,000 shares at \$13.00 per share. On July 9, 1997, the underwriters exercised this option. Net proceeds to the Company from this sale of shares were \$11.1 million after deducting underwriting commissions.

On June 16, 1998, the Company completed a second public offering (the "Second Public Offering") of 400,000 shares of its Common Stock. The net proceeds from this offering of \$7.6 million, after deducting underwriting commissions, were used to repay debt. On July 21, 1998, the underwriters exercised their overallotment option in connection with the Second Public Offering completed in June 1998. An additional 461,479 shares of Common Stock were sold and the net proceeds of \$8.8 million, after deducting underwriting commissions, were used to repay debt.

TREASURY STOCK

On October 5, 1999, the Company announced that its Board of Directors had approved a share repurchase program authorizing the Company to buy up to 4 million shares of its Common Stock. As of December 31, 1999, the Company purchased approximately 1.8 million shares at a cost of approximately \$12.9 million. Subsequent to yearend, the Company has purchased approximately 0.1 million additional shares at a cost of approximately \$0.8 million (unaudited) through March 13, 2000.

RESTRICTED COMMON STOCK

In March 1997, Notre exchanged 2,742,912 shares of Common Stock for an equal number of shares of restricted voting common stock ("Restricted Voting Common Stock"). The holder of Restricted Voting Common Stock is entitled to elect one member of the Company's Board of Directors and to 0.55 of one vote for each share on all other matters on which they are entitled to vote. Holders of Restricted Voting Common Stock are not entitled to vote on the election of any other directors.

Each share of Restricted Voting Common Stock will automatically convert to Common Stock on a share-for-share basis (i) in the event of a disposition of such share of Restricted Voting Common Stock by

COMFORT SYSTEMS USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

the holder thereof (other than a distribution which is a distribution by a holder to its partners or beneficial owners, or a transfer to a related party of such holders (as defined in Sections 267, 707, 318 and/or 4946 of the Internal Revenue Code of 1986, as amended)), (ii) in the event any person acquires beneficial ownership of 15% or more of the total number of outstanding shares of Common Stock of the Company, or (iii) in the event any person offers to acquire 15% or more of the total number of outstanding shares of Common Stock of the Company. After July 1, 1998, the Board of Directors may elect to convert any remaining shares of Restricted Voting Common Stock into shares of Common Stock in the event that 80% or more of the originally outstanding shares of Restricted Voting Common Stock have been previously converted into shares of Common Stock. At December 31, 1999, 756,744 shares of Restricted Voting Common Stock had been converted to shares of Common Stock.

EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed by dividing net income by the weighted average number of shares of common stock outstanding during the year. Diluted EPS is computed considering the dilutive effect of stock options and convertible subordinated notes. Options to purchase 2.2 million shares of Common Stock at prices ranging from \$15.375 to \$21.438 per share were outstanding in 1999, but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the respective average market price of the Common Stock. Diluted EPS is also computed by adjusting both net earnings and shares outstanding as if the conversion of the convertible subordinated notes occurred on the first day of the year. The after tax interest expense related to the assumed conversion of the convertible subordinated notes in 1998 and 1999 was \$753,000 and \$766,000, respectively.

The following table summarizes weighted average shares outstanding for each of the periods presented (in thousands):

	YEAR ENDED DECEMBER 31,		
	1997	1998	1999
Shares issued in connection with the acquisitions of Founding Companies....	5,008	9,721	9,721
Shares sold pursuant to the IPO.....	3,142	6,100	6,100
Shares held by Notre, management and consultants.....	4,240	4,240	4,240
Shares issued in connection with the acquisitions of Pooled Companies.....	5,946	5,946	5,946
Weighted average shares issued in connection with the underwriter's over allotment.....	434	1,122	1,376
Weighted average shares issued in connection with the acquisitions of the Purchased Companies.....	184	5,597	10,932
Weighted average shares repurchased....	--	--	(303)
Weighted average shares sold in the Second Public Offering.....	--	215	400
Weighted average portion of shares issued in connection with the Employee Stock Purchase Plan.....	--	12	117
Weighted average portion of shares issued in connection with the exercise of stock options.....	--	9	32
Weighted average shares outstanding -- Basic.....	18,954	32,962	38,561
Weighted average portion of shares related to stock options under the treasury stock method.....	--	462	69
Weighted average shares related to the issuance of convertible notes.....	--	905	1,069
Weighted average shares outstanding -- Diluted.....	18,954	34,329	39,699
	=====	=====	=====

11. STOCK OPTION PLANS:

LONG-TERM INCENTIVE PLANS

In March 1997, the Company's stockholders approved the Company's 1997 Long-Term Incentive Plan which provides for the granting or awarding of incentive or non-qualified stock options, stock appreciation rights, restricted or deferred stock, dividend equivalents or other incentive awards to directors, officers, key employees and consultants to the Company.

The Company's 1997 Long-Term Incentive Plan provides for the granting of options to key employees to purchase an aggregate of not more than 13% of the total number of shares of the Company's Common Stock outstanding at the time of grant. Such options have been issued by the Company at fair market value on the date of grant and become exercisable in five equal annual installments beginning on the first anniversary of the date of grant. The options expire after seven years from the date of grant if unexercised. Outstanding options may be canceled and reissued under terms specified in the plan.

The following table summarizes activity under the Company's stock option plan:

FIXED OPTIONS	1997		1998	
	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
Outstanding at beginning of year.....	--	\$ --	2,537,203	\$ 13.72
Granted.....	2,537,203	\$ 13.72	1,495,500	\$ 18.54
Exercised.....	--	\$ --	(24,330)	\$ 13.45
Forfeited.....	--	\$ --	(53,344)	\$ 16.01
Expired.....	--	\$ --	--	\$ --
Outstanding at end of year.....	2,537,203	\$ 13.72	3,955,029	\$ 15.51
Options exercisable at year-end.....	--		518,281	
Weighted-average fair value of options granted during the year.....	\$ 3.53		\$ 7.33	

FIXED OPTIONS	1999	
	SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
Outstanding at beginning of year.....	3,955,029	\$15.51
Granted.....	758,200	\$13.36
Exercised.....	(16,924)	\$13.00
Forfeited.....	(125,642)	\$14.78
Expired.....	(13,530)	\$15.90
Outstanding at end of year.....	4,557,133	\$15.18
Options exercisable at year-end.....	1,287,229	
Weighted-average fair value of options granted during the year.....	\$ 6.26	

The following table summarizes information about fixed stock options outstanding at December 31, 1999:

RANGE OF EXERCISE PRICES	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
	NUMBER OUTSTANDING AT 12/31/99	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT 12/31/99	WEIGHTED-AVERAGE EXERCISE PRICE
\$ 7.63- 7.63	96,700	6.8 years	\$ 7.63	--	\$ --
\$11.75-16.88	3,086,403	5.0 years	\$13.78	970,876	\$ 13.57
\$17.88-21.44	1,374,030	5.5 years	\$18.85	316,353	\$ 18.85
\$ 7.63-21.44	4,557,133	5.2 years	\$15.18	1,287,229	\$ 14.87

In September 1997, the Company's stockholders approved the Company's 1998 Employee Stock Purchase Plan which allows employees to purchase shares from the Company's authorized but unissued shares of Common Stock or from shares of Common Stock reacquired by the Company, including shares repurchased on the open market.

COMFORT SYSTEMS USA, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The Company's 1998 Employee Stock Purchase Plan provides for the purchase of 300,000 shares at semi-annual intervals. Full-time employees are eligible to purchase shares with payroll deductions ranging from 2% to 8% of compensation with a maximum deduction of \$2,000 for any purchase period for each participant. The purchase price per share is 85% of the lower of the market price on the first business day of the purchase period or the purchase date.

The Company accounts for its stock-based compensation under Accounting Principles Board Statement No. 25, "Accounting for Stock Issued to Employees" (APB 25). Under this accounting method, no expense in connection with the stock option plan or the stock purchase plan is recognized in the consolidated statements of operations when the exercise price of the stock options is greater than or equal to the value of the Common Stock on the date of grant. In October 1995, the Financial Accounting Standards Board issued SFAS No. 123, "Accounting for Stock-Based Compensation," which requires that if a company accounts for stock-based compensation in accordance with APB 25, the company must also disclose the effects on its results of operations as if an estimate of the value of stock-based compensation at the date of grant was recorded as an expense in the company's statement of operations. These effects for the Company are as follows (in thousands, except per share data):

		1997	1998	1999
		-----	-----	-----
Net Income	As reported.....	\$ (2,064)	\$ 35,013	\$ 42,322
	Pro forma for SFAS No. 123.....	\$ (2,436)	\$ 33,341	\$ 39,519
Income Per Share -- Basic	As reported.....	\$ (.11)	\$ 1.06	\$ 1.10
	Pro forma for SFAS No. 123.....	\$ (.13)	\$ 1.01	\$ 1.02
Income Per Share -- Diluted	As reported.....	\$ (.11)	\$ 1.04	\$ 1.09
	Pro forma for SFAS No. 123.....	\$ (.13)	\$ 0.97	\$ 1.01

LONG-TERM INCENTIVE PLAN -- The effects of applying SFAS No. 123 in the pro forma disclosure may not be indicative of future amounts as additional option awards in future years are anticipated. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	1997	1998	1999
	-----	-----	-----
Expected dividend yield.....	0.00%	0.00%	0.00%
Expected stock price volatility.....	39.41%	44.87%	65.63%
Risk free interest rate.....	5.77%-6.15%	5.00%-6.15%	4.64%-5.87%
Expected life of options.....	7 years	4 years	4 years

EMPLOYEE STOCK PURCHASE PLAN -- The effects of applying SFAS No. 123 in the pro forma disclosure may not be indicative of future amounts as the granting of additional purchase rights is anticipated. Compensation cost associated with the stock purchase plan is recognized for the fair value of the employees' purchase rights, which is estimated using the Black-Scholes model with the following assumptions:

	1998	1999
	-----	-----
Expected dividend yield.....	0.00%	0.00%
Expected volatility.....	42.10%	53.8%
Risk free interest rate.....	5.19%-5.25%	4.56%-4.94%
Expected life of purchase rights.....	0.5 years	0.5 years

The weighted average fair values of the purchase rights granted in 1998 and 1999 were \$5.37 and \$4.88, respectively.

ITEM 9. CHANGES AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEMS 10 TO 13 INCLUSIVE

These items have been omitted in accordance with the instructions to Form 10-K. The Company will file with the Commission a definitive proxy statement including the information to be disclosed under the items in the 120 days following December 31, 1999.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) The following documents are filed as part of this report:

- (1) Consolidated Financial Statements of the Company, which are included at Item 8 of this report.
- (2) None
- (3) Exhibit Listing

INCORPORATED BY REFERENCE TO
THE EXHIBIT INDICATED BELOW
AND TO THE FILING WITH THE
COMMISSION INDICATED BELOW

EXHIBIT NUMBER	DESCRIPTION OF EXHIBITS	EXHIBIT NUMBER	FILING OR FILE NUMBER
3.1	-- Second Amended and Restated Certificate of Incorporation of the Registrant.	3.1	333-24021
3.2	-- Certificate of Amendment dated May 21, 1998	3.2	1998 Form 10-K
3.3	-- Bylaws of the Registrant, as amended	3.3	Filed Herewith
4.1	-- Form of certificate evidencing ownership of Common Stock of the Registrant.	4.1	333-24021
10.1	-- Comfort Systems USA, Inc. 1997 Long-Term Incentive Plan	10.1	333-24021
10.2	-- Comfort Systems USA, Inc. 1997 Non-Employee Directors' Stock Plan.	10.2	333-24021
10.3	-- Form of Employment Agreement between the Registrant and Fred M. Ferreira.	10.3	333-24021
10.4	-- Form of Employment Agreement between the Registrant and J. Gordon Beittenmiller.	10.4	333-24021
10.5	-- Form of Employment Agreement between the Registrant and William George, III.	10.5	333-24021
10.6	-- Form of Employment Agreement between the Registrant and Reagan S. Busbee.	10.6	333-24021
10.7	-- Form of Employment Agreement between the Registrant, Accurate Air Systems, Inc. and Thomas J. Beaty.	10.7	333-24021
10.8	-- Form of Employment Agreement between the Registrant, Atlas Comfort Services USA, Inc. and Brian S. Atlas	10.8	333-24021
10.9	-- Form of Employment Agreement between the Registrant, Contract Service, Inc. and John C. Phillips.	10.9	333-24021
10.10	-- Form of Employment Agreement between the Registrant, Eastern Heating & Cooling, Inc. and Alfred J. Giardenelli, Jr.	10.10	333-24021
10.11	-- Form of Employment Agreement between the Registrant, Quality Air Heating & Cooling, Inc. and Robert J. Powers	10.11	333-24021
10.12	-- Form of Employment Agreement between the Registrant, S. M. Lawrence Company, Inc. and Samuel M. Lawrence III.	10.12	333-24021
10.13	-- Form of Employment Agreement between the Registrant, Tech Heating and Air Conditioning, Inc. and Robert R. Cook	10.13	333-24021
10.14	-- Form of Employment Agreement between the Registrant, Tri-City Mechanical, Inc. and Michael Nothum, Jr.	10.14	333-24021
10.15	-- Form of Employment Agreement between the Registrant, Western Building Services, Inc. and Charles W. Klapperich.	10.15	333-24021
10.16	-- Employment Agreement between the Registrant, F&G Mechanical Corporation and Salvatore P. Giardina.		February 1998 Form 8-K

INCORPORATED BY REFERENCE TO
THE EXHIBIT INDICATED BELOW
AND TO THE FILING WITH THE
COMMISSION INDICATED BELOW

EXHIBIT NUMBER	DESCRIPTION OF EXHIBITS	EXHIBIT NUMBER	FILING OR FILE NUMBER
10.17	-- Employment Agreement between the Registrant, Shambaugh & Son, Inc. and Mark P. Shambaugh.	10.17	1998 Form 10-K
10.18	-- Form of Agreement among certain stockholders.	10.16	333-24021
10.19	-- Lease between M & B Interests, Inc. and Atlas Air Conditioning Company, Inc. dated October 1, 1994.	10.17	333-32595
10.20	-- Lease between Nothum Development, L.L.C. and Tri-City Mechanical, Inc. dated July 1, 1997.	10.20	333-32595
10.21	-- Lease between Samuel Matthews Lawrence, Jr. and S.M. Lawrence Company, Incorporated dated November 1, 1996.	10.21	333-32595
10.22	-- Lease between J&J Investments and Contract Service, Inc. dated March 1, 1997.	10.23	333-32595
10.23	-- Lease by Tech Heating and Air Conditioning, Inc. dated April 2, 1995 as amended by Amendment between Cook Properties, Inc. and Tech Heating and Air Conditioning, Inc. on March 13, 1997.	10.24	1998 Form 10-K
10.24	-- Third Amended and Restated Credit Agreement among the Company and its subsidiaries, Bank One, Texas, N.A., as agent and the banks listed therein dated December 14, 1998.	10.25	333-38009
10.25	-- Lease dated June 30, 1994, between Salpat Realty and F&G Mechanical Corp., together with lease modification agreements dated June 30, 1994 and February 12, 1998.	10.27	1997 Form 10-K
10.26	-- Lease dated October 31, 1998, between Mark Shambaugh and Shambaugh & Sons, Inc. (Opportunity Drive).	10.28	1998 Form 10-K
10.27	-- Lease dated October 31, 1998, between Mark Shambaugh and Shambaugh & Sons, Inc. (Di Salle Boulevard).	10.29	1998 Form 10-K
10.28	-- Lease dated October 31, 1998, between Mark Shambaugh and Shambaugh & Sons, Inc. (Speedway Drive).	10.30	1998 Form 10-K
10.29	-- Lease dated October 31, 1998, between Mark Shambaugh and Shambaugh & Sons, Inc. (South Bend).	10.31	1998 Form 10-K
10.30	-- Lease dated October 31, 1998, between Mark Shambaugh and Shambaugh & Sons, Inc. (Lafayette).	10.32	1998 Form 10-K
10.31	-- Promissory Note dated February 12, 1998 by Sorce Properties LLC in favor of F&G Mechanical Corporation.	10.28	1997 Form 10-K
10.32	-- Pledge Agreement dated February 12, 1998 by Salvatore Fichera and Salvatore P. Giardina in favor of F&G Mechanical Corporation.	10.29	1997 Form 10-K
10.33	-- Form of Indemnity Agreement entered into by the Company with each of the following persons: Fred M. Ferreira, J. Gordon Beittenmiller, Reagan S. Busbee, William George, III, Steven S. Harter, Robert J. Powers, Michael Nothum, Jr., Robert R. Cook, Brian S. Atlas, Thomas J. Beaty, John C. Phillips, Samuel M. Lawrence III, Alfred J. Giardenelli, Jr., Charles W. Klapperich, Larry Martin and John Mercadante, Jr. on June 27, 1997.	10.26	333-32595
10.34	-- Indemnity Agreement between the Company and Notre Capital Ventures II, L.L.C.	10.27	333-32595
10.35	-- Comfort Systems USA, Inc. 1998 Employee Stock Purchase Plan.	10.28	333-38009
10.36	-- Agreement Regarding Sale of Stock between Fred M. Ferreira and the Registrant dated October 31, 1997.	10.1	Third Quarter 1997 Form 10-Q

INCORPORATED BY REFERENCE TO
THE EXHIBIT INDICATED BELOW
AND TO THE FILING WITH THE
COMMISSION INDICATED BELOW

EXHIBIT NUMBER	DESCRIPTION OF EXHIBITS	EXHIBIT NUMBER	FILING OR FILE NUMBER
10.37	-- Agreement Regarding Sale of Stock between Steve S. Harter and the Registrant dated October 31, 1997.	10.2	Third Quarter 1997 Form 10-Q
10.38	-- Agreement Regarding Sale of Stock between J. Gordon Beittenmiller and the Registrant dated October 31, 1997.	10.3	Third Quarter 1997 Form 10-Q
10.39	-- Agreement Regarding Sale of Stock between Thomas J. Beaty and the Registrant dated October 31, 1997.	10.4	Third Quarter 1997 Form 10-Q
10.40	-- Agreement Regarding Sale of Stock between Brian S. Atlas and the Registrant dated October 31, 1997.	10.5	Third Quarter 1997 Form 10-Q
10.41	-- Agreement Regarding Sale of Stock between John C. Phillips and the Registrant dated October 31, 1997.	10.6	Third Quarter 1997 Form 10-Q
10.42	-- Agreement Regarding Sale of Stock between Alfred J. Giardenelli, Jr. and the Registrant dated October 31, 1997.	10.7	Third Quarter 1997 Form 10-Q
10.43	-- Agreement Regarding Sale of Stock between Robert J. Powers and the Registrant dated October 31, 1997.	10.8	Third Quarter 1997 Form 10-Q
10.44	-- Agreement Regarding Sale of Stock between Samuel M. Lawrence and the Registrant dated October 31, 1997.	10.9	Third Quarter 1997 Form 10-Q
10.45	-- Agreement Regarding Sale of Stock between Michael Nothum, Jr. and the Registrant dated October 31, 1997.	10.10	Third Quarter 1997 Form 10-Q
10.46	-- Agreement Regarding Sale of Stock between Bob R. Cook and the Registrant dated October 31, 1997.	10.11	Third Quarter 1997 Form 10-Q
10.47	-- Agreement Regarding Sale of Stock between Charles W. Klapperich and the Registrant dated October 31, 1997.	10.12	Third Quarter 1997 Form 10-Q
10.48	-- Agreement Regarding Sale of Stock between Reagan S. Busbee and the Registrant dated October 31, 1997.	10.13	Third Quarter 1997 Form 10-Q
10.49	-- Agreement Regarding Sale of Stock between William George and the Registrant dated October 31, 1997.	10.14	Third Quarter 1997 Form 10-Q
10.50	-- Agreement and Plan of Merger dated November 15, 1998 by and among the Registrant, Shambaugh & Son, Inc.	2.1	November 1998 Form 8-K
10.51	-- First Amendment to Credit Agreement among the Company and its subsidiaries, Bank One, Texas, N.A., as agent and the banks listed therein dated January 14, 1999.	10.63	1998 Form 10-K
10.52	-- Form of Employment Agreement between the Registrant, Hess Mechanical Corporation and Gary E. Hess.		Filed Herewith
10.53	-- Lease dated April 1, 1998, between Gary E. and Susan B. Hess and Hess Mechanical Corporation.		Filed Herewith
21.1	-- List of subsidiaries of Comfort Systems USA, Inc.		Filed Herewith
23.1	-- Consent of Arthur Andersen LLP		Filed Herewith
27.1	-- Financial Data Schedule		Filed Herewith

(b) Reports on Form 8-K

-- None.

(c) Exhibits: See attached.

(d) The following financial statements are filed as part of this report: as set forth in the Index to Financial Statements at Item 8 of this report.

SIGNATURES

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

COMFORT SYSTEMS USA, INC.
 By: /s/ FRED M. FERREIRA
 FRED M. FERREIRA
 CHIEF EXECUTIVE OFFICER
 Date: March 15, 2000

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, this report has been signed by the following persons in the capacities and on the date indicated.

SIGNATURE	TITLE	DATE
/s/FRED M. FERREIRA FRED M. FERREIRA	Chairman of the Board, Chief Executive Officer and President	March 15, 2000
/s/J. GORDON BEITTENMILLER J. GORDON BEITTENMILLER	Executive Vice President, Chief Financial Officer and Director (PRINCIPAL ACCOUNTING OFFICER)	March 15, 2000
/s/GARY HESS GARY HESS	Executive Vice President, Chief Operating Officer and Director	March 15, 2000
/s/BRIAN S. ATLAS BRIAN S. ATLAS	Director	March 15, 2000
/s/THOMAS J. BEATY THOMAS J. BEATY	Director	March 15, 2000
/s/ROBERT R. COOK ROBERT R. COOK	Director	March 15, 2000
/s/ALFRED J. GIARDENELLI, JR. ALFRED J. GIARDENELLI, JR.	Director	March 15, 2000
/s/SALVATORE P. GIARDINA SALVATORE P. GIARDINA	Director	March 15, 2000
/s/STEVEN S. HARTER STEVEN S. HARTER	Director	March 15, 2000
/s/CHARLES W. KLAPPERICH CHARLES W. KLAPPERICH	Director	March 15, 2000

SIGNATURES -- (CONTINUED)

SIGNATURE	TITLE	DATE
/s/SAMUEL M. LAWRENCE III SAMUEL M. LAWRENCE III	Director	March 15, 2000
/s/LARRY MARTIN LARRY MARTIN	Director	March 15, 2000
/s/JOHN MERCADANTE, JR. JOHN MERCADANTE, JR.	Director	March 15, 2000
/s/MICHAEL NOTHUM, JR. MICHAEL NOTHUM, JR.	Director	March 15, 2000
/s/JOHN C. PHILLIPS JOHN C. PHILLIPS	Director	March 15, 2000
/s/ROBERT J. POWERS ROBERT J. POWERS	Director	March 15, 2000
/s/DIANE DAY SANDERS DIANE DAY SANDERS	Director	March 15, 2000
/s/MARK P. SHAMBAUGH MARK P. SHAMBAUGH	Director	March 15, 2000

BYLAWS

OF

COMFORT SYSTEMS USA, INC.

AS AMENDED THROUGH MARCH 5, 1999

BYLAWS

OF

COMFORT SYSTEMS USA, INC

ARTICLE I

STOCKHOLDERS

SECTION 1. ANNUAL MEETING. The annual meeting of the stockholders of the Corporation shall be held on such date, at such time and at such place within or without the State of Delaware as may be designated by the Board of Directors, for the purpose of electing Directors and for the transaction of such other business as may be properly brought before the meeting, which date shall be within thirteen (13) months subsequent to the last annual meeting of stockholders.

SECTION 2. SPECIAL MEETINGS. Unless otherwise provided in the Certificate of Incorporation of the Corporation, special meetings of the stockholders for any purpose or purposes may be called at any time by the Chief Executive Officer, by a majority of the Board of Directors, or by a majority of the executive committee (if any), at such time and at such place as may be stated in the notice of the meeting. Business transacted at such meeting shall be confined to the purpose(s) stated in the notice of such meeting.

SECTION 3. NOTICE OF STOCKHOLDER BUSINESS AND NOMINATIONS.

(A) ANNUAL MEETINGS OF STOCKHOLDERS.

(i) Nominations of persons for election to the Board of Directors and the proposal of business to be considered by the Stockholders may be made at an annual meeting of Stockholders (A) pursuant to the Corporation's notice of meeting, (B) by or at the direction of the Board of Directors or (C) by any Stockholder who was a Stockholder of record at the time of giving of notice provided for in this Section, who is entitled to vote at the meeting and who complies with the notice procedures set forth in this Section.

(ii) For nominations or other business to be properly brought before an annual meeting by a Stockholder pursuant to section

3(a)(i) of this ARTICLE 1, the Stockholder must have given timely notice thereof in writing to the Secretary of the Corporation and such other business must otherwise be a proper matter for Stockholder action. To be timely, a Stockholder's notice shall be delivered to the Secretary at the principal offices of the Corporation not later than the close of business on the sixtieth (60th) day nor earlier than the close of business on the ninetieth (90th) day prior to the first (1st) anniversary of the preceding year's annual meeting; PROVIDED, HOWEVER, that in the event that the date of the annual meeting is more than thirty (30) days before or more than sixty (60) days after such anniversary date, notice by the Stockholder to be timely must be so delivered not earlier than the close of business on the ninetieth (90th) day prior to such annual meeting and not later than the close of business on the later of the sixtieth (60th) day prior to such annual meeting or the tenth (10th) day following the day on which public announcement of the date of such meeting is first made by the Corporation. In no event shall the public announcement of an adjournment of an annual meeting commence a new time period for the giving of a Stockholders's notice as described above. Such Stockholder's notice shall set forth:

(A) as to each person whom the Stockholder proposes to nominate for election or reelection as a Director all information relating to such person that is required to be disclosed in solicitations of proxies for election of Directors in an election contest, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "EXCHANGE Act") and Rule 14a-11 thereunder (including such person's written consent to being named in the proxy statement as a nominee and to serving as a Director if elected);

(B) as to any other business that the Stockholder proposes to bring before the meeting, a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting and any material interest in such business of such Stockholder and the beneficial owner, if any, on whose behalf the proposal is made; and

(C) as to the Stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made (1) the name and address of such

Stockholder, as they appear on the Corporation's books, and of such beneficial owner and (2) the class and number of shares of the, Corporation which are owned beneficially and of record by such Stockholder and such beneficial owner.

(iii) Notwithstanding anything in the second sentence of Section 3(a)(ii) of this ARTICLE I to the contrary, in the event that the number of Directors to be elected to the Board of Directors is increased and there is no public announcement by the Corporation naming all of the nominees for Director or specifying the size of the increased Board of Directors at least seventy (70) days prior to the first (1st) anniversary of the preceding year's annual meeting, a Stockholder's notice required by this Section shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be delivered to the Secretary at the principal executive offices of the Corporation not later than the close of business on the tenth (10th) day following the day on which such public announcement is first made by the Corporation.

(b) SPECIAL MEETINGS OF STOCKHOLDERS. Only such business shall be conducted at a special meeting of Stockholders as shall have been brought before the meeting pursuant to the Corporation's notice of meeting. Nominations of persons for election to the Board of Directors may be made at a special meeting of Stockholders at which Directors are to be elected pursuant to the Corporation's notice of meeting (a) by or at the direction of the Board of Directors or (b) provided that the Board of Directors has determined that Directors shall be elected at such meeting, by any Stockholder who is a Stockholder of record at the time of giving of notice provided for in this Section 3, who shall be entitled to vote at the meeting and who complies with the notice procedures set forth in this Section 3. In the event the Corporation calls a special meeting of Stockholders for the purpose of electing one or more Directors to the Board of Directors, any such Stockholder may nominate a person or persons (as the case may be), for election to such positions(s) as specified in the Corporation's notice of meeting, if the Stockholder's notice required by Section 3(a)(ii) of this ARTICLE I shall be delivered to the Secretary at the principal executive offices of the Corporation not earlier than the close of business on the ninetieth (90th) day prior to such special meeting and not later than the close of business on the later of the sixtieth (60th) day prior to such special meeting or the tenth (10th) day following the day on which public announcement is first made of the date of the special meeting and, of the nominees proposed by the Board

of Directors to be elected at such meeting. In no event shall the public announcement of an adjournment of a special meeting commence a new time period for the giving of a Stockholder's notice as described above.

(C) GENERAL.

(i) Only such persons who are nominated in accordance with the procedures set forth in this Section 3 shall be eligible to serve as Directors and only such business shall be conducted at a meeting of Stockholders as shall have been brought before the meeting in accordance with the procedures set forth in this Section 3. Except as otherwise provided by applicable law, the Chairman of the meeting shall have the power and duty to determine whether a nomination or any business proposed to be brought before the meeting was made or, proposed, as the case may be, in accordance with the procedures set forth in this Section 3 and, if any proposed nomination or business is not in compliance with this Section 3, to declare that such defective proposal or nomination shall be disregarded.

(ii) For purposes of this Section 3, "public announcement" shall mean disclosure in a press release reported by the Dow Jones News Service, Associate Press or comparable national news service or in a document publicly filed by the Corporation with the Securities and Exchange Commission pursuant to Section 13, 14 or 15(d) of the Exchange Act.

(iii) Notwithstanding the foregoing provisions of this Section 3., a Stockholder shall also comply with all applicable requirements of the Exchange Act and the rules and regulations thereunder with respect to the matters set forth in this Section 3. Nothing in this Section 3 shall be deemed to affect any rights (A) of Stockholders to request inclusion of proposals in the Corporation's proxy statement pursuant to Rule 14a-8 under the Exchange Act; or (B) of the holders of any series of Common Stock or Preferred Stock or any outstanding voting indebtedness to elect Directors under specified circumstances.

Notwithstanding any other provisions of the Certificate of Incorporation of the Corporation and notwithstanding that a lesser percentage may be permitted from time to time by applicable law, no provision of this Section 3 of ARTICLE I may be altered, amended or repealed in any respect, nor may any provision inconsistent therewith be adopted, unless such alteration, amendment, repeal or adoption is approved by the active

vote of the holders of at least 80 percent of the combined voting power of the then outstanding shares of the Corporation's stock entitled to vote generally at elections of Directors voting together as a single class, and at least 80 percent of each class, series and issuance of combined voting power of the then outstanding shares of the Corporation's stock entitled to vote generally at elections of Directors voting separately as a class, series and issuance.

SECTION 4. QUORUM. At any meeting of the stockholders, the holders of a majority in number of the total outstanding shares of stock of the Corporation entitled to vote at such meeting, present in person or represented by proxy, shall constitute a quorum of the stockholders for all purposes, unless the representation of a larger number of shares shall be required by law, by the Certificate of Incorporation or by these Bylaws, in which case the representation of the number of shares so required shall constitute a quorum; provided that at any meeting of the stockholders at which the holders of any class of stock of the Corporation shall be entitled to vote separately as a class, the holders of a majority in number of the total outstanding shares of such class, present in person or represented by proxy, shall constitute a quorum for purposes of such class vote unless the representation of a larger number of shares of such class shall be required by law, by the Certificate of Incorporation or by these Bylaws.

SECTION 5. ADJOURNED MEETINGS. Whether or not a quorum shall be present in person or represented at any meeting of the stockholders, the holders of a majority in number of the shares of stock of the Corporation present in person or represented by proxy and entitled to vote at such meeting may adjourn from time to time; provided, however, that if the holders of any class of stock of the Corporation are entitled to vote separately as a class upon any matter at such meeting, any adjournment of the meeting in respect of action by such class upon such matter shall be determined by the holders of a majority of the shares of such class present in person or represented by proxy and entitled to vote at such meeting. When a meeting is adjourned to another time or place, notice need not be given of the adjourned meeting if the time and place thereof are announced at the meeting at which the adjournment is taken. At the adjourned meeting the stockholders, or the holders of any class of stock entitled to vote separately as a class, as the case may be, may transact any business which might have been transacted by them at the original meeting. If the adjournment is for more than thirty days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the adjourned meeting.

SECTION 6. ORGANIZATION. Each annual and special meeting of Stockholders held in person shall be presided over by a chairman, who shall have the exclusive authority to, among other things, determine (a) whether business and nominations have been properly brought before such meetings, and (b) the order in which business and nominations properly brought before such meeting shall be considered. The chairman of each annual and special meeting shall be the Chairman of the Board of Directors, or such

person as shall be appointed by the resolution approved by the majority of the Board of Directors.

The Secretary of the Corporation shall act as Secretary of all meetings of the stockholders; but in the absence of the Secretary, the Chairman may appoint any person to act as Secretary of the meeting. It shall be the duty of the Secretary to prepare and make, at least ten (10) days before every meeting of stockholders, a complete list of stockholders entitled to vote at such meeting, arranged in alphabetical order and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting or, if not so specified, at the place where the meeting is to be held, for the ten (10) days next preceding the meeting, to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, and shall be produced and kept at the time and place of the meeting during the whole time thereof and subject to the inspection of any stockholder who may be present.

SECTION 7. VOTING. Except as otherwise provided in the Certificate of Incorporation or by law, each stockholder shall be entitled to one vote for each share of the capital stock of the Corporation registered in the name of such stockholder upon the books of the Corporation. Each stockholder entitled to vote at a meeting of stockholders or to express consent or dissent to corporate action in writing without a meeting may authorize another person or persons to act for him by proxy, but no such proxy shall be voted or acted upon after three years from its date, unless the proxy provides for a longer period. When directed by the presiding officer or upon the demand of any stockholder, the vote upon any matter before a meeting of stockholders shall be by ballot. Except as otherwise provided by law or by the Certificate of Incorporation, Directors shall be elected by a plurality of the votes cast at a meeting of stockholders by the stockholders entitled to vote in the election and, whenever any corporate action, other than the election of Directors is to be taken, it shall be authorized by a majority of the votes cast at a meeting of stockholders by the stockholders entitled to vote thereon.

Shares of the capital stock of the Corporation belonging to the Corporation or to another corporation, if a majority of the shares entitled to vote in the election of directors of such other corporation is held, directly or indirectly, by the Corporation, shall neither be entitled to vote nor be counted for quorum purposes.

SECTION 8. INSPECTORS. When required by law or directed by the presiding officer or upon the demand of any stockholder entitled to vote, but not otherwise, the polls shall be opened and closed, the proxies and ballots shall be received and taken in charge, and all questions touching the qualification of voters, the validity of proxies and the acceptance or rejection of votes shall be decided at any meeting of the stockholders by two or more Inspectors who may be appointed by the Board of Directors before the meeting, or if not so appointed, shall be appointed by the presiding officer at the

meeting. If any person so appointed fails to appear or act, the vacancy may be filled by appointment in like manner.

SECTION 9. ACTION WITHOUT MEETING. Unless otherwise provided in the Certificate of Incorporation of the Corporation, prior to a firm commitment underwritten public offering of the Corporation's Common Stock in which gross proceeds equal or exceed \$25 million before deducting underwriters' discounts and other expenses of the offering (the "Offering"), any action permitted or required by law, the Certificate of Incorporation of the Corporation or these Bylaws to be taken at a meeting of stockholders, may be taken without a meeting, without prior notice and without a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted and shall be delivered to the Corporation by delivery to its registered office in the state of incorporation, its principal place of business, or an officer or agent of the Corporation having custody of the book in which proceedings of meetings of stockholders are recorded. Delivery made to the Corporation's registered office shall be by hand or by certified or registered mail, return receipt requested.

Every written consent shall bear the date of signature of each stockholder who signs the consent, and no written consent shall be effective to take the corporate action referred to therein unless, within sixty (60) days of the earliest dated consent delivered in the manner required by this Section to the Corporation, written consents signed by a sufficient number of holders to take action are delivered to the Corporation by delivery to its registered office in the state of incorporation, its principal place of business, or an officer or agent of the Corporation having custody of the book in which proceedings of meetings of stockholders are recorded. Delivery made to the Corporation's registered office shall be by hand or by certified or registered mail, return receipt requested.

Prompt notice of the taking of corporation action without a meeting by less than a unanimous written consent shall be given by the Secretary to those stockholders who have not consented in writing.

Subsequent to the Offering, any action required or permitted to be taken by the Stockholders must be effected at a duly called annual or special meeting of Stockholders and may not be effected without such a meeting by any consent in writing by such holders.

ARTICLE II

BOARD OF DIRECTORS

SECTION 1. NUMBER AND TERM OF OFFICE; CLASSES. The business and affairs of the Corporation shall be managed by or under the direction of a Board of Directors, none of whom need be stockholders of the Corporation. The number of Directors constituting the Board of Directors shall be fixed from time to time by resolution passed by a majority of the Board of Directors. The directors of the Corporation shall be divided into three classes as nearly equal in size as is practicable, hereby designated Class I, Class II and Class III. The term of office of the initial Class I directors shall expire at the 1998 annual meeting of the stockholders, the term of office of the initial Class II directors shall expire at the 1999 annual meeting of the stockholders and the term of office of the initial Class III directors shall expire at the 2000 annual meeting of the stockholders. For the purposes thereof, the initial Class I, Class II and Class III directors shall be those directors so designated by the Board of Directors at its meeting held June 27, 1997. At each annual meeting of stockholders, commencing with the 1998 meeting of stockholders, each of the successors elected to replace the directors of a class whose term shall have expired at such annual meeting shall be elected to hold office until the third annual meeting next succeeding his or her election and until his or her respective successor shall have been duly elected and qualified. If the number of directors is hereafter changed, any newly created directorships or decrease in directorships shall be so apportioned among the classes as to make all classes as nearly equal in number as is practicable, provided that no decrease in the number of directors constituting the Board of Directors shall shorten the term of any remaining incumbent director.

SECTION 2. REMOVAL, VACANCIES AND ADDITIONAL DIRECTORS. Except as otherwise provided in the Certificate of Incorporation, the stockholders may, at any special meeting the notice of which shall state that it is called for that purpose, remove, with or without cause, any Director and fill the vacancy; provided that whenever any Director shall have been elected by the holders of any class of stock of the Corporation voting separately as a class under the provisions of the Certificate of Incorporation, such Director may be removed and the vacancy filled only by the holders of that class of stock voting separately as a class. Except as otherwise provided in the Certificate of Incorporation, vacancies caused by any such removal and not filled by the stockholders at the meeting at which such removal shall have been made, or any vacancy caused by the death or resignation of any Director or for any other reason, and any newly created directorship resulting from any increase in the authorized number of Directors, may be filled by the affirmative vote of a majority of the Directors then in office, although less than a quorum, and any Director so elected to fill any such vacancy or newly created directorship shall hold office until his successor is elected and qualified or until his earlier resignation or removal.

When one or more Directors shall resign effective at a future date, a majority of the Directors then in office, including those who have so resigned, shall have power to fill such vacancy or vacancies, the vote thereon to take effect when such resignation or resignations shall become effective, and each Director so chosen shall hold office as herein provided in connection with the filling of other vacancies

SECTION 3. PLACE OF MEETING. The Board of Directors may hold its meetings in such place or places in the State of Delaware or outside the State of Delaware as the Board from time to time shall determine.

SECTION 4. REGULAR MEETING. Regular meetings of the Board of Directors shall be held at such times and places as the Board from time to time by resolution shall determine. No notice shall be required for any regular meeting of the Board of Directors, but a copy of every resolution fixing or changing the time or place of regular meetings shall be mailed to every Director at least five (5) days before the first meeting held in pursuance thereof.

SECTION 5. SPECIAL MEETING. Special meetings of the Board of Directors shall be held whenever called by direction of the Chairman of the Board, the Vice Chairman of the Board, the President or by any two of the Directors then in office.

Notice of the day, hour and place of holding of each special meeting shall be given by mailing the same at least two (2) days before the meeting or by causing the same to be transmitted by telegraph, cable or wireless at least one day before the meeting to each Director. Unless otherwise indicated in the notice thereof, any and all business other than an amendment of these Bylaws may be transacted at any special meeting, and an amendment of these Bylaws may be acted upon if the notice of the meeting shall have stated that the amendment of these Bylaws is one of the purposes of the meeting. At any meeting at which every Director shall be present, even though without any notice, any business may be transacted, including the amendment of these Bylaws.

SECTION 6. QUORUM. Subject to the provisions of Section 2 of this Article II, a majority of the members of the Board of Directors in office (but, unless the Board shall consist solely of one Director, in no case less than one-third of the total number of Directors nor less than two Directors) shall constitute a quorum for the transaction of business and the vote of the majority of the Directors present at any meeting of the Board of Directors at which a quorum is present shall be the act of the Board of Directors. If at any meeting of the Board there is less than a quorum present, a majority of those present may adjourn the meeting from time to time.

SECTION 7. ORGANIZATION. The Chairman of the Board, or in his absence, the Vice Chairman of the Board, or in his absence, the President shall preside at all meetings of the Board of Directors. In the absence of the Chairman of the Board, the

Vice Chairman of the Board and the President, a Chairman shall be elected from the Directors present. The Secretary of the Corporation shall act as Secretary of all meetings of the Directors; but in the absence of the Secretary, the Chairman may appoint any person to act as Secretary of the meeting.

SECTION 8. COMMITTEE. The Board of Directors may, by resolution passed by a majority of the whole Board, designate one or more committees, each committee to consist of one or more of the Directors of the Corporation. The Board may designate one or more Directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. In the absence or disqualification of a member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another member of the Board of Directors to act at the meeting in the place of any such absent or disqualified member. Any such committee, to the extent provided by resolution passed by a majority of the whole Board, shall have and may exercise all the powers and authority of the Board of Directors in the management of the business and the affairs of the Corporation, and may authorize the seal of the Corporation to be affixed to all papers which may require it; but no such committee shall have the power or authority in reference to amending the Certificate of Incorporation, adopting an agreement of merger or consolidation, recommending to the stockholders the sale, lease or exchange of all or substantially all of the Corporation's property and assets, recommending to the stockholders a dissolution of the Corporation or a revocation of a dissolution, or amending these Bylaws; and unless such resolution, these Bylaws, or the Certificate of Incorporation expressly so provide, no such committee shall have the power or authority to declare a dividend or to authorize the issuance of stock.

SECTION 9. CONFERENCE TELEPHONE MEETINGS. Unless otherwise restricted by the Certificate of Incorporation or by these Bylaws, the members of the Board of Directors or any committee designated by the Board, may participate in a meeting of the Board or such committee, as the case may be, by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and such participation shall constitute presence in person at such meeting.

SECTION 10. CONSENT OF DIRECTORS OR COMMITTEE IN LIEU OF MEETING. Unless otherwise restricted by the Certificate of Incorporation or by these Bylaws, any action required or permitted to be taken at any meeting of the Board of Directors, or of any committee thereto, may be taken without a meeting if all members of the Board or committee, as the case may be, consent thereto in writing and the writing or writings are filed with the minutes of proceedings of the Board or committee, as the case may be.

ARTICLE III

OFFICERS

SECTION 1. OFFICERS. The officers of the Corporation shall be a Chairman of the Board, a Vice Chairman of the Board, a President, one or more Vice Presidents, a Secretary and a Treasurer, and such additional officers, if any, as shall be elected by the Board of Directors pursuant to the provisions of Section 8 of this Article III. The Chairman of the Board, the Vice Chairman of the Board, the President, one or more Vice Presidents, the Secretary and the Treasurer shall be elected by the Board of Directors at its first meeting after each annual meeting of the stockholders. The failure to hold such election shall not of itself terminate the term of office of any officer. All officers shall hold office at the pleasure of the Board of Directors. Any officer may resign at any time upon written notice to the Corporation. Officers may, but need not, be Directors. Any number of offices may be held by the same person.

All officers, agents and employees shall be subject to removal, with or without cause, at any time by the Board of Directors. The removal of an officer without cause shall be without prejudice to his contract rights, if any. The election or appointment of an officer shall not of itself create contract rights. All agents and employees other than officers elected by the Board of Directors shall also be subject to removal, with or without cause, at any time by the officers appointing them.

Any vacancy caused by the death of any officer, his resignation, his removal, or otherwise, may be filled by the Board of Directors, and any officer so elected shall hold office at the pleasure of the Board of Directors.

In addition to the powers and duties, of the officers of the Corporation as set forth in these Bylaws, the officers shall have such authority and shall perform such duties as from time to time may be determined by the Board of Directors.

SECTION 2. POWERS AND DUTIES OF THE CHAIRMAN OF THE BOARD. The Chairman of the Board shall be the chief executive officer of the Corporation and, subject to the control of the Board of Directors, shall have general charge and control of all its business and affairs and shall have all powers and shall perform all duties incident to the office of Chairman of the Board. He shall preside at all meetings of the stockholders and at all meetings of the Board of Directors and shall have such other powers and perform such other duties as may from time to time be assigned to him by these Bylaws or by the Board of Directors.

SECTION 3. POWERS AND DUTIES OF THE VICE CHAIRMAN OF THE BOARD. The Vice Chairman of the Board, shall be the chief executive officer of the Corporation and, subject to the control of the Board of Directors and the Chairman of the Board, shall have general charge and control of all its business and affairs and shall have all powers

and shall perform all duties incident to the office of Vice Chairman of the Board. In the absence of the Chairman of the Board, he shall preside at all meetings of the stockholders and at all meetings of the Board of Directors and shall have such other powers and perform such other duties as may from time to time be assigned to him by these Bylaws or by the Board of Directors or the Chairman of the Board.

SECTION 4. POWERS AND DUTIES OF THE PRESIDENT. The President shall be the chief operating officer of the Corporation and, subject to the control of the Board of Directors, the Chairman of the Board and the Vice Chairman of the Board, shall have general charge and control of all its operations and shall have all powers and shall perform all duties incident to the office of President. In the absence of the Chairman of the Board and the Vice Chairman of the Board, he shall preside at all meetings of the stockholders and at all meetings of the Board of Directors and shall have such other powers and perform such other duties as may from time to time be assigned to him by these Bylaws or by the Board of Directors, the Chairman of the Board or the Vice Chairman of the Board.

SECTION 5. POWERS AND DUTIES OF THE VICE PRESIDENTS. Each Vice President shall have all powers and shall perform all duties incident to the office of Vice President and shall have such other powers and perform such other duties as may from time to time be assigned to him by these By laws or by the Board of Directors, the Chairman of the Board, the Vice Chairman of the Board or the President.

SECTION 6. POWERS AND DUTIES OF THE SECRETARY. The Secretary shall keep the minutes of all meetings of the Board of Directors and the minutes of all meetings of the stockholders in books provided for that purpose; he shall attend to the giving or serving of all notices of the Corporation; he shall have custody of the corporate seal of the Corporation and shall affix the same to such documents and other papers as the Board of Directors or the President shall authorize and direct; he shall have charge of the stock certificate books, transfer books and stock ledgers and such other books and papers as the Board of Directors or the President shall direct, all of which shall at all reasonable times be open to the examination of any Director, upon application, at the office of the Corporation during business hours; and whenever required by the Board of Directors, the Chairman of the Board, the Vice Chairman of the Board or the President shall render statements of such accounts; and he shall have all powers and shall perform all duties incident to the office of Secretary and shall also have such other powers and shall perform such other duties as may from time to time be assigned to him by these Bylaws or by the Board of Directors, the Chairman of the Board., the Vice Chairman of the Board or the President.

SECTION 7. POWERS AND DUTIES OF THE TREASURER. The Treasurer shall have custody of, and when proper shall pay out, disburse or otherwise dispose of, all funds and securities of the Corporation which may have come into his hands; he may endorse on behalf of the Corporation for collection checks, notes and other obligations and shall deposit the same to the credit of the Corporation in such bank or banks or depository or depositories as the Board of Directors may designate; he shall sign all receipts and vouchers for payments made to the Corporation; he shall enter or cause to be entered

regularly in the books of the Corporation kept for the purpose full and accurate accounts of all moneys received or paid or otherwise disposed of by him and whenever required by the Board of Directors, the Chairman of the Board, the Vice Chairman of the Board or the President shall render statements of such accounts; he shall, at all reasonable times, exhibit his books and accounts to any Director of the Corporation upon application at the office of the Corporation during business hours; and he shall have all powers and he shall perform all duties incident to the office of Treasurer and shall also have such other powers and shall perform such other duties as may from time to time be assigned to him by these Bylaws or by the Board of Directors, the Chairman of the Board, the Vice Chairman of the Board or the President.

SECTION 8. ADDITIONAL OFFICERS. The Board of Directors may from time to time elect such other officers (who may but need not be Directors), including a Controller, Assistant Treasurers, Assistant Secretaries and Assistant Controllers, as the Board may deem advisable and such officers shall have such authority and shall perform such duties as may from time to time be assigned to them by the Board of Directors, the Chairman of the Board, the Vice Chairman of the Board or the President.

The Board of Directors may from time to time by resolution delegate to any Assistant Treasurer or Assistant Treasurers any of the powers or duties herein assigned to the Treasurer; and may similarly delegate to any Assistant Secretary or Assistant Secretaries any of the powers or duties assigned to the Secretary.

SECTION 9. GIVING OF BOND BY OFFICERS. All officers of the Corporation, if required to do so by the Board of Directors, shall furnish bonds to the Corporation for the faithful performance of their duties, in such penalties and with such conditions and security as the Board shall require.

SECTION 10. VOTING UPON STOCKS. Unless otherwise ordered by the Board of Directors, the Chairman of the Board, the Vice Chairman of the Board, the President or any Vice President shall have full power and authority on behalf of the Corporation to attend and to act and to vote, or in the name of the Corporation to execute proxies to vote, at any meeting of stockholders of any corporation in which the Corporation may hold stock, and at any such meeting shall possess and may exercise, in person or by proxy, any and all rights, powers and privileges incident to the ownership of such stock. The Board of Directors may from time to time, by resolution, confer like powers upon any other person or persons.

SECTION 11. COMPENSATION OF OFFICERS. The officers of the Corporation shall be entitled to receive such compensation for their services as shall from time to time be determined by the Board of Directors.

ARTICLE IV

INDEMNIFICATION OF DIRECTORS AND OFFICERS

SECTION 1. NATURE OF INDEMNITY. The Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he is or was or has agreed to become a Director or officer of the Corporation, or is or was serving or has agreed to serve at the request of the Corporation as a Director or officer of another corporation, partnership, joint venture, trust or other enterprise, or by reason of any action alleged to have been taken or omitted in such capacity, and may indemnify any person who was or is a party or is threatened to be made a party to such an action, suit or proceeding by reason of the fact that he is or was or has agreed to become an employee or agent of the Corporation, or is or was serving or has agreed to serve at the request of the Corporation as an employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him or on his behalf in connection with such action, suit or proceeding and any appeal therefrom, if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful; except that in the case of an action or suit by or in the right of the Corporation to procure a judgment in its favor (1) such indemnification shall be limited to expenses (including attorneys' fees) actually and reasonably incurred by such person in the defense or settlement of such action or suit, and (1) no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the Corporation unless and only to the extent that the Delaware Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Delaware Court of Chancery or such other court shall deem proper.

The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

SECTION 2. SUCCESSFUL DEFENSE. To the extent that a Director, officer, employee or agent of the Corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in Section I of this Article IV or in defense of any claim, issue or matter therein, he shall be indemnified against expenses

(including attorneys' fees) actually and reasonably incurred by him in connection therewith.

SECTION 3. DETERMINATION THAT INDEMNIFICATION IS PROPER. Any indemnification of a Director or Officer of the Corporation under Section I of this Article IV (unless ordered by a court) shall be made by the Corporation unless a determination is made that indemnification of the Director or officer is not proper in the circumstances because he has not met the applicable standard of conduct set forth in Section I. Any indemnification of an employee or agent of the Corporation under Section I (unless ordered by a court) may be made by the Corporation upon a determination that indemnification of the employee or agent is proper in the circumstances because he has met the applicable standard of conduct set forth in Section 1. Any such determination shall be made (1) by the Board of Directors by a majority vote of a quorum consisting of Directors who were not parties to such action, suit or proceeding, or (2) if such a quorum is not obtainable, or, even if obtainable, a quorum of disinterested Directors so directs, by independent legal counsel in a written opinion, or (3) by the stockholders.

SECTION 4. ADVANCE PAYMENT OF EXPENSES. Unless the Board of Directors otherwise determines in a specific case, expenses incurred by a Director or officer in defending a civil or criminal action, suit or proceeding shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of the Director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the Corporation as authorized in this Article IV. Such expenses incurred by other employees and agents may be so paid upon such terms and conditions, if any, as the Board of Directors deems appropriate. The Board of Directors may authorize the Corporation's legal counsel to represent such Director, officer, employee or agent in any action, suit or proceeding, whether or not the Corporation is a party to such action, suit or proceeding.

SECTION 5. SURVIVAL: PRESERVATION OF OTHER RIGHTS. The foregoing indemnification provisions shall be deemed to be a contract between the Corporation and each Director, officer, employee and agent who serves in any such capacity at any time while these provisions as well as the relevant provisions of the Delaware General Corporation Law are in effect and any repeal or modification thereof shall not affect any right or obligation then existing with respect to any state of facts then or previously existing or any action, suit, or proceeding previously or thereafter brought or threatened based in whole or in part upon any such state of facts. Such a contract right may not be modified retroactively without the consent of such Director, officer, employee or agent.

The indemnification provided by this Article IV shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any bylaw, agreement, vote of stockholders or disinterested Directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a Director, officer, employee or agent and

shall inure to the benefit of the heirs, executors and administrators of such a person. The Corporation may enter into an agreement with any of its Directors, officers, employees or agents providing for indemnification and advancement of expenses, including attorneys fees, that may change, enhance, qualify or limit any right to indemnification or advancement of expenses created by this Article IV.

SECTION 6. SEVERABILITY. If this Article IV or any portion hereof shall be invalidated on any ground by any court of competent jurisdiction, then the Corporation shall nevertheless indemnify each Director or officer and may indemnify each employee or agent of the Corporation as to costs, charges and expenses (including attorneys' fees), judgment, fines and amounts paid in settlement with respect to any action, suit or proceeding, whether civil, criminal, administrative or investigative, including an action by or in the right of the Corporation, to the fullest extent permitted by any applicable portion of this Article IV that shall not have been invalidated and to the fullest extent permitted by applicable law.

SECTION 7. SUBROGATION. In the event of payment of indemnification to a person described in Section I of this Article IV, the Corporation shall be subrogated to the extent of such payment to any right of recovery such person may have and such person, as a condition of receiving indemnification from the Corporation, shall execute all documents and do all things that the Corporation may deem necessary or desirable to perfect such right of recovery, including the execution of such documents necessary to enable the Corporation effectively to enforce any such recovery.

SECTION 8. NO DUPLICATION OF PAYMENTS. The Corporation shall not be liable under this Article IV to make any payment in connection with any claim made against a person described in Section I of this Article IV to the extent such person has otherwise received payment (under any insurance policy, bylaw or otherwise) of the amounts otherwise indemnifiable hereunder.

ARTICLE V

STOCK-SEAL-FISCAL YEAR

SECTION 1. CERTIFICATES FOR SHARES OF Stock. The certificates for shares of stock of the Corporation shall be in such form, not inconsistent with the Certificate of Incorporation, as shall be approved by the Board of Directors. All certificates shall be signed by the Chairman of the Board, the Vice Chairman of the Board, the President or a Vice President and by the Secretary or an Assistant Secretary or the Treasurer or an Assistant Treasurer, and shall not be valid unless so signed.

In case any officer or officers who shall have signed any such certificate or certificates shall cease to be such officer or officers of the Corporation, whether because

of death, resignation or otherwise, before such certificate or certificates shall have been delivered by the Corporation, such certificate or certificates may nevertheless be issued and delivered as though the person or persons who signed such certificate or certificates had not ceased to be such officer or officers of the Corporation.

All certificates for shares of stock shall be consecutively numbered as the same are issued. The name of the person owning the shares represented thereby with the number of such shares and the date of issue thereof shall be entered on the books of the Corporation.

Except as hereinafter provided, all certificates surrendered to the Corporation for transfer shall be canceled, and no new certificates shall be issued until former certificates for the same number of shares have been surrendered and canceled.

SECTION 2. LOST, STOLEN OR DESTROYED CERTIFICATES. Whenever a person owning a certificate for shares of stock of the Corporation alleges that it has been lost, stolen or destroyed, he shall file in the office of the Corporation an affidavit setting forth, to the best of his knowledge and belief, the time, place and circumstances of the loss, theft or destruction, and, if required by the Board of Directors, a bond of indemnity or other indemnification sufficient in the opinion of the Board of Directors to indemnify the Corporation and its agents against any claim that may be made against it or them on account of the alleged loss, theft or destruction of any such certificate or the issuance of a new certificate in replacement therefor. Thereupon the Corporation may cause to be issued to such person a new certificate in replacement for the certificate alleged to have been lost, stolen or destroyed. Upon the stub of every new certificate so issued shall be noted the fact of such issue and the number, date and the name of the registered owner of the lost, stolen or destroyed certificate in lieu of which the new certificate is issued.

SECTION 3. TRANSFER OF SHARES. Shares of stock of the Corporation shall be transferred on the books of the Corporation by the holder thereof, in person or by his attorney duly authorized in writing, upon surrender and cancellation of certificates for the number of shares of stock to be transferred, except as provided in Section 2 of this Article IV.

SECTION 4. REGULATIONS. The Board of Directors shall have power and authority to make such rules and regulations as it may deem expedient concerning the issue, transfer and registration of certificates for shares of stock of the Corporation.

SECTION 5. RECORD DATE. In order that the Corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, or to express consent to corporate action in writing without a meeting or to receive payment of any dividend or other distribution or allotment of any rights, or to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action, as the case may be, the Board of

Directors may fix, in advance, a record date, which shall not be (i) more than sixty (60) nor less than ten (10) days before the date of such meeting, or (ii) in the case of corporate action to be taken by consent in writing without a meeting prior to, or more than ten (10) days after, the date upon which the resolution fixing the record date is adopted by the Board of Directors, or (iii) more than sixty (60) days prior to any other action.

If no record date is fixed, the record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the day next preceding the day on which notice is given or, if notice is waived, at the close of business on the day next preceding the day on which the meeting is held; the record date for determining stockholders entitled to express consent to corporate action in writing without a meeting, when no prior action by the Board of Directors is necessary, shall be the day on which the first written consent is delivered to the Corporation; and the record date for determining stockholders for any other purpose shall be at the close of business on the day on which the Board of Directors adopts the resolution relating thereto. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

SECTION 6. DIVIDENDS. Subject to the provisions of the Certificate of Incorporation, the Board of Directors shall have power to declare and pay dividends upon shares of stock of the Corporation, but only out of funds available for the payment of dividends as provided by law.

Subject to the provisions of the Certificate of Incorporation, any dividends declared upon the stock of the Corporation shall be payable on such date or dates as the Board of Directors shall determine. If the date fixed for the payment of any dividend shall in any year fall upon a legal holiday, then the dividend payable on such date shall be paid on the next day not a legal holiday.

SECTION 7. CORPORATE SEAL. The Board of Directors shall provide a suitable seal, containing the name of the Corporation, which seal shall be kept in the custody of the Secretary. A duplicate of the seal may be kept and be used by any officer of the Corporation designated by the Board of Directors, the Chairman of the Board, the Vice Chairman of the Board or the President.

SECTION 8. FISCAL YEAR. The fiscal year of the Corporation shall be such fiscal year as the Board of Directors from time to time by resolution shall determine.

ARTICLE VI

MISCELLANEOUS PROVISIONS

SECTION 1. CHECKS, NOTES, ETC. All checks, drafts, bills of exchange, acceptances, notes or other obligations or orders for the payment of money shall be signed and, if so required by the Board of Directors, countersigned by such officers of the Corporation and/or other persons as the Board of Directors from time to time shall designate.

Checks, drafts, bills of exchange, acceptances, notes, obligations and orders for the payment of money made payable to the Corporation may be endorsed for deposit to the credit of the Corporation with a duly authorized depository by the Treasurer and/or such other officers or persons as the Board of Directors from time to time may designate.

SECTION 2. LOANS. No loans and no renewals of any loans shall be contracted on behalf of the Corporation except as authorized by the Board of Directors. When authorized so to do, any officer or agent of the Corporation may effect loans and advances for the Corporation from any bank, trust company or other institution or from any firm, corporation or individual, and for such loans and advances may make, execute and deliver promissory notes, bonds or other evidences of indebtedness of the Corporation. When authorized so to do, any officer or agent of the Corporation may pledge, hypothecate or transfer, as security for the payment of any and all loans, advances, indebtedness and liabilities of the Corporation, any and all stocks, securities and other personal property at any time held by the Corporation, and to that end may endorse, assign and deliver the same. Such authority may be general or confined to specific instances.

SECTION 3. CONTRACTS. Except as otherwise provided in these Bylaws or by law or as otherwise directed by the Board of Directors, the Chairman of the Board, the Vice Chairman of the Board, the President or any Vice President shall be authorized to execute and deliver, in the name and on behalf of the Corporation, all agreements, bonds, contracts, deeds, mortgages, and other instruments, either for the Corporation's own account or in a fiduciary or other capacity, and the seal of the Corporation, if appropriate, shall be affixed thereto by any of such officers or the Secretary or an Assistant Secretary. The Board of Directors, the Chairman of the Board, the Vice Chairman of the Board, the President or any Vice President designated by the Board of Directors, the Chairman of the Board, the Vice Chairman of the Board or the President may authorize any other officer, employee or agent to execute and deliver, in the name and on behalf of the Corporation, agreements, bonds, contracts, deeds, mortgages, and other instruments, either for the Corporation's own account or in a fiduciary or other capacity, and, if appropriate, to affix the seal of the Corporation thereto. The grant of such authority by the Board or any such officer may be general or confined to specific instances.

SECTION 4. WAIVERS OF NOTICE. Whenever any notice whatever is required to be given by law, by the Certificate of Incorporation or by these Bylaws to any person or persons, a waiver thereof in writing, signed by the person or persons entitled to the notice, whether before or after the time stated therein, shall be deemed equivalent thereto.

SECTION 5. OFFICES OUTSIDE OF DELAWARE. Except as otherwise required by the laws of the State of Delaware, the Corporation may have an office or offices and keep its books, documents and papers outside of the State of Delaware at such place or places as from time to time may be determined by the Board of Directors, the Chairman of the Board or the Vice Chairman of the Board.

ARTICLE VII

AMENDMENTS

The Board of Directors shall have the power to adopt, amend and repeal from time to time Bylaws of the Corporation, subject to the right of the stockholders entitled to vote with respect thereto to amend or repeal such Bylaws as adopted or amended by the Board of Directors; provided, however, that unless a different percentage is called for in a particular provision hereof, any amendment or repeal of the Bylaws of the Corporation by the stockholders shall be by a vote of the holders of at least $66 \frac{2}{3}$ percent of the total votes eligible to be cast by holders of voting stock with respect to such amendment or repeal.

EXECUTION COUNTERPART

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (the "Agreement") between CS12 Acquisition Corp., a Delaware corporation (the "Company") and a wholly-owned subsidiary of Comfort Systems USA, Inc., a Delaware corporation ("Comfort"), and Gary E. Hess ("Executive") is entered into and effective as of the 1st day of April, 1998. This Agreement supersedes any other employment agreements or understandings, written or oral, between the Company and Executive.

R E C I T A L S

The following statements are true and correct:

As of the date of this Agreement, the Company, Comfort and the other subsidiaries and affiliates of each (collectively, the "Comfort Group") are engaged primarily in the business of mechanical contracting services, including heating, ventilation and air conditioning, plumbing, piping and electrical and related services ("Services").

Executive is employed hereunder by the Company in a confidential relationship wherein Executive, in the course of his employment with the Company, has and will continue to become familiar with and aware of information as to the Comfort Group's customers, specific manner of doing business, including the processes, techniques and trade secrets utilized by the Comfort Group, and future plans with respect thereto, all of which has been and will be established and maintained at great expense to the Company and Comfort. This information is a trade secret and constitutes the valuable goodwill of the Company and Comfort.

NOW, THEREFORE, in consideration of the mutual promises, terms, covenants and conditions set forth herein and the performance of each, the Company and Executive hereby agree as follows:

A G R E E M E N T S

1. EMPLOYMENT AND DUTIES.

(a) The Company hereby employs Executive in an executive position (initially with the title of President and responsibility for the operations of the Company), and Executive hereby accepts this employment upon the terms and conditions herein contained. Executive agrees to devote substantially all of his business time, attention and efforts to promote and further the business of the Company.

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(b) Executive shall faithfully adhere to, execute and fulfill all lawful policies established by the Company and Comfort, including Comfort's Corporate Compliance Policy.

(c) Executive shall not, during the term of Executive's employment hereunder, be engaged in any other business activity pursued for gain, profit or other pecuniary advantage if such activity interferes in any material respect with Executive's duties and responsibilities hereunder. The foregoing limitations shall not be construed as prohibiting Executive from making personal investments in such form or manner as will neither require Executive's services in the operation or affairs of the companies or enterprises in which such investments are made nor violate the terms of Section 4.

(d) Executive's place of employment shall be in Upper Marlboro, Maryland or elsewhere in the Baltimore, Maryland area.

2. COMPENSATION. For all services rendered by Executive, the Company shall compensate Executive as follows:

(a) BASE SALARY. Effective the date hereof, the base salary payable to Executive shall be \$150,000 per year, payable on a regular basis in accordance with the Company's standard payroll procedures, but not less often than monthly. On at least an annual basis, the Company will review Executive's performance and may make increases to such base salary if, in its discretion, any such increase is warranted.

(b) EXECUTIVE PERQUISITES, BENEFITS AND OTHER COMPENSATION. Executive shall be entitled to receive additional benefits and compensation from the Company in such form and to the extent specified below:

(i) Coverage, subject to contributions required of employees generally, for Executive and Executive's dependent family members under health, hospitalization, disability, dental, life and other insurance plans that the Company may have in effect from time to time for the benefit of its employees.

(ii) Reimbursement for all business travel and other out-of-pocket expenses reasonably incurred by Executive in the performance of Executive's services pursuant to this Agreement. Reimbursable expenses shall be appropriately documented in reasonable detail by Executive, and shall be in a format consistent with the Company's expense reporting policy.

(iii) Such other executive perquisites as may be made

available to, or deemed appropriate for, Executive by the Board of Directors of the Company, and participation in all other Company-wide employee benefits as are available from time to time.

3. CONFIDENTIALITY.

(a) CONFIDENTIAL INFORMATION. As used herein, the term "Confidential Information" means any information, technical data or know-how of the Company and the other members of the Comfort Group, including, but not limited to, that which relates to customers, business affairs, business plans, financial matters, financial plans and projections, pending and proposed acquisitions, operational and hiring matters, contracts and agreements, marketing, sales and pricing, prospects of the Comfort Group, and any information, technical data or know-how that contain or reflect any of the foregoing, whether prepared by the Company, any other member of the Comfort Group, Executive or any other person or entity; PROVIDED, HOWEVER, that the term "Confidential Information" shall not include information, technical data or know-how that Executive can demonstrate is generally available to the public not as a result of any breach of this Agreement by Executive.

(b) NO DISCLOSURE. Except in the performance of Executive's duties as an executive of the Company, Executive will not, during or after the Executive's engagement with the Company, disclose to any person or entity or use, for any reason whatsoever, any Confidential Information.

4. NON-COMPETITION AGREEMENT.

(a) COMPETITION. Executive will not, during the period of Executive's employment by or with the Company, and for a period of two (2) years immediately following the termination of Executive's employment, for any reason whatsoever, directly or indirectly, on behalf of Executive or on behalf of or in conjunction with any other person, company, partnership, corporation or business of whatever nature:

(i) engage, as an officer, director, shareholder, owner, partner, joint venturer, or in a managerial capacity, whether as an employee, independent contractor, consultant or advisor, or as a sales representative, or make or guarantee loans or invest, in or for any business engaged in Services in competition with the Company or any other member of the Comfort Group within one hundred (100) miles of where the Company conducts business during the Term (the "Territory");

(ii) call upon any person who is, at that time, within the Territory, an employee of the Company or any other member of the Comfort Group in a technical, managerial or sales capacity for the purpose or with the intent of enticing such employee away from or out of the employ of the Company or such other member of the Comfort Group;

(iii) call upon any person or entity which is at that time, or which has been within two (2) years prior to that time, a customer of the Company or any other member of the Comfort Group for the purpose of soliciting or selling Services; or

(iv) call upon any prospective acquisition candidate, on Executive's own behalf or on behalf of any competitor, which acquisition candidate either was called upon by Executive on behalf of the Company or any other member of the Comfort Group or was the subject of an acquisition analysis made by Executive on behalf of the Company or any other member of the Comfort Group for the purpose of acquiring such acquisition candidate.

Notwithstanding the above, the foregoing covenant shall not be deemed to prohibit Executive from acquiring as an investment not more than the lesser of three percent (3%) or five hundred thousand dollars (\$500,000) in value of any class of securities of a competing business whose securities are traded on a national securities exchange or on an over-the-counter or similar market.

(b) NO VIOLATION. It is specifically agreed that the period during which the agreements and covenants of Executive made in this Section 4 shall be effective shall be computed by excluding from such computation any time during which Executive is in violation of any provision of this Section 4.

5. TERM; TERMINATION; RIGHTS ON TERMINATION. The initial term of this Agreement shall begin on the date hereof and continue for three (3) years (the "Initial Term"), unless Executive's employment has been terminated sooner as herein provided. Commencing on April 1, 2001, a renewal term of this Agreement shall begin on each anniversary of the date hereof and continue for one (1) year (each a "Renewal Term" and, collectively with the Initial Term, the "Term"), unless Executive's employment has been terminated sooner as herein provided. This Agreement and Executive's employment may be terminated in any one of the following ways:

(a) DEATH. The death of Executive shall immediately terminate this Agreement with no severance compensation due to Executive's estate.

(b) DISABILITY. If, as a result of incapacity due to physical or mental illness or injury, Executive shall have been absent from Executive's full-time duties hereunder for four (4) consecutive months, then thirty (30) days after receiving written notice (which notice may occur before or after the end of such four (4) month period, but which shall not be effective earlier than the last day of such four (4) month period), the Company may terminate Executive's employment hereunder, provided Executive is unable to resume his full-time duties at the conclusion of such notice period. In the event this Agreement is terminated as a result of Executive's disability, Executive shall receive from the Company Executive's base salary at the rate then in effect for the lesser of the time period remaining under the Term or one (1) year, and such amount shall be payable during such period in

a manner consistent with Company's standard pay practices. The amount payable hereunder shall be decreased by the amount of benefits otherwise actually paid by the Company to Executive or on Executive's behalf or under any insurance procured by the Company.

(c) GOOD CAUSE. The Company may terminate this Agreement ten (10) days after written notice to Executive for good cause, which shall be any of the following: (i) Executive's willful or material breach of this Agreement; (ii) Executive's gross negligence in the performance or intentional nonperformance of any of Executive's material duties and responsibilities hereunder; (iii) Executive's willful dishonesty, fraud or misconduct with respect to the business or affairs of the Company or any other member of the Comfort Group; (iv) Executive's conviction of a felony crime; (v) Executive's confirmed positive illegal drug test result; (vi) sexual harassment by Executive; or (vii) willful and material failure by Executive to comply with Comfort's Corporate Compliance Policy. In the event of a termination for good cause, as enumerated above, Executive shall have no right to any severance compensation.

(d) WITHOUT CAUSE. At any time after the commencement of Executive's employment, Executive or the Company may, without cause, terminate this Agreement and Executive's employment, effective thirty (30) days after receipt of written notice. Should Executive be terminated by the Company without cause prior to the second anniversary of the date hereof, Executive shall receive from the Company Executive's base salary at the rate then in effect for two (2) years, and such amount shall be payable during such period in a manner consistent with the Company's standard pay practices. Should Executive be terminated by the Company without cause on or after the second anniversary of the date hereof, Executive shall receive from the Company Executive's base salary at the rate then in effect for the lesser of (i) the time period remaining under the Initial Term or the applicable Renewal Term, as the case may be, or (ii) one (1) year, and such amount shall be payable during such period in a manner consistent with the Company's standard pay practices. If Executive resigns or otherwise terminates Executive's employment, Executive shall receive no severance compensation.

(e) NON-RENEWAL. At any time during the Initial Term or any Renewal Term, either party may, without cause and upon not less than thirty (30) days' prior written notice to the other party, terminate this Agreement and Executive's employment, effective at the end of the Initial Term or such Renewal Term, as the case may be. If either party terminates Executive's employment pursuant to this Section 5(e), Executive shall receive no severance compensation.

6. RETURN OF COMPANY PROPERTY. All records, plans, manuals, "field guides", memoranda, lists, documents, statements and other property delivered to Executive by or on behalf of the Company or any other member of the Comfort Group, by any customer of the Company or any other member of the Comfort Group (including, but not limited to, any such customers obtained

by Executive), by any acquisition candidate of the Company or any other member of the Comfort Group, and all records compiled by Executive which pertain to the business or activities of the Company or any other member of the Comfort Group shall be and remain the property of the Company and shall be subject at all times to its discretion and control. Likewise, all correspondence with customers, representatives or acquisition candidates, reports, records, charts, advertising materials, and any data collected by Executive or by or on behalf of the Company or any other member of the Comfort Group or any representative of any of them shall be delivered promptly to the Company without request by it upon termination of Executive's employment with the Company.

7. INVENTIONS. Executive shall disclose promptly to the Company any and all significant conceptions and ideas for inventions, improvements and valuable discoveries, whether patentable or not, which are conceived or made by Executive, solely or jointly with another, during the period of Executive's employment with the Company or within one (1) year thereafter, and which are directly related to the business or activities of the Company or which Executive conceives as a result of his employment by the Company. Executive hereby assigns and agrees to assign all Executive's interests therein to the Company or its nominee. Whenever requested to do so by the Company, Executive shall execute any and all applications, assignments or other instruments that the Company shall deem necessary to apply for and obtain Letters Patent of the United States or any foreign country or to otherwise protect the Company's interest therein.

8. TRADE SECRETS. Executive agrees that Executive will not, during or after the Term, disclose the specific terms of the Company's or any other member of the Comfort Group's relationships or agreements with significant vendors or customers or any other significant and material trade secret of the Company or any other member of the Comfort Group, whether in existence or proposed, to any person, firm, partnership, corporation or business for any reason or purpose whatsoever, unless: (a) such information is, or through no fault of Executive becomes, published or otherwise available to others or the public under circumstances such that such others or the public may utilize such information without any direct or indirect obligation to the Company or any other member of the Comfort Group; (b) such information is, or at any time may be, acquired by Executive from any third party rightfully possessed of such information and having no direct or indirect obligation to the Company or any other member of the Comfort Group with respect thereto; or (c) disclosure is required by law or the order of any governmental authority under color of law, provided, that prior to disclosing any information pursuant to this clause (c), Executive shall, if possible, give prior written notice thereof to the Company and Comfort and provide the Company and Comfort with the opportunity to contest such disclosure.

9. NO PRIOR AGREEMENTS. Executive hereby represents and warrants to the Company that the execution of this Agreement by Executive and Executive's employment by the Company and the performance of Executive's duties hereunder will not violate or be a breach of any agreement with a former employer, client or any other person or entity. Further, Executive agrees to indemnify the Company for any claim, including, but not limited to, attorneys' fees and expenses of investigation, by any such third party that such third party may now have or may hereafter

come to have against the Company based upon or arising out of any non-competition agreement, invention or secrecy agreement between Executive and such third party which was in existence as of the date of this Agreement.

10. ASSIGNMENT; BINDING EFFECT. Executive understands that Executive has been selected for employment by the Company on the basis of Executive's personal qualifications, experience and skills. Executive agrees, therefore, that Executive cannot assign all or any portion of Executive's performance under this Agreement. Executive, Executive's spouse and the estate of each shall not have any right to encumber or dispose of any right to receive payments hereunder, it being understood that such payments and the right thereto are nonassignable and nontransferable; PROVIDED, HOWEVER, that in the event of the death of Executive, any payments that Executive is entitled to receive may be assigned to the beneficiaries of Executive's estate. Subject to the preceding three (3) sentences and the express provisions of Section 11, this Agreement shall be binding upon, inure to the benefit of and be enforceable by the parties hereto and their respective heirs, legal representatives, successors and assigns.

11. COMPLETE AGREEMENT. Executive has no oral representations, understandings or agreements with the Company or any of its officers, directors or representatives covering the same subject matter as this Agreement. This Agreement is the final, complete and exclusive statement and expression of the agreement between the Company and Executive and of all the terms of this Agreement, and it cannot be varied, contradicted or supplemented by evidence of any prior or contemporaneous oral or written agreements.

12. AMENDMENT; WAIVER. This Agreement may not be modified except in a writing signed by the parties, and no term of this Agreement may be waived except by a writing signed by the party waiving the benefit of such term.

13. NOTICES. All notices and communications required or permitted hereunder shall be in writing and shall be deemed to be given if given in writing (including, without limitation, telecopy) addressed as provided below (or to the addressee at such other address as the addressee shall have specified by notice actually received by the addressor), and if either (a) actually delivered in fully legible form to such address (evidenced in the case of a telecopy by a telecopy transmittal receipt to the correct telecopy number), or (b) in the case of a letter, one business day shall have elapsed after the same shall have been deposited with a nationally recognized overnight courier service or five days shall have elapsed after the same shall have been deposited in the United States mail, with first-class postage prepaid and registered or certified with return receipt requested.

To the Company: CS12 Acquisition Corp.
9600 Fallard Court
Upper Marlboro, MD 20772-6703
Attention: President

with a copy to: Comfort Systems USA, Inc.
Three Riverway, Suite 200
Houston, TX 77056
Attention: General Counsel

To Executive: Gary E. Hess
9460 Tobin Circle
Potomac, MD 20854

with a copy to: Tydings & Rosenberg LLP
100 East Pratt Street
Baltimore, Maryland 21202
Attention: A. Lee Lundy, Jr., Esq.

14. SEVERABILITY; ENFORCEABILITY. If any portion of this Agreement is held invalid or inoperative, the other portions of this Agreement shall be deemed valid and operative and, so far as is reasonable and possible, effect shall be given to the intent manifested by the portion held invalid or inoperative. Moreover, in the event any court of competent jurisdiction shall determine that the scope, time or territorial restrictions set forth in any covenant contained herein are unreasonable, then it is the intention of the parties that such restrictions be enforced to the fullest extent which the court deems reasonable, and this Agreement shall thereby be reformed. Each of the covenants contained in this Agreement shall be construed as an agreement independent of any other provision in this Agreement, and the existence of any claim or cause of action of Executive against the Company, whether predicated on this Agreement or otherwise, shall not constitute a defense to the enforcement by the Company of such covenants.

15. SURVIVAL. The provisions of Sections 3, 4, 5, 6, 7 and 8 shall survive the termination of this Agreement.

16. SPECIFIC PERFORMANCE. Because of the difficulty of measuring economic losses to the Company as a result of a breach of the covenants contained in Sections 3, 4, 5, 6, 7 and 8 hereof and because of the immediate and irreparable damage that could be caused to the Company for which it would have no other adequate remedy, Executive agrees that the Company shall be entitled to specific performance and that such covenants may be enforced by the Company in the event of any breach or threatened breach by Executive, by injunctions, restraining orders and other appropriate equitable relief. Executive further agrees to waive any requirement for the securing or posting of any bond in connection with the obtaining of any such injunctive or other equitable relief.

17. ARBITRATION. With the exception of Sections 4 and 8, any unresolved dispute or controversy arising under or in connection with this Agreement shall be settled exclusively by arbitration, conducted by a single arbitrator in the State of Maryland, in accordance with the National Rules for the Resolution of Employment Disputes of the American Arbitration

Association ("AAA") then in effect, provided that the parties may agree to use an arbitrator other than those provided by the AAA. The arbitrator shall not have the authority to add to, detract from, or modify any provision hereof nor to award punitive damages to any injured party. The arbitrator shall have the authority to order back-pay, severance compensation, reimbursement of costs, including those incurred to enforce this Agreement, and interest thereon. A decision by a the arbitrator shall be final and binding. Judgment may be entered on the arbitrator's award in any court having jurisdiction. Responsibility for bearing the cost of the arbitration shall be determined by the arbitrator and shall, subject to other equitable considerations, be proportional to the arbitrator's decision on the merits.

18. ATTORNEYS' FEES. If any litigation is instituted to enforce or interpret the provisions of this Agreement or the transactions described herein, the prevailing party in such action shall be entitled to recover such party's reasonable attorneys' fees and other costs from the other party hereto.

19. GOVERNING LAW. This Agreement shall be governed by and construed in accordance with the internal laws of the State of Maryland.

20. COUNTERPARTS. This Agreement may be executed in multiple counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

COMPANY:

CS12 ACQUISITION CORP.

By _____
William George

Vice President

EXECUTIVE:

Gary E. Hess

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EXECUTION COUNTERPART

LEASE AGREEMENT

THIS LEASE AGREEMENT (this "Lease"), made and entered into as of April 1, 1998 by and among Gary E. Hess and Susan B. Hess, hereinafter referred to collectively as "Landlord," and CS12 Acquisition Corp., a Delaware corporation, hereinafter referred to as "Tenant";

W I T N E S S E T H:

1. PREMISES. Landlord hereby leases unto Tenant and Tenant hereby leases from Landlord, subject to the terms, covenants and conditions of this Lease, that certain tract of land (the "Land") located in Upper Marlboro, Prince Georges County, Maryland, and more particularly described on EXHIBIT "A" attached hereto, together with all buildings, improvements and fixtures located thereon (the "Improvements") and the non-exclusive use of all rights, easements, privileges and appurtenances thereto (said Land, Improvements and appurtenances being hereinafter sometimes collectively referred to as the "Premises").

2. TERM. The term of this Lease shall commence April 1, 1998 (the "Commencement Date") and end sixty (60) months thereafter on April 1, 2003 (the "Initial Term"). Upon the expiration of the Initial Term, a second term shall immediately commence and end sixty (60) months thereafter on April 1, 2008 (the "Second Term"), unless Tenant shall give written notice to Landlord at least one hundred twenty (120) days in advance of the expiration of the Initial Term of Tenant's election not to renew the Lease. Upon the expiration of the Second Term, a third term shall immediately commence and end sixty months thereafter on April 1, 2013 (the "Third Term"), unless Tenant shall give written notice to Landlord at least one hundred twenty (120) days in advance of the expiration of the Second Term of Tenant's election not to renew the Lease. The period beginning on the Commencement Date and ending on the termination of this Lease is referred to herein as the "Term."

3. RENT. Commencing on the Commencement Date and continuing thereafter throughout the Initial Term, Tenant agrees to pay to Landlord as base rental for the Premises (the "Rent") a monthly amount equal to Sixteen Thousand Six Hundred Sixty-Six and 67/100 Dollars (\$16,666.67), which monthly Rent shall be due and payable, without notice or demand and without abatement, deduction, counterclaim or setoff, in advance on the Commencement Date and on or before the fifth (5th) day of each calendar month during the Initial Term, except that all payments due hereunder for any fractional month at the commencement or end of this Lease shall be prorated based upon the number of days in such fractional month during the Initial Term. Commencing on the first day of the Second Term (the "Second Commencement Date") and continuing thereafter throughout the Second Term, the monthly Rent shall be increased to Seventeen Thousand Five Hundred and No/100 Dollars (\$17,500.00), which monthly Rent shall be due and payable, without notice or demand and without abatement, deduction, counterclaim or setoff, in advance on the

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Second Commencement Date and on or before the fifth (5th) day of each calendar month during the Second Term, except that all payments due hereunder for any fractional month at the commencement or end of this Lease shall be prorated based upon the number of days in such fractional month during the Second Term. Commencing on the first day of the Third Term (the "Third Commencement Date") and continuing thereafter throughout the Third Term, the monthly Rent shall be increased to Eighteen Thousand Three Hundred Seventy-Five and No/100 Dollars (\$18,375.00), which monthly Rent shall be due and payable, without notice or demand and without abatement, deduction, counterclaim or setoff, in advance on the Third Commencement Date and on or before the fifth (5th) day of each calendar month during the Third Term, except that all payments due hereunder for any fractional month at the commencement or end of this Lease shall be prorated based upon the number of days in such fractional month during the Third Term.

Any and all sums of money as shall become due from and payable by Tenant under this Lease (other than base Rent as set forth in the immediately preceding paragraph) shall be considered additional rent and Landlord shall have the same remedies upon default by Tenant as it may have for base Rent upon a default by Tenant.

4. USE. The Premises shall be used for executive and administrative offices, parking and related facilities and for no other purpose. Except as hereinafter provided, Tenant shall comply with all governmental laws, ordinances and regulations applicable to the use of the Premises, and shall promptly comply with all governmental orders and directives for the correction, prevention and abatement of nuisances, in or upon, or connected with, Tenant's use of the Premises. Tenant will not permit the Premises to be used for any purpose or in any manner which would render the insurance thereon void.

5. REPRESENTATIONS OF LANDLORD. Landlord represents that as of the Commencement Date, the Premises complies with all applicable laws, ordinances, statutes, regulations, orders, rules and restrictions relating thereto (the "Applicable Laws"), and that the Premises and the existing and prior uses thereof (including any uses by its former tenants) has not prior to the Commencement Date and does not currently violate the provisions of any Applicable Laws relating thereto. If the Premises at any time fails to be in compliance with the Applicable Laws, Tenant shall take all necessary measures to bring the Premises into compliance with the Applicable Laws.

6. TAXES. Landlord agrees to pay before they become delinquent all taxes, assessments and governmental charges of any kind and nature whatsoever lawfully levied or assessed against the Premises and Tenant shall reimburse Landlord, as additional rent, for all such taxes, assessments and governmental charges which

pertain solely to the Premises. Tenant may contest the assessment of such taxes by appropriate proceedings diligently conducted without being in default hereunder. Landlord agrees to cooperate with any such tax contest conducted by Tenant.

7. MAINTENANCE AND REPAIRS.

a. TENANT'S OBLIGATIONS. From and after the Commencement Date and during the Term, Tenant shall, at Tenant's cost and expense: (i) make interior non-structural repairs, replacements and renewals necessary to keep the Premises in as good condition, order and repair as the same is in as of the Commencement Date, reasonable wear and tear and damage by fire or other casualty or condemnation excepted; (ii) keep the lawns and landscaped areas of the Premises watered, fertilized and trimmed; (iii) keep all electrical, mechanical, heating, ventilating and air conditioning, plumbing and any other systems serving the Premises in good order and repair; and (iv) maintain and repair doorways and windows in the Premises.

b. LANDLORD'S OBLIGATIONS. From and after the Commencement Date and during the Term, Landlord shall, at Landlord's cost and expense, keep the roofs of all Improvements free of leaks and maintain the foundation, floor slabs, walls and all other structural supports of such Improvements in good and sound condition.

c. REMEDY UPON FAILURE. In the event either party shall fail to fulfill its obligations to repair and maintain the Premises, the other party, notwithstanding anything herein to the contrary, shall have the right, upon not less than ten (10) days' prior written notice to the breaching party, to make such repairs and maintain the Premises at such breaching party's expense; PROVIDED, HOWEVER, that this provision shall not apply if the breaching party is proceeding with due diligence, in good faith and without delay to take the actions necessary under this Paragraph 7.

8. ALTERATIONS. Tenant may, without the consent of Landlord, make any alterations to the Premises as it may deem advisable, so long as such alterations do not alter the basic character, structure or structural integrity of the Improvements or overload their capacity, in each case complying with all applicable governmental laws, ordinances, regulations and other requirements, including obtaining and paying for all necessary permits. All alterations made to the Premises pursuant to this Paragraph 8 shall become a part of the Premises and shall be Landlord's property from and after the installation thereof and may not be removed or changed without Landlord's prior written consent. Notwithstanding the foregoing, Landlord, upon notice given at least thirty (30) days prior to the expiration or termination of this Lease or upon such shorter notice as is reasonable under the circumstances upon the earlier expiration of the term of this Lease, may require Tenant to remove any specified alterations and to repair and restore in a good and workmanlike manner any damage to the Premises caused by such removal, all at Tenant's sole cost and expense. All Tenant's personal property and trade fixtures shall remain property of Tenant and, on or before the expiration or earlier termination of this Lease, may be removed from the Premises by Tenant at Tenant's sole cost and expense; PROVIDED, HOWEVER, that Tenant shall repair and restore in a good and workmanlike manner any damage to the Premises caused by such removal. The provisions of this Paragraph 8 shall survive the expiration or earlier termination of this Lease.

9. SIGNS. Tenant shall have the right to install signs upon the Premises, subject to any applicable governmental laws, ordinances, regulations and other requirements. Tenant shall remove all such signs by the termination of this Lease. Such installations and removals shall be made in such manner as to avoid injury or defacement of the Improvements, and Tenant shall repair any injury or defacement caused by such installation and/or removal.

10. INSPECTION. Landlord and Landlord's agents and representatives shall have the right to enter and inspect the Premises at any reasonable time during business hours for the purpose of ascertaining the condition of the Premises or in order to make such repairs as may be required or permitted to be made by Landlord under the terms of this Lease. During the period that is six (6) months prior to the end of the Term hereof, Landlord and Landlord's agents and representatives shall have the right to enter the Premises at any reasonable time during business hours for the purpose of showing the Premises and shall have the right to erect on the Premises a suitable sign indicating the Premises are available. Notwithstanding anything stated herein to the contrary, Landlord agrees not to interfere unreasonably with Tenant's use of the Premises or operations of Tenant's business during the Term.

11. UTILITIES. Landlord agrees to provide, at its cost, water, electricity and telephone service connections into the Premises; PROVIDED, HOWEVER, that Tenant shall pay directly to the service provider for all water, gas, heat, lights, power, telephone, sewer, sprinkler charges and other utilities and services used on or from the Premises, together with any taxes, penalties, surcharges or the like pertaining thereto and any maintenance charges for utilities and shall furnish all electric light bulbs and tubes. Landlord shall not be liable in any way to Tenant for any interruption or failure of or defect in the supply or character of any utility furnished to the Premises, now or hereafter, or for any loss, damage or expense Tenant may sustain if either the quantity or character of any utility is changed or is no longer suitable for Tenant's requirements, whether by reason of any requirement, act or omission of the public utility serving the Premises or for any other reason whatsoever.

12. ASSIGNMENT AND SUBLETTING; NO MORTGAGE OR ENCUMBRANCE.

a. ASSIGNMENT AND SUBLETTING. Except upon a change of control or a sale of substantially all of the assets and business of Tenant, Tenant shall not (i) assign this Lease or (ii) sublet, or permit the subletting of, the Premises or any part thereof, without the written consent of the Landlord, which consent shall not be unreasonably withheld. Notwithstanding the foregoing, Tenant may assign this Lease to entities which are in common ownership with Tenant.

b. NO MORTGAGE OR ENCUMBRANCE. Tenant shall not mortgage or encumber Tenant's interest in this Lease in whole or in part without the written consent of Landlord, which consent may be unreasonably withheld.

13. INSURANCE.

a. COVERAGE. Tenant agrees to maintain, at its sole cost and expense, standard fire and extended coverage insurance covering the Improvements for the joint benefit of Tenant, Landlord and Landlord's lender, in an amount not less than 100% (or such greater percentage as may be necessary to comply with the provisions of any co-insurance clauses of the policy) of the replacement costs thereof, insuring against the perils of fire, lighting, and other perils as now or hereafter may be included in "All Risk" insurance coverage, such coverages and endorsements to be as defined, provided and limited in the standard bureau forms prescribed by the insurance regulatory authority for the state in which the Premises are situated for use by insurance companies admitted in such state for the writing of such insurance on risks located within such state. Such insurance policy shall name Landlord as an additional insured party and shall provide for reasonable advance notice to Landlord of any cancellation of such policy.

b. DAMAGE TO PREMISES. If the Improvements should be damaged or destroyed by fire, tornado or other casualty, Tenant shall give immediate written notice thereof to Landlord.

c. IRREPARABLE OR TOTAL DAMAGE. If the Improvements should be totally destroyed by fire, tornado or other casualty, or if they should be so damaged thereby that restoration thereof cannot, in Tenant's reasonable judgment, be completed within ninety (90) days after the date upon which Landlord is notified by Tenant of such damage, this Lease shall, at Tenant's option, terminate and the Rent shall be abated during the unexpired portion of this Lease, effective upon the date of the occurrence of such damage.

d. OBLIGATION TO REBUILD. If the Improvements should be damaged by any casualty and this Lease is not terminated by Tenant pursuant to the foregoing provisions of this Paragraph 13, Landlord shall either: (i) at its sole cost and expense thereupon proceed with reasonable diligence to rebuild and repair such Improvements to substantially the condition in which they existed prior to such damage or (ii) give written notice to Tenant of its intention not to complete such repairs and rebuilding. If all or a part of the Premises are untenable, Rent shall be reduced based on the percentage of the Premises that is not usable. In the event that Landlord should give written notice of its intention not complete such repair and rebuilding of the Improvements or in the event that Landlord shall fail to complete such repairs and rebuilding within ninety (90) days after the date upon which Landlord is notified by Tenant of such damage, Tenant may at its option terminate this Lease by delivering written notice of termination to Landlord as Tenant's exclusive remedy, whereupon all rights and obligations hereunder shall cease and terminate.

e. PUBLIC LIABILITY COVERAGE. Tenant shall at all times during the term of this Lease, or any extension or renewal thereof, maintain, at its own expense, public liability insurance covering the Premises for the joint benefit of Tenant and Landlord and Landlord's

lender, with personal injury coverage, including death, with a combined single limit of not less than Two Million Dollars (\$2,000,000), which policy names Landlord as an additional insured party. Said policy of insurance may be in the form of a general coverage or a floater policy covering these other premises. Tenant shall provide Landlord with certificates or similar documentation evidencing such insurance policy.

f. WAIVER. Each party hereto waives all rights of recovery, claims, actions or causes of actions arising in any manner in its (the "INJURED PARTY'S") favor and against the other party for loss or damage to the Injured Party's property located within or constituting a part or all of the Premises, to the extent the loss or damage (i) is covered by the Injured Party's insurance, or (ii) would have been covered by the insurance the Injured Party is required to carry under this Lease, whichever is greater, regardless of the cause or origin, including the sole, contributory, partial, joint, comparative or concurrent negligence of the other party. This waiver also applies to each party's directors, officers, employees, shareholders, partners, representatives and agents. All insurance carried by either Landlord or Tenant covering the losses and damages described in this Paragraph 13.f shall provide for such waiver of rights of subrogation by the Injured Party's insurance carrier to the maximum extent that the same is permitted under the laws and regulations governing the writing of insurance within the State of Maryland. Both parties hereto are obligated to obtain such a waiver and provide evidence to the other party of such waiver. The waiver set forth in this Paragraph 13.f shall be in addition to, and not in substitution for, any other waivers, indemnities or exclusions of liability set forth in this Lease.

14. LIABILITY.

a. TENANT'S LIABILITY. Except for the claims, rights of recovery and causes of action that Landlord has released and waived pursuant to Paragraph 13.f hereof, Tenant shall be liable to Landlord for and shall indemnify and hold harmless Landlord and Landlord's partners, venturers, directors, officers, agents, employees, invitees, visitors and contractors from all claims, losses, costs, damages or expenses (including but not limited to attorney's fees) resulting or arising or alleged to result or arise from any and all injuries to or death of any person or damage to or loss of any property caused by any negligence or intentional misconduct of Tenant or Tenant's partners, venturers, directors, officers, agents, employees, or by any breach, violation or non-performance of any covenant of Tenant under this Lease other than any injury or damage arising (or alleged to arise) out of any negligence, intentional misconduct or breach of the term of this Lease by Landlord or Landlord's partners, venturers, directors, officers, agents, or employees. If any action or proceeding should be brought by or against Landlord in connection with any such liability or claim, Tenant, on notice from Landlord, shall defend such action or proceeding, at Tenant's expense, by or through attorneys reasonably satisfactory to Landlord.

b. LANDLORD'S LIABILITY. Except for the claims, rights of recovery and causes of action that Tenant has released and waived pursuant to Paragraph 13.f hereof, Landlord shall

be liable to Tenant for and shall indemnify and hold harmless Tenant and Tenant's partners, venturers, directors, officers, agents, employees, invitees, visitors and contractors from all claims, losses, costs, damages or expenses (including but not limited to attorney's fees) resulting or arising or alleged to result or arise from any and all injuries to or death of any person or damage to or loss of any property caused by any negligence or intentional misconduct of Landlord or Landlord's partners, venturers, directors, officers, agents, or employees, or by any breach, violation or non-performance of any covenant of Landlord under this Lease other than any injury or damage arising (or alleged to arise) out of any negligence, intentional misconduct or breach of the term of this Lease by Tenant or Tenant's partners, venturers, directors, officers, agents, or employees. If any action or proceeding should be brought by or against Tenant in connection with any such liability or claim, Landlord, on notice from Tenant, shall defend such action or proceeding, at Landlord's expense, by or through attorneys reasonably satisfactory to Tenant.

c. PERSONAL PROPERTY INSURANCE. Tenant shall procure and maintain throughout the Term of this Lease a policy or policies of insurance, at its sole cost and expense covering Tenant's personal property and any leasehold improvements, alterations and additions in excess of the leasehold improvements existing on the Commencement Date.

15. CONDEMNATION.

a. SUBSTANTIAL TAKING. If the whole or any substantial part of the Premises should be taken for any public or quasi-public use under governmental law, ordinance or regulation, by right of eminent domain or by private purchase in lieu thereof, and the taking would prevent or materially interfere with the use of the Premises for the purpose for which they are being used, this Lease shall, at Tenant's option, terminate and the Rent shall be abated during the unexpired portion of this Lease, effective when the physical taking of said Premises shall occur.

b. PARTIAL TAKING. If part of the Premises shall be taken for any public or quasi-public use under any governmental law, ordinance or regulation, by right of eminent domain or by private purchase in lieu thereof, and this Lease is not terminated as provided in Paragraph 15.a hereof, this Lease shall not terminate but the Rent payable hereunder during the unexpired portion of this Lease shall be reduced based on the percentage of the Premises that is not usable.

c. ALLOCATION OF AWARDS. In the event of any such taking or private purchase in lieu thereof, Landlord and Tenant shall each be entitled to receive and retain such separate awards and/or portion of lump sum awards as may be allocated to their respective interests in any condemnation proceedings.

16. HOLDING OVER. Tenant will, at the termination of this Lease by lapse of time or otherwise, yield up immediate possession to Landlord. If Landlord agrees that Tenant may hold over

after the expiration or termination of this Lease, unless the parties hereto otherwise agree in writing on the terms of such holding over, the hold over tenancy shall be subject to termination by Landlord at any time upon not less than thirty (30) days advance written notice, or by Tenant at any time upon not less than thirty (30) days advance written notice, and all of the other terms and provisions of this Lease shall be applicable during that period, including Tenant's obligation to pay the rental in effect on the termination date, computed on a daily basis for each day of the hold over period. No holding over by Tenant, whether with or without consent of Landlord, shall operate to extend this Lease except as otherwise expressly agreed.

17. QUIET ENJOYMENT. Landlord covenants that it now has good title to the Premises, free and clear of all liens and encumbrances, excepting only any lien for current taxes not yet due, zoning ordinances and other conditions of record set forth on EXHIBIT "B". Landlord represents and warrants that it has full right and authority to enter into this Lease and that Tenant, upon paying the rental herein set forth and performing its other covenants and agreements herein set forth, shall peaceably and quietly have, hold and enjoy the Premises for the term hereof without hindrance or molestation from Landlord, subject to the terms and provisions of this Lease.

18. TENANT'S DEFAULT. The following occurrences shall be deemed to be "Events of Default" by Tenant under this Lease:

a. Tenant shall fail to pay any installment of the Rent when due, or any other payment or reimbursement to Landlord required herein when due, and such failure shall continue for a period of ten (10) days after notice by Landlord; PROVIDED, HOWEVER, that Landlord shall not be required to give Tenant such notice hereunder more than one (1) time during any calendar year;

b. Tenant shall file a petition under any section or chapter of the United States Bankruptcy Code, as presently constituted and hereinafter amended, or Tenant shall be adjudged bankrupt or insolvent by final order issued at the conclusion of proceedings filed against Tenant thereunder or shall make an assignment for the benefit of all of its creditors;

c. A receiver or trustee shall be appointed for all or substantially all of the assets of Tenant and not repealed within ninety (90) days;

d. Tenant shall fail to comply with any term, provision or covenant of this Lease (other than the foregoing in this Paragraph 18), and shall not cure such failure within thirty (30) days after written notice thereof to Tenant; PROVIDED, HOWEVER, if the nature of the default is such that it cannot be cured with the exercise of Tenant's reasonable and good faith efforts within the thirty (30) day period, Tenant shall have up to ninety (90) days from the date of Landlord's notice to cure such default, provided Tenant undertakes such curative action within the thirty (30) day period and diligently and continuously proceeds with such curative action using Tenant's reasonable and good faith efforts; and

e. If Tenant's interest in this Lease shall devolve upon or pass to any person, whether by operation of law or otherwise, except as specifically permitted by the provisions of Paragraph 12 hereof.

19. REMEDY. Upon the occurrence of any of such events of default described in Paragraph 18 hereof, Landlord shall have the option to terminate this Lease, in which event Tenant shall immediately surrender the Premises to Landlord, and if Tenant fails so to do, Landlord may, without prejudice to any other remedy which it may have for possession or arrearages in Rent, enter upon and take possession of the Premises and expel or remove Tenant and any other person who may be occupying such Premises or any part thereof. Tenant agrees to pay all costs and expenses incurred by Landlord, including reasonable attorneys fees, in pursuing its remedies against Tenant in the event of a default by Tenant. Pursuit of the foregoing remedy shall not preclude pursuit of any other remedies provided by law, nor shall pursuit of the remedy herein provided constitute a forfeiture or waiver of any Rent due to Landlord hereunder or of any damages accruing to Landlord by reason of the violation of any of the terms, provisions and covenants herein contained. No act or thing done by the Landlord or its agents during the Term hereby granted shall be deemed to imply a termination of this Lease or an acceptance of the surrender of the Premises, and no agreement to terminate this Lease or accept a surrender of said Premises shall be valid unless in writing signed by Landlord. Forbearance by Landlord to enforce the remedy herein provided upon an Event of Default shall not be deemed or construed to constitute a waiver of such Event of Default or of Landlord's right to enforce its remedy with respect to any subsequent Event of Default.

20. MECHANIC'S LIENS. Tenant shall have no authority, express or implied, to create or place any lien or encumbrance of any kind or nature whatsoever upon, or in any manner to bind, the interest of Landlord in the Premises or to charge the rentals payable hereunder for any claim in favor of any person dealing with Tenant, including those who may furnish materials or perform labor for any construction or repairs, and each such claim shall affect and each such lien shall attach to, if at all, only the leasehold interest granted to Tenant by this instrument. Tenant covenants and agrees that it will pay or cause to be paid all sums legally due and payable by it on account of any labor performed or materials furnished in connection with any work performed on the Premises on which any lien is or can be validly and legally asserted against its leasehold interest in the Premises or the improvements thereon and that it will save and hold Landlord harmless from any and all loss, cost or expense based on or arising out of asserted claims or liens against the leasehold estate. Upon the attachment of a lien on Tenant's interest in the Premises, Tenant shall, within ten (10) business days of such attachment, bond off or otherwise release such lien against the Premises.

21. NOTICES. Each provision of this instrument or of any applicable governmental laws, ordinances, regulations and other requirements with reference to the sending, mailing or delivery of any notice or the making of any payment by Landlord to Tenant or with reference to the sending, mailing or delivery of any notice or the making of any payment by Tenant to Landlord shall be deemed to be complied with when and if the following steps are taken:

a. All Rent and other payments required to be made by Tenant to Landlord hereunder shall be payable to Landlord at the address hereinbelow set forth or at such other address as Landlord may specify from time to time by written notice delivered in accordance herewith.

b. All payments required to be made by Landlord to Tenant hereunder shall be payable to Tenant at the address hereinbelow set forth, or at such other address as Tenant may specify from time to time by written notice delivered in accordance herewith.

c. Any notice or document required or permitted to be delivered hereunder shall be deemed to be delivered (whether actually received or not) when deposited in the United States Mail, postage prepaid, certified or registered mail, addressed to the parties hereto at the respective addresses set out below, or at such other address as they have theretofore specified by written notice delivered in accordance herewith:

Landlord: Gary E. Hess and Susan B. Hess
9460 Tobin Circle
Potomac, Maryland 20854

with a copy to: Tydings & Rosenberg LLP
100 East Pratt Street
Baltimore, Maryland 21202
Attn: A. Lee Lundy, Jr., Esq.

Tenant: CS12 Acquisition Corp.
9600 Fallard Court
Upper Marlboro, Maryland 20772-6703
Attention: President

with a copy to: Comfort Systems USA, Inc.
Three Riverway
Suite 200
Houston, Texas 77056
Attention: General Counsel

All parties included within the terms "Landlord" and "Tenant" respectively, shall be bound by notices given in accordance with the provisions of this Paragraph 22 to the same effect as if each had received such notice.

22. NON-DISTURBANCE AND ATTORNMEN. This Lease shall be subject to all mortgages, deeds of trust and related security instruments which may now or hereafter encumber the Premises and to all renewals, modifications, consolidations, replacements and extensions thereof and to each

advance made or hereafter to be made thereunder, in each case provided that such mortgage, deed of trust or other instrument does not disturb Tenant's occupancy and use of the Premises.

23. HAZARDOUS SUBSTANCES. Tenant shall indemnify, protect and hold harmless Landlord and each of its respective subsidiaries from and against all costs and damages incurred by Landlord in connection with the presence, emanation, migration, disposal, release or threatened release of any oil or other petroleum products or hazardous materials or substances on, within, or to or from the Premises as a result of (a) the operations of the Tenant after the Commencement Date and (b) the activities of invited or uninvited parties on the Premises during the Term of the Lease. Landlord shall indemnify, protect and hold harmless Tenant and each of its respective subsidiaries from and against all costs and damages incurred by Tenant in connection with the presence, emanation, migration, disposal, release or threatened release of any oil or other petroleum products or hazardous materials or substances on, within, or to or from the Premises as a result of (i) any activity or action by any party prior to the Commencement Date, (ii) the condition of the Premises prior to the Commencement Date, including any future manifestations of such conditions, or (iii) the activities of Landlord or the activities of any third party not affiliated with Tenant except for parties on the Premises during the Term of the Lease. Each party agrees that such party will promptly give written notice to the other party of any investigation, claim, demand, lawsuit or other action by any governmental or regulatory agency or private party involving the Premises and any hazardous substance or environmental law of which such party has actual notice.

24. MISCELLANEOUS.

a. CONTEXT. Words in the singular number shall be held to include the plural, unless the context otherwise requires.

b. BINDING EFFECT. The terms, provisions, covenants and conditions contained in this Lease shall apply to, inure to the benefit of and be binding upon, the parties hereto and upon their respective heirs, legal representatives, successors and permitted assigns.

c. HEADINGS. The captions inserted in this Lease are for convenience only and in no way define, limit or otherwise describe the scope or intent of this Lease or any provision hereof, and in no way affect the interpretation of this Lease.

d. FURTHER ASSURANCES. Tenant agrees from time to time within thirty (30) days after request of Landlord, to deliver to Landlord, or Landlord's designee, an estoppel certificate stating that this Lease is in full force and effect, the date to which Rent has been paid, the unexpired Term of this Lease and such other matters pertaining to this Lease as may be requested by Landlord.

e. ENTIRE AGREEMENT; MODIFICATION. The parties acknowledge that all prior written and oral agreements between them and all prior representations made by either party to the other with respect to the subject matter hereof have been incorporated herein or

otherwise satisfied prior to the execution hereof and that this Lease represents the entire agreement among the parties with respect to the subject matter hereof. This Lease may not be altered, changed or amended except by an instrument in writing signed by both parties hereto.

f. SEVERABILITY. If any clause or provision of this Lease is illegal, invalid or unenforceable under present or future laws effective during the Term of this Lease, then and in the event, it is the intention of the parties hereto that the remainder of this Lease shall not be affected thereby, and it is also the intention of the parties to this Lease that in lieu of each clause or provision of this Lease that is illegal, invalid or unenforceable, there be added as a part of this Lease a clause or provision as similar in terms to such illegal, invalid or unenforceable clause or provision as may be possible and be legal, valid and enforceable.

g. NO BROKER. Each party represents and warrants to the other that it has not dealt with any broker in connection with the Premises or this Lease. Each party hereto indemnifies and holds the other harmless from and against any liability for commissions due any broker or finder with whom such party has dealt in connection with this Lease.

h. GOVERNING LAW. The terms of this Lease shall be governed by and construed in accordance with the internal laws of the State of Maryland, without giving effect to any choice or conflict of laws provisions.

IN WITNESS WHEREOF, the parties hereto have caused this Lease to be executed as of the date first above written.

LANDLORD:

Gary E. Hess

Susan B. Hess

Attest:

By: _____
Name: _____
Title: _____

(SEAL)

TENANT:

CS12 ACQUISITION CORP.,
a Delaware corporation

By: _____
Name: _____
Title: _____

Attest:

By: _____
Name: _____
Title: _____

(SEAL)

COMFORT SYSTEMS USA, INC.
LIST OF SUBSIDIARIES

ENTITY NUMBER	NAME OF ENTITY	STATE OF ORGANIZATION
1.	Aaron Mechanical, Inc.	Michigan
2.	ACI Mechanical, Inc.	Delaware
3.	A.C.I. Mechanical USA, Inc.	Delaware
4.	Accurate Air Systems, L.P.	Texas
5.	Accu-Temp GP, Inc.	Delaware
6.	Accu-Temp LP, Inc.	Delaware
7.	Accu-Temp, LLC	Indiana
8.	Air Masters of Tampa Bay, Inc.	Delaware
9.	Air Solutions USA, Inc.	Delaware
10.	Air Temp, Inc.	Delaware
11.	American Mechanical Inc.	Michigan
12.	American Refrigeration Contractors, Inc.	Delaware
13.	Armani Plumbing & Mechanical, Inc.	New York
14.	Atlas-Accurate Holdings, L.L.C.	Delaware
15.	Atlas Air Conditioning Company, L.P.	Texas
16.	Batchelor's Mechanical Contractors, Inc.	Alabama
17.	BCM Controls Corporation	Massachusetts
18.	Border Electric Co., L.P.	Texas
19.	Border Mechanical Co., L.P.	Texas
20.	Carmack Heating & Air, L.L.C.	Utah
21.	Carson Brothers, Inc.	Montana
22.	CEL, Inc. (Casey Electric)	Delaware
23.	Central Mechanical Construction Co., Inc.	Delaware
24.	Central Mechanical, Inc.	Delaware
25.	Climate Control, Inc.	Delaware
26.	Comfort Systems USA (Florida), Inc. (FORMERLY THE DRAKE CORPORATION--ALL TEMP SERVICES, INC. MERGED INTO IT)	Florida
27.	Comfort Systems USA G.P., Inc.	Delaware
28.	Comfort Systems USA (Texas), L.P.	Texas
29.	Contract Service, Inc. [C.S.I./Bonneville]	Utah
30.	CS44 Acquisition Corp. [Edmonds/Service Refrigeration]	Delaware
31.	Design Mechanical Incorporated	Delaware
32.	Eastern Heating & Cooling, Inc.	New York
33.	Eastern Refrigeration Co., Inc.	New York
34.	EDS, Inc. [Energy Development Services]	Minnesota
35.	E.L. Pruitt Company	Delaware
36.	ESS Engineering, Inc.	Delaware
37.	F&G Mechanical Corporation	Delaware
38.	FIX Reinsurance Corporation	Vermont
39.	Fred Hayes Mechanical Contractors, Inc.	Delaware
40.	Freeway Heating & Air Conditioning, Inc.	Utah
41.	GMS Air Conditioning, Inc.	Delaware

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COMFORT SYSTEMS USA, INC.
LIST OF SUBSIDIARIES

ENTITY NUMBER	NAME OF ENTITY	STATE OF ORGANIZATION
42.	Gotham Air Conditioning Service, Inc.	Delaware
43.	Gulfside Mechanical, Inc.	Delaware
44.	H & H Plumbing & Heating, Inc.	Delaware
45.	H & M Mechanical, Inc.	Delaware
46.	Harris General & Mechanical Contractors, Inc.	Delaware
47.	Helm Corporation	Colorado
48.	Helm Corporation San Diego	California
49.	Hess Mechanical Corporation	Delaware
50.	Hillcrest Sheet Metal, Inc.	Delaware
51.	Industrial Cooling Inc.	Delaware
52.	J & J Mechanical, Inc.	Kentucky
53.	James Air Conditioning Enterprise Inc.	Puerto Rico
54.	Kilgust Mechanical, Inc.	Delaware
55.	Kuempel Service, Inc.	Ohio
56.	Lawrence Service, Inc.	Tennessee
57.	Lower Bucks Cooling and Heating Corporation	Pennsylvania
58.	Lowrie Electric Company, Inc.	Tennessee
59.	MDC Service Corporation	California
60.	Mandell Mechanical Corporation	New York
61.	Martin Heating, Inc.	Delaware
62.	Maximum Refrigeration & Air Conditioning Corp.	Delaware
63.	Meadowlands Fire Protection Corp.	New Jersey
64.	Mechanical Service Group, Inc. [Page]	Delaware
65.	Mechanical Technical Services, L.P.	Texas
66.	MJ Mechanical Services, Inc.	Delaware
67.	Neel Mechanical Contractors, Inc.	Delaware
68.	Nogle & Black Mechanical, Inc.	Delaware
69.	North American Mechanical, Inc.	Delaware
70.	North Jersey Mechanical Contractors, Inc.	New Jersey
71.	OK Sheet Metal and Air Conditioning, Inc.	Delaware
72.	Orbit Systems, Inc.	New Hampshire
73.	Outbound Services, Inc.	Delaware
74.	Plant Services Incorporated	Iowa
75.	Quality Air Heating & Cooling, Inc.	Michigan
76.	Radney Plumbing, Inc.	Delaware

77.	River City Mechanical, Inc.	Michigan
78.	River City Mechanical, Incorporated	Delaware
79.	RMC2 Mechanical Systems, Inc.	California
80.	Ross & Associates, Inc.	Delaware
81.	S&K Air Conditioning Co., Inc.	Georgia
82.	S. I. Goldman Company, Inc.	Delaware
83.	S.M. Lawrence Company, Inc.	Tennessee

COMFORT SYSTEMS USA, INC.
LIST OF SUBSIDIARIES

ENTITY NUMBER -----	NAME OF ENTITY -----	STATE OF ORGANIZATION -----
84.	SA Associates, Inc. (fka Salmon & Alder, Inc.)	Utah
85.	Salmon & Alder, LLC	Utah
86.	Seasonair, Inc.	Maryland
87.	Shambaugh & Son, L.P.	Texas
88.	Sheren Plumbing & Heating, Inc.	Delaware
89.	Southern Bluegrass Mechanical, Inc.	Delaware
90.	Standard Heating & Air Conditioning Company	Alabama
91.	Superior Heating and Sheet Metal Company	Delaware
92.	Target Construction, Inc.	Delaware
93.	Tech Heating and Air Conditioning, Inc.	Ohio
94.	Tech Mechanical Inc.	Ohio
95.	Temp-Right Service, Inc.	Delaware
96.	Temprite Air Conditioning and Refrigeration, Inc.	Delaware
97.	The Capital Refrigeration Company	Delaware
98.	The Fagan Company	Kansas
99.	The Harvey Robbin Company	Delaware
100.	Tri-City Mechanical, Inc.	Arizona
101.	Troost Service Co.	Michigan
102.	United Environmental Services, L.P.	Texas
103.	Walker-J-Walker, Inc.	Tennessee
104.	Weather Engineering, Inc.	Delaware
105.	Western Building Services, Inc.	Colorado

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our reports included in this Form 10-K, into the Company's previously filed Registration Statement on Form S-8 on October 16, 1997 File No. 333-38011 and the Company's previously filed Registration Statement on Form S-4 on April 2, 1999 File No. 333-75595.

ARTHUR ANDERSEN LLP

Houston, Texas
March 15, 2000

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