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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2004

OR

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

For the transition period from ______________ to ______________

Commission file number: 1-13011

COMFORT SYSTEMS USA, INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No o

The number of shares outstanding of the issuer's common stock, as of July 29, 2004 was 38,739,648.

COMFORT SYSTEMS USA, INC.

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FOR THE QUARTER ENDED JUNE 30, 2004

COMFORT SYSTEMS USA, INC.

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Amounts)

	December 31, 2003	June 30, 2004
		(Unaudited)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 10,129	$ 16,705
Accounts receivable, less allowance for doubtful accounts of $5,010 and $5,375	167,567	166,495
Other receivables	5,171	4,297
Inventories	9,825	10,778
Costs and estimated earnings in excess of billings	16,162	22,271
Prepaid expenses and other	13,675	11,112
Assets related to discontinued operations	973	—
Total current assets	223,502	231,658
PROPERTY AND EQUIPMENT, net	13,223	12,966
GOODWILL, net	103,470	103,470
OTHER NONCURRENT ASSETS	10,915	9,996
Total assets	$ 351,110	$ 358,090
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 1,594	$ 2,076
Accounts payable	58,516	57,811
Accrued compensation and benefits	22,664	19,267
Billings in excess of costs and estimated earnings	29,657	29,184
Income taxes payable	—	3,132
Other current liabilities	26,746	28,625
Liabilities related to discontinued operations	122	—
Total current liabilities	139,299	140,095
LONG-TERM DEBT, NET OF CURRENT MATURITIES	8,809	7,806
OTHER LONG-TERM LIABILITIES	2,342	2,714
Total liabilities	150,450	150,615
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, 39,258,913 shares issued	393	393
Treasury stock, at cost, 1,041,864 and 521,765 shares, respectively	(6,305)	(3,138)
Additional paid-in capital	337,605	337,104
Deferred compensation	(540)	(1,608)
Retained earnings (deficit)	(130,493)	(125,276)
Total stockholders' equity	200,660	207,475
Total liabilities and stockholders' equity	$ 351,110	$ 358,090

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)

(Unaudited)

	Three Months Ended June 30		Six Months Ended June 30,	
	2003	2004	2003	2004
REVENUES	$ 198,799	$ 203,948	$ 378,068	$ 396,749
COST OF SERVICES	164,902	170,827	317,179	333,604
Gross profit	33,897	33,121	60,889	63,145
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	28,762	25,717	59,174	52,772
RESTRUCTURING CHARGES	1,112	—	2,274	—
Operating income (loss)	4,023	7,404	(559)	10,373
OTHER INCOME (EXPENSE):				
Interest income	43	12	51	43
Interest expense	(1,095)	(294)	(1,645)	(822)
Write-off of debt costs	—	—	(823)	—
Other	102	396	(147)	(270)
Other income (expense)	(950)	114	(2,564)	(1,049)
INCOME (LOSS) BEFORE INCOME TAXES	3,073	7,518	(3,123)	9,324
INCOME TAX EXPENSE (BENEFIT)	626	3,213	(1,430)	4,009
INCOME (LOSS) FROM CONTINUING OPERATIONS	2,447	4,305	(1,693)	5,315
DISCONTINUED OPERATIONS:				
Operating income, net of income tax expense of $84, $4, $225 and $27	126	6	362	39
Estimated loss on disposition, including income tax expense of $0, $235, $231 and $235	—	(137)	(912)	(137)
NET INCOME (LOSS)	$ 2,573	$ 4,174	$ (2,243)	$ 5,217
INCOME (LOSS) PER SHARE:				
Basic—				
Income (loss) from continuing operations	$ 0.07	$ 0.11	$ (0.05)	$ 0.14
Discontinued operations—				
Income from operations	—	—	0.01	—
Estimated loss on disposition	—	—	(0.02)	—
Net income (loss)	$ 0.07	$ 0.11	$ (0.06)	$ 0.14
Diluted—				
Income (loss) from continuing operations	$ 0.07	$ 0.10	$ (0.05)	$ 0.13
Discontinued operations—				
Income from operations	—	—	0.01	—
Estimated loss on disposition	—	—	(0.02)	—
Net income (loss)	$ 0.07	$ 0.10	$ (0.06)	$ 0.13
SHARES USED IN COMPUTING INCOME (LOSS) PER SHARE:				
Basic	37,640	38,340	37,631	38,237
Diluted	37,983	39,998	38,804	39,480

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	Deferred Compen-sation	Retained Earnings (Deficit)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
BALANCE AT DECEMBER 31, 2002	39,258,913	$ 393	(1,341,419)	$ (8,214)	$ 338,606	$ (785)	$ (124,914)	$ 205,086
Issuance of Treasury Stock:								
Issuance of shares for options exercised including tax benefit	—	—	332,041	2,009	(907)	—	—	1,102
Shares received from sale of assets	—	—	(32,486)	(100)	—	—	—	(100)
Amortization of deferred compensation	—	—	—	—	(69)	245	—	176
Other	—	—	—	—	(25)	—	—	(25)
Net loss	—	—	—	—	—	—	(5,579)	(5,579)
BALANCE AT DECEMBER 31, 2003	39,258,913	393	(1,041,864)	(6,305)	337,605	(540)	(130,493)	200,660
Issuance of Treasury Stock:								
Issuance of shares for options exercised including tax benefit (unaudited)	—	—	351,349	2,122	(609)	—	—	1,513
Issuance of restricted stock (unaudited)	—	—	225,000	1,353	361	(1,714)	—	—
Forfeiture of unvested restricted stock (unaudited)	—	—	(56,250)	(308)	—	259	—	(49)
Amortization of deferred compensation (unaudited)	—	—	—	—	(277)	387	—	110
Other (unaudited)	—	—	—	—	24	—	—	24
Net income (unaudited)	—	—	—	—	—	—	5,217	5,217
BALANCE AT JUNE 30, 2004 (unaudited)	39,258,913	$ 393	(521,765)	$ (3,138)	$ 337,104	$ (1,608)	$ (125,276)	$ 207,475

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

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2004	2003	2004
Net income (loss)	$ 2,573	$ 4,174	$ (2,243)	$ 5,217
Adjustments to reconcile net income (loss) to net cash provided by operating activities—				
Estimated loss on disposition of discontinued operations	—	137	912	137
Restructuring charges	1,112	—	2,274	—
Write-off of debt costs	—	—	823	—
Depreciation expense	1,387	1,165	2,723	2,302
Bad debt expense	661	516	1,468	1,195
Deferred tax expense	834	175	1,213	137
Amortization of debt financing costs	224	100	456	196
Loss (gain) on sale of assets	(41)	(31)	215	(67)
Deferred compensation expense	43	8	35	61
Mark-to-market warrant obligation	154	(340)	(92)	371
Amortization of debt discount	150	—	300	—
Changes in operating assets and liabilities, net of effects of divestitures—				
(Increase) decrease in—				
Receivables, net	(10,101)	(2,906)	1,463	(175)
Inventories	509	(163)	1,433	(953)
Prepaid expenses and other current assets	607	3,084	938	2,711
Costs and estimated earnings in excess of billings	872	(3,635)	1,755	(6,111)
Other noncurrent assets	(53)	29	168	135
Increase (decrease) in—				
Accounts payable and accrued liabilities	10,545	7,762	4,607	2,977
Billings in excess of costs and estimated earnings	4,449	2,318	3,522	(473)
Other, net	(2)	—	(19)	—
Taxes paid related to the sale of businesses	—	—	(10,371)	—
Net cash provided by operating activities	13,923	12,393	11,580	7,660
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of property and equipment	(860)	(900)	(1,947)	(2,217)
Proceeds from sales of property and equipment	32	154	111	283
Proceeds from businesses sold, net of cash sold and transaction costs	(2,674)	177	(2,750)	1,110
Net cash used in investing activities	(3,502)	(569)	(4,586)	(824)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Net payments on revolving line of credit	(9,213)	—	(107)	—
Payments on other long-term debt	(619)	(532)	(1,003)	(553)
Borrowings of other long-term debt	18	32	18	32
Debt financing costs	(593)	(69)	(677)	(778)
Proceeds from exercise of options	72	331	86	1,032
Net cash used in financing activities	(10,335)	(238)	(1,683)	(267)
NET INCREASE IN CASH AND CASH EQUIVALENTS	86	11,586	5,311	6,569
CASH AND CASH EQUIVALENTS, beginning of period—continuing operations and discontinued operations	11,329	5,119	6,104	10,136
CASH AND CASH EQUIVALENTS, end of period—continuing operations and discontinued operations	$ 11,415	$ 16,705	$ 11,415	$ 16,705

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

1. Business and Organization

Comfort Systems USA, Inc., a Delaware corporation ("Comfort Systems" and collectively with its subsidiaries, the "Company"), is a national provider of comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services within the mechanical services industry. The Company operates primarily in the commercial, industrial and institutional HVAC markets, and performs most of its services within office buildings, retail centers, apartment complexes, manufacturing plants, and healthcare, education and government facilities. In addition to standard HVAC services, the Company provides specialized applications such as building automation control systems, fire protection, process cooling, electronic monitoring and process piping. Certain locations also perform related activities such as electrical service and plumbing. Approximately 56% of the Company's consolidated 2004 revenues to date are attributable to installation of systems in newly constructed facilities, with the remaining 44% attributable to maintenance, repair and replacement services. The following service activities account for the Company's consolidated 2004 revenues to date: HVAC—75%, plumbing—13%, building automation control systems—6%, and other—6%. These service activities are within the mechanical services industry which is the single industry segment served by Comfort Systems.

2. Summary of Significant Accounting Policies

Basis of Presentation

These interim statements should be read in conjunction with the historical Consolidated Financial Statements and related notes of Comfort Systems included in the Annual Report on Form 10-K as filed with the Securities and Exchange Commission ("SEC") for the year ended December 31, 2003 (the "Form 10-K").

There were no significant changes in the accounting policies of the Company during the current period. For a description of the significant accounting policies of the Company, refer to Note 2 of Notes to Consolidated Financial Statements of Comfort Systems included in the Form 10-K.

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

Cash Flow Information

Cash paid for interest for continuing and discontinued operations for the six months ended June 30, 2003 and 2004 was approximately $0.9 million and $0.4 million, respectively. Cash paid for income taxes for continuing operations for the six months ended June 30, 2003 and 2004 was approximately $1.3 million and $2.1 million, respectively. Cash paid for income taxes for discontinued operations for the six months ended June 30, 2003 and 2004 was approximately $8.3 million and

$0.1 million, respectively. The cash tax payments for the six months ended June 30, 2003 include approximately $10.4 million associated with the sale in 2002 of 19 operations to Emcor Group, Inc. ("Emcor"). These taxes are included in the caption "Taxes paid related to the sale of businesses" in the accompanying Consolidated Statement of Cash Flows.

Segment Disclosure

Comfort Systems' activities are within the mechanical services industry which is the single industry segment served by the Company. Under Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures About Segments of an Enterprise and Related Information," each operating subsidiary represents an operating segment and these segments have been aggregated, as no individual operating unit is material and the operating units meet a majority of the aggregation criteria.

Use of Estimates

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

Income Taxes

The Company files a consolidated return for federal income tax purposes. Income taxes are provided for under the liability method in accordance with SFAS No. 109, "Accounting for Income Taxes," which takes into account differences between financial statement treatment and tax treatment of certain transactions.

The Company's effective tax rates associated with results from continuing operations for the first six months of 2003 and 2004 were 45.8% and 43.0%, respectively. The Company's effective rate is generally higher than statutory rates because of the effect of certain expenses that the Company incurs that are not deductible for tax purposes, and due to reserves that it has established against certain deferred tax assets based on the possibility that the Company will not be able to ultimately realize the tax benefit for certain losses it has incurred, primarily at the state income tax level. In addition, since the Company's recent pre-tax profit margins have been relatively low on a historical and an absolute basis, the impact of non-deductible expenses on the effective rate is magnified.

Income tax expense for the second quarter of 2003 is unusually low. This resulted primarily from the fact that less tax expense was necessary for this period because the Company had taken a conservative position of recording a relatively small tax benefit in the preceding quarter ending March 31, 2003 when it had incurred a loss.

Stock-Based Compensation

The Company accounts for its stock-based compensation using the intrinsic value method 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 Company's stock option plans 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 ("FASB") 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):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2004	2003	2004
Net Income (Loss) as reported	$ 2,573	$ 4,174	$ (2,243)	$ 5,217
Add: Stock-based compensation included in reported net income, net of tax	28	5	23	40
Less: Compensation expense per SFAS No. 123, net of tax	(773)	(492)	(1,474)	(935)
Pro forma Net Income (Loss)	$ 1,828	$ 3,687	$ (3,694)	$ 4,322
Net Income (Loss) Per Share—Basic				
Net Income (Loss) per share as reported	$ 0.07	$ 0.11	$ (0.06)	$ 0.14
Pro forma Net Income (Loss) per share	$ 0.05	$ 0.10	$ (0.10)	$ 0.11
Net Income (Loss) Per Share—Diluted				
Net Income (Loss) per share as reported	$ 0.07	$ 0.10	$ (0.06)	$ 0.13
Pro forma Net Income (Loss) per share	$ 0.05	$ 0.08	$ (0.10)	$ 0.11

Stock Option Plans—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:

	2003	2004
Expected dividend yield	0.00%	0.00%
Expected stock price volatility	62.08%	61.54%
Risk-free interest rate	2.94%-3.64%	4.38%
Expected life of options	7 years	7 years

Reclassifications

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

3. Discontinued Operations

Individual Sales of Operating Companies—During the second quarter of 2004, the Company sold a small operating company. This unit's after-tax income of less than $0.1 million for each of the first six months of 2003 and 2004 has been reported in discontinued operations under "Operating income, net of income tax expense". The Company recorded a loss on the sale of this unit of $0.5 million, including taxes, in the second quarter of 2004 in discontinued operations under "Estimated loss on disposition, including income tax expense". The loss resulted from the non-cash writeoff of goodwill associated with this unit. The goodwill writeoff was not tax deductible.

During the fourth quarter of 2003, the Company sold a small operating company. This unit's after-tax income of $0.2 million for the six months ended June 30, 2003 has been reported in discontinued operations under "Operating income, net of income tax expense." The Company recorded a loss of $1.5 million, net of tax benefit, in the fourth quarter of 2003 in discontinued operations under

"Estimated loss on disposition, including income tax expense." The loss resulted from the non-cash writeoff of goodwill associated with this unit. The goodwill writeoff was not tax deductible.

During the third quarter of 2003, the Company committed to a plan to divest of a small operating company. This unit's after-tax income of $0.1 million for the six months ended June 30, 2003 has been reported in discontinued operations under "Operating income, net of income tax expense." The Company recorded an estimated loss of $2.8 million, including taxes, in the third quarter of 2003 related to this planned disposition in discontinued operations under "Estimated loss on disposition, including income tax expense" based upon an estimated sales price. The final loss as measured at the closing of this sale in the fourth quarter of 2003 was not materially different than the estimate recorded in the preceding quarter. The loss resulted from the non-cash writeoff of goodwill associated with this unit. The goodwill writeoff was not tax deductible.

During the first quarter of 2003, the Company committed to a plan to divest of a small operating company. This unit's after-tax income of $0.1 million for the six months ended June 30, 2003 has been reported in discontinued operations under "Operating income, net of income tax expense." The Company recorded an estimated loss of $0.9 million, including tax expense, in the first quarter of 2003 related to this transaction in discontinued operations under "Estimated loss on disposition, including income tax expense." The final loss as measured at the closing of this sale in the second quarter of 2003 was not materially different than the estimate recorded in the preceding quarter. The loss resulted from the non-cash writeoff of goodwill associated with this unit. The goodwill writeoff was not tax deductible.

Assets and liabilities related to the operation sold in the second quarter of 2004 were as follows (in thousands):

	December 31, 2003
Cash	$ 7
Accounts receivable, net	372
Other current assets	22
Property and equipment, net	8
Goodwill, net	564
Total assets	$ 973
Accounts payable	$ 50
Other current liabilities	72
Total liabilities	$ 122

Revenues and pre-tax income related to the operations discontinued in 2003 and 2004 were as follows (in thousands):

	Six Months Ended June 30,	
	2003	2004
Revenues	$ 8,782	$ 684
Pre-tax income	$ 587	$ 66

Sale of Companies to Emcor—On March 1, 2002, the Company sold 19 operations to Emcor Group, Inc. ("Emcor"). The total purchase price was $186.25 million, including the assumption by Emcor of approximately $22.1 million of subordinated notes to former owners of certain of the divested companies. The Company realized an aggregate loss of $11.5 million, including related tax expense, in connection with the sale of these operations. As a result of the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," the Company also recognized a goodwill impairment charge related to these operations of $32.4 million, net of tax benefit, as of January 1, 2002.

The transaction with Emcor provided for a post-closing adjustment based on a final accounting, done after the closing of the transaction, of the net assets of the operations that were sold to Emcor. That accounting indicated that the net assets transferred to Emcor were approximately $7 million greater than a target amount that had been agreed to with Emcor. In the second quarter of 2002, Emcor paid the Company that amount, and released $2.5 million that had been escrowed in connection with this element of the transaction.

Of Emcor's purchase price, $5 million was deposited into an escrow account to secure potential obligations on the Company's part to indemnify Emcor for future claims and contingencies arising from events and circumstances prior to closing, all as specified in the transaction documents. Of this escrow, $4 million has been applied in determining the Company's liability to Emcor in connection with the settlement of certain claims as described subsequently in this section. The remaining $1 million of escrow is available for book purposes to apply to any future claims and contingencies in connection with this transaction, and has not been recognized as part of the Emcor transaction purchase price.

The net cash proceeds of approximately $150 million received to date from the Emcor transaction were used to reduce the Company's debt. The Company paid $10.4 million of taxes related to this transaction in March 2003.

In the fourth quarter of 2002, the Company recognized a charge of $1.2 million, net of tax benefit of $2.7 million, in discontinued operations under "Estimated loss on disposition, including income tax expense" in connection with the Emcor transaction. This charge primarily relates to a settlement with Emcor for reimbursement of impaired assets and additional liabilities associated with the operations acquired from the Company. Under this settlement, the Company was released from liability on all other outstanding receivables and issues relating to the profitability of projects that were in process at the time Emcor acquired these operations. During May 2003, the Company paid $2.7 million in cash to Emcor associated with this settlement. The settlement agreement also included the use of $2.5 million of the $5 million escrow described above to fund settled claims. The Company further recognized an additional $1.5 million of the remaining escrow applicable to elements of the settlement still to be funded, of which $0.8 million was paid from escrow during September 2003 and an additional $0.2 million was paid from escrow during May 2004. Accordingly, for book purposes, $1.0 million of escrow remains available to apply against future claims that may arise from Emcor in connection with this transaction. The Company recorded a tax benefit of $1.4 million related to this additional charge. In addition, the $1.2 million charge recognized during the fourth quarter of 2002 is also net of a tax credit of $1.3 million as a result of lower final tax liabilities in connection with the overall Emcor transaction than were estimated when the transaction originally closed in the first quarter of 2002.

There are ongoing open matters relating to this transaction that the Company continues to address with Emcor. The Company does not believe these open matters, either individually or in the aggregate, will have a material effect on the Company's financial position when ultimately resolved. The Company maintains reserves for these matters, net of amounts receivable from escrow that it believes will ultimately be applied in settling these matters. During the second quarter of 2004, the Company concluded that the related reserves should be reduced by $0.3 million, net of tax benefit. This amount was reflected in discontinued operations in the second quarter of 2004 as a reduction in the estimated loss on disposition of discontinued operations.

4. Restructuring Charges

During the first three quarters of 2003, the Company recorded restructuring charges of approximately $3.2 million pre-tax. These charges included approximately $1.5 million for severance costs and retention bonuses primarily associated with the curtailment of the Company's energy efficiency marketing activities, a reorganization of the Company's national accounts operations as well as a reduction in corporate personnel. The severance costs and retention bonuses related to the termination of 88 employees, all of whom had left the Company by December 31, 2003. The restructuring charges for this period also included approximately $1.6 million for remaining lease obligations and $0.1 million of other costs recorded in connection with the actions described above.

The Company also recorded restructuring charges in 2000 and 2002. As of December 31, 2003 and June 30, 2004, accrued lease termination costs of $0.6 million and $0.4 million, respectively, remain that were associated with the restructuring charges recorded during 2000 and 2002.

The following table shows the remaining liabilities associated with the cash portion of the restructuring charges as of December 31, 2003 and June 30, 2004 (in thousands):

	Balance at Beginning of Period	Additions	Payments	Balance at End of Period
Year Ended December 31, 2003:				
Severance	$ —	$ 1,506	$ (1,506)	$ —
Lease termination costs and other	1,000	1,716	(971)	1,745
Total	$ 1,000	$ 3,222	$ (2,477)	$ 1,745
Six Months Ended June 30, 2004:				
Lease termination costs and other	$ 1,745	$ —	$ (677)	$ 1,068

5. Long-Term Debt Obligations

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

	December 31, 2003	June 30, 2004
Revolving credit facility	$ —	$ —
Term loan	10,000	9,500
Other	403	382
Total debt	10,403	9,882
Less—current maturities	(1,594)	(2,076)
Total long-term portion of debt	$ 8,809	$ 7,806

Credit Facility

On December 31, 2003, the Company entered into a senior credit facility (the "Facility") provided by a syndicate of banks. As of June 30, 2004 the total of the Facility was $54.5 million, with $30.1 million in borrowings and letters of credit outstanding, and $24.4 million credit available. As of July 29, 2004, the total of the Facility was $54 million, with $29.6 million in borrowings and letters of credit outstanding, and $24.4 million of credit available. The Facility consists of two parts: a term loan and a revolving credit facility.

The original term loan under the Facility (the "Term Loan") was $10 million, which the Company borrowed upon the closing of the Facility. The Term Loan must be repaid in installments of $0.5 million payable at the beginning of each quarter over five years, the first installment of which was paid in the second quarter of 2004. The Facility requires prepayments of the Term Loan in certain circumstances generally involving the sale of assets. All principal payments under the Term Loan permanently reduce the original $10 million capacity under this portion of the Facility.

The Facility also included a three-year $40 million revolving credit facility (the "Revolving Loan") available for borrowings or letters of credit. This was increased to $45 million in the second quarter of 2004. The Facility requires that borrowings outstanding under the Revolving Loan must be less than $2 million for ten consecutive business days at least once during each year. The Company has already satisfied this condition for 2004.

Certain of the Company's vendors require letters of credit to ensure reimbursement for amounts they are disbursing on the Company's behalf, such as to beneficiaries under the Company's self-funded insurance programs. The Company has also occasionally used letters of credit to guarantee performance under its contracts and to ensure payment to its subcontractors and vendors under those contracts. The Company's lenders issue such letters of credit through the Revolving Loan portion of the Facility. A letter of credit commits the lenders to pay specified amounts to the holder of the letter of credit if the holder demonstrates that the Company has failed to perform specified actions. If this were to occur, the Company would be required to reimburse the lenders for amounts they fund to honor the letter of credit holder's claim. Absent a claim, there is no payment or reserving of funds by the Company in connection with a letter of credit. However, because a claim on a letter of credit would require immediate reimbursement by the Company to its lenders, letters of credit are treated as a use of Facility capacity just the same as actual borrowings. Depending on the circumstances of such a reimbursement, the Company may also have to record a charge to earnings for the reimbursement. Claims against letters of credit are rare in the Company's industry. The Company has never had a claim made against a letter of credit that resulted in payments by the issuer of the letter of credit or by the Company. The Company believes that it is unlikely that it will have to fund claims under a letter of credit in the foreseeable future.

The Company's borrowings and letters of credit outstanding under the Facility at each monthend must be less than a borrowing base measured as of the same monthend. The borrowing base is defined under the Facility as 60% of the following: total trade receivables including costs and estimated earnings in excess of billings, less allowances for doubtful accounts, less receivables related to projects that are subject to payment or performance bonds. The borrowing base as of June 30, 2004 was $86.3 million. The Company does not expect that this borrowing base provision will limit credit available under the Facility in the foreseeable future.

The Company's borrowing and letter of credit capacity under the Revolving Loan portion of the Facility at any given time is $45 million less borrowings and letters of credit outstanding, subject to the borrowing base described above. The Facility contains financial covenants defining various financial measures and the levels of these measures with which the Company must comply, as discussed below under Covenants and Restrictions. Covenant compliance is measured as of each quarterend. While the Facility's financial covenants do not specifically govern capacity under the Facility, if the Company's debt level under the Facility at a quarterend covenant compliance measurement date caused the Company to violate the Facility's debt-to-EBITDA covenant (described in more detail below) the Company's borrowing capacity under the Facility could be restricted by the lenders. Accordingly, available capacity amounts shown below are presented both on a financial covenant basis and on a Facility face value basis.

	As of June 30, 2004	As of July 29, 2004
	(in thousands)	
Amounts Outstanding		
Revolving loan	$ —	$ —
Term loan	9,500	9,000
Other non-Facility debt	382	380
Total debt	$ 9,882	$ 9,380
Letters of credit	$ 20,581	$ 20,581
Available Capacity		
Unused Revolving Loan and letter of credit capacity based on Revolving Loan face value of $45 million	$ 24,419	$ 24,419
Unused Revolving Loan and letter of credit capacity based on quarterend debt-to-EBITDA covenant	$ 24,419	n/a

If the Company voluntarily terminates the Facility in full before December 31, 2004, it would owe the Facility's lenders a termination fee of $0.5 million. The Company may voluntarily terminate the Facility in full on or after December 31, 2004 without a termination fee. Short of a full termination, the Company may not reduce the Revolving Loan commitment within the Facility prior to December 31, 2004. During the second year of the Facility, the Company may voluntarily reduce the Revolving Loan commitment by as much as $5 million. During the third year of the Facility, the Company may voluntarily reduce the Revolving Loan commitment by as much as $10 million, less any reductions it made prior to the third year of the Facility.

Collateral

The Facility is secured by first liens on substantially all the assets of the Company except for assets related to projects subject to surety bonds. The Facility is secured by a second lien on these assets, which are discussed further below. The Company's assets are primarily held by its subsidiaries. Accordingly, the Facility is also secured by the capital stock of current and future subsidiaries, and these entities guarantee repayment of amounts due under the Facility.

A common practice in the Company's industry is the posting of payment and performance bonds with customers. These bonds are offered by financial institutions known as sureties, and provide assurance to the customer that in the event the Company encounters significant financial or operational difficulties, the surety will arrange for the completion of the Company's contractual obligations and for the payment of the Company's vendors on the projects subject to the bonds. In cooperation with its lenders, the Company has granted its surety a first lien on assets such as receivables, costs and estimated earnings in excess of billings, and equipment specifically identifiable to projects for which bonds are outstanding, as collateral for potential obligations under bonds. As of June 30, 2004, the amount of these assets was approximately $43.9 million.

Interest Rates and Fees

The Company has a choice of two interest rate options for borrowings under the Facility. Under one option termed the Base Rate Option, the interest rate is determined based on the higher of the Federal Funds Rate plus 0.5% or the prime lending rate offered by Citibank, N.A. (not one of the banks providing the Facility to the Company). Additional margins are then added to the higher of these two rates for Term Loan and Revolving Loan borrowings respectively. These additional margins are determined based on the ratio of the Company's total debt outstanding as of a given quarterend to its earnings before interest, taxes, depreciation and amortization ("EBITDA") for the twelve months ending as of that quarterend, as shown below. EBITDA as defined under the Facility is discussed in more detail below under *Covenants and Restrictions.*

Under the other interest rate option termed the Eurodollar Rate Option, borrowings bear interest based on designated one to six-month Eurodollar rates that correspond very closely to rates described in various general business media sources as the London Interbank Offered Rate or "LIBOR." Additional margins are then added to LIBOR for Term Loan and Revolving Loan borrowings respectively, based on the Company's ratio of debt to EBITDA, as shown below.

Letter of credit fees under the Facility are also based on the Company's ratio of debt to EBITDA, as shown below.

The interest rates underlying the Base Rate and Eurodollar Rate Options under the Facility are floating rates determined by the broad financial markets, meaning they can and do move up and down from time to time. For illustrative purposes, the following are the respective market rates as of June 30, 2004 relating to interest options under the Facility:

Base Rate Option—The higher of:	
Federal Funds Rate plus 0.50%	1.75%
Citibank, N.A. Prime Rate	4.00%
Eurodollar Rate Option	
One-month LIBOR	1.37%
Six-month LIBOR	1.94%

	Debt to EBITDA		
	Less than 0.75	**0.75 to 1.50**	**1.50 or greater**
Additional Per Annum Interest Margin Added Under:			
Term Loan—			
Base Rate Option	1.75%	2.25%	2.75%
Eurodollar Rate Option	2.75%	3.25%	3.75%
Revolving Loan—			
Base Rate Option	1.50%	2.00%	2.50%
Eurodollar Rate Option	2.50%	3.00%	3.50%
Per Annum Letter of Credit Fees (not added to underlying Base Rate or Eurodollar Rate)	1.875%	2.25%	2.625%

The Facility provides that the interest rate margins and fees associated with a ratio of debt to EBITDA of 0.75 to 1.50 were to be in effect through June 30, 2004 regardless of the Company's actual debt to EBITDA ratio during that time.

Commitment fees of 0.375% per annum are payable on the portion of Revolving Loan capacity not in use for borrowings or letters of credit at any given time.

The Company incurred approximately $1.2 million in financing and professional costs in connection with the arrangement and the closing of the Facility. These costs will be amortized to interest expense over the term of the Facility in the amount of approximately $0.4 million per year for the first three years of the Facility, and less than $0.1 million per year during the fourth and fifth years of the Facility. To the extent prepayments of the Term Loan are made or the size of the Facility is reduced, the Company may have to accelerate amortization of these deferred financing and professional costs.

The weighted average interest rate that the Company has paid on borrowings under the Facility during 2004 is 5.4% per annum. This reflects a combination of borrowings under both interest rate options described above, as well as a transaction in which the interest rate relating to $10 million in principal value of debt was fixed at 5.12% through early July, 2004. These rates do not include amortization of debt financing and arrangement costs or mark-to-market adjustments for derivatives. Following the expiration in early July, 2004 of the fixed interest commitment referred to above, the Company estimates that its weighted average interest rate, now entirely on a floating basis, is currently approximately 4.2%.

Covenants and Restrictions

The Facility contains financial covenants defining various financial measures and the levels of these measures with which the Company must comply. Covenant compliance is assessed as of each quarterend. EBITDA is defined under the Facility for financial covenant purposes as net earnings for the four quarters ending as of any given quarterly covenant compliance measurement date, plus the corresponding amounts for (a) interest expense; (b) income taxes; (c) depreciation and amortization; and (d) other non-cash charges. The Facility also stipulates EBITDA for the first three quarters of 2003 as follows: ($2.8) million for the first quarter; $5.7 million for the second quarter; and $8.0 million for the third quarter. The Facility's principal financial covenants include:

Debt Service Coverage Ratio—The Facility requires that the ratio of EBITDA to the sum of interest expense and scheduled principal payments be at least 2.50. Interest expense is defined under the Facility for purposes of this covenant as interest expense for the four quarters ending as of any given quarterly covenant compliance measurement date, excluding corresponding twelve-month amounts for (a) amortization of deferred debt arrangement costs; and (b) mark-to-market interest expense. Scheduled principal payments for this ratio are also measured for the twelve months ending as of any given quarterly covenant compliance measurement date. The Facility provides, however, that during the first three quarters of 2004, interest expense and scheduled principal payments used in this ratio will be the annualized amounts of actual year-to-date interest expense and scheduled principal payments, instead of actual amounts for these items for the twelve months then ended. The Company's debt service coverage ratio as of June 30, 2004 as measured under this covenant was 7.77 as compared to a minimum covenant requirement of 2.50.

Tangible Net Worth—The Facility requires that the Company's tangible net worth not be less than the sum of (a) $75.4 million; (b) 75% of net income earned beginning October 1, 2003; and (c) the net proceeds of any equity transactions. For purposes of this ratio, the Facility defines tangible net worth as stockholders equity less the book value of the following intangible assets: goodwill, patents, copyrights, licenses, franchises, trade names, trade secrets, and operating leases. The Facility also provides that for purposes of this ratio, net income excludes any goodwill impairment charges. The Company's tangible net worth as of June 30, 2004 as measured under this covenant was $104.0 million, as compared to a covenant minimum of $81.7 million.

Debt to EBITDA—The Facility requires that the Company's ratio of debt to EBITDA not exceed 2.0. The Company's debt-to-EBITDA ratio as of June 30, 2004 as measured under this covenant was 0.39.

Capital Expenditures—The Facility limits capital expenditures to $8.0 million per year. The Company's capital expenditures during the six months ended June 30, 2004 were $2.2 million.

Other Restrictions—The Facility prohibits payment of dividends and repurchase of shares by the Company, and limits non-Facility debt, capital lease obligations, acquisitions, investments, and sales of assets. The Facility also includes a customary provision under which the lenders may demand immediate repayment of borrowings and disposition of letters of credit if they conclude that the Company's business or financial position has suffered a material adverse change. However, the Facility does not include any mechanisms allowing the lenders immediate access to the Company's ongoing cash flow in the event of a default or an immediate repayment demand by the lenders. In view of the Company's financial position, and what management believes are its prospects for profitability and positive cash flow in the future, the Company believes that the probability that its lenders will invoke the Facility's material adverse change provision in the foreseeable future is remote. As a result, debt under the Facility is classified as long-term, other than amounts due within one year.

Interest Expense and Related Charges

The credit facility that preceded the Company's current one was in place from October, 2002 to December, 2003. Interest expense for the three months and six months ended June 30, 2003 and 2004 included the following primary elements (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2004	2003	2004
Interest expense on borrowings and unused commitment fees	$ 453	$ 192	$ 776	$ 417
Letter of credit fees	114	2	205	209
Amortization of deferred debt arrangement costs and discount	374	100	756	196
Mark-to-market adjustments on derivatives	154	—	(92)	—
Total	$ 1,095	$ 294	$ 1,645	$ 822

When the Company's previous credit facilities were reduced in size or terminated, corresponding amounts of deferred debt arrangement costs were written off. During the three months ended March 31, 2003, the Company wrote off $0.8 million of deferred financing fees due to a reduction in the size of the Company's credit facility. This charge is reported as "Write-off of debt costs" in the Company's consolidated statement of operations.

6. Commitments and Contingencies

Claims and Lawsuits

The Company is party to litigation in the ordinary course of business. The Company has estimated and provided accruals for probable losses and related legal fees associated with certain of these actions in the accompanying consolidated financial statements. In management's opinion, uninsured losses resulting from the ultimate resolution of these matters will not have a material adverse effect on the Company's operating results or financial condition.

The Company has previously noted that it had a project-related claim for which a binding arbitration verdict was expected in the second quarter of 2004. The Company received this verdict during the second quarter. The amount of the verdict was not materially different than the reserves the Company had established for this matter.

Surety

Many customers, particularly in connection with new construction, require the Company to post performance and payment bonds issued by a financial institution known as a surety. These bonds provide a guarantee to the customer that the Company will perform under the terms of a contract and that the Company will pay subcontractors and vendors who provided goods and services under a contract. If the Company fails to perform under a contract or to pay subcontractors and vendors, the customer may demand that the surety make payments or provide services under the bond. The Company must reimburse the surety for any expenses or outlays it incurs. To date, the Company is not aware of any losses to its surety in connection with bonds the surety has posted on the Company's behalf, and does not expect such losses to be incurred in the foreseeable future.

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

Self-Insurance

The Company is substantially self-insured for worker's compensation, employer's liability, auto liability, general liability and employee group health claims, in view of the relatively high per-incident deductibles the Company absorbs under its insurance arrangements for these risks. Losses up to deductible amounts are estimated and accrued based upon known facts, historical trends and industry averages. A third-party actuary reviews these estimates semi-annually.

7. Stockholders' Equity

Restricted Stock Grants

The Company awarded 225,000 shares of restricted stock to five members of senior management on June 8, 2004 under its 2000 Equity Incentive Plan. The shares are subject to forfeiture if the Company does not meet certain performance levels for the twelve-month period ending June 30, 2005 or if the grantees leave voluntarily or are terminated for cause. Such forfeiture provisions lapse upon achievement of the performance levels, and pro rata over a four-year period that started on the date of grant.

The Company awarded 200,000 shares of restricted stock to its Chief Executive Officer on March 22, 2002 under its 2000 Equity Incentive Plan. The shares were subject to forfeiture if the Company had not achieved certain performance levels for the twelve-month period ending March 31, 2003. These performance levels were met by the Company. The shares are subject to forfeiture if the executive leaves voluntarily or is terminated for cause. Such forfeiture provisions lapse pro rata over a four-year period that started on the date of grant.

The Company awarded 75,000 shares of restricted stock to its President on November 1, 2002 under the same terms as the Chief Executive Officer's grant of restricted shares. The President resigned from the Company in April 2004 and thus forfeited 56,250 shares of this restricted stock award.

Compensation expense relating to the grants is charged to earnings over the respective four-year periods during which their forfeiture provisions lapse. The initial value of each award was established based on the market price on the date of grant, and was reflected as a reduction of stockholders' equity for unearned compensation at that time. This value, and the related compensation expense, is adjusted up or down based on the market price of the Company's stock during the first year following each respective grant while the performance conditions are in effect. Once the performance conditions are met, the value of the award is fixed based on the market price of the Company's stock at that time, and is charged to earnings over the remaining three-year period during which remaining forfeiture provisions lapse. Following the resignation of the Company's former President in April 2004, no further compensation expense in connection with his restricted stock award is being charged to earnings.

Warrant

In connection with a previous credit facility, the Company granted a lender a warrant to purchase 409,051 shares of Company common stock for nominal consideration. This warrant expires October 11, 2007. The warrant agreement also provides for the following:

- In most situations where the Company issues shares, options or warrants, the warrant holder may acquire additional shares or warrants on equivalent terms to maintain the proportionate interest its warrant shares represent in comparison to the Company's total shares outstanding.
- The warrant holder may require the Company to register its warrant shares.
- The warrant holder may include its warrant shares in any public offering of stock by the Company.
- The warrant holder may "put," or require the Company to repurchase, some or all of its warrant shares at the higher of market price, appraised price or book value per share if there is a change of control of the Company or a public offering of shares by the Company. If the warrant holder disposes of shares acquired and registered under this warrant, the warrant holder's put rights in connection with those shares expire.

This warrant included additional put rights when it was originally issued at the outset of the Company's previous credit facility. These additional put rights were waived when this credit facility was terminated in December 2003. The value of the warrant and put when originally issued of $2.9 million was reflected as a discount of the Company's obligations under the previous credit facility, and as an obligation in long-term liabilities. With the termination of this credit facility, the discount reflected against debt under the facility was written off and included in "Write-off of debt costs and discount, net" in the Company's consolidated statement of operations. Due to the modification to the warrant and put agreement restricting the holder's ability to exercise the put provision, the Company recognized a $1.3 million gain in December 2003 associated with the reduction in the value of the warrant and put obligation. This gain was also included in the "Write-off of debt costs and discount, net" caption. However, because the warrant and put remain outstanding, their remaining value continues to be reflected in long-term liabilities.

The value of this warrant and put will change over time, principally in response to changes in the market price of the Company's common stock. The warrant and the put qualify as a derivative for financial reporting purposes. Accordingly, such changes in the value of the warrant and put in any given period will be included in the Company's statement of operations for that period and in the Company's long-term liabilities, even though the warrant and put may not have been terminated and settled in cash during the period. Such adjustments are known as mark-to-market adjustments. During the six months ended June 30, 2003, these adjustments were a gain of $0.1 million, and were included in interest expense because the warrant and put related to the Company's previous credit facility. Because the warrant and put do not relate to the Company's current credit facility, mark-to-market adjustments during the six months ended June 30, 2004, which were losses of $0.4 million, are reflected as other income (expense) in the Company's statement of operations.

The table below provides an indication of the potential effect on the valuation of this derivative that might result from changes in the market price for the Company's stock. In this table, the value of the warrant has been calculated based upon the stock price being $1 lower and $1 higher than the Company's closing stock price at June 30, 2004 (value of warrant and put obligation in thousands).

Stock Price	Value of Warrant and Put Obligation	
$5.39	$	2,305
$6.39(a)	$	2,714
$7.39	$	3,123

(a) This was the Company's closing stock price on June 30, 2004.

Restricted Common Stock

In March 1997, Notre Capital Ventures II, L.L.C. ("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 holders of Restricted Voting Common Stock are 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 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 80% or more of the originally outstanding shares of Restricted Voting Common Stock have been previously converted into shares of Common Stock. As of June 30, 2004, there were 1,093,599 shares of Restricted Voting Common Stock remaining.

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, warrants and contingently issuable restricted stock.

Options to purchase 0.9 million shares of the Company's common stock ("Common Stock") at prices ranging from $7.625 to $21.438 per share were outstanding for the three months ended June 30, 2004 and from $7.00 to $21.438 per share were outstanding for the six months ended June 30, 2004, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the Common Stock. Options to purchase 4.8 million shares of Common Stock at prices ranging from $2.875 to $21.438 per share were outstanding for the three months ended June 30, 2003, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the Common Stock.

Options to purchase $6.2 million shares of Common Stock at prices ranging from $1.90 to $21.438 per share were outstanding for the six months ended June 30, 2003, but were not included in the computation of diluted EPS because the Company reported a loss from continuing operations during this period. Under the calculations normally required by generally accepted accounting principles for determining EPS, including the effect of these options when the Company reports a loss would increase diluted EPS, or have an "anti-dilutive" effect. When this situation occurs, generally accepted accounting principles require that such options or other common stock equivalents be excluded from the determination of diluted EPS. Accordingly, they were excluded for the six months ended June 30, 2003. The Company would have included 103,949 shares related to the dilutive impact of stock options for the six months ended June 30, 2003 if it were not for the loss from continuing operations during the period.

The following table summarizes information regarding the Company's outstanding stock options as of June 30, 2003 and 2004:

	Number of Options Outstanding	
Exercise Price	**June 30, 2003**	**June 30, 2004**
$1.90	967,000	710,250
$2.14	10,000	10,000
$2.19	10,000	10,000
$2.25	334,625	232,500
$2.34	52,000	500
$2.36	50,000	50,000
$2.43	10,000	10,000
$2.875	1,607,183	1,067,485
$3.39	110,000	15,000
$3.8125	500,000	500,000
$3.86	79,000	79,000
$4.18	—	102,500
$4.24	20,000	15,000
$4.77	40,000	40,000
$6.00	193,500	153,000
$6.75	10,000	5,000
$7.00	—	50,000
$7.625	37,700	34,700
All other outstanding options with prior grant dates with exercise prices ranging from $11.75 to $21.438	2,193,000	844,059
	6,224,008	3,928,994

As noted above, the Company issued a warrant to purchase 409,051 shares of Company common stock along with related put rights for nominal consideration. The dilutive impact of this warrant is computed assuming the issuance of shares equal to the value of the warrant obligation at the end of the reporting period, and excluding the income effect for the period of any mark-to-market adjustments made in connection with valuing the warrant. The put and warrant obligation had an anti-dilutive effect for the three months ended June 30, 2003 and for the six months ended June 30, 2004, but a dilutive effect for the six months ended June 30, 2003 and for the three months ended June 30, 2004.

The following tables reconcile the income (loss) from continuing operations and the net income (loss) on the statement of operations with the corresponding earnings (losses) that are used in computing basic and diluted earnings per share for each of the periods presented (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2004	2003	2004
Income (loss) from continuing operations used in computing earnings per share—basic	$ 2,447	$ 4,305	$ (1,693)	$ 5,315
Mark-to-market adjustment related to warrant and put obligation (after tax)	—	(340)	(92)	—
Income (loss) from continuing operations used in computing earnings per share—diluted	$ 2,447	$ 3,965	$ (1,785)	$ 5,315
Net income (loss) used in computing earnings per share—basic	$ 2,573	$ 4,174	$ (2,243)	$ 5,217
Mark-to-market adjustment related to warrant and put obligation (after tax)	—	(340)	(92)	—
Net income (loss) used in computing earnings per share—diluted	$ 2,573	$ 3,834	$ (2,335)	$ 5,217

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2004	2003	2004
Common shares outstanding, end of period(a)	37,691	38,412	37,691	38,412
Effect of using weighted average common shares outstanding	(51)	(72)	(60)	(175)
Shares used in computing earnings per share—basic	37,640	38,340	37,631	38,237
Effect of shares issuable under stock option plans based on the treasury stock method	118	1,078	—	1,051
Effect of shares issuable related to warrants	—	409	1,173	—
Effect of contingently issuable restricted shares	225	171	—	192
Shares used in computing earnings per share—diluted	37,983	39,998	38,804	39,480

(a) Excludes 225,000 and 325,000 shares of unvested contingently issuable restricted stock outstanding as of June 30, 2003 and 2004, respectively (see "Restricted Stock Grants" above).

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

The following discussion should be read in conjunction with our historical Consolidated Financial Statements and related notes thereto included elsewhere in this Form 10-Q and the Annual Report on Form 10-K as filed with the Securities and Exchange Commission for the year ended December 31, 2003 (the "Form 10-K"). This discussion contains "forward-looking statements" regarding our business and industry within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on our current plans and expectations and involve risks and uncertainties that could cause our actual future activities and results of operations to be materially different from those set forth in the forward-looking statements. Important factors that could cause actual results to differ include risks set forth in "Factors Which May Affect Future Results," included in our Form 10-K.

Introduction and Overview

We are a national provider of comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services within the mechanical services industry. The services we provide address a very broad need, as air is circulated through almost all commercial, industrial and institutional buildings virtually year-round. We operate primarily in the commercial, industrial and institutional HVAC markets and perform most of our services within office buildings, retail centers, apartment complexes, manufacturing plants, and healthcare, education and government facilities. In addition to standard HVAC services, we provide specialized applications such as building automation control systems, fire protection, process cooling, electronic monitoring and process piping. Certain locations also perform related activities such as electrical service and plumbing.

Nature and Economics of Our Business

Approximately 80% of our revenues are earned on a project basis for installation of HVAC systems in newly constructed facilities or for replacement of HVAC systems in existing facilities. Customers hire us to ensure such systems deliver specified or generally expected heating, cooling, conditioning and circulation of air in a facility. This entails installing core system equipment such as packaged heating and air conditioning units, or in the case of larger facilities, separate core components such as chillers, boilers, air handlers, and cooling towers. We also typically install connecting and distribution elements such as piping and ducting. Our responsibilities usually require conforming the systems to pre-established engineering drawings and equipment and performance specifications, which we frequently participate in establishing. Our project management responsibilities include staging equipment and materials to project sites, deploying labor to perform the work, and coordinating with other service providers on the project, including any subcontractors we might use to deliver our portion of the work.

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

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

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

As of June 30, 2004, we had 4,276 projects in process. Our average project takes three to six months to complete, with an average contract price of approximately $234,000. Our projects generally require working capital funding of equipment and labor costs. Customer payments on periodic billings generally do not recover these costs until late in the job. Our average project duration together with typical retention terms as discussed above generally allow us to complete the realization of revenue and earnings in cash within one year. Because of the integral nature of HVAC and related controls systems to most buildings, we have the legal right in almost all cases to attach liens to buildings or related funding sources when we have not been fully paid for installing systems, except with respect to some government buildings. The service work that we do, which is discussed further below, usually does not give rise to lien rights.

We also perform larger HVAC projects. As of June 30, 2004, we had two projects in process with a contract price of between $15 and $20 million, five projects between $10 million and $15 million, nine projects between $5 million and $10 million, and 159 projects between $1 million and $5 million. Taken together, projects with contract prices of $1 million or more totaled $503.9 million of aggregate contract value as of June 30, 2004, out of a total contract value for all projects in progress of $998.7 million. Generally, projects closer in size to $1 million will be completed in a year or less. It is unusual for us to work on a project that exceeds two years in length.

In addition to project work, approximately 20% of our revenues represent maintenance and repair service on already-installed HVAC and controls systems. This kind of work usually takes from a few hours to a few days to perform. Prices to the customer are usually based on the equipment and materials used in the service as well as technician labor time. We usually bill the customer for service work when it is complete, typically with payment terms of up to thirty days. We also provide maintenance and repair service under ongoing contracts. Under these contracts, we are paid regular monthly or quarterly amounts and provide specified service based on customer requirements. These agreements typically cover periods ranging from one to three years and are cancelable on 30 to 60 days notice.

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

Profile and Management of Our Operations

Our company was originally formed in 1997 through an initial public offering, or IPO, and simultaneous acquisition of 12 companies engaged in our business. From the time we completed our IPO through December 1999, we acquired 107 HVAC and complementary businesses, of which 26 were "tuck-in" operations that were integrated upon acquisition with existing operations. Since December 1999, we have not acquired any additional companies. Further, since that time, we have sold or ceased operations at 35 companies. We have consolidated another 14 companies into other operations, such that today we have 44 operating units.

Beginning in the fourth quarter of 1999, we shifted our strategy from an emphasis on acquisition-based growth to a focus on improving the performance of our existing operations. Significantly, on March 1, 2002, we sold 19 operations to Emcor Group, Inc. for $186.25 million, including Emcor's assumption of approximately $22.1 million of subordinated notes to former owners of certain of the divested companies. We used the proceeds from this sale to reduce debt. We recognized a loss, including taxes, of $11.5 million and a goodwill impairment charge prior to the sale of $32.4 million, net of taxes, related to the sold operations. For a further discussion of this sale, see Note 3, "Discontinued Operations," in the notes to the historical consolidated Financial Statements.

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

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

Economic and Industry Factors

As an HVAC and building controls services provider, we operate in the broader nonresidential construction services industry and are affected by trends in this sector. While we do not have operations in all major cities of the US, we believe our national presence is sufficiently large that we experience trends in demand for and pricing of our services that are consistent with trends in the national nonresidential construction sector. As a result, we monitor the views of major construction sector forecasters along with macroeconomic factors they believe drive the sector, including trends in gross domestic product, interest rates, business investment, employment, demographics, and the general fiscal condition of federal, state and local governments. Although nonresidential construction activity has demonstrated periods of both significant growth and decline, it has grown at a compound annual rate of approximately 4.5% over the last two decades.

Spending decisions for building construction, renovation and system replacement are generally made on a project basis, usually with some degree of discretion as to when and if projects proceed. With larger amounts of capital, time, and discretion involved, spending decisions are affected to a significant degree by uncertainty, particularly concerns about macroeconomic and geopolitical trends. We have experienced periods of time, such as after the terrorist incidents on September 11, 2001 in the US, and prior to and during the war in Iraq that occurred in early 2003, when uncertainty caused a significant slowdown in decisions to proceed with installation and replacement project work.

Most of the HVAC equipment we install is provided by four large manufacturers. We regularly seek the views of these manufacturers about trends in the commercial HVAC sector. We also evaluate HVAC equipment shipment statistics reported monthly by the Air Conditioning and Refrigeration Institute, which is the principal industry organization of HVAC equipment manufacturers. We believe that many owners of installed HVAC equipment have deferred maintenance and replacement activity during the very challenging economic conditions of the last several years. We also believe that this trend will not continue indefinitely due to the fundamental mechanical nature of the equipment. The large HVAC manufacturers have each made public statements supporting this view. However, there can be no assurance of whether or when we might actually experience increased demand for HVAC service and replacement.

Operating Environment and Management Emphasis

Nonresidential building construction and renovation activity, as reported by the Federal Government, declined over the three year period of 2001 to 2003 in response to the broader US recession as well as uncertainty relating to international events. This was a more extended period of contraction than the sector has experienced in other recent recessions, with particularly steep declines in the commercial and industrial portions of the industry. As a result, like most nonresidential HVAC service providers, we experienced decreasing volume, prices, and therefore gross profits during this period. We responded to these market challenges by pursuing work in sectors less affected by this downturn, such as government, educational, and health care facilities, and by establishing marketing initiatives that take advantage of our size and range of expertise. These initiatives include our regional and national multi-location service efforts, our energy efficiency capabilities, and collaboration among our operating units to seek joint project opportunities. As a result of these responses, the decreases we saw in revenues over the last three years have been less than the overall decline in activity experienced by the broader nonresidential sector. We also responded to declining gross profits over recent years by reducing our selling, general, and administrative expenses, and our indirect project and service overhead costs. We believe our efforts in these areas have partially offset the decline in our profitability over this period. We began to see improvement in both industry activity as well as our own results in late 2003 and in the first half of 2004, as discussed further under "Results of Operations" below.

In addition to addressing revenues and costs more broadly, we also evaluate our operations on a by-unit and by-market basis. A number of our units have experienced significantly lower results at various points over the last three years, including ten units that incurred operating losses in 2003. While the difficult market conditions over this period of time certainly influenced the performance of these units, we also experienced operational execution shortfalls that contributed to lower results. The majority of such underperforming operations have been closed, sold, merged with stronger operations, or reduced in size or operating scope. We also replaced management at most ongoing operations in this group. We currently have 44 operating units. While it would be unusual in a group of this size to have no underperforming units even in better market conditions, we expect to have fewer units with significantly decreased operating results or losses in 2004 than we had in 2003. During the first half of

2004 we had three units that experienced operating losses which, for two of the units, were nominal. We expect these units to return to profitability in the second half of the year.

With the difficult market conditions in our industry over recent years along with the integration challenges we encountered following our substantial acquisition growth during the period from 1997 to 1999, we also operated in an environment of relatively tight credit restrictions from our lenders. In addition, we have had to more actively manage our relationships with the surety market, through which we procure payment and performance bonds required for approximately 25% of our work. Accordingly, cash flow and debt reduction have been particularly high priorities for us over this period of time. As a result of our sale of certain operations to Emcor in early 2002 as well as our continued strong emphasis on cash flow, our debt outstanding, net of cash, is now at zero. At the end of 2003, we put a new credit facility in place with considerably less restrictive and more traditional terms than those of our previous facilities. Further, we believe our relationship with our surety provider, which has been effective over recent years, continues to improve in light of our strong recent results and financial position. We have generated positive free cash flow in thirteen of the last seventeen quarters, and will continue our emphasis in this area. However, we expect that we will have to devote noticeably fewer management and organizational resources to debt and capital structure matters in 2004 than we have in recent years.

As discussed at greater length in "Results of Operations" below, we see some signs of increased activity levels in our industry in 2004. We expect price competition to continue to be strong, as local and regional competitors respond cautiously to changing conditions. We will continue our efforts to find the more active sectors in our markets, and to increase our regional and national account business. However, our primary emphasis for 2004 will be on internal execution and margin improvement, rather than on revenue growth. In addition to the work we have done on our underperforming units as described above, we have increased our focus on project qualification, estimating, pricing and management, and on service performance. This focus includes significant increases in unit level training.

There has been substantial cost inflation in the first half of 2004 in certain commodities that are used in construction activity, including steel, iron, copper, lumber and poly-vinyl chloride ("PVC") pipe. We estimate that direct purchase of these commodities, principally steel, iron and copper, comprises between 10% and 15% of our average project cost. As noted below in "Results of Operations," for some of the projects we performed in the first half of 2004 as well as for some projects currently in process or still to be performed, the actual cost of certain commodities necessary for these projects was or will be significantly greater than the commodity cost estimates we used when we committed to prices for these projects, which typically was done in 2003 before commodity cost inflation became apparent. We began taking steps early in 2004 to reduce future commodity cost exposure, such as early buying of commodities at acceptable prices for particular projects, or for general inventory, as well as including escalation and escape provisions in project bids and contracts. Based on our project experience so far as well as the mitigating steps we have taken, we believe the negative effect of commodity cost inflation specific to our activity will only have a modest impact on our 2004 results. More broadly, it is possible that further increases in or uncertainty about commodity costs will decrease demand for nonresidential construction activity, which could in turn reduce our future revenues. To date, though, we have not seen an identifiable negative effect of commodity costs on activity in our industry.

Based on indications of stabilizing industry conditions and on our emphasis on internal execution and margin improvement, we expect that our 2004 results will be significantly better than our 2003 results. Over the longer term, if industry conditions are stable to improving, we believe we will experience more periods of increased revenues. In addition, while we would not rule out growth by acquisition, particularly in view of how fragmented our industry is, we have no current acquisition plans, and believe it is likely that any acquisitions we might consider during 2004 would be relatively modest.

Critical Accounting Policies

In response to the Securities and Exchange Commission's Release No. 33-8040, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies", we identified our critical accounting policies based upon the significance of the accounting policy to our overall financial statement presentation, as well as the complexity of the accounting policy and our use of estimates and subjective assessments. We have concluded that our most critical accounting policy is our revenue recognition policy. As discussed elsewhere in this report, our business has two service functions: (i) installation, which we account for under the percentage of completion method, and (ii) maintenance, repair and replacement, which we account for as the services are performed, or in the case of replacement, under the percentage of completion method. In addition, we identified other critical accounting policies related to our allowance for doubtful accounts receivable, the recording of our self-insurance liabilities, valuation of deferred tax assets and the assessment of goodwill impairment. These accounting policies, as well as others, are described in Note 2 to the Consolidated Financial Statements included in our Form 10-K.

Percentage of Completion Method of Accounting

Approximately 80% of our revenues were earned on a project basis and recognized through the percentage of completion method of accounting. Under this method as provided by American Institute of Certified Public Accountants Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," contract revenue recognizable at any time during the life of a contract is determined by multiplying expected total contract revenue by the percentage of contract costs incurred at any time to total estimated contract costs. More specifically, as part of the negotiation and bidding process in which we engage in connection with obtaining installation contracts, we estimate our contract costs, which include all direct materials (net of estimated rebates), labor and subcontract costs and indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. Then, as we perform under those contracts, we measure such costs incurred, compare them to total estimated costs to complete the contract, and recognize a corresponding proportion of contract revenue. This measurement and comparison process requires updates to the estimate of total costs to complete the contract, and these updates may include subjective assessments. Our contracts typically provide for a schedule of billings or invoices to the customer based on reaching agreed upon milestones or as we incur costs, although the billing schedule usually does not precisely match the schedule on which we incur costs. As a result, contract revenues recognized in the statement of operations can and usually do differ from amounts that can be billed or invoiced to the customer at any point during the contract.

The percentage of completion method of accounting is also affected by changes in job performance, job conditions, and final contract settlements. These factors may result in revisions to estimated costs and, therefore, revenues. Such revisions are frequently based on further estimates and subjective assessments. We recognize these revisions in the period in which they are determined. If such revisions lead us to conclude that we will recognize a loss on a contract, the full amount of the estimated ultimate loss is recognized in the period we reach that conclusion, regardless of the percentage of completion of the contract. Revisions to project costs and conditions can give rise to change orders under which the customer agrees to pay additional contract price. Revisions can also result in claims we might make against the customer to recover project variances that have not been satisfactorily addressed through change orders with the customer. We do not recognize revenues or margin based on change orders or claims until they have been agreed upon with the customer, with immaterial exceptions. Variations from estimated project costs could have a significant impact on our operating results, depending on project size, and the recoverability of the variation via additional customer payments.

Accounting for Allowance for Doubtful Accounts

We are required to estimate the collectibility of accounts receivable. Inherent in the assessment of the allowance for doubtful accounts are certain judgments and estimates including, among others, the creditworthiness of the customer, our prior collection history with the customer, the ongoing relationships with the customer, the aging of past due balances, our lien rights, if any, in the property where we performed the work, and the availability, if any, of payment bonds applicable to our contract. These estimates are re-evaluated and adjusted as additional information is received.

Accounting for Self-Insurance Liabilities

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

Accounting for Deferred Tax Assets

We regularly evaluate valuation allowances established for deferred tax assets for which future realization is uncertain. We perform this evaluation at least annually at the end of each fiscal year. The estimation of required valuation allowances includes estimates of future taxable income. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the activity underlying these assets becomes deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. If actual future taxable income differs from our estimates, we may not realize deferred tax assets to the extent we have estimated.

Accounting for Goodwill and Other Intangible Assets

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

We are required to assess our goodwill asset amounts for impairment each year, and more frequently if circumstances suggest an impairment may have occurred. The new requirements for assessing whether goodwill assets have been impaired involve market-based information. This information, and its use in assessing goodwill, entails some degree of subjective assessment.

Results of Operations (in thousands):

Table 1—Historical Results

	Three Months Ended June 30,				Six Months Ended June 30,			
	2003		2004		2003		2004	
Revenues	$ 198,799	100.0%	$ 203,948	100.0%	$ 378,068	100.0%	$ 396,749	100.0%
Cost of services	164,902	82.9%	170,827	83.8%	317,179	83.9%	333,604	84.1%
Gross profit	33,897	17.1%	33,121	16.2%	60,889	16.1%	63,145	15.9%
Selling, general and administrative expenses	28,762	14.5%	25,717	12.6%	59,174	15.7%	52,772	13.3%
Restructuring charges	1,112	0.6%	—	—	2,274	0.6%	—	
Operating income (loss)	4,023	2.0%	7,404	3.6%	(559)	(0.1)%	10,373	2.6%
Interest expense, net	(1,052)	(0.5)%	(282)	(0.1)%	(1,594)	(0.4)%	(779)	(0.2)%
Write-off of debt costs	—	—	—	—	(823)	(0.2)%	—	—
Other expense (income)	102	0.1%	396	0.2%	(147)	—	(270)	(0.1)%
Income (loss) before income taxes	3,073	1.5%	7,518	3.7%	(3,123)	(0.8)%	9,324	2.4%
Income tax expense (benefit)	626		3,213		(1,430)		4,009	
Income (loss) from continuing operations	2,447	1.2%	4,305	2.1%	(1,693)	(0.4)%	5,315	1.3%
Discontinued operations—								
Operating results, net of tax	126		6		362		39	
Estimated loss on disposition, including tax	—		(137)		(912)		(137)	
Net income (loss)	$ 2,573		$ 4,174		$ (2,243)		$ 5,217	

Table 2—Supplemental Disclosure—Operating Results of Ongoing Operations Excluding Certain Items

The following table presents operating income excluding operations we have sold or shut down that did not qualify for presentation as discontinued operations under generally accepted accounting principles in our historical income statement. This table also excludes from operating income restructuring charges and goodwill impairment charges in 2003.

We have included this table because we believe it offers an additional view of the core results of our ongoing operations in a way we find useful in managing these operations, and in a way which also responds to frequent questions we receive about the Company from third parties. However, this presentation of operating income is not in accordance with generally accepted accounting principles, and should not be considered an alternative to operating income as determined under generally accepted accounting principles and presented above in Table 1—Historical Results. In particular, while this table excludes restructuring charges, we have recorded them in each of the previous three years. In addition, impairment charges under the recently changed goodwill accounting rules are generally expected to occur periodically as goodwill recognized in connection with the acquisition of businesses responds over time to changes in those businesses' markets and operations.

	2003									
	Q1	**%**	**O2**	**%**	**Q3**	**%**	**Q4**	**%**	**Total**	**%**
Revenues	$ 179,269		$ 198,799		$ 207,740		$ 197,363		$ 783,171	
Divested units not reflected in discontinued operations	(4,037)		—		(4)		—		(4,041)	
Revenues from ongoing operations	175,232	100.0%	198,799	100.0%	207,736	100.0%	197,363	100.0%	779,130	100.0%
Cost of services	152,277		164,902		172,900		167,246		657,325	
Divested units not reflected in discontinued operations	(4,021)		(16)		(9)		—		(4,046)	
Cost of services from ongoing operations	148,256	84.6%	164,886	82.9%	172,891	83.2%	167,246	84.7%	653,279	83.8%
Gross profit from ongoing operations	26,976	15.4%	33,913	17.1%	34,845	16.8%	30,117	15.3%	125,851	16.2%
Selling, general and administrative expenses	30,412		28,762		27,825		27,031		114,030	
Divested units not reflected in discontinued operations	(723)		(20)		(11)		—		(754)	
Selling, general and administrative expenses from ongoing operations	29,689	16.9%	28,742	14.5%	27,814	13.4%	27,031	13.7%	113,276	14.5%
Operating income (loss) from ongoing operations excluding goodwill impairment and restructuring charges	(2,713)	(1.5)%	5,171	2.6%	7,031	3.4%	3,086	1.6%	12,575	1.6%
Interest expense, net	(542)	(0.3)%	(1,052)	(0.5)%	(1,078)	(0.5)%	(1,155)	(0.6)%	(3,827)	(0.5)%
Other income (expense)	(249)	(0.1)%	102	0.1%	42	—	(73)	—	(178)	—
Income (loss) from ongoing operations before income taxes excluding goodwill impairment, restructuring charges and the writeoff of debt costs and discount, net	(3,504)		4,221		5,995		1,858		8,570	
Income tax expense (benefit)	(1,114)		1,028		2,775		(277)		2,412	
Income (loss) from ongoing operations (after tax), excluding goodwill impairment, restructuring charges and the writeoff of debt costs and discount, net	$ (2,390)	(1.4)%	$ 3,193	1.6%	$ 3,220	1.6%	$ 2,135	1.1%	$ 6,158	0.8%
Income (loss) from continuing operations (after tax)	$ (4,140)		$ 2,447		$ 2,595		$ (2,038)		$ (1,136)	
Divested units not reflected in discontinued operations (after tax)	460		23		8		—		491	
Restructuring charges (after tax)	755		723		617		—		2,095	
Goodwill impairment (after tax)	—		—		—		2,460		2,460	
Writeoff of debt costs and discount (after tax)	535		—		—		1,713		2,248	
Income (loss) from ongoing operations (after tax), excluding restructuring charges, goodwill impairment and the writeoff of debt costs and discount, net	$ (2,390)	(1.4)%	$ 3,193	1.6%	$ 3,220	1.6%	$ 2,135	1.1%	$ 6,158	0.8%
Diluted earnings per share—income (loss) from ongoing operations (after tax), excluding restructuring charges, goodwill impairment and the writeoff of debt costs and discount, net	$ (0.07)		$ 0.08		$ 0.08		$ 0.05		$ 0.16	

	2004			
	Q1	%	Q2	%
Revenues	$ 192,801		$ 203,948	
Divested units not reflected in discontinued operations	—		—	
Revenues from ongoing operations	192,801	100.0%	203,948	100.0%
Cost of services	162,777		170,827	
Divested units not reflected in discontinued operations	—		—	
Cost of services from ongoing operations	162,777	84.4%	170,827	83.8%
Gross profit from ongoing operations	30,024	15.6%	33,121	16.2%
Selling, general and administrative expenses	27,055		25,717	
Divested units not reflected in discontinued operations	—		—	
Selling, general and administrative expenses from ongoing operations	27,055	14.0%	25,717	12.6%
Operating income (loss) from ongoing operations excluding goodwill impairment and restructuring charges	2,969	1.5%	7,404	3.6%
Interest expense, net	(497)	(0.3)%	(282)	(0.1)%
Other income (expense)	(666)	(0.3)%	396	0.2%
Income (loss) from ongoing operations before income taxes excluding goodwill impairment, restructuring charges and the writeoff of debt costs and discount, net	1,806		7,518	
Income tax expense (benefit)	796		3,213	
Income (loss) from ongoing operations (after tax), excluding goodwill impairment, restructuring charges and the writeoff of debt costs and discount, net	$ 1,010		$ 4,305	
Income (loss) from continuing operations (after tax)	$ 1,010		$ 4,305	
Divested units not reflected in discontinued operations (after tax)	—		—	
Restructuring charges (after tax)	—		—	
Writeoff of debt costs (after tax)	—		—	
Income (loss) from ongoing operations (after tax), excluding restructuring charges, goodwill impairment and the writeoff of debt costs and discount, net	$ 1,010	0.5%	$ 4,305	2.1%
Diluted earnings per share—income (loss) from ongoing operations (after tax), excluding restructuring charges, goodwill impairment and the writeoff of debt costs and discount, net	$ 0.03		$ 0.10	

Revenues—Revenues increased $5.1 million, or 2.6%, to $203.9 million for the second quarter of 2004 and increased $18.7 million, or 4.9%, to $396.7 million for the first six months of 2004 compared to the same periods in 2003. Excluding operations that were sold in 2003 and not reflected in discontinued operations, revenues increased 6.1% at ongoing operations for the first six months of 2004. The gain in revenues stemmed primarily from our improving performance in the multi-family sector, which is currently very active, offset to a lesser degree by a decline in our Phoenix area revenues where we had particularly strong project activity in the second quarter of 2003.

We also saw modest year-over-year revenue increases at our ongoing operations in the third and fourth quarters of 2003, following the three-year period of industry activity declines noted previously.

We continue to see signs that activity levels in our industry may increase in 2004 as compared to the levels of the last three years. These observations are based on nonresidential construction spending trends, shipment data from HVAC equipment manufacturers, and anecdotal indications of renewed project consideration.

We and other industry participants also believe that there has been a general deferral of maintenance and replacement activity in the installed base of commercial, industrial, and institutional HVAC equipment, in response to the more difficult economy of the last several years. We and other industry participants believe this trend will not continue indefinitely due to the fundamental mechanical nature of the equipment, but it is not clear when maintenance and replacement activity might increase. While we believe these trends and expectations are positive, there can be no assurance that industry activity levels will actually increase this year or in the foreseeable future.

Also as noted in the introduction above, there has been significant inflation in the first half of 2004 in the cost of certain commodities used in the construction sector, including steel, iron, copper, lumber and PVC pipe. This inflation does not appear to have affected our revenues or backlog, and is expected to have only a modest impact on our profitability, as discussed further below under *Gross Profit*. However, more broadly, it is possible that further increases in or uncertainty about commodity costs will decrease demand for nonresidential construction activity, which could in turn reduce our future revenues. To date, though, we have not seen an identifiable negative effect of commodity costs on activity in our industry.

In view of all of these factors, we may continue to experience only modest revenue growth or revenue declines in upcoming periods. In addition, if general economic activity in the US slows significantly from current levels, we may realize decreases in revenue and lower operating margins.

Backlog primarily contains installation and replacement project work, and maintenance agreements. These projects generally last less than a year. Service work and short duration projects are generally billed as performed and therefore do not flow through backlog. Accordingly, backlog represents only a portion of our revenues for any given future period, and it represents revenues that are likely to be reflected in our operating results over the next six to twelve months. As a result, we believe the predictive value of backlog information is limited to indications of general revenue direction over the near term, and should not be interpreted as indicative of ongoing revenue performance over several quarters.

Backlog associated with continuing operations as of June 30, 2004 was $488.6 million, a 21.0% increase from December 31, 2003 backlog of $403.9 million, and a 7.6% increase from comparable June 30, 2003 backlog of $453.9 million.

Gross Profit—Gross profit decreased $0.8 million, or 2.3%, to $33.1 million for the second quarter of 2004 and increased $2.3 million, or 3.7%, to $63.1 million for the first six months of 2004 compared to the same periods in 2003. As a percentage of revenues, historical gross profit for the second quarter of 2004 was 16.2%, down from 17.1% in the second quarter of 2003, and 17.1% for the same period at ongoing operations. As a percentage of revenues, historical gross profit for the first six months of 2004 was 15.9%, down from 16.1% in the first six months of 2003, and 16.3% for the same period at ongoing operations. These declines resulted primarily from increases in the prices for certain commodity materials that we could not recover in higher prices to our customers, as discussed further below. We also experienced decreased margins in our San Diego operations where we are working through project execution challenges associated with combining two operations, and in our Washington D.C. project operations, which had particularly strong project mix and execution results in last year's second quarter, offset to a lesser degree by improved profitability in our Houston-based multi-family operations.

For some of the projects we performed in the first half of 2004 as well as for some projects currently in process or still to be performed, the actual cost of certain commodities necessary for these projects, principally steel, iron and copper, was or will be significantly greater than the commodity cost estimates we used when we committed to prices for these projects, which typically was done in 2003 before commodity price inflation became apparent. While we do not believe unrecovered commodity inflation affected our first quarter results, we estimate that it had a negative effect of approximately $1.0 million on second quarter and year-to-date 2004 gross profit, or 0.5% of second quarter revenues, and 0.3% of year-to-date revenues. We began taking steps early in 2004 to reduce future commodity cost exposure, such as early buying of commodities at acceptable prices for particular projects, or for general inventory, as well as including escalation and escape provisions in project bids and contracts. Based on our project experience so far as well as the preventative steps we have taken, we believe the negative effect of commodity cost inflation will have a lesser impact in future quarters than in the current quarter, and therefore a relatively modest impact on 2004 results as a whole.

Gross profit indications in our backlog as of June 30, 2004 were marginally higher than they have been at most recent quarter ends. Nonetheless, we remain cautious about gross profit expectations in coming periods. While we believe industry activity levels are increasing, they appear to be doing so at only a modest rate, and still remain at relatively low levels following the three years of decline the industry experienced from 2001 to 2003. We expect continuing price competition in this environment until noticeably higher activity levels are reached and until the majority of our competition becomes convinced that industry growth is more than temporary. Additionally, with regard to gross profit indications in backlog, as noted above under *Revenues*, a significant portion of our activity is not captured in backlog at any given quarter end due to the amount of service and short-duration project work we do. Further, we can and have experienced lower final gross profit margins when work in backlog is ultimately completed, as compared to the gross profit indications that work had when it was only partially completed or new to backlog. Accordingly, while gross profit information in backlog provides some indication of general direction of gross profit, it does not assure future levels or trends in consolidated gross profit percentage.

As noted in the *Introduction* above, we are placing a particular emphasis in 2004 on internal execution and margin improvement, rather than on revenue growth. This includes a strong focus on those of our units that have underperformed, along with increased training efforts on project qualification, estimating, pricing and management, and on service performance. We believe these efforts will help us increase gross profits, although we cannot assure that this will occur. Further, if we are successful in these efforts, we cannot assure that they will offset adverse industry trends, if such trends occur.

Selling, General and Administrative Expenses ("SG&A")—SG&A decreased $3.0 million, or 10.6%, to $25.7 million for the second quarter of 2004 and decreased $6.4 million, or 10.8%, to $52.8 million for the first six months of 2004 compared to the same periods in 2003. As a percentage of revenues, SG&A decreased from 14.5% in the second quarter of 2003 to 12.6% in the second quarter of 2004, and posted a similar decrease at ongoing operations. As a percentage of revenues, SG&A decreased from 15.7% in the first six months of 2003 to 13.3% in the first six months of 2004, and posted a similar decrease at ongoing operations. The decrease in SG&A primarily resulted from the following: (a) a broad-based cost reduction initiative that we undertook beginning in the second quarter of 2003; (b) consolidation of certain operating units, particularly in San Diego; and (c) the sale or closure of certain units that did not qualify for discontinued operations presentation.

Restructuring Charges—During the first two quarters of 2003, we recorded restructuring charges of approximately $2.3 million pre-tax. These charges included approximately $1.3 million for severance costs and retention bonuses primarily associated with the curtailment of our energy efficiency marketing activities, a reorganization of our national accounts operations as well as a reduction in corporate personnel. The severance costs and retention bonuses related to the termination of 88 employees, all of whom had left the Company by December 31, 2003. The restructuring charges for this period also included approximately $0.9 million for remaining lease obligations and $0.1 million of other costs recorded in connection with the actions described above.

Interest Expense, Net—Interest expense, net for the three months and six months ended June 30, 2003 and 2004 included the following primary elements (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2004	2003	2004
Interest expense on borrowings and unused commitment fees	$ 453	$ 192	$ 776	$ 417
Letter of credit fees	114	2	205	209
Amortization of deferred debt arrangement costs and discount	374	100	756	196
Mark-to-market adjustments on derivatives	154	—	(92)	—
Interest income	(43)	(12)	(51)	(43)
Total	$ 1,052	282	$ 1,594	$ 779

Other Expense (Income)—Other income was $0.4 million for the second quarter of 2004 and $0.1 million for the second quarter of 2003. Other expense was $0.3 million for the first six months of 2004 and $0.1 million for the first six months of 2003. The first quarter of 2003 includes a loss of $0.3 million on the disposition of a division of one of our operations. The second quarter of 2004 and the first six months of 2004 include a gain of $0.3 million and a loss of $0.4 million, respectively, resulting from mark-to-market adjustments on the warrant and put obligation. The mark-to-market adjustments to the value of the warrant and put obligation will generally correspond to changes in the market price of our stock, typically resulting in $0.4 million of expense for every $1 increase in our stock price, and conversely, $0.4 million of income for every $1 decrease in our stock price.

Write-off of Debt Costs—First quarter 2003 reflects a non-cash charge of $0.8 million for deferred debt costs that were associated with previously higher levels of capacity under our previous credit facility.

Income Tax Expense (Benefit)—Our effective tax rates associated with results from continuing operations for the first six months of 2003 and 2004 were 45.8% and 43.0%, respectively. Our effective rate is generally higher than statutory rates because of the effect of certain expenses that we incur that are not deductible for tax purposes, and due to reserves that we have established against certain deferred tax assets based on the possibility that we will not be able to ultimately realize the tax benefit for certain losses we have incurred, primarily at the state income tax level. In addition, since our recent pre-tax profit margins have been relatively low on a historical and an absolute basis, the impact of non-deductible expenses on our effective rate is magnified.

Income tax expense for the second quarter of 2003 is unusually low. This resulted primarily from the fact that less tax expense was necessary for this period because we had taken a conservative position of recording a relatively small tax benefit in the preceding quarter ending March 31, 2003 when we had incurred a loss. Had tax expense for the second quarter of 2003 reflected the same tax rate as in this year's second quarter, net income would have been approximately $776,000, or $0.02 per diluted share, lower in the second quarter of 2003.

Discontinued Operations—Individual Sales of Operating Companies—During the second quarter of 2004, we sold a small operating company. This unit's after-tax income of less than $0.1 million for each of the first six months of 2003 and 2004 has been reported in discontinued operations under "Operating income, net of income tax expense". We recorded a loss on the sale of this unit of $0.5 million, including taxes, in the second quarter of 2004 in discontinued operations under

"Estimated loss on disposition, including income tax expense". The loss resulted from the non-cash writeoff of goodwill associated with this unit. The goodwill writeoff was not tax deductible.

During the fourth quarter of 2003, we sold a small operating company. This unit's after-tax income of $0.2 million for the six months ended June 30, 2003 has been reported in discontinued operations under "Operating results, net of tax." We recorded a loss of $1.5 million, net of tax benefit, in the fourth quarter of 2003 in discontinued operations under "Estimated loss on disposition, including tax." The loss resulted from the non-cash writeoff of goodwill associated with this unit. The goodwill writeoff was not tax deductible.

During the third quarter of 2003, we committed to a plan to divest of a small operating company. This unit's after-tax income of $0.1 million for the six months ended June 30, 2003 has been reported in discontinued operations under "Operating results, net of tax." We recorded an estimated loss of $2.8 million, including taxes, in the third quarter of 2003 related to this planned disposition in "Estimated loss on disposition, including tax" based upon an estimated sales price. The final loss as measured at the closing of this sale in the fourth quarter of 2003 was not materially different than the estimate recorded in the preceding quarter. The loss resulted from the non-cash writeoff of goodwill associated with this unit. The goodwill writeoff was not tax deductible.

During the first quarter of 2003, we committed to a plan to divest of a small operating company. This unit's after-tax income of $0.1 million for the six months ended June 30, 2003 has been reported in discontinued operations under "Operating results, net of tax." We recorded an estimated loss of $0.9 million, including taxes, in the first quarter of 2003 related to this transaction in "Estimated loss on disposition, including tax." The final loss as measured at the closing of this sale in the second quarter of 2003 was not materially different than the estimate recorded in the preceding quarter. The loss resulted from the non-cash writeoff of goodwill associated with this unit. The goodwill writeoff was not tax deductible.

Discontinued Operations—Sale of Companies to Emcor—On March 1, 2002, we sold 19 operations to Emcor Group. The total purchase price was $186.25 million, including the assumption by Emcor of approximately $22.1 million of subordinated notes to former owners of certain of the divested companies. We realized an aggregate loss of $11.5 million, including related tax expense, in connection with the sale of these operations. As a result of the adoption of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," we also recognized a goodwill impairment charge related to these operations of $32.4 million, net of tax benefit, as of January 1, 2002.

The transaction with Emcor provided for a post-closing adjustment based on a final accounting, done after the closing of the transaction, of the net assets of the operations that were sold to Emcor. That accounting indicated that the net assets transferred to Emcor were approximately $7 million greater than a target amount that had been agreed to with Emcor. In the second quarter of 2002, Emcor paid us that amount, and released $2.5 million that had been escrowed in connection with this element of the transaction.

Of Emcor's purchase price, $5 million was deposited into an escrow account to secure potential obligations on our part to indemnify Emcor for future claims and contingencies arising from events and circumstances prior to closing, all as specified in the transaction documents. Of this escrow, $4 million has been applied in determining the Company's liability to Emcor in connection with the settlement of certain claims as described subsequently in this section. The remaining $1 million of escrow is available for book purposes to apply to any future claims and contingencies in connection with this transaction, and has not been recognized as part of the Emcor transaction purchase price.

The net cash proceeds of approximately $150 million received to date from the Emcor transaction were used to reduce our debt. We paid $10.4 million of taxes related to this transaction in March 2003.

In the fourth quarter of 2002, we recognized a charge of $1.2 million, net of tax benefit of $2.7 million, in discontinued operations under "Estimated loss on disposition, including tax" in connection with the Emcor transaction. This charge primarily related to a settlement with Emcor for reimbursement of impaired assets and additional liabilities associated with the operations acquired from us. Under this settlement, we were released from liability on all other outstanding receivables and issues relating to the profitability of projects that were in process at the time Emcor acquired these operations from us. During May 2003, we paid $2.7 million in cash to Emcor associated with this settlement. The settlement agreement also includes the use of $2.5 million of the $5 million escrow described above to fund settled claims. We further recognized an additional $1.5 million of the remaining escrow applicable to elements of the settlement still to be funded, of which $0.8 million was paid from escrow in September 2003 and an additional $0.2 million was paid from escrow during May 2004. Accordingly, for book purposes, $1.0 million of escrow remains available to apply against future claims that may arise from Emcor in connection with this transaction. We recorded a tax benefit of $1.4 million related to this additional charge. In addition, the $1.2 million charge recognized during the fourth quarter of 2002 is also net of a tax credit of $1.3 million as a result of lower final tax liabilities in connection with the overall Emcor transaction than we estimated when the transaction originally closed in the first quarter of 2002.

There are ongoing open matters relating to this transaction that we continue to address with Emcor. We do not believe these open matters, either individually or in the aggregate, will have a material effect on our financial position when ultimately resolved. We maintain reserves for these matters, net of amounts receivable from escrow that we believe will ultimately be applied in settling these matters. During the second quarter of 2004, we concluded that the related reserves should be reduced by $0.3 million, net of tax benefit. This amount was reflected in discontinued operations in the second quarter of 2004 as a reduction in the estimated loss on disposition of discontinued operations.

Outlook—As noted earlier in this review, while we see signs that industry activity levels are increasing in 2004, our primary emphasis for this year is on margin improvement rather than revenue growth. Our ongoing margin improvement efforts include a focus on reducing the number of our units with significantly decreased operating results or losses in 2004 as compared to 2003, and intensified project and service performance training at the unit level. Also as noted above, following the difficult operating conditions of 2001-2003, our ongoing operations posted year-over-year revenue increases in the third and fourth quarters of 2003 along with an essentially flat operating income comparison in the third quarter and an increase in the fourth quarter. Our first quarter and second quarter results in 2004 have also shown revenue increases, as well as respectable growth in income. Based on these efforts and developments, and on our belief that industry and economic conditions are improving, we expect that our 2004 results will be significantly better than our 2003 results, although there can be no assurance that we will achieve this outcome.

Liquidity and Capital Resources

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2004	2003	2004
	(in thousands)		(in thousands)	
Cash provided by (used in):				
Operating activities	$ 13,923	$ 12,393	$ 11,580	$ 7,660
Investing activities	$ (3,502)	$ (569)	$ (4,586)	$ (824)
Financing activities	$ (10,335)	$ (238)	$ (1,683)	$ (267)
Free cash flow:				
Cash provided by operating activities	$ 13,923	$ 12,393	$ 11,580	$ 7,660
Taxes paid related to the sale of businesses	—	—	10,371	—
Purchases of property and equipment	(860)	(900)	(1,947)	(2,217)
Proceeds from sales of property and equipment	32	154	111	283
Free cash flow	$ 13,095	$ 11,647	$ 20,115	$ 5,726

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

Our business does not require significant amounts of investment in long-term fixed assets. The substantial majority of the capital used in our business is working capital that funds our costs of labor and installed equipment deployed in project work until our customers pay us. Customary terms in our industry allow customers to withhold a small portion of the contract price until after we have completed the work, typically for six months. Amounts withheld under this practice are known as retention or retainage. Our average project duration together with typical retention terms generally allow us to complete the realization of revenue and earnings in cash within one year. Accordingly, we believe free cash flow, by encompassing both profit margins and the use of working capital over our approximately one-year working capital cycle, is an effective measure of operating effectiveness and efficiency. We have included free cash flow information here for this reason, and because we are often asked about it by third parties evaluating the Company. However, free cash flow is not considered under generally accepted accounting principles to be a primary measure of an entity's financial results, and accordingly free cash flow should not be considered an alternative to operating income, net income, or amounts shown in our consolidated statements of cash flows as determined under generally accepted accounting principles.

For the three months ended June 30, 2004, we had positive free cash flow of $11.6 million, as compared to $13.1 million during the second quarter of 2003. For the six months ended June 30, 2004, we had free cash flow of $5.7 million following very strong fourth quarter 2003 cash flow, as compared to free cash flow of $20.1 million during the first six months of 2003. This decrease resulted from the requirement of $1.9 million in working capital primarily relating to early buying of metal commodities due to volatile conditions in the markets for these materials, and an increase in the proportion of projects that are in early stages when the lag between labor and equipment cash requirements and contractual billing dates is typically the greatest. This compares to a recovery of $13.9 million of working capital from our operations in the first six months of 2003 following comparatively low cash flow in the fourth quarter of 2002.

During the first quarter of 2003, free cash flow as well as borrowings from our credit facility were used to pay final tax payments of $10.4 million associated with the sale of the operations to Emcor.

Credit Facility—On December 31, 2003, we entered into a senior credit facility (the "Facility") provided by a syndicate of banks. As of June 30, 2004 the total of the Facility was $54.5 million, with $30.1 million in borrowings and letters of credit outstanding, and $24.4 million credit available. As of July 29, 2004, the total of the Facility was $54 million, with $29.6 million in borrowings and letters of credit outstanding, and $24.4 million of credit available. The Facility is secured by substantially all of our assets, including the capital stock of all our current and future subsidiaries and substantially all of their assets. Amounts due under the Facility are also guaranteed by our current and future subsidiaries. The Facility consists of two parts: a term loan and a revolving credit facility.

The original term loan under the Facility (the "Term Loan") was $10 million, which the Company borrowed upon the closing of the Facility. The Term Loan must be repaid in installments of $0.5 million payable at the beginning of each quarter over five years, the first installment of which was paid in the second quarter of 2004. The Facility requires prepayments of the Term Loan in certain circumstances generally involving the sale of assets. All principal payments under the Term Loan permanently reduce the original $10 million capacity under this portion of the Facility.

The Facility also included a three-year $40 million revolving credit facility (the "Revolving Loan") available for borrowings or letters of credit. This was increased to $45 million in the second quarter of 2004. Letters of credit are discussed at greater length below under *Off-Balance Sheet Arrangements and Other Commitments.* The Facility requires that borrowings outstanding under the Revolving Loan must be less than $2 million for ten consecutive business days at least once during each year. We have already satisfied this condition for 2004.

Our borrowings and letters of credit outstanding under the Facility at each monthend must be less than a borrowing base measured as of the same monthend. The borrowing base is defined under the Facility as 60% of the following: total trade receivables including costs and estimated earnings in excess of billings, less allowances for doubtful accounts, less receivables related to projects that are subject to payment or performance bonds. The borrowing base as of June 30, 2004 was $86.3 million. We do not expect that this borrowing base provision will limit credit available under the Facility in the foreseeable future.

Our borrowing and letter of credit capacity under the Revolving Loan portion of the Facility at any given time is $45 million less borrowings and letters of credit outstanding, subject to the borrowing base described above. The Facility contains financial covenants defining various financial measures and the levels of these measures with which we must comply, as discussed further below. Covenant compliance is measured as of each quarterend. While the Facility's financial covenants do not specifically govern capacity under the Facility, if our debt level under the Facility at a quarterend covenant compliance measurement date caused us to violate the Facility's debt-to-EBITDA covenant (described in more detail below) our borrowing capacity under the Facility could be restricted by the lenders. Accordingly, available capacity amounts shown below are presented both on a financial covenant basis and on a Facility face value basis.

	As of June 30, 2004	As of July 29, 2004
	(in thousands)	
Amounts Outstanding		
Revolving loan	$ —	$ —
Term loan	9,500	9,000
Other non-Facility debt	382	380
Total debt	$ 9,882	$ 9,380
Letters of credit	$ 20,581	$ 20,581
Available Capacity		
Unused Revolving Loan and letter of credit capacity based on Revolving Loan face value of $45 million	$ 24,419	$ 24,419
Unused Revolving Loan and letter of credit capacity based on quarterend debt-to-EBITDA covenant	$ 24,419	n/a

The Facility contains financial covenants defining various financial measures and the levels of these measures with which we must comply. Covenant compliance is assessed as of each quarterend. Earnings before interest, taxes, depreciation and amortization ("EBITDA") is defined under the Facility for financial covenant purposes as net earnings for the four quarters ending as of any given quarterly covenant compliance measurement date, plus the corresponding amounts for (a) interest expense; (b) income taxes; (c) depreciation and amortization; and (d) other non-cash charges. The Facility also stipulates EBITDA for the first three quarters of 2003 as follows: ($2.8) million for the first quarter; $5.7 million for the second quarter; and $8.0 million for the third quarter. The Facility's principal financial covenants include:

Debt Service Coverage Ratio—The Facility requires that the ratio of EBITDA to the sum of interest expense and scheduled principal payments be at least 2.50. Interest expense is defined under the Facility for purposes of this covenant as interest expense for the four quarters ending as of any given quarterly covenant compliance measurement date, excluding corresponding twelve-month amounts for (a) amortization of deferred debt arrangement costs; and (b) mark-to-market interest expense. Scheduled principal payments for this ratio are also measured for the twelve months ending as of any given quarterly covenant compliance measurement date. The Facility provides, however, that during the first three quarters of 2004, interest expense and scheduled principal payments used in this ratio will be the annualized amounts of actual year-to-date interest expense and scheduled principal payments, instead of actual amounts for these items for the twelve months then ended. The Company's debt service coverage ratio as of June 30, 2004 as measured under this covenant was 7.77 as compared to a minimum covenant requirement of 2.50.

Tangible Net Worth—The Facility requires that our tangible net worth not be less than the sum of (a) $75.4 million; (b) 75% of net income earned beginning October 1, 2003; and (c) the net proceeds of any equity transactions. For purposes of this ratio, the Facility defines tangible net worth as stockholders equity less the book value of the following intangible assets: goodwill, patents, copyrights, licenses, franchises, trade names, trade secrets, and operating leases. The Facility also provides that for purposes of this ratio, net income excludes any goodwill impairment charges. The Company's tangible net worth as of June 30, 2004 as measured under this covenant was $104.0 million, as compared to a covenant minimum of $81.7 million.

Debt to EBITDA—The Facility requires that our ratio of debt to EBITDA not exceed 2.0. Our debt-to-EBITDA ratio as of June 30, 2004 as measured under this covenant was 0.39.

Capital Expenditures—The Facility limits capital expenditures to $8.0 million per year. Our capital expenditures during the six months ended June 30, 2004 were $2.2 million.

Other Restrictions—The Facility prohibits payment of dividends and repurchase of shares by the Company, and limits non-Facility debt, capital lease obligations, acquisitions, investments, and sales of assets. The Facility also includes a customary provision under which the lenders may demand immediate repayment of borrowings and disposition of letters of credit if they conclude that our business or financial position has suffered a material adverse change. However, the Facility does not include any mechanisms allowing the lenders immediate access to our ongoing cash flow in the event of a default or an immediate repayment demand by the lenders. In view of our financial position, and what we believe are our prospects for profitability and positive cash flow in the future, we believe that the probability that our lenders will invoke the material adverse change provision of the Facility in the foreseeable future is remote. As a result, debt under the Facility is classified as long-term, other than amounts due within one year.

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

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

Certain of our vendors require letters of credit to ensure reimbursement for amounts they are disbursing on our behalf, such as to beneficiaries under our self-funded insurance programs. We have also occasionally used letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. The letters of credit we provide are actually issued by our lenders through our Credit Facility as described above. A letter of credit commits the lenders to pay specified amounts to the holder of the letter of credit if the holder demonstrates that we have failed to perform specified actions. If this were to occur, we would be required to reimburse the lenders. Depending on the circumstances of such a reimbursement, we may also have to record a charge to earnings for the reimbursement. Absent a claim, there is no payment or reserving of funds by the Company in connection with a letter of credit. However, because a claim on a letter of credit would require immediate reimbursement by us to our lenders, letters of credit are treated as a use of Credit Facility capacity just the same as actual borrowings. Claims against letters of credit are rare in our industry. To date we have not had a claim made against a letter of credit that resulted in payments by our lenders or by us. We believe that it is unlikely that we will have to fund claims under a letter of credit in the foreseeable future.

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

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

The following recaps the future maturities of our debt along with other contractual obligations as of June 30, 2004 (in thousands):

	Twelve Months Ended June 30,						
	2005	2006	2007	2008	2009	Thereafter	Total
Revolving loan	$ —	$	$ —	$ —	$ —	$ —	$ —
Term loan	2,000	2,000	2,000	2,000	1,500	—	9,500
Other debt	76	71	66	71	59	39	382
Total debt	$ 2,076	$ 2,071	$ 2,066	$ 2,071	$ 1,559	$ 39	$ 9,882
Operating lease obligations	$ 8,189	$ 6,817	$ 5,498	$ 4,565	$ 2,952	$ 11,248	$ 39,269

As of June 30, 2004 we also have $20.6 million of letter of credit commitments, of which $20.2 million expire in 2004 and the remaining $0.4 million expire in 2005. While the majority of these commitments expire in 2004, we expect the majority of them, primarily those supporting our property and casualty insurance programs, will be renewed annually.

Other than the operating lease obligations noted above, we have no significant purchase or operating commitments outside of commitments to deliver equipment and provide labor in the ordinary course of performing project work. In addition, Other Long-Term Liabilities on our balance sheet include $2.7 million associated with a warrant and put obligation. This amount substantially reflects the value of the warrant portion of the obligation that can be converted into equity by the holder. Because this conversion would not require a cash disbursement, we have not included this obligation in the table of commitments above.

Outlook—We have generated positive net free cash flow in thirteen of the last seventeen quarters in challenging economic and industry conditions. We also have a relatively low level of debt, and cash balances that exceed our total debt. We anticipate that free cash flow from operations and credit capacity under the Facility will provide us with sufficient liquidity to fund our operations for the foreseeable future.

Seasonality and Cyclicality

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

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

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

We are exposed to market risk primarily related to potential adverse changes in interest rates. Management is actively involved in monitoring exposure to market risk and continues to develop and utilize appropriate risk management techniques. We are not exposed to any other significant financial market risks including commodity price risk (except as discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations"), 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.

ITEM 4. *Controls and Procedures*

The Company's executive management is responsible for insuring the effectiveness of our disclosure controls and procedures. We carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the most recent fiscal year. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective at the reasonable assurance level to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported in accordance with and within the time periods specified in Securities and Exchange Commission rules and forms. There has been no change in our internal control over financial reporting during the three months ended June 30, 2004 that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. ***Legal Proceedings***

The Company is party to litigation in the ordinary course of business. The Company has estimated and provided accruals for probable losses and related legal fees associated with certain of these actions in the accompanying consolidated financial statements. In management's opinion, uninsured losses resulting from the ultimate resolution of these matters will not have a material adverse effect on the Company's operating results or financial condition.

The Company has previously noted that it had a project-related claim for which a binding arbitration verdict was expected in the second quarter of 2004. The Company received this verdict during the second quarter. The amount of the verdict was not materially different than the reserves the Company had established for this matter.

Item 2. ***Recent Sales of Unregistered Securities***

None.

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

The Company held its annual meeting of stockholders in Houston, Texas on May 20, 2004. The sole item of business was the election of directors, as stated in the Company's Proxy Statement dated April 27, 2004. All of the Company's incumbent directors were reelected by a majority of the outstanding shares eligible to vote with respect to such election, each for a term expiring at the next annual meeting. Out of a potential of 37,355,450 shares of Common Stock outstanding, William F. Murdy had 29,452,036 shares voted in favor, with 391,168 shares withheld. J. Gordon Beittenmiller had 29,542,036 shares voted in favor, with 391,168 shares withheld. Herman E. Bulls had 29,542,036 shares voted in favor, with 391,168 shares withheld. Vincent J. Costantini had 29,542,036 shares voted in favor, with 391,168 shares withheld. Alfred J. Giardenelli, Jr. had 29,542,106 shares voted in favor, with 391,099 shares withheld. James H. Schultz had 29,542,036 shares voted in favor, with 391,168 shares withheld. Robert D. Wagner, Jr. had 29,542,036 shares voted in favor, with 391,168 shares withheld. With respect to the individual director designated for election by the holders of the Restricted Voting Common Stock, out of a potential of 1,093,599 shares of Restricted Voting Common Stock outstanding, Steven S. Harter had 956,219 shares voted in favor, with no shares withheld.

Item 6. ***Exhibits and Reports on Form 8-K***

(a) Exhibits

10.1 Restricted Stock Award Agreement dated June 8, 2004 by the Company to William F. Murdy.

10.2 Restricted Stock Award Agreement dated June 8, 2004 by the Company to J. Gordon Beittenmiller.

10.3 Restricted Stock Award Agreement dated June 8, 2004 by the Company to William George.

10.4 Restricted Stock Award Agreement dated June 8, 2004 by the Company to Thomas N. Tanner.

10.5 First Amendment to Amended Restated Credit Agreement dated as of May 12, 2004 by and among the Company; Bank of Texas, NA, individually and as administrative agent; Hibernia National Bank, as Documentation Agent; and the Lenders and Guarantors.

10.6 Second Amendment to Amended Restated Credit Agreement dated as of June 10, 2004 by and among the Company; Bank of Texas, NA, individually and as administrative agent; Hibernia National Bank, as Documentation Agent; and the Lenders and Guarantors.

10.7 Third Amendment to Amended Restated Credit Agreement dated as of June 23, 2004 by and among the Company; Bank of Texas, NA, individually and as administrative agent; Hibernia National Bank, as Documentation Agent; and the Lenders and Guarantors.

31.1 Rule 13a-14(a) Certification of William F. Murdy pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Rule 13a-14(a) Certification of J. Gordon Beittenmiller pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Section 1350 Certification of William F. Murdy pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Section 1350 Certification of J. Gordon Beittenmiller pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

(i) The Company filed a report on Form 8-K with the Securities and Exchange Commission on May 5, 2004. Under Item 7 of that report the Company announced that on May 3, 2004, the Company issued a press release, reporting Comfort's financial results for the first quarter of 2004.

SIGNATURES

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

COMFORT SYSTEMS USA, INC.

August 2, 2004	By:	/s/ WILLIAM F. MURDY
		William F. Murdy *Chairman of the Board and* *Chief Executive Officer*
August 2, 2004	By:	/s/ J. GORDON BEITTENMILLER
		J. Gordon Beittenmiller *Executive Vice President,* *Chief Financial Officer and Director*

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Exhibit 10.1

William F. Murdy

COMFORT SYSTEMS USA, INC.
2000 Equity Incentive Plan

Restricted Stock Award Agreement

Comfort Systems USA, Inc.
777 Post Oak Blvd, 5th Floor
Houston, TX 77056

Ladies and Gentlemen:

The undersigned (i) acknowledges that he has received an award (the "Award") of restricted stock from Comfort Systems USA, Inc., a Delaware corporation (the "Company") under the 2000 Equity Incentive Plan (the "Plan"), subject to the terms set forth below and in the Plan; (ii) further acknowledges receipt of a copy of the Plan as in effect on the date hereof; and (iii) agrees with the Company as follows:

1. *Effective Date*. This Agreement shall take effect as of June 8, 2004, which is the date of grant of the Award.

2. *Shares Subject to Award*. The Award consists of 100,000 shares (the "Shares") of common stock of the Company ("Stock"). The undersigned's rights to the Shares are subject to the restrictions described in this Agreement and the Plan (which is incorporated herein by reference with the same effect as if set forth herein in full) in addition to such other restrictions, if any, as may be imposed by law.

3. *Meaning of Certain Terms*. Except as otherwise expressly provided, all terms used herein shall have the same meaning as in the Plan. The term "vest" as used herein with respect to any Share means the lapsing of the restrictions described herein and in the Plan with respect to such Share.

4. *Nontransferability of Shares*. The Shares acquired by the undersigned pursuant to this Agreement shall not be sold, transferred, pledged, assigned or otherwise encumbered or disposed of except as provided below and in the Plan.

5. *Forfeiture Risk*. Except as provided in Section 7(b) of this Agreement, if the undersigned ceases to be employed by the Company and its subsidiaries for any reason, including death, any then unvested Shares acquired by the undersigned hereunder shall be immediately forfeited. The undersigned hereby (i) appoints the Company as the attorney-in-fact of the undersigned to take such actions as may be necessary or appropriate to effectuate a transfer of the record ownership of any such shares that are unvested and forfeited hereunder, (ii) agrees to deliver to the Company, as a precondition to the issuance of any certificate or certificates with respect to unvested Shares hereunder, one or more stock powers, endorsed in blank, with respect to such Shares, and (iii) agrees to sign such other powers and take such other actions as the Company may reasonably request to accomplish the transfer or forfeiture of any unvested Shares that are forfeited hereunder.

6. *Retention of Certificates*. Any certificates representing unvested Shares shall be held by the Company. The undersigned agrees that the Company may give stop transfer instructions to the depository to ensure compliance with the provisions hereof.

7. *Vesting of Shares*. The shares acquired hereunder shall vest in accordance with the provisions of this Paragraph 7 and applicable provisions of the Plan, as follows:

(a) If the Committee determines that, for the period from July 1, 2004 through June 30, 2005, the Company did not have positive earnings from its continuing operations, all as determined and reported in accordance with generally accepted accounting principles in the Company's regularly prepared financial statements, Employee shall immediately and irrevocably forfeit all of the Shares.

(b) If and only if the positive earnings goal in Section 7(a) has been achieved, and provided that the undersigned is then, and since the date of grant has continuously been employed by the Company or its subsidiaries, then the Shares shall vest as follows:

25,000 Shares on August 5, 2005;

an additional 25,000 Shares on June 8, 2006;

an additional 25,000 Shares on June 8, 2007; and

an additional 25,000 Shares on June 8, 2008.

provided, however, that, not withstanding (a) or (b) above, any unvested Shares that have not earlier been forfeited shall vest immediately in the event of (i) a "Change in Control" as defined in the Employment Agreement dated June 27, 2000 between the undersigned and the Company (the "Employment Agreement") or (ii) the termination by the Company of executive without cause as defined in the Employment Agreement.

8. *Legend*. Any certificates representing unvested Shares shall be held by the Company, and any such certificate shall contain a legend substantially in the following form:

THE TRANSFERABILITY OF THIS CERTIFICATE AND THE SHARES OF STOCK REPRESENTED HEREBY ARE SUBJECT TO THE TERMS AND CONDITIONS (INCLUDING FORFEITURE) OF THE COMPANY'S 2000 EQUITY INCENTIVE PLAN AND A RESTRICTED STOCK AWARD AGREEMENT ENTERED INTO BETWEEN THE REGISTERED OWNER AND COMFORT SYSTEMS USA, INC. COPIES OF SUCH PLAN AND AGREEMENT ARE ON FILE IN THE OFFICES OF COMFORT SYSTEMS USA, INC.

As soon as practicable following the vesting of any such Shares the Company shall cause a certificate or certificates covering such Shares to be delivered to the undersigned.

9. *Dividends, etc.*. The undersigned shall be entitled to (i) receive any and all dividends or other distributions paid with respect to those Shares of which he is the record owner on the record date for such dividend or other distribution, and (ii) vote any Shares of which he is the record owner on the record date for such vote; *provided, however*, that any property (other than cash) distributed with respect to a share of Stock (the "associated share") acquired hereunder, including without limitation a distribution of Stock by reason of a stock dividend, stock split or otherwise, or a distribution of other securities with respect to an associated share, shall be subject to the restrictions of this Agreement in the same manner and for so long as the associated share remains subject to such restrictions, and shall be promptly forfeited to the Company if and when the associated share is so forfeited; *and further provided*, that the Administrator may require that any cash distribution with respect to the Shares other than a normal cash dividend be placed in escrow or otherwise made subject to such restrictions as the Administrator deems appropriate to carry out the intent of the Plan. References in this Agreement to the Shares shall refer, *mutatis mutandis*, to any such restricted amounts.

10. *Sale of Vested Shares.* The undersigned understands that he will be free to sell any Share once it has vested, subject to (i) satisfaction of any applicable tax withholding requirements with respect to the vesting or transfer of such Share; (ii) the completion of any administrative steps (for example, but without limitation, the transfer of certificates) that the Company may reasonably impose; and (iii) applicable company policies and the requirements of federal and state securities laws.

11. *Certain Tax Matters*. The undersigned expressly acknowledges the following:

a. The undersigned has been advised to confer promptly with a professional tax advisor to consider whether the undersigned should make a so-called "83(b) election" with respect to the Shares. Any such election, to be effective, must be made in accordance with applicable regulations and within thirty (30) days following the date of this award. The Company has made no recommendation to the undersigned with respect to the advisability of making such an election.

b. The award or vesting of the Shares acquired hereunder, and the payment of dividends with respect to such shares, may give rise to "wages" subject to withholding. The undersigned expressly acknowledges and agrees that his rights hereunder are subject to his paying to the Company in cash (or by such other means as may be acceptable to the Company in its discretion, including, if the Committee so determines, by the delivery of previously acquired Stock or shares of Stock acquired hereunder or by the withholding of amounts from any payment hereunder) all taxes required to be withheld in connection with such award, vesting or payment.

Very truly yours,

/s/ WILLIAM F. MURDY

William F. Murdy

The foregoing Restricted Stock Award Agreement is hereby accepted:

COMFORT SYSTEMS USA, INC.

By /s/ WILLIAM GEORGE

Name: William George

Title: Senior Vice President

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Exhibit 10.2

J. Gordon Beittenmiller

COMFORT SYSTEMS USA, INC.
2000 Equity Incentive Plan

Restricted Stock Award Agreement

Comfort Systems USA, Inc.
777 Post Oak Blvd, 5th Floor
Houston, TX 77056

Ladies and Gentlemen:

The undersigned (i) acknowledges that he has received an award (the "Award") of restricted stock from Comfort Systems USA, Inc., a Delaware corporation (the "Company") under the 2000 Equity Incentive Plan (the "Plan"), subject to the terms set forth below and in the Plan; (ii) further acknowledges receipt of a copy of the Plan as in effect on the date hereof; and (iii) agrees with the Company as follows:

1. *Effective Date*. This Agreement shall take effect as of June 8, 2004, which is the date of grant of the Award.

2. *Shares Subject to Award*. The Award consists of 50,000 shares (the "Shares") of common stock of the Company ("Stock"). The undersigned's rights to the Shares are subject to the restrictions described in this Agreement and the Plan (which is incorporated herein by reference with the same effect as if set forth herein in full) in addition to such other restrictions, if any, as may be imposed by law.

3. *Meaning of Certain Terms*. Except as otherwise expressly provided, all terms used herein shall have the same meaning as in the Plan. The term "vest" as used herein with respect to any Share means the lapsing of the restrictions described herein and in the Plan with respect to such Share.

4. *Nontransferability of Shares*. The Shares acquired by the undersigned pursuant to this Agreement shall not be sold, transferred, pledged, assigned or otherwise encumbered or disposed of except as provided below and in the Plan.

5. *Forfeiture Risk*. Except as provided in Section 7(b) of this Agreement, if the undersigned ceases to be employed by the Company and its subsidiaries for any reason, including death, any then unvested Shares acquired by the undersigned hereunder shall be immediately forfeited. The undersigned hereby (i) appoints the Company as the attorney-in-fact of the undersigned to take such actions as may be necessary or appropriate to effectuate a transfer of the record ownership of any such shares that are unvested and forfeited hereunder, (ii) agrees to deliver to the Company, as a precondition to the issuance of any certificate or certificates with respect to unvested Shares hereunder, one or more stock powers, endorsed in blank, with respect to such Shares, and (iii) agrees to sign such other powers and take such other actions as the Company may reasonably request to accomplish the transfer or forfeiture of any unvested Shares that are forfeited hereunder.

6. *Retention of Certificates*. Any certificates representing unvested Shares shall be held by the Company. The undersigned agrees that the Company may give stop transfer instructions to the depository to ensure compliance with the provisions hereof.

7. *Vesting of Shares*. The shares acquired hereunder shall vest in accordance with the provisions of this Paragraph 7 and applicable provisions of the Plan, as follows:

(a) If the Committee determines that, for the period from July 1, 2004 through June 30, 2005, the Company did not have positive earnings from its continuing operations, all as determined and reported in accordance with generally accepted accounting principles in the Company's regularly prepared financial statements, Employee shall immediately and irrevocably forfeit all of the Shares.

(b) If and only if the positive earnings goal in Section 7(a) has been achieved, and provided that the undersigned is then, and since the date of grant has continuously been employed by the Company or its subsidiaries, then the Shares shall vest as follows:

12,500 Shares on August 5, 2005;

an additional 12,500 Shares on June 8, 2006;

an additional 12,500 Shares on June 8, 2007; and

an additional 12,500 Shares on June 8, 2008.

provided, however, that, not withstanding (a) or (b) above, any unvested Shares that have not earlier been forfeited shall vest immediately in the event of (i) a "Change in Control" as defined in the Employment Agreement dated December 1, 2003 between the undersigned and the Company (the "Employment Agreement") or (ii) the termination by the Company of executive without cause as defined in the Employment Agreement.

8. *Legend*. Any certificates representing unvested Shares shall be held by the Company, and any such certificate shall contain a legend substantially in the following form:

> THE TRANSFERABILITY OF THIS CERTIFICATE AND THE SHARES OF STOCK REPRESENTED HEREBY ARE SUBJECT TO THE TERMS AND CONDITIONS (INCLUDING FORFEITURE) OF THE COMPANY'S 2000 EQUITY INCENTIVE PLAN AND A RESTRICTED STOCK AWARD AGREEMENT ENTERED INTO BETWEEN THE REGISTERED OWNER AND COMFORT SYSTEMS USA, INC. COPIES OF SUCH PLAN AND AGREEMENT ARE ON FILE IN THE OFFICES OF COMFORT SYSTEMS USA, INC.

As soon as practicable following the vesting of any such Shares the Company shall cause a certificate or certificates covering such Shares to be delivered to the undersigned.

9. *Dividends, etc.*. The undersigned shall be entitled to (i) receive any and all dividends or other distributions paid with respect to those Shares of which he is the record owner on the record date for such dividend or other distribution, and (ii) vote any Shares of which he is the record owner on the record date for such vote; *provided, however*, that any property (other than cash) distributed with respect to a share of Stock (the "associated share") acquired hereunder, including without limitation a distribution of Stock by reason of a stock dividend, stock split or otherwise, or a distribution of other securities with respect to an associated share, shall be subject to the restrictions of this Agreement in the same manner and for so long as the associated share remains subject to such restrictions, and shall be promptly forfeited to the Company if and when the associated share is so forfeited; *and further provided*, that the Administrator may require that any cash distribution with respect to the Shares other than a normal cash dividend be placed in escrow or otherwise made subject to such restrictions as the Administrator deems appropriate to carry out the intent of the Plan. References in this Agreement to the Shares shall refer, *mutatis mutandis*, to any such restricted amounts.

10. *Sale of Vested Shares.* The undersigned understands that he will be free to sell any Share once it has vested, subject to (i) satisfaction of any applicable tax withholding requirements with respect to the vesting or transfer of such Share; (ii) the completion of any administrative steps (for example, but without limitation, the transfer of certificates) that the Company may reasonably impose; and (iii) applicable company policies and the requirements of federal and state securities laws.

11. *Certain Tax Matters*. The undersigned expressly acknowledges the following:

a. The undersigned has been advised to confer promptly with a professional tax advisor to consider whether the undersigned should make a so-called "83(b) election" with respect to the Shares. Any such election, to be effective, must be made in accordance with applicable regulations and within thirty (30) days following the date of this award. The Company has made no recommendation to the undersigned with respect to the advisability of making such an election.

b. The award or vesting of the Shares acquired hereunder, and the payment of dividends with respect to such shares, may give rise to "wages" subject to withholding. The undersigned expressly acknowledges and agrees that his rights hereunder are subject to his paying to the Company in cash (or by such other means as may be acceptable to the Company in its discretion, including, if the Committee so determines, by the delivery of previously acquired Stock or shares of Stock acquired hereunder or by the withholding of amounts from any payment hereunder) all taxes required to be withheld in connection with such award, vesting or payment.

Very truly yours,

/s/ J. GORDON BEITTENMILLER

J. Gordon Beittenmiller

The foregoing Restricted Stock Award Agreement is hereby accepted:

COMFORT SYSTEMS USA, INC.

By /s/ WILLIAM F. MURDY

William F. Murdy
Chief Executive Officer

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Exhibit 10.3

William George

COMFORT SYSTEMS USA, INC.
2000 Equity Incentive Plan

Restricted Stock Award Agreement

Comfort Systems USA, Inc.
777 Post Oak Blvd, 5th Floor
Houston, TX 77056

Ladies and Gentlemen:

The undersigned (i) acknowledges that he has received an award (the "Award") of restricted stock from Comfort Systems USA, Inc., a Delaware corporation (the "Company") under the 2000 Equity Incentive Plan (the "Plan"), subject to the terms set forth below and in the Plan; (ii) further acknowledges receipt of a copy of the Plan as in effect on the date hereof; and (iii) agrees with the Company as follows:

1. *Effective Date*. This Agreement shall take effect as of June 8, 2004, which is the date of grant of the Award.

2. *Shares Subject to Award*. The Award consists of 30,000 shares (the "Shares") of common stock of the Company ("Stock"). The undersigned's rights to the Shares are subject to the restrictions described in this Agreement and the Plan (which is incorporated herein by reference with the same effect as if set forth herein in full) in addition to such other restrictions, if any, as may be imposed by law.

3. *Meaning of Certain Terms*. Except as otherwise expressly provided, all terms used herein shall have the same meaning as in the Plan. The term "vest" as used herein with respect to any Share means the lapsing of the restrictions described herein and in the Plan with respect to such Share.

4. *Nontransferability of Shares*. The Shares acquired by the undersigned pursuant to this Agreement shall not be sold, transferred, pledged, assigned or otherwise encumbered or disposed of except as provided below and in the Plan.

5. *Forfeiture Risk*. Except as provided in Section 7(b) of this Agreement, if the undersigned ceases to be employed by the Company and its subsidiaries for any reason, including death, any then unvested Shares acquired by the undersigned hereunder shall be immediately forfeited. The undersigned hereby (i) appoints the Company as the attorney-in-fact of the undersigned to take such actions as may be necessary or appropriate to effectuate a transfer of the record ownership of any such shares that are unvested and forfeited hereunder, (ii) agrees to deliver to the Company, as a precondition to the issuance of any certificate or certificates with respect to unvested Shares hereunder, one or more stock powers, endorsed in blank, with respect to such Shares, and (iii) agrees to sign such other powers and take such other actions as the Company may reasonably request to accomplish the transfer or forfeiture of any unvested Shares that are forfeited hereunder.

6. *Retention of Certificates*. Any certificates representing unvested Shares shall be held by the Company. The undersigned agrees that the Company may give stop transfer instructions to the depository to ensure compliance with the provisions hereof.

7. *Vesting of Shares*. The shares acquired hereunder shall vest in accordance with the provisions of this Paragraph 7 and applicable provisions of the Plan, as follows:

(a) If the Committee determines that, for the period from July 1, 2004 through June 30, 2005, the Company did not have positive earnings from its continuing operations, all as determined and reported in accordance with generally accepted accounting principles in the Company's regularly prepared financial statements, Employee shall immediately and irrevocably forfeit all of the Shares.

(b) If and only if the positive earnings goal in Section 7(a) has been achieved, and provided that the undersigned is then, and since the date of grant has continuously been employed by the Company or its subsidiaries, then the Shares shall vest as follows:

7,500 Shares on August 5, 2005;

an additional 7,500 Shares on June 8, 2006;

an additional 7,500 Shares on June 8, 2007; and

an additional 7,500 Shares on June 8, 2008.

provided, however, that, not withstanding (a) or (b) above, any unvested Shares that have not earlier been forfeited shall vest immediately in the event of (i) a "Change in Control" as defined in the Employment Agreement dated December 1, 2003 between the undersigned and the Company (the "Employment Agreement") or (ii) the termination by the Company of executive without cause as defined in the Employment Agreement.

8. *Legend*. Any certificates representing unvested Shares shall be held by the Company, and any such certificate shall contain a legend substantially in the following form:

> THE TRANSFERABILITY OF THIS CERTIFICATE AND THE SHARES OF STOCK REPRESENTED HEREBY ARE SUBJECT TO THE TERMS AND CONDITIONS (INCLUDING FORFEITURE) OF THE COMPANY'S 2000 EQUITY INCENTIVE PLAN AND A RESTRICTED STOCK AWARD AGREEMENT ENTERED INTO BETWEEN THE REGISTERED OWNER AND COMFORT SYSTEMS USA, INC. COPIES OF SUCH PLAN AND AGREEMENT ARE ON FILE IN THE OFFICES OF COMFORT SYSTEMS USA, INC.

As soon as practicable following the vesting of any such Shares the Company shall cause a certificate or certificates covering such Shares to be delivered to the undersigned.

9. *Dividends, etc.*. The undersigned shall be entitled to (i) receive any and all dividends or other distributions paid with respect to those Shares of which he is the record owner on the record date for such dividend or other distribution, and (ii) vote any Shares of which he is the record owner on the record date for such vote; *provided, however*, that any property (other than cash) distributed with respect to a share of Stock (the "associated share") acquired hereunder, including without limitation a distribution of Stock by reason of a stock dividend, stock split or otherwise, or a distribution of other securities with respect to an associated share, shall be subject to the restrictions of this Agreement in the same manner and for so long as the associated share remains subject to such restrictions, and shall be promptly forfeited to the Company if and when the associated share is so forfeited; *and further provided*, that the Administrator may require that any cash distribution with respect to the Shares other than a normal cash dividend be placed in escrow or otherwise made subject to such restrictions as the Administrator deems appropriate to carry out the intent of the Plan. References in this Agreement to the Shares shall refer, *mutatis mutandis*, to any such restricted amounts.

10. *Sale of Vested Shares.* The undersigned understands that he will be free to sell any Share once it has vested, subject to (i) satisfaction of any applicable tax withholding requirements with respect to the vesting or transfer of such Share; (ii) the completion of any administrative steps (for example, but without limitation, the transfer of certificates) that the Company may reasonably impose; and (iii) applicable company policies and the requirements of federal and state securities laws.

11. *Certain Tax Matters*. The undersigned expressly acknowledges the following:

a. The undersigned has been advised to confer promptly with a professional tax advisor to consider whether the undersigned should make a so-called "83(b) election" with respect to the Shares. Any such election, to be effective, must be made in accordance with applicable regulations and within thirty (30) days following the date of this award. The Company has made no recommendation to the undersigned with respect to the advisability of making such an election.

b. The award or vesting of the Shares acquired hereunder, and the payment of dividends with respect to such shares, may give rise to "wages" subject to withholding. The undersigned expressly acknowledges and agrees that his rights hereunder are subject to his paying to the Company in cash (or by such other means as may be acceptable to the Company in its discretion, including, if the Committee so determines, by the delivery of previously acquired Stock or shares of Stock acquired hereunder or by the withholding of amounts from any payment hereunder) all taxes required to be withheld in connection with such award, vesting or payment.

Very truly yours,

/s/ WILLIAM GEORGE

William George

The foregoing Restricted Stock Award Agreement is hereby accepted:

COMFORT SYSTEMS USA, INC.

By /s/ WILLIAM F. MURDY

William F. Murdy
Chief Executive Officer

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Exhibit 10.4

Thomas N. Tanner

COMFORT SYSTEMS USA, INC.
2000 Equity Incentive Plan

Restricted Stock Award Agreement

Comfort Systems USA, Inc.
777 Post Oak Blvd, 5th Floor
Houston, TX 77056

Ladies and Gentlemen:

The undersigned (i) acknowledges that he has received an award (the "Award") of restricted stock from Comfort Systems USA, Inc., a Delaware corporation (the "Company") under the 2000 Equity Incentive Plan (the "Plan"), subject to the terms set forth below and in the Plan; (ii) further acknowledges receipt of a copy of the Plan as in effect on the date hereof; and (iii) agrees with the Company as follows:

1. *Effective Date*. This Agreement shall take effect as of June 8, 2004, which is the date of grant of the Award.

2. *Shares Subject to Award*. The Award consists of 30,000 shares (the "Shares") of common stock of the Company ("Stock"). The undersigned's rights to the Shares are subject to the restrictions described in this Agreement and the Plan (which is incorporated herein by reference with the same effect as if set forth herein in full) in addition to such other restrictions, if any, as may be imposed by law.

3. *Meaning of Certain Terms*. Except as otherwise expressly provided, all terms used herein shall have the same meaning as in the Plan. The term "vest" as used herein with respect to any Share means the lapsing of the restrictions described herein and in the Plan with respect to such Share.

4. *Nontransferability of Shares*. The Shares acquired by the undersigned pursuant to this Agreement shall not be sold, transferred, pledged, assigned or otherwise encumbered or disposed of except as provided below and in the Plan.

5. *Forfeiture Risk*. Except as provided in Section 7(b) of this Agreement, if the undersigned ceases to be employed by the Company and its subsidiaries for any reason, including death, any then unvested Shares acquired by the undersigned hereunder shall be immediately forfeited. The undersigned hereby (i) appoints the Company as the attorney-in-fact of the undersigned to take such actions as may be necessary or appropriate to effectuate a transfer of the record ownership of any such shares that are unvested and forfeited hereunder, (ii) agrees to deliver to the Company, as a precondition to the issuance of any certificate or certificates with respect to unvested Shares hereunder, one or more stock powers, endorsed in blank, with respect to such Shares, and (iii) agrees to sign such other powers and take such other actions as the Company may reasonably request to accomplish the transfer or forfeiture of any unvested Shares that are forfeited hereunder.

6. *Retention of Certificates*. Any certificates representing unvested Shares shall be held by the Company. The undersigned agrees that the Company may give stop transfer instructions to the depository to ensure compliance with the provisions hereof.

7. *Vesting of Shares*. The shares acquired hereunder shall vest in accordance with the provisions of this Paragraph 7 and applicable provisions of the Plan, as follows:

(a) If the Committee determines that, for the period from July 1, 2004 through June 30, 2005, the Company did not have positive earnings from its continuing operations, all as determined and reported in accordance with generally accepted accounting principles in the Company's regularly prepared financial statements, Employee shall immediately and irrevocably forfeit all of the Shares.

(b) If and only if the positive earnings goal in Section 7(a) has been achieved, and provided that the undersigned is then, and since the date of grant has continuously been employed by the Company or its subsidiaries, then the Shares shall vest as follows:

7,500 Shares on August 5, 2005;

an additional 7,500 Shares on June 8, 2006;

an additional 7,500 Shares on June 8, 2007; and

an additional 7,500 Shares on June 8, 2008.

provided, however, that, not withstanding (a) or (b) above, any unvested Shares that have not earlier been forfeited shall vest immediately in the event of (i) a "Change in Control" as defined in the Employment Agreement dated January 1, 2004 between the undersigned and the Company (the "Employment Agreement") or (ii) the termination by the Company of executive without cause as defined in the Employment Agreement.

8. *Legend*. Any certificates representing unvested Shares shall be held by the Company, and any such certificate shall contain a legend substantially in the following form:

THE TRANSFERABILITY OF THIS CERTIFICATE AND THE SHARES OF STOCK REPRESENTED HEREBY ARE SUBJECT TO THE TERMS AND CONDITIONS (INCLUDING FORFEITURE) OF THE COMPANY'S 2000 EQUITY INCENTIVE PLAN AND A RESTRICTED STOCK AWARD AGREEMENT ENTERED INTO BETWEEN THE REGISTERED OWNER AND COMFORT SYSTEMS USA, INC. COPIES OF SUCH PLAN AND AGREEMENT ARE ON FILE IN THE OFFICES OF COMFORT SYSTEMS USA, INC.

As soon as practicable following the vesting of any such Shares the Company shall cause a certificate or certificates covering such Shares to be delivered to the undersigned.

9. *Dividends, etc.*. The undersigned shall be entitled to (i) receive any and all dividends or other distributions paid with respect to those Shares of which he is the record owner on the record date for such dividend or other distribution, and (ii) vote any Shares of which he is the record owner on the record date for such vote; *provided, however*, that any property (other than cash) distributed with respect to a share of Stock (the "associated share") acquired hereunder, including without limitation a distribution of Stock by reason of a stock dividend, stock split or otherwise, or a distribution of other securities with respect to an associated share, shall be subject to the restrictions of this Agreement in the same manner and for so long as the associated share remains subject to such restrictions, and shall be promptly forfeited to the Company if and when the associated share is so forfeited; *and further provided*, that the Administrator may require that any cash distribution with respect to the Shares other than a normal cash dividend be placed in escrow or otherwise made subject to such restrictions as the Administrator deems appropriate to carry out the intent of the Plan. References in this Agreement to the Shares shall refer, *mutatis mutandis*, to any such restricted amounts.

10. *Sale of Vested Shares.* The undersigned understands that he will be free to sell any Share once it has vested, subject to (i) satisfaction of any applicable tax withholding requirements with respect to the vesting or transfer of such Share; (ii) the completion of any administrative steps (for example, but without limitation, the transfer of certificates) that the Company may reasonably impose; and (iii) applicable company policies and the requirements of federal and state securities laws.

11. *Certain Tax Matters*. The undersigned expressly acknowledges the following:

a. The undersigned has been advised to confer promptly with a professional tax advisor to consider whether the undersigned should make a so-called "83(b) election" with respect to the Shares. Any such election, to be effective, must be made in accordance with applicable regulations and within thirty (30) days following the date of this award. The Company has made no recommendation to the undersigned with respect to the advisability of making such an election.

b. The award or vesting of the Shares acquired hereunder, and the payment of dividends with respect to such shares, may give rise to "wages" subject to withholding. The undersigned expressly acknowledges and agrees that his rights hereunder are subject to his paying to the Company in cash (or by such other means as may be acceptable to the Company in its discretion, including, if the Committee so determines, by the delivery of previously acquired Stock or shares of Stock acquired hereunder or by the withholding of amounts from any payment hereunder) all taxes required to be withheld in connection with such award, vesting or payment.

Very truly yours,

/s/ THOMAS N. TANNER

Thomas N. Tanner

The foregoing Restricted Stock Award Agreement is hereby accepted:

COMFORT SYSTEMS USA, INC.

By /s/ WILLIAM F. MURDY

William F. Murdy
Chief Executive Officer

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Exhibit 10.5

FIRST AMENDMENT TO
AMENDED RESTATED CREDIT AGREEMENT

THIS FIRST AMENDMENT TO AMENDED AND RESTATED CREDIT AGREEMENT (the "*Amendment*") is made and entered into effective as of May 12, 2004, by and among COMFORT SYSTEMS USA, INC., Delaware corporation ("Borrower"); BANK OF TEXAS NA, individually and as Administrative Agent ("Administrative Agent"); HIBERNIA NATIONAL BANK, as Documentation Agent; and the Lenders ("Lenders") and Guarantors ("Guarantors") set forth on the signature pages hereto.

R E C I T A L S:

WHEREAS, Borrower, the Administrative Agent, the Document Agent and the Lenders entered into an Amended and Restated Credit Agreement dated December 31, 2003 (which as the same may be amended from time to time is herein called the "*Credit Agreement*"), pursuant to which Borrower amended and restated the Prior Credit Documents; and

WHEREAS, Borrower, Administrative Agent, Document Agent, Lenders and Guarantors desire to amend the Credit Agreement as herein set forth.

NOW THEREFORE, in consideration of the premises herein contained and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. *Definitions*. Except as otherwise provided below, unless the context hereof indicates otherwise, all capitalized terms used herein shall have the same meaning as such capitalized terms are defined in the Credit Agreement.

2. *Amendments to the Credit Agreement*. The Credit Agreement is, effective the date hereof, and subject to the satisfaction of the conditions precedent set forth in Section 3 hereof, amended by deleting Section 2.12 in its entirety and substituting the following:

"Section 2.12. *Letter of Credit Fees*. In consideration of LC Issuer's issuance of any Letter of Credit, Borrower agrees to pay (a) to Administrative Agent, for the account of all Lenders in accordance with their respective Percentage Shares, a per annum letter of credit issuance fee at a rate equal to 75% of the Eurodollar Margin in effect for Revolving Loans, and (b) to such LC Issuer for its own account, a letter of credit fronting fee at a rate equal to 0.125% per annum. The letter of credit fee and the letter of credit fronting fee will be calculated on the undrawn face amount of each Letter of Credit outstanding on each day at the above-applicable rates and will be due and payable in arrears on the first day of each Fiscal Quarter and at the end of the Commitment Period."

3. *Conditions Precedent to Effectiveness of Amendment*. This Amendment shall become effective when, and only when, the Administrative Agent shall have received counterparts of this Amendment executed by Borrower, the Guarantors and all of the Lenders.

4. *Representations and Warranties of Borrower*. Borrower represents and warrants as follows:

(a) Borrower is duly authorized and empowered to execute, deliver and perform this Amendment and all other instruments referred to or mentioned herein to which it is a party, and all action on its part requisite for the due execution, delivery and the performance of this Amendment has been duly and effectively taken. This Amendment, when executed and delivered, will constitute valid and binding obligations of Borrower, enforceable against it in accordance with its terms. This Amendment does not violate any provisions of the organizational documents of Borrower, or any material contract, agreement, law or regulation to which Borrower is subject, and does not require the consent or approval of any regulatory authority or governmental body of the United States or any state; and

(b) When duly executed and delivered, each of this Amendment and the Credit Agreement will be legal and binding obligations of Borrower, enforceable in accordance with their respective terms, except as limited by bankruptcy, insolvency or similar laws of general application relating to the enforcement of creditors' rights and by equitable principles of general application.

5. *Representations and Warranties of Guarantors*. Each Guarantor represents and warrants that such Guarantor is duly authorized and empowered to execute, deliver and perform this Amendment and all other instruments referred to or mentioned herein to which it is a party, and all action on its part requisite for the due execution, delivery and the performance of this Amendment has been duly and effectively taken. This Amendment does not violate any provisions of the organizational documents of such Guarantor, or any material contract, agreement, law or regulation to which Guarantor is subject, and does not require the consent or approval of any regulatory authority or governmental body of the United States or any state.

6. *Reference to and Effect on the Loan Documents*.

(a) Upon the effectiveness of this Amendment, each reference in the Credit Agreement to "this Agreement", "hereunder", "hereof", "herein" or words of like import, and each reference in the Loan Documents shall mean and be a reference to the Credit Agreement as amended hereby.

(b) Except as specifically amended above, the Credit Agreement and the Notes, and all other Loan Documents shall remain in full force and effect and are hereby ratified and confirmed. Without limiting the generality of the foregoing, the Security Documents and all collateral described therein do and shall continue to secure the payment of all obligations of Borrower under the Credit Agreement as amended hereby, and the Note(s), and under the other Security Documents.

(c) The execution, delivery and effectiveness of this Amendment shall not, except as expressly provided herein, operate as a waiver of any right, power or remedy of Lender under any of the Security Documents, nor constitute a waiver of any provision of any of the Security Documents.

7. *Execution in Counterparts*. This Amendment may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed and delivered shall be deemed to be an original and all of which taken together shall constitute but one and the same instrument.

8. *Governing Law*. This Amendment shall be governed by and construed in accordance with the laws of the State of Texas.

9. *Final Agreement*. **THIS WRITTEN AMENDMENT REPRESENTS THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.**

IN WITNESS WHEREOF, the parties hereto have caused this instrument to be duly executed in multiple counterparts, each of which is an original instrument for all purposes, all as of the day and year first above written.

BORROWER:

COMFORT SYSTEMS USA, INC.,

By: /s/ J. GORDON BEITTENMILLER

J. Gordon Beittenmiller
Executive Vice President and
Chief Financial Officer

LENDERS:

BANK OF TEXAS NA
Administrative Agent and Lender

By: /s/ H. GALE SMITH, JR.

H. Gale Smith, Jr.
Senior Vice President

HIBERNIA NATIONAL BANK,
Documentation Agent, LC Issuer and Lender

By: /s/ MICHAEL MEISS

Michael Meiss
Senior Vice President

BANK OF SCOTLAND, Lender

By: /s/ JOSEPH FRATUS

Joseph Fratus
First Vice President

FIRSTCAPITAL BANK, SSB, Lender

By: /s/ WILLIAM H. FOWLER

William H. Fowler
Senior Vice President

GUARANTORS:

ACI MECHANICAL, INC.

ACI MECHANICAL USA, INC.

ARC COMFORT SYSTEMS USA, INC.

ACCURATE AIR SYSTEMS, L.P.,
by Atlas-Accurate Holdings, L.L.C.,
as general partner

ACCU-TEMP GP, INC.
ACCU-TEMP LP, INC.

AIR TEMP, INC.

ATLAS-ACCURATE HOLDINGS, L.L.C.,
by CS53 Acquisition Corp.,
as acting member

ATLAS AIR CONDITIONING COMPANY, L.P., by
Atlas-Accurate Holdings, L.L.C. as general partner

BATCHELOR'S MECHANICAL CONTRACTORS, INC.

BCM CONTROLS CORPORATION

CALIFORNIA COMFORT SYSTEMS USA, INC.

CEL, INC.

CENTRAL MECHANICAL, INC.

CLIMATE CONTROL, INC.

COMFORT SYSTEMS USA (ARKANSAS), INC.

COMFORT SYSTEMS USA (BALTIMORE), INC.

COMFORT SYSTEMS USA (BOWLING GREEN), INC.

COMFORT SYSTEMS USA (BRISTOL), INC.

COMFORT SYSTEMS USA (CLEVELAND), INC.

COMFORT SYSTEMS USA (FLORIDA), INC.

COMFORT SYSTEMS USA G.P., INC.

COMFORT SYSTEMS USA (HARTFORD), INC.

COMFORT SYSTEMS USA (INTERMOUNTAIN), INC.

COMFORT SYSTEMS USA NATIONAL ACCOUNTS, LLC,
by Accu-Temp LP, Inc., as acting member

COMFORT SYSTEMS USA (SYRACUSE), INC.

COMFORT SYSTEMS USA (TEXAS), L.P.,
by Comfort Systems USA G.P., Inc.,
as general partner

COMFORT SYSTEMS USA (TWIN CITIES), INC.

COMFORT SYSTEMS USA (WESTERN MICHIGAN), INC.

CS44 ACQUISITION CORP.

CS53 ACQUISITION CORP.

DESIGN MECHANICAL INCORPORATED

EASTERN HEATING & COOLING, INC.

ESS ENGINEERING, INC.

GULFSIDE MECHANICAL, INC.

H & M MECHANICAL, INC.

HELM CORPORATION

HESS MECHANICAL CORPORATION

INDUSTRIAL COOLING INC.

J & J MECHANICAL, INC.

JAMES AIR CONDITIONING ENTERPRISE INC.

MARTIN HEATING, INC.

MECHANICAL SERVICE GROUP, INC.

MECHANICAL TECHNICAL SERVICES, L.P.,
by Atlas-Accurate Holdings, L.L.C.,
as general partner

MJ MECHANICAL SERVICES, INC.

NEEL MECHANICAL CONTRACTORS, INC.

NORTH AMERICAN MECHANICAL, INC.

QUALITY AIR HEATING & COOLING, INC.

S&K AIR CONDITIONING CO., INC.

S. I. GOLDMAN COMPANY, INC.

S.M. LAWRENCE COMPANY, INC.

SA ASSOCIATES, INC.

SALMON & ALDER, LLC,
by SA Associates, Inc. as acting member

SEASONAIR, INC.

SHEREN PLUMBING & HEATING, INC.

TARGET CONSTRUCTION, INC.

TEMP-RIGHT SERVICE, INC.

THE CAPITAL REFRIGERATION COMPANY

TRI-CITY MECHANICAL, INC.

UNITED ENVIRONMENTAL SERVICES, L.P.,
by Atlas-Accurate Holdings, L.L.C.,
as general partner

WESTERN BUILDING SERVICES, INC.

By: /s/ J. GORDON BEITTENMILLER

J. GORDON BEITTENMILLER,
Vice President and Assistant Secretary

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Exhibit 10.5

FIRST AMENDMENT TO AMENDED RESTATED CREDIT AGREEMENT

QuickLinks -- Click here to rapidly navigate through this document

Exhibit 10.6

SECOND AMENDMENT TO
AMENDED RESTATED CREDIT AGREEMENT

THIS SECOND AMENDMENT TO AMENDED AND RESTATED CREDIT AGREEMENT (the "*Amendment*") is made and entered into effective as of June 10, 2004 by and among COMFORT SYSTEMS USA, INC., Delaware corporation ("Borrower"); BANK OF TEXAS NA, individually and as Administrative Agent ("Administrative Agent"); HIBERNIA NATIONAL BANK, as Documentation Agent; and the Lenders ("Lenders") and Guarantors ("Guarantors") set forth on the signature pages hereto,.

R E C I T A L S:

WHEREAS, Borrower, the Administrative Agent, the Document Agent and the Lenders entered into an Amended and Restated Credit Agreement dated December 31, 2003, as amended by the First Amendment to Amended and Restated Credit Agreement dated as of May 12, 2004 (the "*Credit Agreement*"), pursuant to which Borrower amended and restated the Prior Credit Documents; and

WHEREAS, Borrower, Administrative Agent, Document Agent, Lenders and Guarantors desire to amend the Credit Agreement as herein set forth to reflect a scheduled partial repayment of the Term Loan in the amount of $500,000 and to permit Lenders to make assignments that are not pro rata between the revolving and term facilities and to increase the revolving facility by $5,000,000.

NOW THEREFORE, in consideration of the premises herein contained and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. *Definitions*. Except as otherwise provided below, unless the context hereof indicates otherwise, all capitalized terms used herein shall have the same meaning as such capitalized terms are defined in the Credit Agreement.

2. *Amendments to the Credit Agreement*. The Credit Agreement is, subject to the satisfaction of the conditions precedent set forth in Section 3 hereof, hereby amended as follows:

(a) *Definitions*. Article I of the Credit Agreement is hereby amended by:

(i) deleting the definition of the term "Percentage Share";

(ii) amending the definitions of the following terms to read as follows:

"Required Lenders" means Lenders having Aggregate Percentage Shares that equal or exceed sixty-six and two-thirds percent ($66^{2}/3$%)."

"'Revolving Loan Commitment' means as to any Lender the commitment to make its Revolving Loan Percentage Share of Revolving Credit Advances or incur its Revolving Loan Percentage Share of Letter of Credit Obligations as set forth on the signature pages hereto, or in the most recent Assignment and Acceptance, if any, executed by such Lender, as such amount may be adjusted, if at all, from time to time in accordance with this Agreement."

"'Term Loan Commitment' means as to any Term Lender the commitment of such Term Lender to makes its Term Loan Percentage Share of the Term Loans as set forth on the signature pages hereto or in the most recent Assignment and Acceptance, if any, executed by such Lender, as such amount may be adjusted from time to time in accordance with this Agreement."; and

(iii) by adding the following new defined terms and their definitions in proper alphabetical sequence as follows:

"'Aggregate Percentage Share' means as to any Lender the percentage obtained by dividing (i) the sum of the unpaid principal balance of such Lender's Loans at the time in question plus the Matured LC Obligations which such Lender has funded pursuant to Section 2.11(c) plus the portion of the Maximum Drawing Amount which such Lender might be obligated to fund under Section 2.11(c), by (ii) the sum of the aggregate unpaid principal balance of all Loans at such time plus the aggregate amount of LC Obligations outstanding at such time.

"'Revolving Loan Percentage Share' means as to any Lender the percentage set forth opposite such Lender's name on the signature pages hereto, or in the most recent Assignment and Acceptance, if any, executed by such Lender, under the heading 'Revolving Loan Percentage Share.'"

"'Term Loan Percentage Share' means as to any Lender the percentage set forth opposite such Lender's name on the signature pages hereto, or in the most recent Assignment and Acceptance, if any, executed by such Lender, under the heading 'Term Loan Percentage Share.'"

(b) *Cover Page*. The Cover Page of the Credit Agreement is hereby amended by deleting the number "$50,000,000" and inserting "$54,500,000" in lieu thereof.

(c) Section 2.1(a) is amended by inserting the words "Term Loan" immediately preceding the words "Percentage Share" in each instance in which such words appear therein.

(d) Section 2.1(b) is amended by inserting the words "Revolving Loan" immediately preceding the words "Percentage Shares" in each instance in which such words appear therein.

(e) Section 2.5(c)) is amended by inserting the words "Revolving Loan" immediately preceding the words "Percentage Share" in each instance in which such words appear therein.

(f) Section 2.11(c) is amended by inserting the words "Revolving Loan" immediately preceding the words "Percentage Share" in each instance in which such words appear therein.

(g) Section 2.11(d) is amended by inserting the words "Revolving Loan" immediately preceding the words "Percentage Share" in each instance in which such words appear therein.

(h) Section 2.12 is amended by inserting the words "Revolving Loan" immediately preceding the words "Percentage Shares" in each instance in which such words appear therein.

(i) Section 9.4 is amended by inserting the word "Aggregate" immediately preceding the words "Percentage Share" in each instance in which such words appear therein.

(j) Section 10.1(a) is amended by inserting the word "Aggregate" immediately preceding the words "Percentage Shares" in each instance in which such words appear therein.

(k) Section 10.5(a) is amended by inserting the word "Aggregate" immediately preceding the words "Percentage Shares" in each instance in which such words appear therein.

(l) Section 10.5(c)(i) is amended to read as follows:

"(i) Any assignment of Revolving Loans owing to the assignor Lender shall also apply to the unused portion of the assignor Lender's Revolving Loan Commitments, and any assignment of Revolving Loan Commitments of the assignor Lender shall also apply to the Revolving Loans owing to such assignor Lender, so that after such assignment is made (A) the assignor Lender shall hold Revolving Loans in amount equal to its Revolving Loan Percentage Share (as specified in the relevant Assignment and Acceptance) of all outstanding Revolving Loans and shall be committed to make its Revolving Loan Percentage Share (as specified in the relevant Assignment and Acceptance) of all future Revolving Loans, (B) the assignee shall hold Revolving Loans in an amount equal to its Revolving Loan Percentage Share (as specified in the relevant Assignment and Acceptance) of all outstanding Revolving Loans and shall be committed to make its Revolving Loan Percentage Share (as specified in the relevant Assignment and Acceptance) of all future Revolving Loans, and (C) except in the case of an assignment of the entire remaining amount of the assignor's Revolving Loan Percentage Share of the aggregate Revolving Loan Commitments, both assignor's and assignee's Revolving Loan Percentage Share of the aggregate Revolving Loan Commitments after giving effect to such assignment shall equal or exceed $2,500,000."

(m) Section 10.5(c)(ii) is amended by inserting the words "Term Loan Percentage Shares and Revolving Loan" immediately preceding the words "Percentage Shares" in each instance in which such words appear therein.

(n) Section 10.5(f) is amended by inserting the words "Term Loan Percentage Shares and Revolving Loan" immediately preceding the words "Percentage Shares" in each instance in which such words appear therein.

(o) Section 10.14 is amended by:

(i) deleting the phrase "shall be in the form attached hereto as Exhibit 10.14 and" in the second sentence thereof; and

(ii) deleting the term "Percentage Shares" in the penultimate sentence of Section 10.14 and adding the following in lieu thereof:

"Term Loan Percentage Shares and Revolving Loan Percentage Shares, as the case may be."

(p) Schedule 3.1, Lenders Schedule, is hereby amended in its entirety to read as follows:

"SCHEDULE 3.1

LENDERS SCHEDULE

Domestic Lending Office	Term Loan Percentage Share	Revolving Loan Percentage Share	Term Loan Commitment	Revolving Loan Commitment	Total Commitment
Bank of Texas NA 5 Houston Center 1401 McKinney, Suite 1650 Houston, Texas 77010 Telephone: (713) 289-5823 Fax: (713) 289-5825	29.7368%	26.6667%	$ 2,825,000	$ 12,000,000	**$ 14,825,000**
Hibernia National Bank 1800 Bering Drive, Suite 510, Houston, Texas 77057 Telephone: (713) 706-5420 Fax: (713) 706-499	19.4737%	17.7778%	$ 1,850,000	$ 8,000,000	**$ 9,850,000**
Bank of Scotland 565 Fifth Avenue New York, NY 10017 Telephone: (212) 450-0837 Fax: (212) 479-2806	20.0000%	17.7778%	$ 1,900,000	$ 8,000,000	**$ 9,900,000**
FirstCapital Bank, ssb 5433 Westheimer, Suite 100 Houston, Texas 77056 Telephone: (713) 386-2460 Fax: (713) 840-1332	15.0000%	13.3333%	$ 1,425,000	$ 6,000,000	**$ 7,425,000**
First Bank & Trust 8820 Westheimer Houston, Texas 77063 Telephone: Fax:	7.3684%	15.1111%	$ 700,000	$ 6,800,000	**$ 7,500,000**
RZB Finance LLC 1133 Avenue of the Americas 16th Floor New York, NY 10036 Telephone: Fax:	8.4211%	9.3333%	$ 800,000	$ 4,200,000	**$ 5,000,000**

"

3. *Conditions Precedent to Effectiveness of Amendment*. This Amendment shall become effective when, and only when, the Administrative Agent shall have received all of the following documents,

each document (unless otherwise indicated) being dated the date hereof, in form and substance reasonably satisfactory to the Administrative Agent:

(a) Counterparts of this Amendment duly executed by Borrower, Guarantors and Lenders;

(b) A copy of the resolutions approving the Credit Agreement as amended by this Amendment, and authorizing the transactions contemplated herein or therein duly adopted by the Board of Directors of the Borrower, accompanied by a certificate of the duly authorized Secretary of Borrower, that such copy is a true and correct copy of the resolutions duly adopted by the Board of Directors of the Borrower and have not been amended, modified or revoked in any respect and are in full force and effect as of the date hereof;

(c) A copy of the resolutions approving the Credit Agreement as amended by this Amendment, and authorizing the transactions contemplated herein or therein duly adopted by the Board of Directors of each Guarantor, accompanied by a certificate of the duly authorized Secretary of Guarantor, that such copy is a true and correct copy of the resolutions duly adopted by the Board of Directors of such Guarantor and have not been amended, modified or revoked in any respect and are in full force and effect as of the date hereof;

(d) Replacement Notes made and duly executed by the Borrower in favor of Bank of Texas NA and Hibernia National Bank to reflect the new Revolving Loan Commitments of and the new amounts of the Term Loans held by said Lenders;

(e) Notes made and duly executed by the Borrower in favor of First Bank & Trust and RZB Finance LLC to reflect the new Revolving Loan Commitments of and the new amounts of Term Loans held by said Lenders;

(f) Payment by Borrower of the reasonable fees and expenses of counsel to the Administrative Agent connection with the preparation and negotiation of this Amendment and all documents and instruments contemplated hereby; and

(g) The legal opinion of counsel to Borrower and Guarantors, in form and substance reasonably satisfactory to the Administrative Agent and its counsel.

4. *Representations and Warranties of Borrower*. Borrower represents and warrants as follows:

(a) Borrower and Guarantors are each duly authorized and empowered to execute, deliver and perform this Amendment and all other instruments referred to or mentioned herein to which it is a party, and all action on its part requisite for the due execution, delivery and the performance of this Amendment has been duly and effectively taken.

(b) After giving affect to this Amendment, the representations and warranties contained in the Credit Agreement, as amended hereby, and any other Loan Documents executed in connection herewith or therewith are true in all material respects on and as of the date hereof as though made on and as of the date hereof, except to the extent that such representation or warranty was made as of a specific date, in which case such representation or warranty was true in all material respects when made;

(c) After giving affect to this Amendment, no event has occurred and is continuing which constitutes a Default; and

(d) When duly executed and delivered, each of this Amendment and the Credit Agreement will be legal and binding obligations of Borrower, enforceable in accordance with their respective terms, except as limited by bankruptcy, insolvency or similar laws of general application relating to the enforcement of creditors' rights and by equitable principles of general application.

5. *Reference to and Effect on the Loan Documents*.

(a) Upon the effectiveness of this Amendment, each reference in the Credit Agreement to "this Agreement", "hereunder", "hereof", "herein" or words of like import, and each reference in the Loan Documents shall mean and be a reference to the Credit Agreement as amended hereby.

(b) Except as specifically amended above, the Credit Agreement, the Notes, and all other Loan Documents shall remain in full force and effect and are hereby ratified and confirmed. Without limiting the generality of the foregoing, the Security Documents and all collateral described therein do and shall continue to secure the payment of all obligations of Borrower under the Credit Agreement as amended hereby, the Notes, and under the Security Documents.

(c) The execution, delivery and effectiveness of this Amendment shall not, except as expressly provided herein, operate as a waiver of any right, power or remedy of Lender under any of the Security Documents, nor constitute a waiver of any provision of any of the Security Documents.

6. *Costs and Expenses*. Borrower agrees to pay on demand all costs and expenses of Lenders in connection with the preparation, reproduction, execution and delivery of this Amendment and the other instruments and documents to be delivered hereunder, including the reasonable fees and out-of-pocket expenses of counsel for Lenders. In addition, Borrower shall pay any and all fees payable or determined to be payable in connection with the execution and delivery, filing or recording of this Amendment and the other instruments and documents to be delivered hereunder, and agrees to save Lenders harmless from and against any and all liabilities with respect to or resulting from any delay in paying or omission to pay such fees.

7. *Execution in Counterparts*. This Amendment may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed and delivered shall be deemed to be an original and all of which taken together shall constitute but one and the same instrument.

8. *Governing Law*. This Amendment shall be governed by and construed in accordance with the laws of the State of Texas.

9. *Final Agreement*. **THIS WRITTEN AMENDMENT REPRESENTS THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.**

IN WITNESS WHEREOF, the parties hereto have caused this instrument to be duly executed in multiple counterparts, each of which is an original instrument for all purposes, all as of the day and year first above written.

BORROWER:

COMFORT SYSTEMS USA, INC.

By: /s/ J. GORDON BEITTENMILLER

J. Gordon Beittenmiller
Executive Vice President and
Chief Financial Officer

			LENDERS:
Term Loan Commitment:	$	2,825,000	BANK OF TEXAS NA,
Revolving Loan Commitment:	$	12,000,000	Administrative Agent and Lender
Term Loan Percentage Share:		29.7368%	
Revolving Loan Percentage Share:		26.6667%	
			By: /s/ H. GALE SMITH, JR.
			H. Gale Smith, Jr. Senior Vice President
Term Loan Commitment:	$	1,850,000	HIBERNIA NATIONAL BANK,
Revolving Loan Commitment:	$	8,000,000	Documentation Agent,
Term Loan Percentage Share:		19.4737%	LC Issuer and Lender
Revolving Loan Percentage Share:		17.7778%	
			By: /s/ MICHAEL MEISS
			Michael Meiss Senior Vice President
Term Loan Commitment:	$	1,900,000	BANK OF SCOTLAND, Lender
Revolving Loan Commitment:	$	8,000,000	
Term Loan Percentage Share:		20.0000%	
Revolving Loan Percentage Share:		17.7778%	
			By: /s/ JOSEPH FRATUS
			Joseph Fratus First Vice President
Term Loan Commitment:	$	1,425,000	FirstCapital Bank, ssb, Lender
Revolving Loan Commitment:	$	6,000,000	
Term Loan Percentage Share:		15.0000%	
Revolving Loan Percentage Share:		13.3333%	
			By: /s/ WILLIAM H. FOWLER
			William H. Fowler Senior Vice President
Term Loan Commitment:	$	800,000	RZB FINANCE LLC, Lender
Revolving Loan commitment:	$	4,200,000	
Term Loan Percentage Share:		8.4211%	
Revolving Loan Percentage Share:		9.3333%	
			By: /s/
			By: /s/

Term Loan Commitment:	$	700,000	
Revolving Loan Commitment:	$	6,800,000	
Term Loan Percentage Share:		7.3684%	
Revolving Loan Percentage Share:		15.1111%	

FIRST BANK & TRUST, Lender

By: /s/ MICHAEL S. MARTIN

Michael S. Martin
Vice President

GUARANTORS:

ACI MECHANICAL, INC.

ACI MECHANICAL USA, INC.

ARC COMFORT SYSTEMS USA, INC.

ACCURATE AIR SYSTEMS, L.P.,
by Atlas-Accurate Holdings, L.L.C.,
as general partner

ACCU-TEMP GP, INC.
ACCU-TEMP LP, INC.

AIR TEMP, INC.

ATLAS-ACCURATE HOLDINGS, L.L.C.,
by CS53 Acquisition Corp.,
as acting member

ATLAS AIR CONDITIONING COMPANY, L.P., by
Atlas-Accurate Holdings, L.L.C. as general partner

BATCHELOR'S MECHANICAL CONTRACTORS, INC.

BCM CONTROLS CORPORATION

CALIFORNIA COMFORT SYSTEMS USA, INC.

CEL, INC.

CENTRAL MECHANICAL, INC.

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COMFORT SYSTEMS USA (ARKANSAS), INC.

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COMFORT SYSTEMS USA (BRISTOL), INC.

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COMFORT SYSTEMS USA G.P., INC.

COMFORT SYSTEMS USA (HARTFORD), INC.

COMFORT SYSTEMS USA (INTERMOUNTAIN), INC.

COMFORT SYSTEMS USA NATIONAL ACCOUNTS, LLC,
by Accu-Temp LP, Inc., as acting member

COMFORT SYSTEMS USA (SYRACUSE), INC.

COMFORT SYSTEMS USA (TEXAS), L.P.,
by Comfort Systems USA G.P., Inc.,
as general partner

COMFORT SYSTEMS USA (TWIN CITIES), INC.

COMFORT SYSTEMS USA (WESTERN MICHIGAN), INC.

CS44 ACQUISITION CORP.

CS53 ACQUISITION CORP.

DESIGN MECHANICAL INCORPORATED

EASTERN HEATING & COOLING, INC.

ESS ENGINEERING, INC.

GULFSIDE MECHANICAL, INC.

H & M MECHANICAL, INC.

HELM CORPORATION

HESS MECHANICAL CORPORATION

INDUSTRIAL COOLING INC.

J & J MECHANICAL, INC.

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S. I. GOLDMAN COMPANY, INC.

S.M. LAWRENCE COMPANY, INC.

SA ASSOCIATES, INC.

SALMON & ALDER, LLC,
by SA Associates, Inc. as acting member

SEASONAIR, INC.

SHEREN PLUMBING & HEATING, INC.

TARGET CONSTRUCTION, INC.

TEMP-RIGHT SERVICE, INC.

THE CAPITAL REFRIGERATION COMPANY

TRI-CITY MECHANICAL, INC.

UNITED ENVIRONMENTAL SERVICES, L.P.,
by Atlas-Accurate Holdings, L.L.C.,
as general partner

WESTERN BUILDING SERVICES, INC.

By: **/s/ J. GORDON BEITTENMILLER**

J. GORDON BEITTENMILLER,
Vice President and Assistant Secretary

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Exhibit 10.7

THIRD AMENDMENT TO
AMENDED RESTATED CREDIT AGREEMENT

THIS THIRD AMENDMENT TO AMENDED AND RESTATED CREDIT AGREEMENT (the "*Amendment*") is made and entered into effective as of June 23, 2004, by and among COMFORT SYSTEMS USA, INC., a Delaware corporation ("Borrower"); BANK OF TEXAS NA, as a Lender and as Administrative Agent ("Administrative Agent"); HIBERNIA NATIONAL BANK, as a Lender and as Documentation Agent; and the Lenders ("Lenders") and Guarantors ("Guarantors") set forth on the signature pages hereto.

R E C I T A L S:

WHEREAS, Borrower, the Administrative Agent, the Document Agent and the Lenders entered into an Amended and Restated Credit Agreement dated December 31, 2003, as amended by the First Amendment to Amended and Restated Credit Agreement dated as of May 12, 2004, and the Second Amendment to Amended and Restated Credit Agreement dated as of June 10, 2004 (the "*Credit Agreement*"), pursuant to which Borrower amended and restated the Prior Credit Documents; and

WHEREAS, Borrower, Administrative Agent, Document Agent, Lenders and Guarantors desire to amend the Credit Agreement as herein set forth to correct a typographical error and to clarify that certain changes, amendments, or modifications to the terms of the Indemnity Agreement will not constitute a change, amendment or modification which could reasonably be expected to adversely affect a Lender Party.

NOW THEREFORE, in consideration of the premises herein contained and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. *Definitions*. Except as otherwise provided below, unless the context hereof indicates otherwise, all capitalized terms used herein shall have the same meaning as such capitalized terms are defined in the Credit Agreement.

2. *Amendments to the Credit Agreement*. The Credit Agreement is, subject to the satisfaction of the conditions precedent set forth in Section 3 hereof, hereby amended as follows:

(a) *Definitions*. Article I of the Credit Agreement is hereby amended by adding the following new defined terms and their definitions in proper alphabetical sequence as follows:

"'*Bonded Contract Ratio*' means the percentage determined by dividing Bonded Receivables as of the end of the applicable Fiscal Quarter by the sum of Bonded Receivables plus Eligible Receivables as of the end of such Fiscal Quarter.

'*Bonded Contract Ratio Certificate*' means a report in the form attached hereto as Exhibit 6.2(e), appropriately completed, which reflects the Bonded Contract Ratio as of the end of the preceding Fiscal Quarter."

(b) To correct a typographical error, Section 4.2(c) is amended in its entirety to read as follows:

"The making of such Loan or the issuance of such Letter of Credit shall not be prohibited by any Law and shall not subject any Lender or any LC Issuer to any penalty or other onerous condition under or pursuant to any such Law."

(c) Section 6.2 is amended by adding a new Section 6.2(e) immediately following Section 6.2 (d) to read as follows:

"(e) As soon as available, and in any event within twenty (20) days after the end of each Fiscal Quarter in each Fiscal Year, a Bonded Contract Ratio Certificate substantially in the form of Exhibit 6.2(e), duly completed by an authorized officer of Borrower, with information required therein completed to reflect the Bonded Contract Ratio as of the end of the preceding Fiscal Quarter."

(d) Section 7.12 is amended in its entirety to read as follows:

"Section 7.12 *Indemnity Agreement*.

(a) Borrower will not and will not permit any Restricted Person to, directly or indirectly, change, amend, or otherwise modify the terms of the Indemnity Agreement if such change, amendment or modification could reasonably be expected to adversely affect a Lender Party.

(b) For purposes of this Section an amendment to the Indemnity Agreement which provides for bonding capacity as of the end of any Fiscal Quarter (i) in an amount equal to or less than $145,000,000 (without regard to the Bonded Contract Ratio) or (ii) in an amount greater than $145,000,000 but not in excess of (x) the amount which will cause the Bonded Contract Ratio as of the end of such Fiscal Quarter to exceed 30 percent or (y) $225,000,000, whichever is less, shall not be considered a direct or indirect change, amendment, or modification which could reasonably be expected to adversely affect a Lender Party.

(c) Notwithstanding the provisions of subsection (a) of this Section, a Restricted Person which has executed a Guaranty and such other documentation as may be required by the Administrative Agent, may become an additional "Principal" and "Indemnitor" (as those terms are defined in the Indemnity Agreement) under the Indemnity Agreement."

(e) The Credit Agreement is hereby amended by adding the following new exhibit in proper numerical sequence as follows:

"*EXHIBIT 6.2(e)*

BONDED CONTRACT RATIO CERTIFICATE

FOR THE FISCAL QUARTER BEGINNING , 200
AND ENDING , 200

To: BANK OF TEXAS NA, ADMINISTRATIVE AGENT

From: COMFORT SYSTEMS USA, INC.

Date: , 200

Re: Amended and Restated Credit Agreement dated December 31, 2003, (including any amendments or modifications thereof, the "*Credit Agreement*"), among Comfort Systems USA, Inc. (the "Company"); Bank of Texas NA, as Administrative Agent, Hibernia National Bank, as Documentation Agent; and Certain Financial Institutions, as Lenders

This Bonded Contract Ratio Certificate is delivered pursuant to the Credit Agreement. All capitalized terms used but not defined herein shall have the respective meanings specified in the Credit Agreement.

For the purpose of determining the Bonded Contract Ratio, the undersigned does hereby certify that as of , 200 , as follows:

A.	Bonded Receivables:	
B.	Eligible Receivables:	
C.	Total:	
D.	Bonded Contract Ratio (line A divided by line C):	"

3. *Conditions Precedent to Effectiveness of Amendment*. This Amendment shall become effective when, and only when, the Administrative Agent shall have received all of the following documents, each document (unless otherwise indicated) being dated the date hereof, in form and substance reasonably satisfactory to the Administrative Agent:

(a) Counterparts of this Amendment duly executed by Borrower, Guarantors and Lenders;

(b) Payment by Borrower of the reasonable fees and expenses of counsel to the Administrative Agent connection with the preparation and negotiation of this Amendment and all documents and instruments contemplated hereby.

4. *Representations and Warranties of Borrower*. Borrower represents and warrants as follows:

(a) Borrower and Guarantors are each duly authorized and empowered to execute, deliver and perform this Amendment and all other instruments referred to or mentioned herein to which it is a party, and all action on its part requisite for the due execution, delivery and the performance of this Amendment has been duly and effectively taken.

(b) After giving affect to this Amendment, the representations and warranties contained in the Credit Agreement, as amended hereby, and any other Loan Documents executed in connection herewith or therewith are true in all material respects on and as of the date hereof as though made on and as of the date hereof, except to the extent that such representation or warranty was made as of a specific date, in which case such representation or warranty was true in all material respects when made;

(c) After giving affect to this Amendment, no event has occurred and is continuing which constitutes a Default; and

(d) When duly executed and delivered, each of this Amendment and the Credit Agreement will be legal and binding obligations of Borrower, enforceable in accordance with their respective terms, except as limited by bankruptcy, insolvency or similar laws of general application relating to the enforcement of creditors' rights and by equitable principles of general application.

5. *Reference to and Effect on the Loan Documents*.

(a) Upon the effectiveness of this Amendment, each reference in the Credit Agreement to "this Agreement", "hereunder", "hereof", "herein" or words of like import, and each reference in the Loan Documents shall mean and be a reference to the Credit Agreement as amended hereby.

(b) Except as specifically amended above, the Credit Agreement, the Notes, and all other Loan Documents shall remain in full force and effect and are hereby ratified and confirmed. Without limiting the generality of the foregoing, the Security Documents and all collateral described therein do and shall continue to secure the payment of all obligations of Borrower under the Credit Agreement as amended hereby, the Notes, and under the Security Documents.

(c) The execution, delivery and effectiveness of this Amendment shall not, except as expressly provided herein, operate as a waiver of any right, power or remedy of Lender under any of the Security Documents, nor constitute a waiver of any provision of any of the Security Documents.

6. *Costs and Expenses*. Borrower agrees to pay on demand all costs and expenses of Lenders in connection with the preparation, reproduction, execution and delivery of this Amendment and the other instruments and documents to be delivered hereunder, including the reasonable fees and out-of-pocket expenses of counsel for Lenders. In addition, Borrower shall pay any and all fees payable or determined to be payable in connection with the execution and delivery, filing or recording of this Amendment and the other instruments and documents to be delivered hereunder, and agrees to save Lenders harmless from and against any and all liabilities with respect to or resulting from any delay in paying or omission to pay such fees.

7. *Execution in Counterparts*. This Amendment may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed and delivered shall be deemed to be an original and all of which taken together shall constitute but one and the same instrument.

8. *Governing Law*. This Amendment shall be governed by and construed in accordance with the laws of the State of Texas.

9. *Final Agreement*. **THIS WRITTEN AMENDMENT REPRESENTS THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.**

IN WITNESS WHEREOF, the parties hereto have caused this instrument to be duly executed in multiple counterparts, each of which is an original instrument for all purposes, all as of the day and year first above written.

BORROWER:

COMFORT SYSTEMS USA, INC.

By: /s/ J. GORDON BEITTENMILLER

J. Gordon Beittenmiller
Executive Vice President and
Chief Financial Officer

LENDERS:

BANK OF TEXAS NA,
Administrative Agent and Lender

By: /s/ GALE SMITH, JR.

H. Gale Smith, Jr.
Senior Vice President

HIBERNIA NATIONAL BANK,
Documentation Agent,
LC Issuer and Lender

By: /s/ MICHAEL MEISS

Michael Meiss
Senior Vice President

BANK OF SCOTLAND, Lender

By: /s/

First Vice President

FirstCapital Bank, ssb, Lender

By: /s/ WILLIAM H. FOWLER

William H. Fowler
Senior Vice President

RZB FINANCE LLC, Lender

By: /s/

By: /s/

FIRST BANK & TRUST, Lender

By: /s/ MICHAEL S. MARTIN

Michael S. Martin
Vice President

GUARANTORS:

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THE CAPITAL REFRIGERATION COMPANY

TRI-CITY MECHANICAL, INC.

UNITED ENVIRONMENTAL SERVICES, L.P.,
by Atlas-Accurate Holdings, L.L.C., as general partner

WESTERN BUILDING SERVICES, INC.

By: /s/ J. GORDON BEITTENMILLER

J. GORDON BEITTENMILLER,
Vice President and Assistant Secretary

Exhibit 31.1

RULE 13a-14(a) CERTIFICATION IN ACCORDANCE WITH SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, William F. Murdy, Chairman of the Board and Chief Executive Officer of Comfort Systems USA, Inc. (the "Company"), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the Company;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2004

By: /s/ WILLIAM F. MURDY

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

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Exhibit 31.2

RULE 13a-14(a) CERTIFICATION IN ACCORDANCE WITH SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, J. Gordon Beittenmiller, Executive Vice President and Chief Financial Officer of Comfort Systems USA, Inc. (the "Company"), certify that:

1. I have reviewed this quarterly report on Form 10-Q of the Company;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2004

By: /s/ J. GORDON BEITTENMILLER

J. Gordon Beittenmiller
Executive Vice President and Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002*

In connection with the Quarterly Report of Comfort Systems USA, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William F. Murdy, Chairman of the Board and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

By: /s/ WILLIAM F. MURDY

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

* A signed original of this written statement required by Section 906 has been provided to Comfort Systems USA, Inc. and will be retained by Comfort Systems USA, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

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Exhibit 32.2

CERTIFICATION PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002*

In connection with the Annual Report of Comfort Systems USA, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, J. Gordon Beittenmiller, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

By: /s/ J. GORDON BEITTENMILLER

J. Gordon Beittenmiller
Executive Vice President and Chief Financial Officer

* A signed original of this written statement required by Section 906 has been provided to Comfort Systems USA, Inc. and will be retained by Comfort Systems USA, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.