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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

Form 10-K

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

For the Fiscal Year Ended December 31, 2013

Commission file number: 1-13011

Comfort Systems USA, Inc.

(Exact name of registrant as specified in its charter)

Delaware	76-0526487
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

**675 Bering Drive
Suite 400
Houston, Texas 77057
(713) 830-9600**

(Address and telephone number of Principal Executive Offices)

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

<u>Title of Each Class</u>	<u>Name of Each Exchange on which Registered</u>
Common Stock, \$.01 par value	New York Stock Exchange

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

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

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a
smaller reporting company)

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

The aggregate market value of the voting stock held by non-affiliates of the registrant at June 30, 2013 was approximately \$556.8 million, based on the \$14.92 last sale price of the registrant's common stock on the New York Stock Exchange on June 30, 2013.

As of February 21, 2014, 37,634,927 shares of the registrant's common stock were outstanding (excluding treasury shares of 3,488,438).

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III (other than the required information regarding executive officers) is incorporated by reference from the registrant's definitive proxy statement, which will be filed with the Commission not later than 120 days following December 31, 2013.

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FORWARD-LOOKING STATEMENTS

Certain statements and information in this Annual Report on Form 10-K may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words "believe," "expect," "anticipate," "plan," "intend," "foresee," "should," "would," "could," or other similar expressions are intended to identify forward-looking statements, which are generally not historic in nature. These forward-looking statements are based on the current expectations and beliefs of Comfort Systems USA, Inc. and its subsidiaries (collectively, the "Company") concerning future developments and their effect on the Company. While the Company's management believes that these forward-looking statements are reasonable as and when made, there can be no assurance that future developments affecting the Company will be those that it anticipates. All comments concerning the Company's expectations for future revenue and operating results are based on the Company's forecasts for its existing operations and do not include the potential impact of any future acquisitions. The Company's forward-looking statements involve significant risks and uncertainties (some of which are beyond the Company's control) and assumptions that could cause actual future results to differ materially from the Company's historical experience and its present expectations or projections. Known material factors that could cause the Company's actual results to differ from those in the forward-looking statements are those described in Part I, "Item 1A. Risk Factors."

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to publicly update or revise any forward-looking statements after the date they are made, whether as a result of new information, future events, or otherwise.

PART I

The terms "Comfort Systems," "we," "us," or "the Company" refer to Comfort Systems USA, Inc. or Comfort Systems USA, Inc. and its consolidated subsidiaries, as appropriate in the context.

ITEM 1. Business

Comfort Systems USA, Inc., a Delaware corporation, was established in 1997. We provide comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services within the mechanical services industry. We have 36 operating units in 79 cities and 88 locations throughout the United States.

We operate primarily in the commercial, industrial and institutional HVAC markets and perform most of our services within office buildings, retail centers, apartment complexes, manufacturing plants, and healthcare, education and government facilities. In addition to standard HVAC services, we provide specialized applications such as building automation control systems, fire protection, process cooling, electronic monitoring and process piping. Certain locations also perform related activities such as electrical service and plumbing. Approximately 99% of our consolidated 2013 revenue was derived from commercial, industrial and institutional customers and large multi-family residential projects. Approximately 42% of our revenue was attributable to installation services in newly constructed facilities and 58% was attributable to maintenance, repair and replacement services. Our consolidated 2013 revenue was derived from the following service activities, all of which are in the mechanical services industry, the single industry segment we serve:

<u>Service Activity</u>	<u>Percentage of Revenue</u>
HVAC	75%
Plumbing	15%
Building Automation Control Systems	6%
Other	4%
Total	<u>100%</u>

Our Internet address is <http://www.comfortsystemsusa.com>. We make available free of charge on or through our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Our website also includes our code of ethics, titled "Corporate Compliance Policy: Standards and Procedures Regarding Business Practices," together with other governance materials including our corporate governance guidelines and our Board committee charters. Printed versions of our code of ethics and our corporate governance guidelines may be obtained upon written request to our Corporate Compliance Officer at our headquarters address.

Industry Overview

We believe that the commercial, industrial, and institutional HVAC industry has historically generated annual revenue in excess of \$40 billion. HVAC systems are necessary to virtually all commercial, industrial and institutional buildings as well as homes. Because most buildings are sealed, HVAC systems provide the primary method of circulating fresh air in such buildings. In many instances, replacing an aging system with a modern, energy-efficient HVAC system significantly reduces a building's operating costs and improves air quality and HVAC system effectiveness. Older commercial, industrial and institutional facilities often have poor air quality as well as inadequate air conditioning, and older HVAC systems result in significantly higher energy costs than do modern systems. These factors cause many facility owners to consider replacing older systems before the end of their functioning lives.

Many factors positively affect HVAC industry growth, particularly (i) population growth, which has increased the need for commercial, industrial and institutional space, (ii) an aging installed base of buildings and HVAC environmental and energy efficiency equipment, (iii) increasing sophistication, complexity and efficiency of HVAC systems, (iv) growing emphasis on environmental and energy efficiency, and (v) reduction or elimination of the refrigerants commonly used in older HVAC systems. We believe these factors should increase demand for the reconfiguration or replacement of existing HVAC systems and may also mitigate, to some extent, the effect on the HVAC industry of the cyclical nature inherent in the traditional construction industry.

The HVAC industry can be broadly divided into two service functions:

- installation in newly constructed facilities, which provided approximately 42% of our revenue in 2013, and
- maintenance, repair and replacement in existing facilities, which provided the remaining 58% of our 2013 revenue.

Installation Services—Installation services consist of "design and build" and "plan and spec" projects. In "design and build" projects, the commercial HVAC company is responsible for designing, engineering and installing a cost-effective, energy-efficient system customized to the specific needs of the building owner. Costs and other project terms are normally negotiated between the building owner or its representative and the HVAC company. Companies that specialize in "design and build" projects generally have specially trained HVAC engineers, CAD/CAM design systems and in-house sheet metal and prefabrication capabilities. These companies use a consultative approach with customers and tend to develop long-term relationships with building owners and developers, general contractors, architects, consulting engineers and property managers. "Plan and spec" installation refers to projects in which a third-party architect or consulting engineer designs the HVAC systems and the installation project is "put out for bid." We believe that "plan and spec" projects usually take longer to complete than "design and build" projects because the system design and installation process generally are not integrated, thus resulting in more frequent adjustments to the technical specifications of the project and

corresponding changes in work requirements and schedules. These adjustments can occur during the bid process or during the project itself, in either case adding weeks or months to the project schedule. Furthermore, in "plan and spec" projects, the HVAC company is not responsible for project design and other parties must also approve any changes, thereby increasing overall project time and cost.

Maintenance, Repair and Replacement Services—These services include maintaining, repairing, replacing, reconfiguring and monitoring previously installed HVAC systems and building automation controls. The growth and aging of the installed base of HVAC systems and the demand for more efficient and sophisticated systems and building automation controls have fueled growth in this service line. The increasing complexity of these HVAC systems is leading many commercial, industrial and institutional building owners and property managers to increase attention to maintenance and to outsource maintenance and repair, often through service agreements with HVAC service providers. In addition, further restrictions have been placed on the use of certain types of refrigerants used in HVAC systems, which, along with indoor air quality concerns, may increase demand for the reconfiguration and replacement of existing HVAC systems. State-of-the-art control and monitoring systems feature electronic sensors and microprocessors. These systems require specialized training to install, maintain and repair, and the typical building engineer employed directly by a building owner or manager has not received this training. Increasingly, HVAC systems in commercial, industrial and institutional buildings are being remotely monitored through computer-based communications systems to improve energy efficiency and expedite problem diagnosis and correction, thereby allowing us to provide maintenance and repair services at a lower cost.

Strategy

We focus on strengthening operating competencies and on increasing profit margins. The key objectives of our strategy are to generate growth in our construction and service operations, improve productivity through innovation and to acquire complementing businesses. In order to accomplish our objectives we are currently focused on the following elements:

Achieve Excellence in Core Competencies—We have identified six core competencies that we believe are critical to attracting and retaining customers, increasing operating income and cash flow and creating additional employment opportunities. The six core competencies are: (i) customer cultivation and rapport, (ii) design and build expertise, (iii) estimating, (iv) job costing and job measurements, (v) safety, and (vi) service capability.

Achieve Operating Efficiencies—We think we can achieve operating efficiencies and cost savings through purchasing economies, adopting "best practices" operating programs, and focusing on job management to deliver services in a cost-effective and efficient manner. We have placed great emphasis on improving the "job loop" at our locations—qualifying, estimating, pricing and executing projects effectively and efficiently, then promptly assessing project experience for applicability to current and future projects. We also use our combined purchasing to gain volume discounts on products and services such as HVAC components, raw materials, services, vehicles, bonding, insurance and employee benefits.

Attract, Retain and Invest in our Employees—We seek to attract and retain quality employees by providing them an enhanced career path from working for a larger company, the opportunity to realize a more stable income and attractive benefits packages. Over the past few years we have made substantial investments in training, including programs for project managers, field superintendents, service managers, sales managers, estimators, and more recently, leadership and development of key managers and leaders. We believe these programs can lead to significantly increased efficiency and growth.

Focus on Commercial, Industrial and Institutional Markets—We primarily focus on the commercial, industrial and institutional markets, with particular emphasis on "design and build" installation services, and on maintenance, repair and replacement services. We believe that the commercial, industrial and institutional HVAC markets are attractive because of their growth opportunities, large and diverse customer base, reduced weather exposure as compared to residential markets, attractive margins and potential for long-term relationships with building owners, property managers, general contractors and architects. We believe that although the end-use is ultimately residential, large multi-family projects have many of the same characteristics as commercial construction and we participate in this market when conditions are favorable. Approximately 99% of our consolidated 2013 revenue was derived from commercial, industrial and institutional customers and large multi-family residential projects.

Leveraging Resources and Capabilities—We believe significant operating efficiencies can be achieved by leveraging resources among our operating locations. For example, we have shifted certain prefabrication activities into centralized locations thereby increasing asset utilization in these centralized locations and redirecting prefabrication employees into other operational areas. We also allocate our engineering, field and supervisory labor from one operation to another to more fully use our employee base, meet our customers' needs and share expertise. We believe we have realized scale benefits from combining purchasing, insurance, benefits, bonding and financing activities across our operations. We also believe larger regional and national commercial, industrial and institutional entities can benefit from consolidating their HVAC needs with service companies that are capable of providing those services regionally or nationally. In response to this opportunity, we operate a national call center to dispatch technicians to regional and national sites requiring service and use web-based proprietary information systems to maintain information on the customer's sites and equipment.

Maintain a Diverse Customer, Geographic and Project Base—We have what we believe is a well-diversified distribution of revenue across end-use sectors that reduces our exposure to negative developments in any given sector. We also believe we have a reasonable degree of geographical diversification, again reducing our exposure to negative developments in any given region. Our distribution of revenue in 2013 by end-use sector was as follows:

Manufacturing	23%
Education	19%
Healthcare	14%
Government	12%
Office Buildings	10%
Retail/Restaurants	8%
Multi-Family	5%
Lodging and Entertainment	3%
Distribution	2%
Religious/Not for profit	1%
Residential	1%
Other	2%
Total	<u>100%</u>

Approximately 83% of our revenue is earned on a project basis for installation of HVAC systems in newly constructed facilities or for replacement of HVAC systems in existing facilities. As of December 31, 2013, we had 3,321 projects in process with an aggregate contract value of approximately \$1,787.4 million. Our average project takes six to nine months to complete, with an average contract price of approximately \$538,000. This relatively small average project size, when taken together with the approximately 17% of our revenue derived from maintenance and service, provides us with what we

believe is a broad base of work for a company involved in the construction services sector. A stratification of projects in progress as of December 31, 2013, by contract price, is as follows:

<u>Contract Price of Project</u>	<u>No. of Projects</u>	<u>Aggregate Contract Price Value (millions)</u>
Under \$1 million	2,959	\$ 317.1
\$1 million - \$5 million	282	659.4
\$5 million - \$10 million	53	361.8
\$10 million - \$15 million	16	191.5
Greater than \$15 million	11	257.6
Total	<u>3,321</u>	<u>\$ 1,787.4</u>

Seek Growth Through Expansion and Acquisitions—We believe that we can increase our operating income by opportunistically entering new markets or service lines through expansion and acquisition. We have based such expansion on existing customers, relationships or expertise, and expect to selectively pursue such opportunities in the future. We continually seek opportunities to acquire businesses that have attractive valuations and meet other criteria involving financial, operational, management and geographic considerations.

We are investing in initiatives to expand the proportion of our revenue that is service based. We are actively concentrating our existing managerial resources on training and hiring experienced employees to procure and profitably perform service work. In some locations we have added service capability, and we believe our investments and efforts will stimulate growth in all aspects of the commercial HVAC and service and repair business.

Operations and Services Provided

We provide a wide range of installation, maintenance, repair and replacement services for HVAC and related systems in commercial, industrial and institutional properties. We manage our locations on a decentralized basis, with local management maintaining responsibility for day-to-day operating decisions. Our local management is augmented by regional leadership that focuses on core business competencies, regional financial performance, cooperation and coordination between locations, implementing best practices and on major corporate initiatives. In addition to senior management, local personnel generally include design engineers, sales personnel, customer service personnel, installation and service technicians, sheet metal and prefabrication technicians, estimators and administrative personnel. We have centralized certain administrative functions such as insurance, employee benefits, training, safety programs, marketing and cash management to enable our local operating management to focus on pursuing new business opportunities and improving operating efficiencies. We also combine certain back office and administrative functions at various locations.

Installation Services—Our installation business related to newly constructed facilities, which comprised approximately 42% of our consolidated 2013 revenue, involves the design, engineering, integration, installation and start-up of HVAC, building automation controls and related systems. We provide "design and build" and "plan and spec" installation services for office buildings, retail centers, apartment complexes, manufacturing plants, healthcare, education and government facilities and other commercial, industrial and institutional facilities. In a "design and build" installation, working with the customer, we determine the needed capacity and energy efficiency of the HVAC system that best suits the proposed facility. We then estimate the amount of time, labor, materials and equipment needed to build the specified system. The final design, terms, price and timing of the project are then negotiated with the customer or its representatives, after which any necessary modifications are made to the system plan. In "plan and spec" installation, we participate in a bid process to provide labor,

equipment, materials and installation based on plans and engineering specifications provided by a customer, general contractor or consulting engineer.

Once an agreement has been reached, we order the necessary materials and equipment for delivery to meet the project schedule. In many instances, we fabricate the ductwork and piping and assemble certain components for the system based on the mechanical drawing specifications, eliminating the need to subcontract ductwork or piping fabrication. Then we install the system at the project site, working closely with the general contractor. Our average project takes six to nine months to complete, with an average contract price of approximately \$538,000. We also perform larger project work, with 362 contracts in progress at December 31, 2013 with contract prices in excess of \$1 million. Our largest project currently in progress has a contract price of \$58.8 million. 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.

We also install process cooling systems and building automation controls and monitoring systems. Process cooling systems are used primarily in industrial facilities to provide heating and/or cooling to precise temperature and climate standards for products being manufactured and for the manufacturing equipment. Building automation control systems are used in HVAC and process cooling systems to maintain pre-established temperature or climate standards for commercial or industrial facilities. Building automation control systems are capable not only of controlling a facility's entire HVAC system, often on a room-by-room basis, but can also be programmed to integrate energy management, and monitoring for purposes of security, fire, card key access, lighting and other building systems. This monitoring can be performed on-site or remotely through a computer-based communications system. The monitoring system communicates an exception when a system is operating outside pre-established parameters. Diagnosis of potential problems and remedial adjustments can often be performed remotely from system monitoring terminals.

Maintenance, Repair and Replacement Services—Our maintenance, repair and replacement services comprised approximately 58% of our consolidated 2013 revenue and include the maintenance, repair, replacement, reconfiguration and monitoring of HVAC systems and industrial process piping. Approximately 71% of our maintenance, repair and replacement revenue were derived from replacing and reconfiguring existing HVAC systems for commercial, industrial and institutional customers. Replacement and reconfiguration are usually performed on a project basis and often use consultative expertise similar to that provided in the "design and build" installation market.

Maintenance and repair services are provided either in response to service calls or under a service agreement. Service calls are coordinated by customer service representatives or dispatchers that use computer and communication technology to process orders, arrange service calls, communicate with customers, dispatch technicians and invoice customers. Service technicians work from service vehicles equipped with commonly used parts, supplies and tools to complete a variety of jobs. Commercial, industrial and institutional service agreements usually have terms of one to three years, with automatic annual renewals, and typically with thirty- to sixty-day cancellation notice periods. We also provide remote monitoring of temperature, pressure, humidity and air flow for HVAC systems. If the system is not operating within the specifications set forth by the customer and cannot be remotely adjusted, a service crew is dispatched to analyze and repair the system.

Sources of Supply

The raw materials and components we use include HVAC system components, ductwork, steel, sheet metal and copper tubing and piping. These raw materials and components are generally available from a variety of domestic or foreign suppliers at competitive prices. Delivery times are typically short for most raw materials and standard components, but during periods of peak demand, may extend to one month or more. Over the last several years, many steel, iron and copper products, in particular, have experienced significant price fluctuation and some constrained availability. We estimate that direct purchase of commodities and finished products comprises between 10% and 15% of our average project cost. We have procedures to reduce commodity cost exposure; early buying of commodities for particular projects, or for general inventory, as well as including escalation and escape provisions in project bids and contracts wherever possible. The negative effects of unrecovered commodity cost inflation in our project results have been modest, and are reviewed further in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" later in this report.

Chillers for large units typically have the longest delivery time and generally have lead times of up to six months. The major components of commercial HVAC systems are compressors and chillers that are manufactured primarily by Carrier, Lennox, McQuay, Trane and York. The major suppliers of building automation control systems are Honeywell, Johnson Controls, Siemens, York, Automated Logic, Novar and Andover Control Corporation. We do not have any significant contracts guaranteeing us a supply of raw materials or components.

Cyclicality and Seasonality

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

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

Sales and Marketing

We have a diverse customer base, with no single customer accounting for more than 3% of consolidated 2013 revenue. Management and a dedicated sales force are responsible for developing and maintaining successful long-term relationships with key customers. Customers generally include building owners and developers and property managers, as well as general contractors, architects and consulting engineers. We intend to continue our emphasis on developing and maintaining long-term relationships with our customers by providing superior, high-quality service in a professional manner. We believe we can continue to leverage the diverse technical and marketing strengths at individual locations to expand the services offered in other local markets. With respect to multi-location service opportunities, we maintain a national sales force in our national accounts group.

Employees

As of December 31, 2013, we had 6,698 employees. We have collective bargaining agreements covering six employees. We have not experienced and do not expect any significant strikes or work stoppages and believe our relations with employees covered by collective bargaining agreements are good.

Recruiting, Training and Safety

Our continued success depends, in part, on our ability to continue to attract, retain and motivate qualified engineers, service technicians, field supervisors and project managers. We believe our success in retaining qualified employees will be based on the quality of our recruiting, training, compensation, employee benefits programs and opportunities for advancement. We provide on-the-job training, technical training, apprenticeship programs, attractive benefit packages and career advancement opportunities within our company.

We have established comprehensive safety programs throughout our operations to ensure that all technicians comply with safety standards we have established and that are established under federal, state and local laws and regulations. Additionally, we have implemented a "best practices" safety program throughout our operations, which provides employees with incentives to improve safety performance and decrease workplace accidents. Regional safety directors establish safety programs and benchmarking to improve safety within their region. Finally, our employment screening process seeks to determine that prospective employees have requisite skills, sufficient background references and acceptable driving records, if applicable. Our rate of incidents recordable under the standards of the Occupational Safety and Health Administration ("OSHA") per one hundred employees per year, also known as the OSHA recordable rate, was 2.60 during 2013. This level was 46% better than the most recently published OSHA rate for our industry.

Insurance and Litigation

The primary insured risks in our operations are bodily injury, property damage and workers' compensation injuries. We retain the risk for workers' compensation, employer's liability, auto liability, general liability and employee group health claims resulting from uninsured deductibles per incident or occurrence. Because we have very large deductibles, the vast majority of our claims are paid by us, so as a practical matter we self-insure the great majority of these risks. Losses up to such per-incident deductible amounts are estimated and accrued based upon known facts, historical trends and industry averages using the assistance of an actuary to project the extent of these obligations.

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

We typically warrant labor for the first year after installation on new HVAC systems and pass through to the customer manufacturers' warranties on equipment. We generally warrant labor for thirty days after servicing existing HVAC systems. We do not expect warranty claims to have a material adverse effect on our financial position or results of operations.

Competition

The HVAC industry is highly competitive and consists of thousands of local and regional companies. We believe that purchasing decisions in the commercial, industrial and institutional markets are based on (i) competitive price, (ii) long-term customer relationships, (iii) quality, timeliness and reliability of services provided, (iv) an organization's perceived stability based on years in business, financial strength and access to bonding, (v) range of services provided, and (vi) scale of operation. To improve our competitive position we focus on both the consultative "design and build" installation market and the maintenance, repair and replacement market to promote first the development and then the strengthening of long-term customer relationships. In addition, we believe our ability to

provide multi-location coverage, access to project financing and specialized technical skills for facilities owners gives us a strategic advantage over smaller competitors who may be unable to provide these services to customers at a competitive price.

We believe that we are larger than most of our competitors, which are generally small, owner-operated companies that typically operate in a limited geographic area. However, there are divisions of larger contracting companies, utilities and HVAC equipment manufacturers that provide HVAC services in some of the same service lines and geographic areas we serve. Some of these competitors and potential competitors have greater financial resources than we do to finance development opportunities and support their operations. We believe our smaller competitors generally compete with us based on price and their long-term relationships with local customers. Our larger competitors compete with us on those factors but may also provide attractive financing and comprehensive service and product packages.

Vehicles

We operate a fleet of various owned or leased service trucks, vans and support vehicles. We believe these vehicles generally are well maintained and sufficient for our current operations.

Governmental Regulation and Environmental Matters

Our operations are subject to various federal, state and local laws and regulations, including: (i) licensing requirements applicable to engineering, construction and service technicians, (ii) building and HVAC codes and zoning ordinances, (iii) regulations relating to consumer protection, including those governing residential service agreements, and (iv) regulations relating to worker safety and protection of the environment. We believe we have all required licenses to conduct our operations and are in substantial compliance with applicable regulatory requirements. If we fail to comply with applicable regulations we could be subject to substantial fines or revocation of our operating licenses.

Many state and local regulations governing the HVAC services trades require individuals to hold permits and licenses. In some cases, a required permit or license held by a single individual may be sufficient to authorize specified activities for all of our service technicians who work in the state or county that issued the permit or license. We seek to ensure that, where possible, we have two employees who hold any such permits or licenses that may be material to our operations in a particular geographic region.

Our operations are subject to the federal Clean Air Act, as amended, which governs air emissions and imposes specific requirements on the use and handling of chlorofluorocarbons, or CFCs, and certain other refrigerants. Clean Air Act regulations require the certification of service technicians involved in the service or repair of equipment containing these refrigerants and also regulate the containment and recycling of these refrigerants. These requirements have increased our training expenses and expenditures for containment and recycling equipment. The Clean Air Act is intended ultimately to eliminate the use of CFCs in the United States and to require alternative refrigerants to be used in replacement HVAC systems. We do not believe these regulations involving CFCs will materially affect our business on the whole because, although they require us to incur modest ongoing training costs, our competitors also incur such costs, and the regulations may encourage our customers to update their HVAC systems.

Executive Officers

We have five executive officers.

Brian Lane, age 56, has served as our Chief Executive Officer and President since December 2011 and as a director since 2010. Mr. Lane served as our President and Chief Operating Officer from

March 2010 until December 2011. Mr. Lane joined the Company in October 2003 and served as Vice President and then Senior Vice President for Region One of the Company until he was named Executive Vice President and Chief Operating Officer in January 2009. Prior to joining the Company, Mr. Lane spent fifteen years at Halliburton, a global provider of products and services to energy, industrial, and government customers, including employment by Brown and Root, an engineering and construction company. During his tenure, he held various positions in business development, strategy, and project activities, including the position of Regional Director of Europe and Africa. Additionally, he held the position of Vice President at Kvaerner, an international engineering and construction company.

William George, age 49, has served as our Executive Vice President and Chief Financial Officer since May 2005, was our Senior Vice President, General Counsel and Secretary from May 1998 to May 2005, and was our Vice President, General Counsel and Secretary from March 1997 to April 1998. From October 1995 to February 1997, Mr. George was Vice President and General Counsel of American Medical Response, Inc., a publicly-traded healthcare transportation company. From September 1992 to September 1995, Mr. George practiced corporate and antitrust law at Ropes & Gray, a Boston, Massachusetts law firm.

Julie S. Shaeff, age 48, has served as our Senior Vice President and Chief Accounting Officer since May 2005, was our Vice President and Corporate Controller from March 2002 to May 2005, and was our Assistant Corporate Controller from September 1999 to February 2002. From 1996 to August 1999, Ms. Shaeff was Financial Accounting Manager—Corporate Controllers Group for Browning-Ferris Industries, Inc., a publicly-traded waste services company. From 1987 to 1995, she held various positions with Arthur Andersen LLP. Ms. Shaeff is a Certified Public Accountant.

Trent T. McKenna, age 41, has served as our Senior Vice President, General Counsel and Secretary since August 2013, was our Vice President, General Counsel and Secretary from May 2005 to August 2013 and was our Associate General Counsel from August 2004 to May 2005. From February 1999 to August 2004, Mr. McKenna was a practicing attorney in the area of complex commercial litigation in the Houston, Texas office of Akin Gump Strauss Hauer & Feld LLP, an international law firm.

James Mylett, age 50, has served as our Senior Vice President of Service since October 2013. Prior to joining the Company, Mr. Mylett spent fourteen years at Johnson Controls, which manufactures, installs, and services automatic temperature regulation systems for buildings. During his time at Johnson Controls, Mr. Mylett held various positions, including that of Vice President and General Manager—North America Service Operations from August 2011 to October 2013. From October 2010 to August 2011, he served as Vice President and General Manager—West Region, and from December 2005 to September 2010, he served as Vice President of Service and Solutions—South Region. Previously, Mr. Mylett worked for Carrier Corporation, where he established and developed the company's national accounts service business.

ITEM 1A. Risk Factors

Our business is subject to a variety of risks. You should carefully consider the risks described below, together with all the information included in this report. Our business, financial condition and results of operations could be adversely affected by the occurrence of any of these events, which could cause actual results to differ materially from expected and historical results, and the trading price of our common stock could decline.

Because we bear the risk of cost overruns in most of our contracts, we may experience reduced profits or, in some cases, losses under these contracts if costs increase above our estimates.

Our contract prices are established largely upon estimates and assumptions of our projected costs, including assumptions about: future economic conditions; prices, including commodities prices;

availability of labor, including the costs of providing labor, equipment, and materials; and other factors outside our control. If our estimates or assumptions prove to be inaccurate, if circumstances change in a way that renders our assumptions and estimates inaccurate or we fail to successfully execute the work, cost overruns may occur and we could experience reduced profits or a loss for affected projects. For instance, unanticipated technical problems may arise, we could have difficulty obtaining permits or approvals, local laws, labor costs or labor conditions could change, bad weather could delay construction, raw materials prices could increase, our suppliers' or subcontractors' may fail to perform as expected or site conditions may be different than we expected. We are also exposed to increases in energy prices, particularly as they relate to gasoline prices. Additionally, in certain circumstances, we guarantee project completion or the achievement of certain acceptance and performance testing levels by a scheduled date. Failure to meet schedule or performance requirements typically results in additional costs to us, and in some cases we may also create liability for consequential and liquidated damages. Performance problems for existing and future projects could cause our actual results of operations to differ materially from those we anticipate and could damage our reputation within our industry and our customer base.

Many of the markets we do work in are currently experiencing or have recently experienced an economic downturn that may materially and adversely affect our business because our business is dependent on levels of construction activity.

The demand for our services is dependent upon the existence of construction projects and service requirements within the markets in which we operate. Any period of economic recession affecting a market or industry in which we transact business is likely to adversely impact our business. Many of the projects we work on have long lifecycles from conception to completion, and the bulk of our performance generally occurs late in a construction project's lifecycle. We experience the results of economic trends well after an economic cycle begins, and therefore will continue to experience the results of an economic recession well after conditions in the general economy have improved. Further, some of the local or regional markets we do work in have yet to enter a period of sustained recovery.

We cannot predict the severity or lasting effects of the recent recession, particularly in some local or regional markets that have not yet entered a period of sustained recovery. We believe that the current uncertainty about economic conditions caused by the recent recession means that many of our customers are likely to continue to postpone spending while credit markets remain disinclined to fund commercial and industrial developments. The industries and markets we operate in have always been and will continue to be vulnerable to these general macroeconomic downturns because they are cyclical in nature. The recent recession caused a drop off in the demand for projects within our markets and industries in some regions and continues to cause a similar drop off in other regions. The drop off in demand has led to and will likely continue to lead to greater price competition as well as decreased revenue and profit. The lasting effects of the recent recession have increased economic instability with our vendors, subcontractors, developers, and general contractors, which has caused us greater liability exposure and has resulted in us not being paid on some projects, as well as decreasing our revenue and profit. Further, to the extent more of our vendors, subcontractors, developers, or general contractors seek bankruptcy protection, the bankruptcy will likely force us to incur additional costs in attorneys' fees, as well as other professional consultants, and will result in decreased revenue and profit.

The percentage of our profits and revenue attributable to projects performed directly or indirectly for federal, state, and local government entities increased during and as a result of the economic downturn, in part because the private-sector decreased its investment in construction and building projects, but has decreased during 2013. A continuing reduction in federal, state, or local government spending in our industries and markets could result in decreased revenue and profit.

Our backlog is subject to unexpected adjustments and cancellations, which means that amounts included in our backlog may not result in actual revenue or translate into profits.

The revenue projected from our backlog may not be realized, or, if realized, may not result in profits. Projects may remain in our backlog for an extended period of time, or project cancellations or scope adjustments may occur with respect to contracts reflected in our backlog.

Third parties contribute significantly to our completion of many projects.

We hire third-party subcontractors to perform work and depend on third-party suppliers to provide equipment and materials necessary to complete our projects. If we are unable to retain qualified subcontractors or suppliers, or if our subcontractors or suppliers do not perform as anticipated for any reason, our execution and profitability could be harmed.

A significant portion of our business depends on our ability to provide surety bonds. Any difficulties in the financial and surety markets may adversely affect our bonding capacity and availability.

In the past we have expanded, and it is possible we will continue to expand, the number and percentage of total contract dollars that require an underlying bond. Historically surety market conditions have experienced times of difficulty as a result of significant losses incurred by many surety companies and the results of macroeconomic trends outside of our control. Consequently, during times when less overall bonding capacity is available in the market, surety terms have become more expensive and more restrictive. As such, we cannot guarantee our ability to maintain a sufficient level of bonding capacity in the future, which could preclude our ability to bid for certain contracts or successfully contract with some customers. Additionally, even if we continue to be able to access bonding capacity to sufficiently bond future work, we may be required to post collateral to secure bonds, which would decrease the liquidity we would have available for other purposes. Our surety providers are under no commitment to guarantee our access to new bonds in the future; thus, our ability to access or increase bonding capacity is at the sole discretion of our surety providers. If our surety companies were to limit or eliminate our access to bonds, our alternatives would include seeking bonding capacity from other surety companies, increasing business with clients that do not require bonds and posting other forms of collateral for project performance, such as letters of credit or cash. We may be unable to secure these alternatives in a timely manner, on acceptable terms, or at all. As such, if we were to experience an interruption or reduction in the availability of bonding capacity, it is likely we would be unable to compete for or work on certain projects.

Goodwill impairment charges negatively impacted our earnings in 2011 and in previous years. Earnings for future periods may be impacted by additional charges for goodwill and intangible assets.

We carry a significant amount of goodwill and identifiable intangible assets on our consolidated balance sheets. Goodwill is the excess of purchase price over the fair value of the net assets of acquired businesses. We assess goodwill for impairment each year, and more frequently if circumstances suggest an impairment may have occurred. The recent recession, along with other factors, caused the fair value of some of our assets to be lower than their carrying value, resulting in an impairment to goodwill. We may determine at a future date that an additional significant impairment has occurred in the value of our unamortized intangible assets or fixed assets, which could require us to write off an additional portion of our assets and could adversely affect our financial condition or our reported results of operations.

Our use of the percentage-of-completion method of accounting could result in a reduction or reversal of previously recorded revenue or profits.

A material portion of our revenue is recognized using the percentage-of-completion method of accounting, which results in our recognizing contract revenue and earnings ratably over the contract term in the proportion that our actual costs bear to our estimated contract costs. The earnings or losses recognized on individual contracts are based on estimates of contract revenue, costs and profitability. We review our estimates of contract revenue, costs and profitability on an ongoing basis. Prior to contract completion, we may adjust our estimates on one or more occasions as a result of change orders to the original contract, collection disputes with the customer on amounts invoiced or claims against the customer for increased costs incurred by us due to customer-induced delays and other factors. Contract losses are recognized in the fiscal period when the loss is determined. Contract profit estimates are also adjusted in the fiscal period in which it is determined that an adjustment is required. As a result of the requirements of the percentage-of-completion method of accounting, the possibility exists, for example, that we could have estimated and reported a profit on a contract over several periods and later determined, usually near contract completion, that all or a portion of such previously estimated and reported profits were overstated. If this occurs, the full aggregate amount of the overstatement will be reported for the period in which such determination is made, thereby eliminating all or a portion of any profits from other contracts that would have otherwise been reported in such period or even resulting in a loss being reported for such period. On a historical basis, we believe that we have made reasonably reliable estimates of the progress towards completion on our long-term contracts. However, given the uncertainties associated with these types of contracts, it is possible for actual costs to vary from estimates previously made, which may result in reductions or reversals of previously recorded revenue and profits.

Intense competition in our industry could reduce our market share and our profit.

The markets we serve are highly competitive. Our industry is characterized by many small companies whose activities are geographically concentrated. We compete on the basis of our technical expertise and experience, financial and operational resources, nationwide presence, industry reputation and dependability. While we believe our customers consider a number of these factors in awarding available contracts, a large portion of our work is awarded through a bid process. Consequently, price is often the principal factor in determining which contractor is selected, especially on smaller, less complex projects. Smaller competitors are sometimes able to win bids for these projects based on price alone due to their lower cost and financial return requirements. We expect competition to intensify in our industry, presenting us with significant challenges in our ability to maintain strong growth rates and acceptable profit margins. We also expect increased competition from in-house service providers, because some of our customers have employees who perform service work similar to the services we provide. Vertical consolidation is also expected to intensify competition in our industry. If we are unable to meet these competitive challenges, we will lose market share to our competitors and experience an overall reduction in our profits. In addition, our profitability would be impaired if we have to reduce our prices to remain competitive.

We are a decentralized company and place significant decision making powers with our subsidiaries' management, which presents certain risks.

We believe that our practice of placing significant decision making powers with local management is important to our successful growth and allows us to be responsive to opportunities and to our customers' needs. However, this practice presents certain risks, including the risk that we may be slower or less effective in our attempts to identify or react to problems affecting an important business than we would under a more centralized structure or that we would be slower to identify a misalignment between a subsidiary's and the Company's overall business strategy. Further, if a subsidiary location

fails to follow the Company's compliance policies, we could be made party to a contract, arrangement or situation that requires the assumption of large liabilities or has less advantageous terms than is typically found in the market.

We have subsidiary operations through the United States and are exposed to multiple state and local regulations, as well as federal laws and requirements applicable to government contractors. Changes in law, regulations or requirements, or a material failure of any of our subsidiaries or us to comply with any of them, could increase our costs and have other negative impacts on our business.

Our 88 locations are located in 29 states, which exposes us to a variety of different state and local laws and regulations, particularly those pertaining to contractor licensing requirements. These laws and regulations govern many aspects of our business, and there are often different standards and requirements in different locations. In addition, our subsidiaries that perform work for federal government entities are subject to additional federal laws and regulatory and contractual requirements. Changes in any of these laws, or our or any of our subsidiaries' material failure to comply with them, can adversely impact our operations by, among other things, increasing costs, distracting management's time and attention from other items, and harming our reputation.

As government contractors, our subsidiaries are subject to a number of rules and regulations, and their contracts with government entities are subject to audit. Violations of the applicable rules and regulations could result in a subsidiary being barred from future government contracts.

Government contractors must comply with many regulations and other requirements that relate to the award, administration and performance of government contracts. A violation of these laws and regulations could result in imposition of fines and penalties, the termination of a government contract or debarment from bidding on government contracts in the future. Further, despite our decentralized nature, a violation at one of our locations could impact other locations' ability to bid on and perform government contracts; additionally, because of our decentralized nature, we face risks in maintaining compliance with all local, state and federal government contracting requirements. Prohibition against bidding on future government contracts could have an adverse effect on our financial condition and results of operations.

If we are unable to attract and retain qualified managers and employees, we will be unable to operate efficiently, which could reduce our profitability.

Our business is labor intensive, and many of our operations experience a high rate of employment turnover. At times of low unemployment rates in the United States, it will be more difficult for us to find qualified personnel at low cost in some geographic areas where we operate. Additionally, our business is managed by a small number of key executive and operational officers. We may be unable to hire and retain the sufficient skilled labor force necessary to operate efficiently and to support our growth strategy. Our labor expenses may increase as a result of a shortage in the supply of skilled personnel. Labor shortages, increased labor costs or the loss of key personnel could reduce our profitability and negatively impact our business. Further, our relationship with some customers could suffer if we are unable to retain the employees with whom those customers primarily work and have established relationships.

Past and future environmental, safety and health regulations could impose significant additional costs on us that reduce our profits.

HVAC systems are subject to various environmental statutes and regulations, including the Clean Air Act and those regulating the production, servicing and disposal of certain ozone-depleting refrigerants used in HVAC systems. There can be no assurance that the regulatory environment in which we operate will not change significantly in the future. Various local, state and federal laws and

regulations impose licensing standards on technicians who install and service HVAC systems. And additional laws, regulations and standards apply to contractors who perform work that is being funded by public money, particularly federal public funding. Our failure to comply with these laws and regulations could subject us to substantial fines, the loss of our licenses or potentially debarment from future publicly funded work. It is impossible to predict the full nature and effect of judicial, legislative or regulatory developments relating to health and safety regulations and environmental protection regulations applicable to our operations.

Our insurance policies against many potential liabilities require high deductibles, and our risk management policies and procedures may leave us exposed to unidentified or unanticipated risks. Additionally, difficulties in the insurance markets may adversely affect our ability to obtain necessary insurance.

Although we maintain insurance policies with respect to our related exposures, these policies are subject to high deductibles; as such, we are, in effect, self-insured for substantially all of our typical claims. We hire an actuary to determine any liabilities for unpaid claims and associated expenses for the three major lines of coverage (workers' compensation, general liability and auto liability). The determination of these claims and expenses and the appropriateness of the estimated liability are reviewed and updated quarterly. However, insurance liabilities are difficult to assess and estimate due to the many relevant factors, the effects of which are often unknown, including the severity of an injury, the determination of our liability in proportion to other parties, the number of incidents that have occurred but are not reported and the effectiveness of our safety program. Our accruals are based on known facts, historical trends (both internal trends and industry averages) and our reasonable estimate of our future expenses. We believe our accruals are adequate. However, our risk management strategies and techniques may not be fully effective in mitigating our risk exposure in all market environments or against all types of risk. In January 2009 our company-wide risk manager left the company, and his former job responsibilities continue to be shared between several of our officers. If any of the variety of instruments, processes or strategies we use to manage our exposure to various types of risk are not effective, which could include a failed transition of the prior risk manager's work duties, we may incur losses that are not covered by our insurance policies or that exceed our accruals or coverage limits.

Additionally, we typically are contractually required to provide proof of insurance on projects we work on. Historically insurance market conditions become more difficult for insurance consumers during periods when insurance companies suffer significant investment losses as well as casualty losses. Consequently, it is possible that insurance markets will become more expensive and restrictive. Also, our prior casualty loss history might adversely affect our ability to procure insurance within commercially reasonable ranges. As such, we may not be able to maintain commercially reasonable levels of insurance coverage in the future, which could preclude our ability to work on many projects. Our insurance providers are under no commitment to renew our existing insurance policies in the future; therefore, our ability to obtain necessary levels or kinds of insurance coverage is subject to market forces outside our control. If we were unable to obtain necessary levels of insurance, it is likely we would be unable to compete for or work on most projects.

If we experience delays and/or defaults in customer payments, we could be unable to recover all expenditures.

Because of the nature of our contracts, at times we commit resources to projects prior to receiving payments from the customer in amounts sufficient to cover expenditures on projects as they are incurred. Delays in customer payments may require us to make a working capital investment. If a customer defaults in making their payments on a project to which we have devoted resources, it could have a material negative effect on our results of operations.

Actual and potential claims, lawsuits and proceedings could ultimately reduce our profitability and liquidity and weaken our financial condition.

We are likely to continue to be named as a defendant in legal proceedings claiming damages from us in connection with the operation of our business. Most of the actions against us arise out of the normal course of our performing services on project sites. We also are, and are likely to continue to be, from time to time a plaintiff in legal proceedings against customers, in which we seek to recover payment of contractual amounts we are owed as well as claims for increased costs we incur. When appropriate, we establish provisions against possible exposures, and we adjust these provisions from time to time according to ongoing exposure. If our assumptions and estimates related to these exposures prove to be inadequate or inaccurate, we could experience a reduction in our profitability and liquidity and a weakening of our financial condition. In addition, claims, lawsuits and proceedings may harm our reputation or divert management resources away from operating our business.

Our recent and future acquisitions may not be successful.

We expect to continue pursuing selective acquisitions of businesses. We cannot assure that we will be able to locate acquisitions or that we will be able to consummate transactions on terms and conditions acceptable to us, or that acquired businesses will be profitable. Acquisitions may expose us to additional business risks different than those we have traditionally experienced. We also may encounter difficulties integrating acquired businesses and successfully managing the growth we expect to experience from these acquisitions.

We may choose to finance future acquisitions with debt, equity, cash or a combination of the three. We can give no assurances that any future acquisitions will not dilute earnings or disrupt the payment of a stockholder dividend. To the extent we succeed in making acquisitions, a number of risks will result, including:

- the assumption of material liabilities (including for environmental-related costs);
- failure of due diligence to uncover situations that could result in legal exposure or to quantify the true liability exposure from known risks;
- the diversion of management's attention from the management of daily operations to the integration of operations;
- difficulties in the assimilation and retention of employees, in the assimilation of different cultures and practices, in the assimilation of broad and geographically dispersed personnel and operations, and the retention of employees generally;
- the risk of additional financial and accounting challenges and complexities in areas such as tax planning, treasury management, financial reporting and internal controls; and
- we may not be able to realize the cost savings or other financial benefits we anticipated prior to the acquisition.

The failure to successfully integrate acquisitions could have an adverse effect on our business, financial condition and results of operations.

Our common stock, which is listed on the New York Stock Exchange, has from time to time experienced significant price and volume fluctuations. These fluctuations are likely to continue in the future, and our stockholders may suffer losses.

The market price of our common stock may change significantly in response to various factors and events beyond our control. A variety of events may cause the market price of our common stock to fluctuate significantly, including the following: (i) the risk factors described in this Report on

Form 10-K; (ii) a shortfall in operating revenue or net income from that expected by securities analysts and investors; (iii) quarterly fluctuations in our operating results; (iv) changes in securities analysts' estimates of our financial performance or that of our competitors or companies in our industry generally; (v) general conditions in our customers' industries; (vi) general conditions in the securities markets; (vii) our announcements of significant contracts, milestones, acquisitions; (viii) our relationship with other companies; (ix) our investors' view of the sectors and markets in which we operate; and (x) additions or departures of key personnel. Some companies that have volatile market prices for their securities have been subject to security class action suits filed against them. If a suit were to be filed against us, regardless of the outcome, it could result in substantial costs and a diversion of our management's attention and resources. This could have a material adverse effect on our business, results of operations and financial condition.

If we do not effectively manage the size and cost of our operations, our existing infrastructure may become either strained or over-burdensome, and we may be unable to increase revenue growth.

The growth that we have experienced in the past, and that we may experience in the future, may provide challenges to our organization, requiring us to expand our personnel and our operations. Future growth may strain our infrastructure, operations and other managerial and operating resources. We have also experienced in the past severe constriction in the markets in which we operate and, as a result, in our operating requirements. Failing to maintain the appropriate cost structure for a particular economic cycle may result in our incurring costs that affect our profitability. If our business resources become strained or over-burdensome, our earnings may be adversely affected and we may be unable to increase revenue growth. Further, we may undertake contractual commitments that exceed our labor resources, which could also adversely affect our earnings and our ability to increase revenue growth.

Our effective tax rate may increase.

We conduct business across the United States and file income taxes in various tax jurisdictions. Our effective tax rates could be affected by many factors, some of which are outside of our control, including changes in tax laws and regulations in the various tax jurisdictions in which we file income taxes, issues relating to tax audits or examinations and any related interest or penalties, and uncertainty in obtaining deductions or credits claimed in various jurisdictions. Our results of operations is reported based on our determination of the amount of taxes we owe in various tax jurisdictions. Significant judgment is required in determining our provision for income taxes and our determination of tax liability is always subject to review or examination by tax authorities in applicable tax jurisdictions. An adverse outcome of such a review of examination could adversely affect our operating results and financial condition. Further, the results of tax examinations and audits could have a negative impact on our financial results and cash flows where the results differ from the liabilities recorded in our financial statements.

Failure or circumvention of our disclosure controls and procedures or internal controls over financial reporting could seriously harm our financial condition, results of operations, and our business.

We plan to continue to maintain and strengthen internal controls and procedures to enhance the effectiveness of our disclosure controls and internal controls over financial reporting. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, and not absolute, assurances that the objectives of the system are met. Any failure of our disclosure controls and procedures or internal controls over financial reporting could harm our financial condition and results of operations.

A cyber security breach could adversely affect our business.

We use sophisticated information technology systems, networks, and infrastructure in conducting some of our day-to-day operations and providing services to certain customers. These systems, networks, and infrastructure may be vulnerable to deliberate attacks or accidental events that interfere with their functionality or the confidentiality of our information or our customers' data. Our inability to prevent cyber-attacks or adequately protect against other disruptions could adversely affect our business.

Our charter contains certain anti-takeover provisions that may inhibit or delay a change in control.

Our certificate of incorporation authorizes our board of directors to issue, without stockholder approval, one or more series of preferred stock having such preferences, powers and relative, participating, optional and other rights (including preferences over the common stock respecting dividends and distributions and voting rights) as the board of directors may determine. The issuance of this "blank-check" preferred stock could render more difficult or discourage an attempt to obtain control by means of a tender offer, merger, proxy contest or otherwise. Additionally, certain provisions of the Delaware General Corporation Law may also discourage takeover attempts that have not been approved by the Board of Directors.

ITEM 1B. *Unresolved Staff Comments*

None.

ITEM 2. *Properties*

We own four properties, two of which we acquired through acquisition and two that we formerly leased. Other than these four properties, we lease the real property and buildings from which we operate. Our facilities are located in 29 states and Puerto Rico and consist of offices, shops and fabrication, maintenance and warehouse facilities. Generally, leases range from three to ten years and are on terms we believe to be commercially reasonable. A majority of these premises are leased from individuals or entities with whom we have no other business relationship. In certain instances these leases are with current or former employees. To the extent we renew, enter into leases or otherwise change leases with current or former employees, we enter into such agreements on terms that reflect a fair market valuation for the properties. Leased premises range in size from approximately 1,000 square feet to 110,000 square feet. To maximize available capital, we generally intend to continue to lease our properties, but may consider further purchases of property where we believe ownership would be more economical. We believe that our facilities are sufficient for our current needs.

We lease our executive and administrative offices in Houston, Texas.

ITEM 3. *Legal Proceedings*

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

ITEM 4. *Mine Safety Disclosures*

Not applicable.

PART II**ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

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

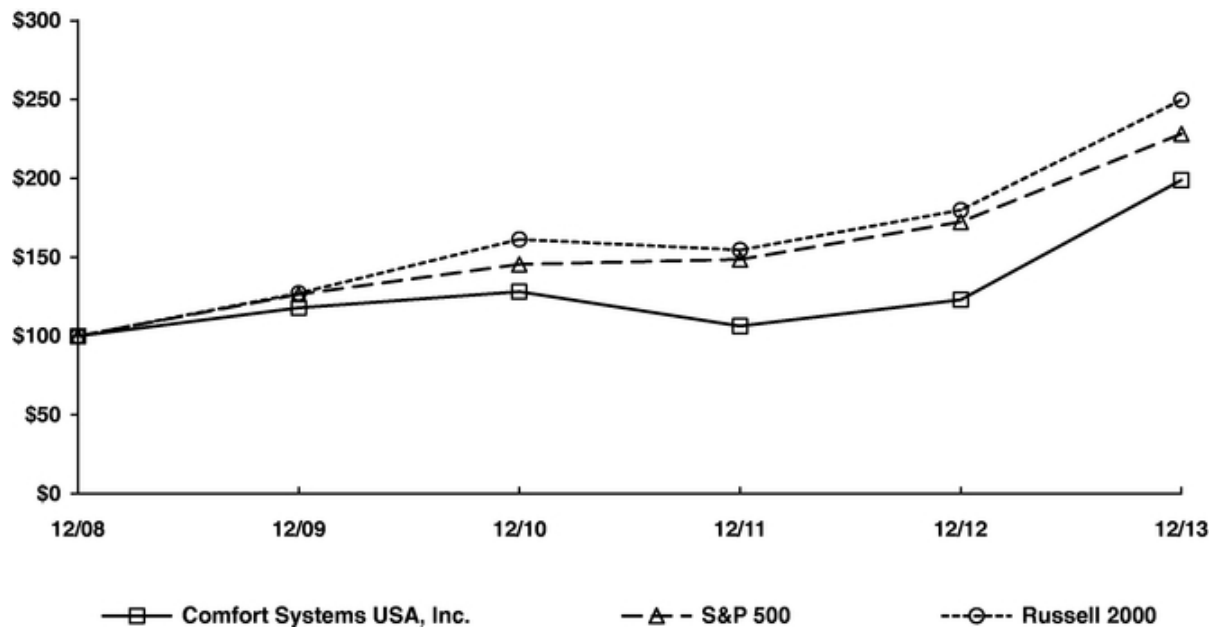
	<u>High</u>	<u>Low</u>	<u>Cash Dividends Declared</u>
Fourth Quarter, 2013	\$ 20.58	\$ 16.16	\$ 0.055
Third Quarter, 2013	\$ 16.98	\$ 15.10	\$ 0.055
Second Quarter, 2013	\$ 15.33	\$ 11.70	\$ 0.050
First Quarter, 2013	\$ 14.19	\$ 11.90	\$ 0.050
Fourth Quarter, 2012	\$ 12.16	\$ 9.61	\$ 0.050
Third Quarter, 2012	\$ 11.82	\$ 9.10	\$ 0.050
Second Quarter, 2012	\$ 11.25	\$ 8.94	\$ 0.050
First Quarter, 2012	\$ 12.94	\$ 9.97	\$ 0.050

As of February 21, 2014 there were approximately 314 stockholders of record of our Common Stock, and the last reported sale price on that date was \$16.54 per share.

We expect to continue paying cash dividends quarterly, although there is no assurance as to future dividends because they depend on future earnings, capital requirements, and financial condition. In addition, our revolving credit agreement limits the amount of dividends we can pay at any time that the ratio of our Adjusted Indebtedness to our Credit Facility Adjusted EBITDA exceeds 1.0.

The following Corporate Performance Graph and related information shall not be deemed "soliciting material" or to be "filed" with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act or the Exchange Act, except to the extent that we specifically incorporate it by reference into such filing.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
Among Comfort Systems USA, Inc., the S&P 500 Index, and the Russell 2000 Index



* \$100 invested on 12/31/08 in stock or index, including reinvestment of dividends.
Fiscal year ending December 31.

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Copyright© 2014 Russell Investment Group. All rights reserved.

Recent Sales of Unregistered Securities

None.

Issuer Purchases of Equity Securities

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from time to time approved extensions of the program to acquire additional shares. Since the inception of the repurchase program, the Board has approved 6.6 million shares to be repurchased.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. Since the inception of the program in 2007 and as of December 31, 2013, we have repurchased a cumulative total of 6.0 million shares at an average price of \$11.00 per share.

During the year ended December 31, 2013, we purchased our common shares in the following amounts at the following weighted-average prices:

Period	Total Number of Shares Purchased	Weighted-Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
January 1 - January 31	—	\$ —	5,891,673	708,864
February 1 - February 28	—	\$ —	5,891,673	708,864
March 1 - March 31	11,700	\$ 12.41	5,903,373	697,164
April 1 - April 30	29,181	\$ 13.34	5,932,554	667,983
May 1 - May 31	9,082	\$ 13.30	5,941,636	658,901
June 1 - June 30	—	\$ —	5,941,636	658,901
July 1 - July 31	—	\$ —	5,941,636	658,901
August 1 - August 31	9,219	\$ 15.81	5,950,855	649,682
September 1 - September 30	66,359	\$ 15.53	6,017,214	583,323
October 1 - October 31	—	\$ —	6,017,214	583,323
November 1 - November 30	—	\$ —	6,017,214	583,323
December 1 - December 31	—	\$ —	6,017,214	583,323
	<u>125,541</u>	<u>\$ 14.59</u>	<u>6,017,214</u>	<u>583,323</u>

ITEM 6. Selected Financial Data

The following selected historical financial data has been derived from our audited financial statements and should be read in conjunction with the historical Consolidated Financial Statements and related notes:

	Year Ended December 31,				
	2013	2012	2011	2010	2009
(in thousands, except per share amounts)					
STATEMENT OF OPERATIONS DATA:					
Revenue	\$ 1,357,272	\$ 1,331,185	\$ 1,216,654	\$ 1,063,520	\$ 1,068,860
Operating income (loss)(a)	\$ 46,258	\$ 22,303	\$ (42,641)	\$ 31,442	\$ 53,812
Income (loss) from continuing operations	\$ 28,632	\$ 11,494	\$ (32,474)	\$ 20,564	\$ 32,900
Discontinued operations—					
Operating income (loss), net of tax	\$ (76)	\$ 355	\$ (4,018)	\$ (6,547)	\$ 1,357
Gain (loss) on disposition, net of tax	—	—	—	\$ 723	\$ (75)
Net income (loss) including noncontrolling interests	\$ 28,556	\$ 11,849	\$ (36,492)	\$ 14,740	\$ 34,182
Net income (loss) attributable to Comfort Systems USA, Inc.	\$ 27,269	\$ 13,463	\$ (36,830)	\$ 14,740	\$ 34,182
Income (loss) per share attributable to Comfort Systems USA, Inc.:					
Basic—					
Income (loss) from continuing operations	\$ 0.73	\$ 0.35	\$ (0.88)	\$ 0.54	\$ 0.86
Discontinued operations—					
Income (loss) from operations	—	0.01	(0.11)	(0.17)	0.04
Gain (loss) on disposition	—	—	—	0.02	—
Net income (loss)	<u>\$ 0.73</u>	<u>\$ 0.36</u>	<u>\$ (0.99)</u>	<u>\$ 0.39</u>	<u>\$ 0.90</u>
Diluted—					
Income (loss) from continuing operations	\$ 0.73	\$ 0.35	\$ (0.88)	\$ 0.54	\$ 0.86
Discontinued operations—					
Income (loss) from operations	—	0.01	(0.11)	(0.17)	0.03
Gain (loss) on disposition	—	—	—	0.02	—
Net income (loss)	<u>\$ 0.73</u>	<u>\$ 0.36</u>	<u>\$ (0.99)</u>	<u>\$ 0.39</u>	<u>\$ 0.89</u>
Cash dividends per share	<u>\$ 0.210</u>	<u>\$ 0.200</u>	<u>\$ 0.200</u>	<u>\$ 0.200</u>	<u>\$ 0.190</u>
BALANCE SHEET DATA:					
Working capital	\$ 127,559	\$ 103,966	\$ 109,766	\$ 134,738	\$ 164,125
Total assets	\$ 601,822	\$ 580,754	\$ 593,980	\$ 640,020	\$ 574,948
Total debt	\$ 2,000	\$ 7,400	\$ 15,381	\$ 29,936	\$ 7,608
Total stockholders' equity	\$ 314,022	\$ 287,306	\$ 283,106	\$ 312,784	\$ 305,984
Total Comfort Systems USA, Inc. stockholders' equity	\$ 295,834	\$ 270,405	\$ 264,591	\$ 312,784	\$ 305,984

- (a) Included in operating income are goodwill impairment charges of \$57.3 million for 2011. There were no goodwill impairment charges for 2013, 2012, 2010 or 2009.

ITEM 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and related notes included elsewhere in this annual report on Form 10-K. Also see "Forward-Looking Statements" discussion.

Introduction and Overview

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

Nature and Economics of Our Business

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

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

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 December 31, 2013, we had 3,321 projects in process. Our average project takes six to nine months to complete, with an average contract price of approximately \$538,000. 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. We have what we believe is a well-diversified distribution of revenue across end-use sectors that we believe reduces our exposure to negative developments in any given sector. Because of the integral nature of HVAC and related controls systems to most buildings, we have the legal right in almost all cases to attach liens to buildings or related funding sources when we have not been fully paid for installing systems, except with respect to some government buildings. The service work that we do, which is discussed further below, usually does not give rise to lien rights.

We also perform larger HVAC projects. As of December 31, 2013, we had 11 projects in process with a contract price greater than \$15 million, 16 projects between \$10 million and \$15 million, 53 projects between \$5 million and \$10 million, and 282 projects between \$1 million and \$5 million. Taken together, projects with contract prices of \$1 million or more totaled \$1,470.3 million of aggregate contract value as of December 31, 2013, or approximately 82%, out of a total contract value for all projects in progress of \$1,787.4 million. Generally, projects closer in size to \$1 million will be completed in one year or less. It is unusual for us to work on a project that exceeds two years in length.

In addition to project work, approximately 17% of our revenue 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 with thirty- to sixty-day cancellation notice periods.

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

Profile and Management of Our Operations

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

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

Economic and Industry Factors

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

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

Operating Environment and Management Emphasis

Nonresidential building construction and renovation activity, as reported by the federal government, declined over the three year period of 2001 to 2003, expanded moderately during 2004 and 2005, and was strong over the three year period from 2006 to 2008. We experienced significant industry activity declines over the four year period from 2009 to 2012, and 2013 activity levels have been stable compared to recent years. During the periods of decline, we responded to market challenges by pursuing work in sectors less affected by the downturn, such as government, educational, and healthcare facilities, and by establishing marketing initiatives that take advantage of our size and range of expertise. We also responded to declining gross profits over those years by reducing our selling, general, and administrative expenses, and our indirect project and service overhead costs. We believe our efforts in these areas partially offset the decline in our profitability over that period.

As a result of our continued strong emphasis on cash flow, our debt outstanding under our revolving credit facility is zero, and we have substantial uncommitted cash balances, as discussed further in "Liquidity and Capital Resources" below. We have a credit facility in place with considerably less

restrictive terms than those of our previous facilities; this facility does not expire until July 2018. We have strong surety relationships to support our bonding needs, and we believe our relationships with the surety markets are positive in light of our strong current results and financial position. We have generated positive free cash flow in each of the last fifteen calendar years and will continue our emphasis in this area. We believe that the relative size and strength of our balance sheet and surety support as compared to most companies in our industry represent competitive advantages for us.

As discussed at greater length in "Results of Operations" below, we have seen declining activity levels in our industry since late 2008 and we expect price competition to continue to be strong, as local and regional competitors respond cautiously to changing conditions. We will continue our efforts to find the more active sectors in our markets, and to increase our regional and national account business. Our primary emphasis for 2014 will be on execution and cost control, and on maintaining activity levels that will permit us to earn reasonable profits while preserving our core workforce. We have increased our focus on project qualification, estimating, pricing and management, and on service performance.

Critical Accounting Policies

Our critical accounting policies are based upon the significance of the accounting policy to our overall financial statement presentation, as well as the complexity of the accounting policy and our use of estimates and subjective assessments. Our most critical accounting policy is revenue recognition. As discussed elsewhere in this annual report on Form 10-K, our business has two service functions: (i) installation, which we account for under the percentage of completion method, and (ii) maintenance, repair and replacement, which we account for as the services are performed, or in the case of replacement, under the percentage of completion method. In addition, we identified other critical accounting policies related to our allowance for doubtful accounts receivable, the recording of our self-insurance liabilities, valuation of deferred tax assets, accounting for acquisitions and the recoverability of goodwill and identifiable intangible assets. These accounting policies, as well as others, are described in Note 2 to the Consolidated Financial Statements included elsewhere in this annual report on Form 10-K.

Percentage of Completion Method of Accounting

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

measurement and comparison process requires updates to the estimate of total costs to complete the contract, and these updates may include subjective assessments.

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

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

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

Revisions to project costs and conditions can give rise to change orders under which the customer agrees to pay additional contract price. Revisions can also result in claims we might make against the customer to recover project variances that have not been satisfactorily addressed through change orders with the customer. Except in certain circumstances, we do not recognize revenue or margin based on change orders or claims until they have been agreed upon with the customer. The amount of revenue associated with unapproved change orders and claims is currently immaterial.

Variations from estimated project costs could have a significant impact on our operating results, depending on project size, and the recoverability of the variation via additional customer payments.

Accounting for Allowance for Doubtful Accounts

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

Accounting for Self-Insurance Liabilities

We are substantially self-insured for workers' compensation, employer's liability, auto liability, general liability and employee group health claims in view of the relatively high per-incident deductibles

we absorb under our insurance arrangements for these risks. Losses up to deductible amounts are estimated and accrued based upon known facts, historical trends and industry averages. Loss estimates associated with the larger and longer-developing risks—workers' compensation, auto liability and general liability—are reviewed by a third party actuary quarterly.

We believe these accruals are adequate. However, insurance liabilities are difficult to estimate due to unknown factors, including the severity of an injury, the determination of our liability in proportion to other parties, timely reporting of occurrences, ongoing treatment or loss mitigation, general trends in litigation recovery outcomes and the effectiveness of safety and risk management programs. Therefore, if actual experience differs from the assumptions and estimates used for recording the liabilities, adjustments may be required and would be recorded in the period that such experience becomes known.

Accounting for Deferred Tax Assets

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

Acquisitions

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

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

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

Recoverability of Goodwill and Identifiable Intangible Assets

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

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

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

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

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

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

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

Results of Operations (in thousands):

	Year Ended December 31,					
	2013		2012		2011	
Revenue	\$ 1,357,272	100.0%	\$ 1,331,185	100.0%	\$ 1,216,654	100.0%
Cost of services	1,117,389	82.3%	1,123,564	84.4%	1,035,124	85.1%
Gross profit	239,883	17.7%	207,621	15.6%	181,530	14.9%
Selling, general and administrative expenses	194,214	14.3%	185,809	14.0%	167,053	13.7%
Goodwill impairment	—	—	—	—	57,354	4.7%
Gain on sale of assets	(589)	—	(491)	—	(236)	—
Operating income (loss)	46,258	3.4%	22,303	1.7%	(42,641)	(3.5)%
Interest income	23	—	24	—	128	—
Interest expense	(1,351)	(0.1)%	(1,595)	(0.1)%	(1,886)	(0.2)%
Changes in the fair value of contingent earn-out obligations	1,646	0.1%	662	—	5,528	0.5%
Other income	204	—	145	—	934	0.1%
Income (loss) before income taxes	46,780	3.4%	21,539	1.6%	(37,937)	(3.1)%
Income tax expense (benefit)	18,148	—	10,045	—	(5,463)	—
Income (loss) from continuing operations	28,632	2.1%	11,494	0.9%	(32,474)	(2.7)%
Discontinued operations—						
Operating income (loss), net of tax	(76)	—	355	—	(4,018)	—
Net income (loss) including noncontrolling interests	28,556	—	11,849	—	(36,492)	—
Less: Net income (loss) attributable to noncontrolling interests	1,287	—	(1,614)	—	338	—
Net income (loss) attributable to Comfort Systems USA, Inc.	<u>\$ 27,269</u>	—	<u>\$ 13,463</u>	—	<u>\$ (36,830)</u>	—

2013 Compared to 2012

We had 37 operating locations as of December 31, 2012. During the first quarter of 2013, we consolidated one company into other operations. As of December 31, 2013, we had 36 operating locations.

Revenue—Revenue increased \$26.1 million, or 2.0% to \$1,357.3 million in 2013 compared to 2012. The increase is primarily due to our Arizona operation (\$23.5 million) and our EAS operation (\$47.3 million) which performed a significant amount of project work during 2013. This increase was partially offset by lower revenue in our large operation headquartered in Virginia (\$53.1 million), which had a fast-paced, large data center project in the first half of 2012 which did not reoccur in 2013 due to its completion in the prior year.

Backlog reflects revenue still to be recognized under contracted or committed installation and replacement project work. Project work generally lasts less than one year. Service agreement revenue and service work and short duration projects which are generally billed as performed do not flow through backlog. Accordingly, backlog represents only a portion of our revenue for any given future period, and it represents revenue that is likely to be reflected in our operating results over the next six to twelve months. As a result, we believe the predictive value of backlog information is limited to indications of general revenue direction over the near term, and should not be interpreted as indicative of ongoing revenue performance over several quarters.

Backlog as of December 31, 2013 was \$603.6 million, a 5.7% increase from September 30, 2013 backlog of \$570.9 million and a 2.3% decrease from December 31, 2012 backlog of \$618.0 million. Sequential backlog increased primarily due to our EAS operation (\$22.9 million) which had increased project bookings. The year-over-year backlog decrease was primarily due to our Arizona operation (\$22.7 million) which performed a significant amount of project work during the current year.

Gross Profit—Gross profit increased \$32.3 million, or 15.5%, to \$239.9 million in 2013 as compared to 2012. The increase in gross profit was due to improved profitability at a majority of our operations in 2013 but primarily at our EAS operation (approximately \$5.7 million), improved market conditions which resulted in an increase in volumes at our Arizona operation (approximately \$5.6 million) and job underperformance at one of our Maryland operations in 2012 (approximately \$5.7 million). Also, gross profit increased approximately \$2.5 million due to a prior period accounting adjustment. These corrections are reflected on a pretax basis in revenue and cost of sales, which include \$3.3 million and \$0.8 million, respectively. These accounting adjustments are described in Note 2 to the Consolidated Financial Statements included elsewhere in this annual report on Form 10-K. As a percentage of revenue, gross profit increased from 15.6% in 2012 to 17.7% in 2013 primarily due to the factors discussed above. In addition, the gross profit percentage increased due to improved profitability at our large operation headquartered in Virginia despite lower revenues, and included a claim settled during the first quarter of 2013 with the general contractor on a large data center project that had been accelerated by the owner on which we recognized approximately \$1.6 million of additional gross profit during the current year.

Selling, General and Administrative Expenses ("SG&A")—SG&A increased \$8.4 million, or 4.5%, to \$194.2 million for 2013 as compared to 2012. Excluding amortization expense, SG&A increased \$8.9 million, or 5.0%. This increase is primarily due to increased salary expense (\$4.6 million) as a result of an increased portion of our work in maintenance, repair and replacement services that has higher SG&A costs, and increased bonuses payable (\$3.6 million) as a result of improved operating results. These increases were partially offset by a decrease in bad debt expense (\$2.4 million) as a result of a receivable settlement for a gain of \$0.8 million, and higher than normal bad debt expense in the prior year due to specific collectability concerns at our operations in Maryland and Tennessee which do not represent trends we expect to continue in the future. As a percentage of revenue, SG&A increased from 14.0% in 2012 to 14.3% in 2013, primarily due to the factors discussed above.

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

	Year Ended December 31,	
	2013	2012
	(in thousands)	
SG&A	\$ 194,214	\$ 185,809
Less: Amortization expense	(6,992)	(7,461)
SG&A, excluding amortization expense	<u>\$ 187,222</u>	<u>\$ 178,348</u>

Interest Expense—Interest expense decreased \$0.2 million, or 15.3%, in 2013. The decrease is due to the decrease in notes to former owners and borrowings on the revolving credit facility.

Changes in the Fair Value of Contingent Earn-out Obligations—The contingent earn-out obligations are measured at fair value each reporting period and changes in estimates of fair value are recognized

in earnings. Income from changes in the fair value of contingent earn-out obligations increased \$1.0 million in 2013 to \$1.6 million. The primary reason for the increase is a reduction of estimated future cash flows during 2013 related to the 2010 acquisition of ColonialWebb and the 2011 acquisition of EAS. At the time that we valued our contingent obligations for these acquisitions we did not anticipate the duration of weak market conditions and as a result the initial value of the earnout payments was higher than what we currently expect to incur. Based on updated measurements in 2013, this change in estimate resulted in a \$1.6 million writedown of the fair value of the liability. In 2012, we incurred a smaller writedown of \$0.6 million related to ColonialWebb based on updated measurements at that time.

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

Our effective tax rate for 2013 was 38.8%, as compared to 46.6% in 2012. The effective rate for 2013 is higher than the federal statutory rate of 35.0% primarily due to state income taxes (4.1%), the effect of non-deductible expenses (1.3%) and an increase in the valuation allowance primarily associated with our operations in Puerto Rico (3.1%). These increases were partially offset by the impact of the noncontrolling interest of EAS which for tax purposes is treated as a partnership (1.0%), the effect of the production activity deduction (1.1%) and the effect of purchase accounting adjustments (1.0%). The effective rate for 2012 is higher than the federal statutory rate of 35.0% primarily due to state income taxes (4.7%), the impact of the noncontrolling interest of EAS which for tax purposes is treated as a partnership (2.6%), the effect of non-deductible expenses (2.2%) and an increase in the valuation allowance primarily associated with our operations in Puerto Rico (2.1%). Refer to Note 10 to the Consolidated Financial Statements for a reconciliation of the federal statutory income tax rate to the effective tax rate reflected in our financial statements. The decrease in the effective tax rate from 2012 to 2013 is primarily due to less impact on the rate from valuation allowance, contingency reserves, non-deductible expenses and from noncontrolling interests switching from an increase to a decrease in the effective rate. We currently estimate our effective tax rate for 2014 will be between 35% and 45%.

Discontinued Operations—During the fourth quarter of 2012, we substantially completed the shutdown of our operation located in Delaware. The after tax loss of \$0.1 million for the year ended December 31, 2013 and the after tax income of \$0.1 million for the year ended December 31, 2012 have been recorded in discontinued operations under "Operating income (loss), net of tax expense (benefit)."

In addition, we recorded after tax income of \$0.3 million in 2012 associated with the reduction of estimated liabilities associated with the sale and shutdown of previous discontinued operations. This amount is reflected in 2012 discontinued operations under "Operating income (loss), net of tax expense (benefit)" in addition to those mentioned above.

Net Income (Loss) Attributable to Noncontrolling Interests—Net income (loss) attributable to noncontrolling interests increased \$2.9 million in 2013 to income of \$1.3 million as compared to a loss in 2012. This increase reflects the impact of higher earnings at EAS, our non-wholly owned consolidated subsidiary, which was due primarily to higher revenues and better absorption of overhead costs in the current year.

2012 Compared to 2011

We had 38 operating locations as of December 31, 2011. We discontinued operations at one company during 2012. As of December 31, 2012, we had 37 operating locations. Acquisitions are included in our results of operations from the respective acquisition date. The same-store comparison from 2012 to 2011, as described below, excludes the first ten months of 2012 for EAS, which was acquired during November 2011. An operating location is included in the same-store comparison on the first day it has comparable prior year operating data. An operating location is excluded from the same-store comparison in the current year and comparable prior years when it is properly characterized as a discontinued operation under applicable accounting standards.

Revenue—Revenue increased \$114.5 million, or 9.4% to \$1,331.2 million in 2012 compared to 2011. The increase included a 3.4% increase in revenue related to same-store activity and a 6.0% increase from acquisitions. The same-store revenue increase stemmed primarily from increased activity in the nonresidential markets throughout the United States especially in the manufacturing sector (approximately \$79.2 million) as a result of a large, short duration data center project at our large operation headquartered in Virginia that was substantially completed in the first half of 2012. This increase was partially offset due to decreased revenue in the healthcare sector (approximately \$53.4 million).

Backlog reflects revenue still to be recognized under contracted or committed installation and replacement project work. Project work generally lasts less than one year. Service agreement revenue and service work and short duration projects which are generally billed as performed do not flow through backlog. Accordingly, backlog represents only a portion of our revenue for any given future period, and it represents revenue that is likely to be reflected in our operating results over the next six to twelve months. As a result, we believe the predictive value of backlog information is limited to indications of general revenue direction over the near term, and should not be interpreted as indicative of ongoing revenue performance over several quarters.

Backlog as of December 31, 2012 was \$618.0 million, a 0.8% decrease from September 30, 2012 backlog of \$622.8 million and a 1.8% decrease from December 31, 2011 backlog of \$629.5 million. The sequential backlog decreased primarily related to our Tennessee operation. The year over year backlog decrease was primarily due to the large, short duration data center project at ColonialWebb as previously discussed.

Gross Profit—Gross profit increased \$26.1 million, or 14.4%, to \$207.6 million in 2012 as compared to 2011. As a percentage of revenue, gross profit increased from 14.9% in 2011 to 15.6% in 2012. The increase included a \$22.6 million, or 12.5%, increase in gross profit on a same-store basis and a \$3.5 million, or 1.9%, increase related to the acquisition of EAS. The same-store increase in gross profit resulted primarily from improved profitability at our New York and Virginia operations in 2012 (approximately \$3.9 million and \$8.6 million, respectively) and job underperformance at our Southern Alabama operations in 2011 (approximately \$4.8 million). This was partially offset by a job write-down that we recorded in the first quarter of 2012 on a project that had been accelerated by the owner. The additional costs associated with this acceleration exceeded \$3 million and as of year-end we were pursuing a claim for compensation for such costs. Following year-end, the Company entered into an agreement with the general contractor regarding the claim and reached an agreement in principal as to the bulk of remaining open issues with its subcontractors. As a result of these matters, we received \$1.6 million of incremental gross profit during the first quarter of 2013.

Selling, General and Administrative Expenses ("SG&A")—SG&A increased \$18.8 million, or 11.2%, to \$185.8 million for 2012 as compared to 2011. On a same-store basis, excluding amortization expense, SG&A increased \$13.5 million, or 8.4%. This increase is primarily due to higher medical costs (\$2.5 million) that were due to an increased frequency of large dollar claims and higher compensation

accruals (\$3.4 million) related to an increase in bonuses and commissions payable as a result of improved operating results. Additionally, an increase in bad debt expense (\$2.5 million) was primarily due to specific collectability concerns at our operations in Maryland and Tennessee which do not represent trends we expect to continue in the future. Amortization expense increased \$1.2 million, or 18.6%, primarily related to the EAS acquisition in 2011. As a percentage of revenue, SG&A increased from 13.7% in 2011 to 14.0% in 2012, primarily due to the factors discussed above.

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

	Year Ended December 31,	
	2012	2011
	(In thousands)	
SG&A	\$ 185,809	\$ 167,053
Less: SG&A from companies acquired	(4,050)	—
Less: Amortization expense	(7,461)	(6,293)
Same-store SG&A, excluding amortization expense	<u>\$ 174,298</u>	<u>\$ 160,760</u>

Interest Expense—Interest expense decreased \$0.3 million, or 15.4%, in 2012. The decrease is due to the decrease in notes to former owners.

Changes in the Fair Value of Contingent Earn-out Obligations—The contingent earn-out obligations are measured at fair value each reporting period and changes in estimates of fair value are recognized in earnings. Income from changes in the fair value of contingent earn-out obligations decreased \$4.9 million in 2012 to \$0.7 million. The primary reason for the decrease is a reduction of estimated future cash flows during 2011 related to the 2010 acquisition of ColonialWebb. At the time that we valued our contingent obligation at ColonialWebb we did not anticipate the duration of weak market conditions and as a result the initial value of the earnout payments was higher than what we expected to incur. This change in estimate resulted in a \$5.2 million writedown of the fair value of the liability. In 2012, we incurred an additional writedown of \$0.6 million related to ColonialWebb based on updated measurements.

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

Our effective tax rate for 2012 was 46.6%, as compared to 14.4% in 2011. The effective rate for 2012 is higher than the federal statutory rate of 35.0% primarily due to state income taxes (4.7%), the impact of the noncontrolling interest of EAS which for tax purposes is treated as a partnership (2.6%), the effect of non-deductible expenses (2.2%) and an increase in the valuation allowance primarily associated with our operations in Puerto Rico (2.1%). The effective rate for 2011 associated with our pre-tax loss in that year is lower than the federal statutory rate of 35.0%. This rate is lower primarily due to the non-cash goodwill impairment charge of \$57.4 million of which \$26.4 million was not deductible for income tax purposes resulting in a significant impact on the effective tax rate (24.3%), as well as an increase in the valuation allowance (9.0%) related to deferred tax assets for state net

operating loss carryforwards and other state deferred tax assets primarily in Virginia and Maryland. These amounts were partially offset by permanent differences generated by acquisition related fair value adjustments (7.9%) and state income tax benefits (5.2%). Refer to Note 10 to the Consolidated Financial Statements for a reconciliation of the federal statutory income tax rate to the effective tax rate reflected in our financial statements. The increase in the effective tax rate from 2011 to 2012 is primarily due to the impact of the non-cash goodwill charge discussed above.

Discontinued Operations—During the fourth quarter of 2012, we substantially completed the shutdown of our operation located in Delaware which we decided to curtail operating in the fourth quarter of 2011. During 2011, we impaired the intangible assets of \$1.6 million associated with this operation as a result of this decision. The after tax income of \$0.1 million for the year ended December 31, 2012 and the after tax loss of \$4.0 million for the year ended December 31, 2011 have been recorded in discontinued operations under "Operating income (loss), net of tax expense (benefit)."

In addition, we recorded after tax income of \$0.3 million in 2012 associated with the reduction of estimated liabilities associated with the sale and shutdown of previous discontinued operations. These amounts are reflected in discontinued operations under "Operating income (loss), net of tax expense (benefit)" in addition to those mentioned above.

Net Income (Loss) Attributable to Noncontrolling Interests—Net income (loss) attributable to noncontrolling interests decreased \$2.0 million in 2012 to a loss of \$1.6 million. This decrease reflects the impact of lower earnings at EAS, our non-wholly owned consolidated subsidiary, which was negatively impacted by job delays and underperformance.

Outlook

Weakness in the environment for nonresidential construction activity persisted in 2013, as nonresidential construction activity remained at subdued levels similar to recent years. We expect underlying weakness to continue to impact revenues during 2014. Our backlog remains at generally lower levels than we have experienced in the past, although it is still at solid levels in light of ongoing industry conditions. Our primary emphasis for 2014 will remain on execution, including a focus on cost discipline and efficient project and service performance. Based on our backlog, and in light of economic conditions for our industry, we expect that revenues will continue at the levels that we have experienced in recent years, and that 2014 profitability will be comparable to the improved levels of 2013.

Liquidity and Capital Resources

	Year Ended December 31,		
	2013	2012	2011
	(in thousands)		
Cash provided by (used in):			
Operating activities	\$ 38,423	\$ 30,510	\$ 29,680
Investing activities	(16,253)	(23,168)	(35,750)
Financing activities	(10,873)	(17,822)	(29,039)
Net increase (decrease) in cash and cash equivalents	<u>\$ 11,297</u>	<u>\$ (10,480)</u>	<u>\$ (35,109)</u>
Free cash flow:			
Cash provided by operating activities	\$ 38,423	\$ 30,510	\$ 29,680
Purchases of property and equipment	(17,403)	(11,782)	(8,666)
Proceeds from sales of property and equipment	1,107	1,106	717
Free cash flow	<u>\$ 22,127</u>	<u>\$ 19,834</u>	<u>\$ 21,731</u>

Cash Flow

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

2013 Compared to 2012

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

We generated \$38.4 million of cash flow from operating activities during 2013 compared with \$30.5 million during 2012. The \$7.9 million increase is primarily due to higher net income in 2013 of \$16.7 million and by an increase in accounts payable and accrued liabilities of \$22.3 million which relates to the timing of vendor payments and increased bonus accruals based on improved operating results. This increase was partially offset by increased receivable balances of \$15.3 million due to the timing of customer billings and payments and a decrease in billings in excess of costs of \$11.0 million due to the timing of project billings.

Cash Used in Investing Activities—During 2013, cash used in investing activities was \$16.3 million compared with \$23.2 million during 2012. The \$6.9 million decrease in cash used primarily relates to cash paid for acquisitions in 2012 (\$12.7 million) which was partially offset by a \$5.6 million increase in capital expenditures in the current year primarily related to transportation equipment.

Cash Used in Financing Activities—Cash used in financing activities was \$10.9 million for 2013 compared to \$17.8 million during 2012. We repurchased approximately 0.1 million shares in 2013 for \$1.8 million as compared to 0.3 million shares in 2012 for \$2.9 million. Additionally, we paid \$5.4 million of debt related to acquisitions in 2013 as compared to \$7.3 million in 2012. In addition, proceeds from the exercise of options provided an increase in cash flow of \$4.9 million in 2013 compared to \$0.3 million in 2012. This increase was due to higher options exercised in 2013 due to a favorable stock price.

2012 Compared to 2011

Cash Provided by Operating Activities—We generated \$30.5 million of cash flow from operating activities during 2012 compared with \$29.7 million during 2011. The \$0.8 million increase is primarily due to higher profitability in 2012.

Cash Used in Investing Activities—During 2012, cash used for investing activities was \$23.2 million compared with \$35.8 million during 2011. The most significant item affecting the comparison of our investing cash flows for these years primarily related to \$12.7 million paid for acquisitions in 2012 as compared to \$30.0 million in 2011.

Cash Used in Financing Activities—Cash used for financing activities was \$17.8 million for 2012 compared to \$29.0 million during 2011. The most significant item affecting the comparison of our financing cash flows for these years primarily relates to our share repurchase program and payments on other long-term debt. We repurchased approximately 0.3 million shares in 2012 for \$2.9 million as compared to 0.7 million shares in 2011 for \$7.3 million. Additionally, we paid \$7.3 million of debt related to acquisitions in 2012 as compared to \$14.4 million in 2011.

Free Cash Flow

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

Share Repurchase Program

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from time to time approved extensions of the program to acquire additional shares. Since the inception of the repurchase program, the Board has approved 6.6 million shares to be repurchased.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and

subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. We repurchased 0.1 million shares for approximately \$1.8 million for the year ended December 31, 2013 at an average price of \$14.59 per share. We repurchased 0.3 million shares for approximately \$2.9 million and 0.7 million shares for approximately \$7.3 million under our share repurchase program for the years ended December 31, 2012 and 2011, respectively. Since the inception of the program in 2007 and as of December 31, 2013, we have repurchased a cumulative total of 6.0 million shares at an average price of \$11.00 per share.

Debt

Credit Facility

On June 25, 2013, we amended our senior credit facility (the "Facility") provided by a syndicate of banks increasing our borrowing capacity from \$125.0 million to \$175.0 million. The Facility, which is available for borrowings and letters of credit, expires in July 2018 and is secured by a first lien on substantially all of the Company's personal property except for assets related to projects subject to surety bonds and assets held by certain unrestricted subsidiaries and a second lien on the Company's assets related to projects subject to surety bonds. We incurred approximately \$0.6 million in financing and professional costs in connection with the amendment to the Facility, which combined with the previous unamortized costs of \$0.7 million, will be amortized on a straight-line basis as a non-cash charge to interest expense over the remaining term of the Facility. As of December 31, 2013, we had no outstanding borrowings, \$48.1 million in letters of credit outstanding and \$126.9 million of credit available.

There are two interest rate options for borrowings under the Facility, the Base Rate Loan option and the Eurodollar Rate Loan option. These rates are floating rates determined by the broad financial markets, meaning they can and do move up and down from time to time. Additional margins are then added to these two rates. We estimate that the interest rate applicable to the borrowings under the Facility would be approximately 1.6% as of December 31, 2013.

Certain of our vendors require letters of credit to ensure reimbursement for amounts they are disbursing on our behalf, such as to beneficiaries under our self-funded insurance programs. We have also occasionally used letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. Our lenders issue such letters of credit through the Facility for a fee. We have never had a claim made against a letter of credit that resulted in payments by a lender or by us and believe such claims are unlikely in the foreseeable future. The letter of credit fees range from 1.25% to 2.00% per annum, based on the ratio of Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA, as defined in the credit agreement.

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

Interest expense included the following primary elements (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Interest expense on notes to former owners	\$ 97	\$ 255	\$ 795
Interest expense on borrowings and unused commitment fees	279	444	243
Letter of credit fees	731	667	622
Amortization of deferred debt arrangement costs	244	229	226
Total	\$ 1,351	\$ 1,595	\$ 1,886

The Facility contains financial covenants defining various measures and the levels of these measures with which we must comply. Covenant compliance is assessed as of each quarter end. Credit Facility Adjusted 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; (d) other non-cash charges; and (e) pre-acquisition results of acquired companies. The following is a reconciliation of Credit Facility Adjusted EBITDA to net income (in thousands):

Net income including noncontrolling interests	\$ 28,556
Income taxes—continuing operations	18,148
Interest expense, net	1,328
Depreciation and amortization expense	18,572
Stock compensation expense	3,974
Income taxes—discontinued operations	(119)
EBITDA attributable to noncontrolling interest	(2,342)
Pre-acquisition results of acquired companies, as defined under the Facility	—
Credit Facility Adjusted EBITDA	\$ 68,117

The Facility's principal financial covenants include:

Leverage Ratio— The Facility requires that the ratio of our Consolidated Total Indebtedness to our Credit Facility Adjusted EBITDA not exceed 3.00 through December 31, 2014, 2.75 through December 31, 2015 and 2.50 through maturity. The leverage ratio as of December 31, 2013 was 0.03.

Fixed Charge Coverage Ratio— The Facility requires that the ratio of Credit Facility Adjusted EBITDA, less non-financed capital expenditures, tax provision, dividends and amounts used to repurchase stock to the sum of interest expense and scheduled principal payments of indebtedness be at least 2.00; provided that the calculation of the fixed charge coverage ratio excludes stock repurchases and the payment of dividends at any time that the Company's Net Leverage Ratio does not exceed 1.50. The Facility also allows the fixed charge coverage ratio not to be reduced for stock repurchases through June 30, 2015 in an aggregate amount not to exceed \$25 million if at the time of and after giving effect to such repurchase the Company's Net Leverage Ratio was less than or equal to 1.50. Capital expenditures, tax provision, dividends and stock repurchase payments are defined under the Facility for purposes of this covenant to be amounts for the four quarters ending as of any given quarterly covenant compliance measurement date. The fixed charge coverage ratio as of December 31, 2013 was 10.88.

Other Restrictions— The Facility permits acquisitions of up to \$20.0 million per transaction, provided that the aggregate purchase price of such an acquisition and of acquisitions in the same

fiscal year does not exceed \$50.0 million. However, these limitations only apply when the Company's Net Leverage Ratio is equal to or greater than 2.00.

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

We are in compliance with all of our financial covenants as of December 31, 2013.

Notes to Former Owners

We issued subordinated notes to the former owners of acquired companies as part of the consideration used to acquire these companies. These notes had an outstanding balance of \$2.0 million as of December 31, 2013 and bear interest, payable annually, at a weighted average interest rate of 3.3%. The maturity date of the outstanding balance is July 2014.

Other Debt

In conjunction with our acquisition of ColonialWebb in 2010, we acquired long-term debt related to an industrial revenue bond associated with its office building and warehouse. In July 2013, we paid the outstanding balance of \$2.4 million. The weighted average interest rate on this variable rate debt as of the last day outstanding was approximately 0.21%.

In addition, our majority owned subsidiary, EAS, has a revolving \$2.5 million credit line that is available for temporary working capital needs and expires June 30, 2014. As of December 31, 2013, we had no outstanding borrowings and, therefore, \$2.5 million of credit available. We estimate that the weighted average interest rate applicable to borrowings under this variable rate credit line would be approximately 2.7% as of December 31, 2013.

Outlook

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

Off-Balance Sheet Arrangements and Other Commitments

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

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

Certain of our vendors require letters of credit to ensure reimbursement for amounts they are disbursing on our behalf, such as to beneficiaries under our self-funded insurance programs. We have also occasionally used letters of credit to guarantee performance under our contracts and to ensure

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

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

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

Contractual Obligations

The following recaps the future maturities of our contractual obligations as of December 31, 2013 (in thousands):

	Twelve Months Ended December 31,					Thereafter	Total
	2014	2015	2016	2017	2018		
Notes to former owners	\$ 2,000	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 2,000
Interest payable	54	—	—	—	—	—	54
Operating lease obligations	10,453	9,341	7,844	7,139	6,040	8,422	49,239
Total	<u>\$ 12,507</u>	<u>\$ 9,341</u>	<u>\$ 7,844</u>	<u>\$ 7,139</u>	<u>\$ 6,040</u>	<u>\$ 8,422</u>	<u>\$ 51,293</u>

As discussed in Note 10 "Income Taxes", included in our Consolidated Balance Sheet at December 31, 2013 is approximately \$0.4 million of liabilities associated with uncertain tax positions. Due to the uncertain and complex application of tax regulations, combined with the difficulty in

predicting when tax audits may be concluded, we cannot make reliable estimates of the timing of cash outflows relating to these liabilities.

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

As of December 31, 2013, we also have \$48.1 million in letter of credit commitments, of which \$31.9 million will expire in 2014 and \$16.2 million will expire in 2015. The substantial majority of these letters of credit are posted with insurers who disburse funds on our behalf in connection with our workers' compensation, auto liability and general liability insurance program. These letters of credit provide additional security to the insurers that sufficient financial resources will be available to fund claims on our behalf, many of which develop over long periods of time, should we ever encounter financial duress. Posting of letters of credit for this purpose is a common practice for entities that manage their self-insurance programs through third-party insurers as we do. While the majority of these letter of credit commitments expire in 2014, we expect nearly all of them, particularly those supporting our insurance programs, will be renewed annually.

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

ITEM 7A. *Quantitative and Qualitative Disclosures about Market Risk*

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

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

The following table presents principal amounts (stated in thousands) and related average interest rates by year of maturity for our debt obligations and their indicated fair market value at December 31, 2013:

	Twelve Months Ended					Thereafter	Total
	December 31,						
	2014	2015	2016	2017	2018		
Fixed Rate Debt	\$ 2,000	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 2,000
Average Interest Rate	3.3%	—	—	—	—	—	3.3%

We estimate that the weighted average interest rate applicable to the borrowings under the Facility would be approximately 1.6% as of December 31, 2013.

We measure certain assets at fair value on a nonrecurring basis. These assets are recognized at fair value when they are deemed to be other-than-temporarily impaired. During the year ended December 31, 2013, no goodwill or other intangible asset impairments were recorded. We did not recognize any other impairments on those assets required to be measured at fair value on a nonrecurring basis.

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

ITEM 8. *Financial Statements and Supplementary Data*

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Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2013 based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2013.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included elsewhere herein, has issued an attestation report auditing the effectiveness of our internal control over financial reporting as of December 31, 2013.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders of Comfort Systems USA, Inc.

We have audited the accompanying consolidated balance sheets of Comfort Systems USA, Inc. as of December 31, 2013 and 2012, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Comfort Systems USA, Inc. at December 31, 2013 and 2012, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Comfort Systems USA, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated February 27, 2014 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Houston, Texas
February 27, 2014

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Comfort Systems USA, Inc.

We have audited Comfort Systems USA, Inc.'s internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework)* (the COSO criteria). Comfort Systems USA, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Comfort Systems USA, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Comfort Systems USA, Inc. as of December 31, 2013 and 2012, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2013 of Comfort Systems USA, Inc. and our report dated February 27, 2014 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Houston, Texas
February 27, 2014

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

	December 31,	
	2013	2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 52,054	\$ 40,757
Accounts receivable, less allowance for doubtful accounts of \$4,460 and \$6,333, respectively	267,470	256,959
Other receivables	16,373	12,376
Inventories	8,430	9,638
Prepaid expenses and other	24,209	25,037
Costs and estimated earnings in excess of billings	28,122	26,204
Assets related to discontinued operations	339	1,582
Total current assets	<u>396,997</u>	<u>372,553</u>
PROPERTY AND EQUIPMENT, NET	46,861	41,416
GOODWILL	114,588	114,588
IDENTIFIABLE INTANGIBLE ASSETS, NET	37,383	44,515
OTHER NONCURRENT ASSETS	5,993	7,682
Total assets	<u>\$ 601,822</u>	<u>\$ 580,754</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ —	\$ 300
Current maturities of notes to former owners	2,000	—
Accounts payable	100,825	100,641
Accrued compensation and benefits	44,093	36,892
Billings in excess of costs and estimated earnings	64,588	73,814
Accrued self-insurance expense	29,398	29,096
Other current liabilities	28,168	27,077
Liabilities related to discontinued operations	366	767
Total current liabilities	<u>269,438</u>	<u>268,587</u>
LONG-TERM DEBT, NET OF CURRENT MATURITIES	—	2,100
NOTES TO FORMER OWNERS, NET OF CURRENT MATURITIES	—	5,000
DEFERRED INCOME TAX LIABILITIES	9,941	7,954
OTHER LONG-TERM LIABILITIES	8,421	9,807
Total liabilities	<u>287,800</u>	<u>293,448</u>
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$.01 par, 5,000,000 shares authorized, none issued and outstanding	—	—
Common stock, \$.01 par, 102,969,912 shares authorized, 41,123,365 and 41,123,365 shares issued, respectively	411	411
Treasury stock, at cost, 3,488,438 and 3,879,299 shares, respectively	(37,468)	(41,012)
Additional paid-in capital	318,123	317,534
Retained earnings (deficit)	14,768	(6,528)
Comfort Systems USA, Inc. stockholders' equity	<u>295,834</u>	<u>270,405</u>
Noncontrolling interests	18,188	16,901
Total stockholders' equity	<u>314,022</u>	<u>287,306</u>
Total liabilities and stockholders' equity	<u>\$ 601,822</u>	<u>\$ 580,754</u>

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

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands, Except Per Share Data)

	Year Ended December 31,		
	2013	2012	2011
REVENUE	\$ 1,357,272	\$ 1,331,185	\$ 1,216,654
COST OF SERVICES	1,117,389	1,123,564	1,035,124
Gross profit	239,883	207,621	181,530
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	194,214	185,809	167,053
GOODWILL IMPAIRMENT	—	—	57,354
GAIN ON SALE OF ASSETS	(589)	(491)	(236)
Operating income (loss)	46,258	22,303	(42,641)
OTHER INCOME (EXPENSE):			
Interest income	23	24	128
Interest expense	(1,351)	(1,595)	(1,886)
Changes in the fair value of contingent earn-out obligations	1,646	662	5,528
Other	204	145	934
Other income (expense)	522	(764)	4,704
INCOME (LOSS) BEFORE INCOME TAXES	46,780	21,539	(37,937)
INCOME TAX EXPENSE (BENEFIT)	18,148	10,045	(5,463)
INCOME (LOSS) FROM CONTINUING OPERATIONS	28,632	11,494	(32,474)
Income (loss) from discontinued operations, net of income tax expense (benefit) of \$(119), \$212 and \$(2,709)	(76)	355	(4,018)
NET INCOME (LOSS) INCLUDING NONCONTROLLING INTERESTS	28,556	11,849	(36,492)
Less: Net income (loss) attributable to noncontrolling interests	1,287	(1,614)	338
NET INCOME (LOSS) ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC	\$ 27,269	\$ 13,463	\$ (36,830)
INCOME (LOSS) PER SHARE ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC.:			
Basic—			
Income (loss) from continuing operations	\$ 0.73	\$ 0.35	\$ (0.88)
Income (loss) from discontinued operations	—	0.01	(0.11)
Net income (loss)	\$ 0.73	\$ 0.36	\$ (0.99)
Diluted—			
Income (loss) from continuing operations	\$ 0.73	\$ 0.35	\$ (0.88)
Income (loss) from discontinued operations	—	0.01	(0.11)
Net income (loss)	\$ 0.73	\$ 0.36	\$ (0.99)
SHARES USED IN COMPUTING INCOME (LOSS) PER SHARE:			
Basic	37,245	37,112	37,389
Diluted	37,536	37,259	37,389
DIVIDENDS PER SHARE	\$ 0.210	\$ 0.200	\$ 0.200

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

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In Thousands, Except Share Amounts)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings (Deficit)	Non- Controlling Interests	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
BALANCE AT DECEMBER 31, 2010	41,123,365	\$ 411	(3,221,775)	\$ (34,714)	\$ 326,467	\$ 20,620	—	\$ 312,784
Net income (loss)	—	—	—	—	—	(36,830)	338	(36,492)
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit	—	—	65,950	707	(258)	—	—	449
Issuance of restricted stock	—	—	230,702	2,488	(2,488)	—	—	—
Shares received in lieu of tax withholding payment on vested restricted stock	—	—	(50,793)	(662)	—	—	—	(662)
Tax benefit from vesting of restricted stock	—	—	—	—	54	—	—	54
Stock-based compensation expense	—	—	—	—	3,604	—	—	3,604
Dividends	—	—	—	—	(3,771)	(3,781)	—	(7,552)
Share repurchase	—	—	(738,590)	(7,256)	—	—	—	(7,256)
Acquisition of EAS	—	—	—	—	—	—	17,377	17,377
Contribution from noncontrolling interest	—	—	—	—	—	—	800	800
BALANCE AT DECEMBER 31, 2011	41,123,365	411	(3,714,506)	(39,437)	323,608	(19,991)	18,515	283,106
Net income (loss)	—	—	—	—	—	13,463	(1,614)	11,849
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit	—	—	102,750	1,087	(714)	—	—	373
Issuance of restricted stock	—	—	70,000	742	(742)	—	—	—
Shares received in lieu of tax withholding payment on vested restricted stock	—	—	(51,507)	(544)	—	—	—	(544)
Tax benefit from vesting of restricted stock	—	—	—	—	56	—	—	56
Stock-based compensation expense	—	—	—	—	2,797	—	—	2,797
Dividends	—	—	—	—	(7,471)	—	—	(7,471)
Share repurchase	—	—	(286,036)	(2,860)	—	—	—	(2,860)
BALANCE AT DECEMBER 31, 2012	41,123,365	411	(3,879,299)	(41,012)	317,534	(6,528)	16,901	287,306
Net income (loss)	—	—	—	—	—	27,269	1,287	28,556
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit	—	—	439,762	4,711	522	—	—	5,233
Issuance of restricted stock	—	—	122,375	1,301	(1,301)	—	—	—
Shares received in lieu of tax withholding payment on vested restricted stock	—	—	(45,266)	(631)	—	—	—	(631)
Tax benefit from vesting of restricted stock	—	—	—	—	184	—	—	184
Forfeiture of unvested restricted stock	—	—	(469)	(5)	5	—	—	—
Stock-based compensation expense	—	—	—	—	3,041	—	—	3,041
Dividends	—	—	—	—	(1,862)	(5,973)	—	(7,835)
Share repurchase	—	—	(125,541)	(1,832)	—	—	—	(1,832)
BALANCE AT DECEMBER 31, 2013	41,123,365	\$ 411	(3,488,438)	\$ (37,468)	\$ 318,123	\$ 14,768	\$ 18,188	\$ 314,022

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

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

	Year Ended December 31,		
	2013	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss) including noncontrolling interests	\$ 28,556	\$ 11,849	\$ (36,492)
Adjustments to reconcile net income (loss) to net cash provided by operating activities—			
Amortization of identifiable intangible assets	7,132	8,837	7,462
Depreciation expense	11,440	11,793	12,591
Goodwill and other intangible asset impairments	—	—	58,922
Bad debt expense	19	2,453	936
Deferred tax expense (benefit)	4,514	3,541	(9,525)
Amortization of debt financing costs	245	229	226
Gain on sale of assets	(589)	(607)	(239)
Changes in the fair value of contingent earn-out obligations	(1,646)	(662)	(5,528)
Stock-based compensation expense	3,974	2,797	3,604
Changes in operating assets and liabilities, net of effects of acquisitions and divestitures—			
(Increase) decrease in—			
Receivables, net	(12,427)	2,913	10,390
Inventories	1,208	1,195	(270)
Prepaid expenses and other current assets	(109)	370	977
Costs and estimated earnings in excess of billings	(1,918)	1,636	4,162
Other noncurrent assets	(491)	(3,334)	917
Increase (decrease) in—			
Accounts payable and accrued liabilities	6,776	(15,507)	(21,477)
Billings in excess of costs and estimated earnings	(9,226)	1,776	5,426
Other long-term liabilities	965	1,231	(2,402)
Net cash provided by operating activities	<u>38,423</u>	<u>30,510</u>	<u>29,680</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(17,403)	(11,782)	(8,666)
Proceeds from sales of property and equipment	1,107	1,106	717
Proceeds from businesses sold	43	164	156
Sales of marketable securities	—	—	2,000
Cash paid for acquisitions, earn-outs and intangible assets, net of cash acquired	—	(12,656)	(29,957)
Net cash used in investing activities	<u>(16,253)</u>	<u>(23,168)</u>	<u>(35,750)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net borrowings on revolving line of credit	—	—	—
Payments on other long-term debt	(5,400)	(7,349)	(14,387)
Debt financing costs	(552)	—	(517)
Payments of dividends to shareholders	(7,875)	(7,498)	(7,520)
Share repurchase program	(1,832)	(2,860)	(7,256)
Shares received in lieu of tax withholding	(631)	(544)	(662)
Excess tax benefit of stock-based compensation	534	100	210
Proceeds from exercise of options	4,883	329	293
Capital contribution from noncontrolling interests	—	—	800
Net cash used in financing activities	<u>(10,873)</u>	<u>(17,822)</u>	<u>(29,039)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>11,297</u>	<u>(10,480)</u>	<u>(35,109)</u>
CASH AND CASH EQUIVALENTS, beginning of year—continuing operations and discontinued operations	40,757	51,237	86,346
CASH AND CASH EQUIVALENTS, end of year—continuing operations and discontinued operations	<u>\$ 52,054</u>	<u>\$ 40,757</u>	<u>\$ 51,237</u>

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

COMFORT SYSTEMS USA, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****December 31, 2013****1. Business and Organization**

Comfort Systems USA, Inc., a Delaware corporation, provides comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services within the mechanical services industry. We operate primarily in the commercial, industrial and institutional HVAC markets and perform most of our services within office buildings, retail centers, apartment complexes, manufacturing plants and healthcare, education and government facilities. In addition to standard HVAC services, we provide specialized applications such as building automation control systems, fire protection, process cooling, electronic monitoring and process piping. Certain locations also perform related activities such as electrical service and plumbing. Approximately 42% of our consolidated 2013 revenue is attributable to installation of systems in newly constructed facilities, with the remaining 58% attributable to maintenance, repair and replacement services. The following activities account for our consolidated 2013 revenue: HVAC 75%, plumbing 15%, building automation control systems 6% and other 4%. These activities are within the mechanical services industry which is the single industry segment we serve.

2. Summary of Significant Accounting Policies***Principles of Consolidation***

These financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The accompanying consolidated financial statements include our accounts and those of our subsidiaries in which we have a controlling interest. All significant intercompany accounts and transactions have been eliminated.

Reclassifications

Certain reclassifications have been made in prior period financial statements to conform to current period presentation. These reclassifications are either of a normal and recurring nature or are due to discontinued operations accounting related to the shutdown of our Delaware operation in 2012. Neither have resulted in any changes to previously reported net income for any periods.

Accounting Adjustment

The accompanying financial statements for the year ended December 31, 2013 includes the correction of prior period accounting errors which resulted in additional net after-tax income in the period of approximately \$1.3 million. We determined that the errors primarily impacted years prior to 2010. These corrections are reflected on a pretax basis in revenue, cost of sales and selling, general, and administrative expenses, which include \$3.3 million, \$0.8 million and \$0.3 million, respectively.

We have considered the guidance found in ASC 250-10 and ASC 270-10 (SEC Staff Accounting Bulletin No. 99, Materiality, Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements), in evaluating whether a restatement of prior financial statements is required as a result of the misstatement to such financial statements. ASC 250 requires that corrections of errors be recorded by restatement of prior periods if the error is material. We quantitatively and qualitatively assessed the materiality of the errors and concluded that the errors were not material to our earnings for the year ended December 31, 2013, and any of our previously issued financial statements.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

2. Summary of Significant Accounting Policies (Continued)

Use of Estimates

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

Cash Flow Information

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

Cash paid (in thousands) for:

	Year Ended December 31,		
	2013	2012	2011
Interest	\$ 799	\$ 1,326	\$ 1,720
Income taxes for continuing operations	15,821	13,948	1,613
Income taxes for discontinued operations	—	5	8
Total	<u>\$ 16,620</u>	<u>\$ 15,279</u>	<u>\$ 3,341</u>

Revenue Recognition

Approximately 83% of our revenue was earned on a project basis and recognized through the percentage of completion method of accounting. Under this method, contract revenue recognizable at any time during the life of a contract is determined by multiplying expected total contract revenue by the percentage of contract costs incurred at any time to total estimated contract costs. More specifically, as part of the negotiation and bidding process in connection with obtaining installation contracts, we estimate our contract costs, which include all direct materials (exclusive of rebates), labor and subcontract costs and indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. These contract costs are included in our results of operations under the caption "Cost of Services." Then, as we perform under those contracts, we measure costs incurred, compare them to total estimated costs to complete the contract and recognize a corresponding proportion of contract revenue. Labor costs are considered to be incurred as the work is performed. Subcontractor labor is recognized as the work is performed, but is generally subjected to approval as to milestones or other evidence of completion. Non-labor project costs consist of purchased equipment, prefabricated materials and other materials. Purchased equipment on our projects is substantially produced to job specifications and is a value added element to our work. The costs are considered to be incurred when title is transferred to us, which typically is upon delivery to the work site. Prefabricated materials, such as ductwork and piping, are generally performed at our shops and recognized as contract costs when fabricated for the unique specifications of the job. Other materials

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

2. Summary of Significant Accounting Policies (Continued)

costs are not significant and are generally recorded when delivered to the work site. This measurement and comparison process requires updates to the estimate of total costs to complete the contract, and these updates may include subjective assessments.

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

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

Contracts in progress are as follows (in thousands):

	December 31,	
	2013	2012
Costs incurred on contracts in progress	\$ 989,072	\$ 1,182,085
Estimated earnings, net of losses	126,431	134,534
Less—Billings to date	(1,151,969)	(1,364,229)
	<u>\$ (36,466)</u>	<u>\$ (47,610)</u>
Costs and estimated earnings in excess of billings	\$ 28,122	\$ 26,204
Billings in excess of costs and estimated earnings	(64,588)	(73,814)
	<u>\$ (36,466)</u>	<u>\$ (47,610)</u>

Accounts receivable include amounts billed to customers under retention or retainage provisions in construction contracts. Such provisions are standard in our industry and usually allow for a small portion of progress billings or the contract price to be withheld by the customer until after we have completed work on the project, typically for a period of six months. Based on our experience with similar contracts in recent years, the majority of our billings for such retention balances at each balance sheet date are finalized and collected within the subsequent year. Retention balances at December 31, 2013 and 2012 are \$51.4 million and \$48.0 million, respectively, and are included in accounts receivable.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

2. Summary of Significant Accounting Policies (Continued)

Accounts payable at December 31, 2013 and 2012 included \$10.3 million and \$11.3 million of retainage under terms of contracts with subcontractors, respectively. The majority of the retention balances at each balance sheet date are finalized and paid within the subsequent year.

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

Revisions to project costs and conditions can give rise to change orders under which the customer agrees to pay additional contract price. Revisions can also result in claims we might make against the customer to recover project variances that have not been satisfactorily addressed through change orders with the customer. Except in certain circumstances, we do not recognize revenue or margin based on change orders or claims until they have been agreed upon with the customer. The amount of revenue associated with unapproved change orders and claims is currently immaterial.

Variations from estimated project costs could have a significant impact on our operating results, depending on project size, and the recoverability of the variation via additional customer payments.

Revenue associated with maintenance, repair and monitoring services and related contracts are recognized as services are performed. Amounts associated with unbilled service work orders are reflected as a current asset in our balance sheet under the caption "Costs and estimated earnings in excess of billings" and amounts billed in advance of work orders being performed are reflected as a current liability in our balance sheet under the caption "Billings in excess of costs and estimated earnings."

Accounts Receivable

The carrying value of our receivables, net of the allowance for doubtful accounts, represents the estimated net realizable value. We estimate our allowance for doubtful accounts based upon the creditworthiness of our customers, prior collection history, ongoing relationships with our customers, the aging of past due balances, our lien rights, if any, in the property where we performed the work and the availability, if any, of payment bonds applicable to the contract. The receivables are written off when they are deemed to be uncollectible.

Inventories

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

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

2. Summary of Significant Accounting Policies (Continued)

Property and Equipment

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

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

Recoverability of Goodwill and Identifiable Intangible Assets

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

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

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

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

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

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

2. Summary of Significant Accounting Policies (Continued)

include revenue, book equity plus debt and earnings before interest, taxes, depreciation and amortization ("EBITDA").

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

Long-Lived Assets

Long-lived assets are comprised principally of goodwill, identifiable intangible assets, property and equipment, and deferred income tax assets. We periodically evaluate whether events and circumstances have occurred that indicate that the remaining balances of these assets may not be recoverable. We use estimates of future income from operations and cash flows, as well as other economic and business factors, to assess the recoverability of these assets.

Acquisitions

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

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

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

Self-Insurance Liabilities

We are substantially self-insured for workers' compensation, employer's liability, auto liability, general liability and employee group health claims, in view of the relatively high per-incident deductibles we absorb under our insurance arrangements for these risks. Losses up to deductible amounts are estimated and accrued based upon known facts, historical trends and industry averages. Loss estimates associated with the larger and longer-developing risks—workers' compensation, auto liability and general liability—are reviewed by a third-party actuary quarterly. Our self-insurance arrangements are further discussed in Note 12 "Commitments and Contingencies."

Warranty Costs

We typically warrant labor for the first year after installation on new HVAC systems. We generally warrant labor for thirty days after servicing of existing HVAC systems. A reserve for warranty costs is

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

2. Summary of Significant Accounting Policies (Continued)

estimated and recorded based upon the historical level of warranty claims and management's estimate of future costs.

Income Taxes

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

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

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

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

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

Segment Disclosure

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

Concentrations of Credit Risk

We provide services in a broad range of geographic regions. Our credit risk primarily consists of receivables from a variety of customers including general contractors, property owners and developers and commercial and industrial companies. We are subject to potential credit risk related to changes in business and economic factors throughout the United States within the nonresidential construction industry. However, we are entitled to payment for work performed and have certain lien rights in that work. Further, we believe that our contract acceptance, billing and collection policies are adequate to manage potential credit risk. We regularly review our accounts receivable and estimate an allowance for uncollectible amounts. We have a diverse customer base, with no single customer accounting for more than 3% of consolidated 2013 revenue.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

2. Summary of Significant Accounting Policies (Continued)

Financial Instruments

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

3. Fair Value Measurements

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

- Level 1—quoted prices in active markets for identical assets and liabilities;
- Level 2—observable market based inputs or unobservable inputs that are corroborated by market data; and
- Level 3—significant unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

The following table summarizes the fair values, and levels within the fair value hierarchy in which the fair value measurements fall, for assets and liabilities measured on a recurring basis as of December 31, 2013 (in thousands):

	Balance December 31, 2013	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 52,054	\$ 52,054	\$ —	\$ —
Life insurance—cash surrender value	\$ 2,943	\$ —	\$ 2,943	\$ —
Contingent earn-out obligations	\$ 320	\$ —	\$ —	\$ 320

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

One of our operations has life insurance policies covering 41 employees with a combined face value of \$41.2 million. The policy is invested in mutual funds and the fair value measurement of the cash surrender balance associated with these policies is determined using Level 2 inputs within the fair value hierarchy and will vary with investment performance. The cash surrender value of these policies is \$2.9 million as of December 31, 2013 and \$2.5 million as of December 31, 2012. These assets are included in "Other Noncurrent Assets" in our consolidated balance sheets.

We value contingent earn-out obligations using a probability weighted discounted cash flow method. This fair value measurement is based on significant unobservable inputs in the market and thus represents a Level 3 measurement within the fair value hierarchy. This analysis reflects the contractual terms of the purchase agreements (e.g., minimum and maximum payments, length of

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

3. Fair Value Measurements (Continued)

earn-out periods, manner of calculating any amounts due, etc.) and utilizes assumptions with regard to future cash flows, probabilities of achieving such future cash flows and a discount rate. The contingent earn-out obligations are measured at fair value each reporting period and changes in estimates of fair value are recognized in earnings.

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

	December 31, 2013	December 31, 2012
Balance at beginning of year	\$ 1,966	\$ 2,488
Issuances	—	140
Adjustments to fair value	(1,646)	(662)
Balance at end of year	<u>\$ 320</u>	<u>\$ 1,966</u>

We measure certain assets at fair value on a nonrecurring basis. These assets are recognized at fair value when they are deemed to be other-than-temporarily impaired. During the years ended December 31, 2013 and 2012, there were no goodwill or other intangible asset impairments recorded. See Note 6 "Goodwill and Identifiable Intangible Assets, Net" for further discussion. We did not recognize any other impairments on those assets required to be measured at fair value on a nonrecurring basis.

4. Acquisitions*Acquisition of EAS*

On November 2, 2011, we acquired a 60% majority interest in Environmental Air Systems, LLC ("EAS"). EAS is a regional mechanical contractor with principal offices in Greensboro and Raleigh, North Carolina. EAS engages in a broad range of mechanical contracting projects, HVAC service and controls, and sophisticated prefabrication of mechanical systems, in North Carolina, South Carolina and throughout the Atlantic region. The acquisition date fair value of consideration transferred was \$30.4 million, of which \$15.7 million was allocated to goodwill.

Other Acquisitions

No acquisitions were completed in 2013. We completed various acquisitions from 2011 to 2012, which were not material, individually or in the aggregate, and were "tucked-in" with existing operations. The results of operations of acquisitions are included in our consolidated financial statements from their respective acquisition dates. Additional contingent purchase price ("earn-out") has been or will be paid if certain acquisitions achieve predetermined profitability targets. The total purchase price for these acquisitions, including earn-outs, was \$14.2 million in 2012 and \$2.9 million in 2011.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

5. Discontinued Operations

During the fourth quarter of 2012, we substantially completed the shutdown of our operation located in Delaware which we decided to curtail operating in the fourth quarter of 2011. During 2011, we impaired the intangible assets of \$1.6 million associated with this operation as a result of this decision. The after tax loss was \$0.1 million and \$4.0 million for the years ended December 31, 2013 and 2011, respectively. For the year ended December 31, 2012, after tax income was recorded for this operation of \$0.1 million. These results have been recorded in discontinued operations under "Operating income (loss), net of tax expense (benefit)."

In addition, we recorded after tax income of \$0.3 million for the year ended December 31, 2012 which was associated with the reduction of estimated liabilities associated with the sale and shutdown of previous discontinued operations. This amount is reflected in discontinued operations under "Operating income (loss), net of tax expense (benefit)" in addition to those mentioned above.

Our consolidated statements of operations and the related earnings per share amounts have been restated to reflect the effects of the discontinued operations. No interest expense is allocated to discontinued operations.

Revenue and pre-tax income (loss) related to discontinued operations are as follows (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Revenue	\$ 49	\$ 4,668	\$ 23,366
Pre-tax income (loss)	\$ (195)	\$ 567	\$ (6,727)

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

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

	December 31, 2013	December 31, 2012
Balance at beginning of year	\$ 114,588	\$ 107,093
Additions (See Note 4)	—	7,495
Balance at end of year	\$ 114,588	\$ 114,588

We perform our annual impairment testing on October 1, or more frequently, if events and circumstances indicate impairment may have occurred. As discussed in Note 2, "Summary of Significant Accounting Policies," we have the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of the reporting unit is less than the carrying value.

During our annual impairment testing on October 1, we performed a qualitative assessment for each reporting unit which considered various factors, including changes in the carrying value of the reporting unit, forecasted operating results, long-term growth rates and discount rates. Additionally, we considered qualitative key events and circumstances (i.e. macroeconomic environment, industry and

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

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

market specific conditions, cost factors and events specific to the reporting unit, etc.). Based on this assessment, we concluded that it was more likely than not that the fair value of each of the reporting units was greater than its carrying value. Accordingly, no further testing was required.

There was no impairment of goodwill as a result of our annual goodwill impairment test in 2013. We also did not encounter any events or changes in circumstances that indicated an impairment was more likely than not during interim periods in 2013.

During 2012 and 2011, the fair value of each reporting unit was estimated using a discounted cash flow model combined with market valuation approaches. We assigned a weighting of 50% to the discounted cash flow analysis, 40% to the public company approach and 10% to the transaction approach for the year ended December 31, 2012. In certain instances, there was no weighting assigned to the transaction approach due to a lack of comparable market data and a weighting of 50% was assigned to the public company approach for those impacted reporting units. There was no impairment of goodwill as a result of our annual goodwill impairment test in 2012. We assigned a weighting of 50% to the discounted cash flow analysis and 50% to the public company approach for the year ended December 31, 2011. There was no weighting assigned to the transaction approach due to the lack of comparable market data in 2011. We recorded a goodwill impairment of \$57.3 million during 2011 related to four reporting units serving the Virginia, Maryland and North Carolina markets.

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

Identifiable Intangible Assets, Net

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

	Estimated Useful Lives in Years	December 31, 2013		December 31, 2012	
		Gross Book Value	Accumulated Amortization	Gross Book Value	Accumulated Amortization
Customer relationships	2 - 15	\$ 40,404	\$ (20,978)	\$ 40,404	\$ (15,579)
Backlog	1 - 2	6,515	(6,515)	6,515	(6,375)
Noncompete agreements	2 - 7	2,890	(2,649)	2,890	(2,380)
Tradenames	2 - 25	23,695	(5,979)	23,695	(4,655)
Total		<u>\$ 73,504</u>	<u>\$ (36,121)</u>	<u>\$ 73,504</u>	<u>\$ (28,989)</u>

The amounts attributable to customer relationships, noncompete agreements and tradenames are amortized to "Selling, General and Administrative Expenses" on a pattern of economic benefit or a straight-line method over periods from two to twenty-five years. The amounts attributable to backlog are being amortized to "Cost of Services" on a proportionate method over the remaining backlog period. Amortization expense for the years ended December 31, 2013, 2012 and 2011 was \$7.1 million, \$8.8 million and \$7.1 million, respectively.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

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

At December 31, 2013, future amortization expense of identifiable intangible assets is as follows (in thousands):

Year ended December 31—	
2014	\$ 6,106
2015	4,873
2016	3,748
2017	2,997
2018	2,320
Thereafter	17,339
Total	<u>\$ 37,383</u>

7. Property and Equipment

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

	Estimated Useful Lives in Years	December 31,	
		2013	2012
Land	—	\$ 2,404	\$ 2,404
Transportation equipment	1 - 7	46,233	38,352
Machinery and equipment	1 - 15	22,920	21,670
Computer and telephone equipment	1 - 10	19,012	18,481
Buildings and leasehold improvements	2 - 40	25,371	24,438
Furniture and fixtures	2 - 17	5,036	4,741
		<u>120,976</u>	<u>110,086</u>
Less—Accumulated depreciation		(74,115)	(68,670)
Property and equipment, net		<u>\$ 46,861</u>	<u>\$ 41,416</u>

Depreciation expense for the years ended December 31, 2013, 2012 and 2011 was \$11.4 million, \$11.7 million and \$11.9 million, respectively.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

8. Detail of Certain Balance Sheet Accounts

Activity in our allowance for doubtful accounts consists of the following (in thousands):

	December 31,		
	2013	2012	2011
Balance at beginning of year	\$ 6,333	\$ 4,615	\$ 5,029
Additions for bad debt expense	19	2,753	214
Deductions for uncollectible receivables written off, net of recoveries	(1,892)	(1,090)	(770)
Allowance for doubtful accounts of acquired companies at date of acquisition	—	55	142
Balance at end of year	<u>\$ 4,460</u>	<u>\$ 6,333</u>	<u>\$ 4,615</u>

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

	December 31,	
	2013	2012
Accrued warranty costs	\$ 6,795	\$ 6,781
Accrued job losses	758	2,137
Accrued rent and lease obligations	673	673
Accrued sales and use tax	1,821	1,710
Deferred revenue	1,320	1,143
Liabilities due to former owners	4,054	2,349
Other current liabilities	12,747	12,284
	<u>\$ 28,168</u>	<u>\$ 27,077</u>

9. Long-Term Debt Obligations

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

	December 31,	
	2013	2012
Revolving credit facility	\$ —	\$ —
Other debt	—	2,400
Notes to former owners	2,000	5,000
Total debt	2,000	7,400
Less—current portion	(2,000)	(300)
Total long-term portion of debt	<u>\$ —</u>	<u>\$ 7,100</u>

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

9. Long-Term Debt Obligations (Continued)

At December 31, 2013, future principal payments of long-term debt are as follows (in thousands):

Year ended December 31—	
2014	\$ 2,000
2015	—
2016	—
2017	—
2018	—
Thereafter	—
	<u>\$ 2,000</u>

Interest expense included the following primary elements (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Interest expense on notes to former owners	\$ 97	\$ 255	\$ 795
Interest expense on borrowings and unused commitment fees	279	444	243
Letter of credit fees	731	667	622
Amortization of debt financing costs	244	229	226
Total	<u>\$ 1,351</u>	<u>\$ 1,595</u>	<u>\$ 1,886</u>

Revolving Credit Facility

On June 25, 2013, we amended our senior credit facility (the "Facility") provided by a syndicate of banks increasing our borrowing capacity from \$125.0 million to \$175.0 million. The Facility, which is available for borrowings and letters of credit, expires in July 2018 and is secured by a first lien on substantially all of the Company's personal property except for assets related to projects subject to surety bonds and assets held by certain unrestricted subsidiaries and a second lien on the Company's assets related to projects subject to surety bonds. We incurred approximately \$0.6 million in financing and professional costs in connection with the amendment to the Facility, which combined with the previous unamortized costs of \$0.7 million, will be amortized on a straight-line basis as a non-cash charge to interest expense over the remaining term of the Facility. As of December 31, 2013, we had no outstanding borrowings, \$48.1 million in letters of credit outstanding, and \$126.9 million of credit available.

Collateral

A common practice in our 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 we encounter significant financial or operational difficulties, the surety will arrange for the completion of our contractual obligations and for the payment of our vendors on the projects subject to the bonds. In cooperation with our lenders, we granted our sureties a first lien on assets such as receivables, costs and estimated earnings in excess of billings, and equipment

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

9. Long-Term Debt Obligations (Continued)

specifically identifiable to projects for which bonds are outstanding, as collateral for potential obligations under bonds. As of December 31, 2013, the book value of these assets was approximately \$69.5 million.

Covenants and Restrictions

The Facility contains financial covenants defining various financial measures and the levels of these measures with which we must comply. Covenant compliance is assessed as of each quarter end. Credit Facility Adjusted 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; (d) other non-cash charges and (e) pre-acquisition results of acquired companies. The following is a reconciliation of Credit Facility Adjusted EBITDA to net income (in thousands):

Net income including noncontrolling interests	\$ 28,556
Income taxes—continuing operations	18,148
Interest expense, net	1,328
Depreciation and amortization expense	18,572
Stock compensation expense	3,974
Income taxes—discontinued operations	(119)
EBITDA attributable to noncontrolling interests	(2,342)
Pre-acquisition results of acquired companies, as defined under the Facility	—
Credit Facility Adjusted EBITDA	<u>\$ 68,117</u>

The Facility's principal financial covenants include:

Leverage Ratio— The Facility requires that the ratio of our Consolidated Total Indebtedness to our Credit Facility Adjusted EBITDA not exceed 3.00 through December 31, 2014, 2.75 through December 31, 2015 and 2.50 through maturity. The leverage ratio as of December 31, 2013 was 0.03.

Fixed Charge Coverage Ratio— The Facility requires that the ratio of Credit Facility Adjusted EBITDA, less non-financed capital expenditures, tax provision, dividends and amounts used to repurchase stock to the sum of interest expense and scheduled principal payments of indebtedness be at least 2.00; provided that the calculation of the fixed charge coverage ratio excludes stock repurchases and the payment of dividends at any time that the Company's Net Leverage Ratio does not exceed 1.50. The Facility also allows the fixed charge coverage ratio not to be reduced for stock repurchases through June 30, 2015 in an aggregate amount not to exceed \$25 million if at the time of and after giving effect to such repurchase the Company's Net Leverage Ratio was less than or equal to 1.50. Capital expenditures, tax provision, dividends and stock repurchase payments are defined under the Facility for purposes of this covenant to be amounts for the four quarters ending as of any given quarterly covenant compliance measurement date. The fixed charge coverage ratio as of December 31, 2013 was 10.88.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

9. Long-Term Debt Obligations (Continued)

Other Restrictions— The Facility permits acquisitions of up to \$20.0 million per transaction, provided that the aggregate purchase price of such an acquisition and of acquisitions in the same fiscal year does not exceed \$50.0 million. However, these limitations only apply when the Company's Net Leverage Ratio is equal to or greater than 2.00.

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

We are in compliance with all of our financial covenants as of December 31, 2013.

Interest Rates and Fees

There are two interest rate options for borrowings under the Facility, the Base Rate Loan Option and the Eurodollar Rate Loan Option. Under the Base Rate Loan Option, the interest rate is determined based on the highest of the Federal Funds Rate plus 0.5%, the prime lending rate offered by Wells Fargo Bank, N.A. or the one-month Eurodollar Rate plus 1.00%. Under the Eurodollar Rate Loan Option, the interest rate is determined based on the one- to six-month Eurodollar Rate. The Eurodollar Rate corresponds 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 these rates. The additional margins are determined based on the ratio of our Consolidated Total Indebtedness as of a given quarter end to our "Credit Facility Adjusted EBITDA" for the twelve months ending as of that quarter end, as defined in the credit agreement and shown below.

The interest rates 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 December 31, 2013 relating to interest options under the Facility:

Base Rate Loan Option:	
Federal Funds Rate plus 0.50%	0.59%
Wells Fargo Bank, N.A. Prime Rate	3.25%
One-month LIBOR plus 1.00%	1.20%
Eurodollar Rate Loan Option:	
One-month LIBOR	0.20%
Six-month LIBOR	0.35%

Certain of our vendors require letters of credit to ensure reimbursement for amounts they are disbursing on our behalf, such as to beneficiaries under our self-funded insurance programs. We have also occasionally used letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. Our lenders issue such letters of credit through the Facility. 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 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 us in connection with a letter of credit. However, because a claim on a letter of credit would require

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

9. Long-Term Debt Obligations (Continued)

immediate reimbursement by us to our lenders, letters of credit are treated as a use of facility capacity just the same as actual borrowings. We have never had a claim made against a letter of credit that resulted in payments by a lender or by us and believe such claim is unlikely in the foreseeable future.

Commitment fees are payable on the portion of the revolving loan capacity not in use for borrowings or letters of credit at any given time. Letter of credit fees and commitment fees are based on the ratio of Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA, as defined in the credit agreement.

	Consolidated Total Indebtedness to Credit Facility Adjusted EBITDA			
	Less than 0.75	0.75 to 1.50	1.50 to 2.25	2.25 or greater
Additional Per Annum Interest Margin Added Under:				
Base Rate Loan Option	0.25%	0.50%	0.75%	1.00%
Eurodollar Rate Loan Option	1.25%	1.50%	1.75%	2.00%
Letter of credit fees	1.25%	1.50%	1.75%	2.00%
Commitment fees on any portion of the Revolving Loan capacity not in use for borrowings or letters of credit at any given time	0.20%	0.25%	0.30%	0.35%

We estimate that the weighted average interest rate applicable to the borrowings under the Facility would be approximately 1.6% as of December 31, 2013.

Notes to Former Owners

We issued subordinated notes to the former owners of acquired companies as part of the consideration used to acquire these companies. These notes had an outstanding balance of \$2.0 million as of December 31, 2013 and bear interest, payable annually, at a weighted average interest rate of 3.3%. The maturity date of the outstanding balance is July 2014.

Other Debt

In conjunction with our acquisition of ColonialWebb in 2010, we acquired long-term debt related to an industrial revenue bond associated with its office building and warehouse. In July 2013, we paid the outstanding balance of \$2.4 million. The weighted average interest rate on this variable rate debt as of the last day outstanding was approximately 0.21%.

In addition, our majority owned subsidiary, EAS, has a revolving \$2.5 million credit line that is available for temporary working capital needs and expires June 30, 2014. As of December 31, 2013, we had no outstanding borrowings and, therefore, \$2.5 million of credit available. We estimate that the weighted average interest rate applicable to borrowings under this variable rate credit line would be approximately 2.7% as of December 31, 2013.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

10. Income Taxes

Provision for Income Taxes

The provision for income taxes relating to continuing operations consists of the following (in thousands):

	December 31,		
	2013	2012	2011
Current—			
Federal	\$ 11,707	\$ 5,679	\$ 2,207
State and Puerto Rico	1,954	1,151	1,673
	<u>13,661</u>	<u>6,830</u>	<u>3,880</u>
Deferred—			
Federal	3,254	2,897	(10,121)
State and Puerto Rico	1,233	318	778
	<u>4,487</u>	<u>3,215</u>	<u>(9,343)</u>
	<u>\$ 18,148</u>	<u>\$ 10,045</u>	<u>\$ (5,463)</u>

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

	December 31,		
	2013	2012	2011
Income tax expense (benefit) at the statutory rate of 35%	\$ 16,373	\$ 7,539	\$ (13,278)
Changes resulting from—			
State income taxes, net of federal tax effect	1,910	1,011	(1,972)
Increase (decrease) in valuation allowance	1,465	455	3,431
Increase (decrease) in tax contingency reserves	(145)	198	28
Increase (decrease) from noncontrolling interests	(450)	565	(118)
Non-deductible expenses	594	481	386
Domestic production activity deduction	(520)	(378)	—
Goodwill impairment	—	—	9,223
Purchase accounting adjustments	(472)	(210)	(2,992)
Other	(607)	384	(171)
	<u>\$ 18,148</u>	<u>\$ 10,045</u>	<u>\$ (5,463)</u>

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

10. Income Taxes (Continued)

Deferred Tax Assets (Liabilities)

Significant components of the net deferred tax assets and net deferred tax liabilities as reflected on the balance sheet are as follows (in thousands):

	Year Ended December 31,	
	2013	2012
Deferred income tax assets—		
Accounts receivable and allowance for doubtful accounts	\$ 1,660	\$ 2,293
Stock compensation	2,165	2,444
Accrued liabilities and expenses	19,290	19,661
Net operating loss carryforwards	7,794	6,562
Other	613	1,017
Total deferred income tax assets	<u>31,522</u>	<u>31,977</u>
Deferred income tax liabilities—		
Property and equipment	(6,660)	(5,357)
Long-term contracts	(671)	(306)
Goodwill	(3,364)	(1,124)
Intangible assets	(2,803)	(3,932)
Other	(947)	(1,131)
Total deferred income tax liabilities	<u>(14,445)</u>	<u>(11,850)</u>
Less—Valuation allowance	<u>(7,605)</u>	<u>(6,140)</u>
Net deferred income tax assets	<u>\$ 9,472</u>	<u>\$ 13,987</u>

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

	December 31,	
	2013	2012
Deferred income tax assets—		
Prepaid expenses and other	\$ 18,279	\$ 19,952
Other noncurrent assets	1,472	2,324
Total deferred income tax assets	<u>\$ 19,751</u>	<u>\$ 22,276</u>
Deferred income tax liabilities—		
Other current liabilities	\$ 338	\$ 335
Deferred income tax liabilities	9,941	7,954
Total deferred income tax liabilities	<u>\$ 10,279</u>	<u>\$ 8,289</u>

As of December 31, 2013, we had \$7.8 million of future tax benefits related to \$106.4 million of available state and Puerto Rican net operating loss carryforwards ("NOLs") which expire between 2014 and 2033. A valuation allowance of \$7.6 million has been recorded against net deferred tax assets of

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

10. Income Taxes (Continued)

state and Puerto Rico. We recorded an increase in valuation allowances of \$1.5 million for the year ended December 31, 2013. Our deferred tax assets for Puerto Rico are fully valued. A deferred tax asset for state NOLs, net of related valuation allowance, of \$1.6 million reflects our conclusion that it is likely that this asset will be realized based upon expected future earnings in certain subsidiaries. We update this assessment of the realizability of deferred tax assets relating to state net NOLs annually. A return to profitability in our entities with valuation allowances on their NOL's and deferred tax assets would result in a reversal of a portion of the valuation allowance relating to realized deferred tax assets. A sustained period of profitability could cause a change in our judgment of the remaining deferred tax assets. If that were to occur then it is likely that we would reverse some or all of the remaining deferred tax asset valuation allowance.

As of December 31, 2013 and 2012, approximately \$0.3 million and \$0.3 million, respectively, of unrecognized tax benefits, if recognized in future periods, would impact our effective tax rate. This liability is included in "Other Long-Term Liabilities" in the consolidated balance sheets. We do not expect that the total amount of unrecognized tax benefits will significantly increase or decrease within the next twelve months.

We recognize potential interest and penalties related to unrecognized tax benefits in income tax expense. Total interest and penalties decreased \$0.4 million during the year ended December 31, 2013. We recognized \$0.4 million in interest during the year ended December 31, 2012. We had accrued approximately \$0.3 million and \$0.7 million for the payment of interest and penalties at December 31, 2013 and 2012, respectively. Our tax records are subject to review by the Internal Revenue Service for the 2010 tax year forward and by various state authorities for the 2005 tax year forward.

Liabilities for Uncertain Tax Positions

A reconciliation of the beginning and ending amount of unrecognized tax benefits, excluding accrued interest and penalties, is as follows (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Balance at beginning of year	\$ 499	\$ 696	\$ 696
Additions based on tax positions related to the current year	—	—	—
Additions for tax positions of prior years	—	—	—
Reductions for tax positions of prior years	(86)	(197)	—
Settlements	—	—	—
Balance at end of year	<u>\$ 413</u>	<u>\$ 499</u>	<u>\$ 696</u>

11. Employee Benefit Plans

We and certain of our subsidiaries sponsor various retirement plans for most full-time and some part-time employees. These plans primarily consist of defined contribution plans. The defined contribution plans generally provide for contributions up to 2.5% of covered employees' salaries or

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

11. Employee Benefit Plans (Continued)

wages. These contributions totaled \$5.5 million in 2013, \$5.2 million in 2012 and \$5.1 million in 2011. Of these amounts, approximately \$0.1 million was payable to the plans at December 31, 2013 and 2012.

Certain of our subsidiaries also participate or have participated in various multi-employer pension plans for the benefit of employees who are union members. As of December 31, 2013 and 2012, we had 6 and 5 employees, respectively, who were union members. There were no contributions made to multi-employer pension plans in 2013, 2012 or 2011. The data available from administrators of other multi-employer pension plans is not sufficient to determine the accumulated benefit obligations, nor the net assets attributable to the multi-employer plans in which our employees participate or previously participated.

Certain individuals at one of our operations are entitled to receive fixed annual payments that reach a maximum amount, as specified in the related agreements, for a 15 year period following retirement or, in some cases, the attainment of 65 years of age. We recognize the unfunded status of the plan as a non-current liability in our Consolidated Balance Sheet. Benefits vest 50% after ten years of service, 75% after fifteen years of service and are fully vested after 20 years of service. We had an unfunded benefit liability of \$3.2 million and \$3.0 million recorded as of December 31, 2013 and 2012, respectively.

12. Commitments and Contingencies*Leases*

We lease certain facilities and equipment under noncancelable operating leases. Rent expense for the years ended December 31, 2013, 2012 and 2011 was \$16.2 million, \$15.2 million, and \$12.0 million, respectively. We recognize escalating rental payments that are quantifiable at the inception of the lease on a straight-line basis over the lease term. Concurrent with the acquisitions of certain companies, we entered into various agreements with previous owners to lease buildings used in our operations. The terms of these leases generally range from three to ten years and certain leases provide for escalations in the rental expenses each year, the majority of which are based on inflation. Included in the 2013, 2012 and 2011 rent expense above are approximately \$3.8 million, \$3.4 million and \$2.2 million of rent paid to these related parties, respectively.

The following represents future minimum rental payments under noncancelable operating leases (in thousands):

Year ended December 31—	
2014	\$ 10,453
2015	9,341
2016	7,844
2017	7,139
2018	6,040
Thereafter	8,422
	<u>\$ 49,239</u>

COMFORT SYSTEMS USA, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****December 31, 2013****12. Commitments and Contingencies (Continued)*****Claims and Lawsuits***

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

Surety

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

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

Self-Insurance

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

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

12. Commitments and Contingencies (Continued)

Our self-insurance arrangements currently are as follows:

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

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

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

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

Employee Medical— We have two medical plans. The deductible for employee group health claims is \$325,000 per person, per policy (calendar) year for each plan. Insurance then covers any responsibility for medical claims in excess of the deductible amount.

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

13. Stockholders' Equity

2012 Equity Incentive Plan

In May 2012, our stockholders approved our 2012 Equity Incentive Plan (the "2012 Plan"), which provides for the granting of incentive or non-qualified stock options, stock appreciation rights, restricted or deferred stock, dividend equivalents or other incentive awards to directors, employees, or consultants. The number of shares authorized and reserved for issuance under the 2012 Plan is 5.1 million shares. As of December 31, 2013, there were 4.4 million shares available for issuance under this plan. The 2012 Plan will expire in May 2022. Additionally, we have outstanding stock options, stock awards and stock units that were issued under other plans, and no further grants may be made under those plans.

Share Repurchase Program

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

13. Stockholders' Equity (Continued)

time to time approved extensions of the program to acquire additional shares. Since the inception of the repurchase program, the Board has approved 6.6 million shares to be repurchased.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. We repurchased 0.1 million shares for the year ended December 31, 2013 at an average price of \$14.59 per share. Since the inception of the program in 2007 and as of December 31, 2013, we have repurchased a cumulative total of 6.0 million shares at an average price of \$11.00 per share.

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, contingently issuable restricted stock and restricted stock units. The vesting of unvested contingently issuable restricted stock is based on the achievement of certain earnings per share targets. These shares are considered contingently issuable shares for purposes of calculating diluted earnings per share. These shares are not included in the diluted earnings per share denominator until the performance criteria are met, if it is assumed that the end of the reporting period was the end of the contingency period.

Unvested restricted stock and restricted stock units are included in diluted earnings per share, weighted outstanding until the shares and units vest. Upon vesting, the vested restricted stock and restricted stock units are included in basic earnings per share weighted outstanding from the vesting date.

There were no anti-dilutive stock options for the year ended December 31, 2013 and approximately 1.0 million anti-dilutive stock options excluded from the calculation of diluted EPS for the year ended December 31, 2012. Assuming dilution, approximately 0.7 million anti-dilutive stock options would have been excluded from the calculation of diluted EPS for the year ended December 31, 2011. The effect of 0.2 million of common stock equivalents have been excluded from the calculation of diluted EPS for the year ended December 31, 2011, due to our net loss position in this period.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

13. Stockholders' Equity (Continued)

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

	Year Ended December 31,		
	2013	2012	2011
Common shares outstanding, end of period(a)	37,578	37,069	37,050
Effect of using weighted average common shares outstanding	(333)	43	339
Shares used in computing earnings per share—basic	37,245	37,112	37,389
Effect of shares issuable under stock option plans based on the treasury stock method	183	87	—
Effect of contingently issuable restricted shares	108	60	—
Shares used in computing earnings per share—diluted	<u>37,536</u>	<u>37,259</u>	<u>37,389</u>

(a) Excludes 0.1 million, 0.2 million and 0.4 million shares of unvested contingently issuable restricted stock outstanding for the years ended December 31, 2013, 2012 and 2011, respectively (see Note 14 "Stock-Based Compensation").

14. Stock-Based Compensation

Under the 2012 Equity Incentive Plan (the "2012 Plan") grants of stock options, restricted stock and restricted stock units, and performance share units have been, and will be, determined and administered by the compensation committee of the Board of Directors. Total stock-based compensation expense was \$4.0 million, \$2.8 million and \$3.6 million for the years ended December 31, 2013, 2012 and 2011, respectively. Total income tax benefit recognized for stock-based compensation arrangements was \$1.5 million, \$1.0 million and \$1.3 million for each of the years ended December 31, 2013, 2012 and 2011. We present the benefits of tax deductions in excess of recognized compensation costs ("excess tax benefits") as financing cash flows in the consolidated statements of cash flows.

Upon the vesting of restricted shares, we have allowed the holder to elect to surrender an amount of shares to meet their minimum statutory tax withholding requirements. These shares are accounted for as treasury stock based upon the value of the stock on the date of vesting.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

14. Stock-Based Compensation (Continued)

Stock Options

The following table summarizes activity under our stock option plans (shares in thousands):

Stock Options	Year Ended December 31,					
	2013		2012		2011	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	1,143	\$ 11.59	1,056	\$ 10.84	1,061	\$ 9.58
Granted	156	\$ 13.86	190	\$ 11.19	142	\$ 13.87
Exercised	(440)	\$ 11.10	(103)	\$ 3.20	(66)	\$ 4.46
Forfeited	(1)	\$ 13.87	—	\$ —	—	\$ —
Expired	—	\$ —	—	\$ —	(81)	\$ 4.82
Outstanding at end of year	<u>858</u>	\$ 12.24	<u>1,143</u>	\$ 11.59	<u>1,056</u>	\$ 10.84
Options exercisable at end of year	<u>528</u>		<u>810</u>		<u>762</u>	

The total intrinsic value of options exercised during the years ended December 31, 2013, 2012 and 2011 was \$3.0 million, \$0.8 million and \$0.5 million, respectively. Stock options exercisable as of December 31, 2013 have a weighted-average remaining contractual term of 5.2 years and an aggregate intrinsic value of \$4.0 million. As of December 31, 2013, we have 0.9 million options that are vested or expected to vest; these options have a weighted average exercise price of \$12.24 per share, have a weighted-average remaining contractual term of 6.5 years and an aggregate intrinsic value of \$6.1 million.

The following table summarizes information about stock options outstanding at December 31, 2013 (shares in thousands):

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/13	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at 12/31/13	Weighted-Average Exercise Price
\$6.38 - \$7.94	48	1.38	\$ 6.40	48	\$ 6.40
\$10.73 - \$12.90	447	6.31	\$ 11.66	320	\$ 11.84
\$13.15 - \$15.03	363	7.40	\$ 13.73	160	\$ 13.57
\$6.38 - \$15.03	<u>858</u>	6.50	\$ 12.24	<u>528</u>	\$ 11.88

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

14. Stock-Based Compensation (Continued)

The fair value of each option award is estimated, based on several assumptions, on the date of grant using the Black-Scholes option valuation model. The fair values and the assumptions used for the 2013, 2012 and 2011 grants are shown in the table below:

	Year Ended December 31,		
	2013	2012	2011
Weighted-average fair value per share of options granted	\$5.06	\$4.03	\$5.04
Fair value assumptions:			
Expected dividend yield	1.82%	1.86%	1.70%
Expected stock price volatility	46.6%	46.5%	44.2%
Risk-free interest rate	0.96%	1.17%	2.24%
Expected term	5.6 years	5.3 years	5.3 years

Stock options are accounted for as equity instruments, and compensation cost is recognized using the straight-line method over the vesting period. Stock options generally vest over a three-year vesting period. Certain stock option and restricted stock awards provide for accelerated vesting if the employee retires at any time when the sum of their age and years of service is at least 75. As of December 31, 2013, the unrecognized compensation cost related to stock options was \$0.7 million, which is expected to be recognized over a weighted-average period of 1.8 years. The total fair value of options vested during the year ended December 31, 2013 was \$0.7 million.

The following table summarizes information about nonvested stock option awards as of December 31, 2013 and changes for the year ended December 31, 2013 (shares in thousands):

Stock Options	Shares	Weighted-Average Grant Date Fair Value	
Nonvested at December 31, 2012	333	\$	4.40
Granted	156	\$	5.06
Vested	(158)	\$	4.51
Forfeited	(1)	\$	5.04
Nonvested at December 31, 2013	330	\$	4.66

We generally issue treasury shares for stock options and restricted stock, unless treasury shares are not available.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

14. Stock-Based Compensation (Continued)

Restricted Stock and Restricted Stock Units

The following table summarizes activity under our restricted stock plans (shares in thousands):

<u>Restricted Stock and Restricted Stock Units</u>	<u>Shares</u>		
	<u>2013</u>	<u>2012</u>	<u>2011</u>
Unvested at beginning of year	272	302	312
Granted	169	224	231
Vested	(240)	(254)	(241)
Forfeited	(2)	—	—
Unvested at end of year	<u>199</u>	<u>272</u>	<u>302</u>

Approximately \$1.1 million of compensation expense related to restricted stock and restricted stock units will be recognized over a weighted-average period of 0.8 years. The total fair value of shares vested during the year ended December 31, 2013 was \$3.1 million. The weighted-average fair value per share of restricted stock shares and units awarded during 2013, 2012 and 2011 was \$13.57, \$10.78 and \$11.29, respectively. The aggregate intrinsic value of restricted stock vested during the years ended December 31, 2013, 2012 and 2011 was \$4.7 million, \$3.1 million and \$2.6 million, respectively.

Performance Stock Units

Under the 2012 Plan, we granted dollar-denominated performance vesting restricted stock units ("PSUs") which cliff vest at the end of a three-year performance period. The PSUs are subject to two performance measures; 50% of the PSUs are based on the annual performance of our stock price relative to a group of our peers (total shareholder return) and 50% of the PSUs are measured based on meeting or exceeding a pre-determined annual earnings per share target as set by our board of directors (EPS). Depending on the Company's performance in relation to the established performance measures, the awards may vest at zero to a maximum of 2.0 times the dollar-denominated award granted at target. Upon achievement of the necessary performance metrics, the award will be determined in dollars and may be settled in cash or stock based on the market price of the Company's common stock at the end of the performance period, at our discretion.

Compensation expense for dollar-denominated performance units will ultimately be equal to the final dollar value awarded to the grantee upon vesting, settled either in cash or stock. However, throughout the performance period we must record an accrued expense based on an estimate of that future payout. For units determined by EPS performance, the awards are evaluated quarterly against established targets in order to estimate the liability throughout the vesting period. For units determined by total shareholder return performance, a Monte Carlo simulation model was used to estimate accruals throughout the vesting period. The model simulates our total shareholder return and compares it against our peer group over the three-year performance period to produce a predicted distribution of relative share performance. This is applied to the reward criteria to give an expected value of the total shareholder return element. During 2013, the vesting criteria was set for both 2013 and 2012 grants. There were no performance stock unit grants in 2011. The calculated fair market value as of December 31, 2013 is \$2.4 million. The accrued expense related to performance stock units as of December 31, 2013 is \$0.9 million. Approximately \$1.5 million of compensation expense related to

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

14. Stock-Based Compensation (Continued)

performance stock units will be recognized over a weighted-average period of 1.1 years. No awards vested during the year ended December 31, 2013.

We generally issue treasury shares for stock compensation purposes, unless treasury shares are not available.

15. Quarterly Results of Operations (Unaudited)

Quarterly financial information for the years ended December 31, 2013 and 2012 is summarized as follows (in thousands, except per share data):

	2013			
	Q1	Q2	Q3(a)	Q4
Revenue	\$ 325,890	\$ 351,053	\$ 349,989	\$ 330,340
Gross profit	51,467	59,967	67,021	61,428
Operating income	5,086	14,379	17,734	9,059
Income from continuing operations	2,749	8,314	11,637	5,932
Income (loss) from discontinued operations, net of tax	(54)	—	(25)	3
Net income including noncontrolling interests	2,695	8,314	11,612	5,935
Less: Net income attributable to noncontrolling interests	163	552	233	339
Net income attributable to Comfort Systems USA, Inc.	2,532	7,762	11,379	5,596
INCOME PER SHARE ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC.:				
Basic—				
Income from continuing operations	\$ 0.07	\$ 0.21	\$ 0.31	\$ 0.15
Income from discontinued operations	—	—	—	—
Net income	<u>\$ 0.07</u>	<u>\$ 0.21</u>	<u>\$ 0.31</u>	<u>\$ 0.15</u>
Diluted—				
Income from continuing operations	\$ 0.07	\$ 0.21	\$ 0.30	\$ 0.15
Income from discontinued operations	—	—	—	—
Net income	<u>\$ 0.07</u>	<u>\$ 0.21</u>	<u>\$ 0.30</u>	<u>\$ 0.15</u>
Net cash provided by (used in) operating activities	\$ (10,351)	\$ 6,700	\$ 27,433	\$ 14,641

- (a) Included in unaudited quarterly results of operations for the third quarter of 2013 is the correction of prior period accounting errors which resulted in net after-tax income of approximately \$1.3 million, or \$0.03 per diluted share. Refer to Footnote 2 for additional disclosure.

COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2013

15. Quarterly Results of Operations (Unaudited) (Continued)

	2012			
	Q1	Q2	Q3	Q4
Revenue	\$ 326,902	\$ 353,172	\$ 335,241	\$ 315,870
Gross profit	42,931	54,096	55,521	55,073
Operating income (loss)	(3,003)	7,441	9,767	8,098
Income (loss) from continuing operations	(2,431)	3,949	5,423	4,553
Income (loss) from discontinued operations, net of tax	(237)	98	(98)	592
Net income (loss) including noncontrolling interests	(2,668)	4,047	5,325	5,145
Less: Net income (loss) attributable to noncontrolling interests	(1,639)	(421)	(348)	794
Net income (loss) attributable to Comfort Systems USA, Inc.	(1,029)	4,468	5,673	4,351
INCOME (LOSS) PER SHARE ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC.:				
Basic—				
Income (loss) from continuing operations	\$ (0.02)	\$ 0.12	\$ 0.15	\$ 0.10
Income (loss) from discontinued operations	(0.01)	—	—	0.02
Net income (loss)	<u>\$ (0.03)</u>	<u>\$ 0.12</u>	<u>\$ 0.15</u>	<u>\$ 0.12</u>
Diluted—				
Income (loss) from continuing operations	\$ (0.02)	\$ 0.12	\$ 0.15	\$ 0.10
Income (loss) from discontinued operations	(0.01)	—	—	0.02
Net income (loss)	<u>\$ (0.03)</u>	<u>\$ 0.12</u>	<u>\$ 0.15</u>	<u>\$ 0.12</u>
Net cash provided by (used in) operating activities	\$ (19,816)	\$ 6,793	\$ 16,455	\$ 27,078

The sums of the individual quarterly earnings per share amounts do not necessarily agree with year-to-date earnings per share as each quarter's computation is based on the weighted average number of shares outstanding during the quarter, the weighted average stock price during the quarter and the dilutive effects of options and contingently issuable restricted stock in each quarter.

ITEM 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure*

None.

ITEM 9A. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures

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

Internal Controls over Financial Reporting

Management's report on our internal controls over financial reporting can be found in Item 8 of this report. The Independent Registered Public Accounting Firm's Attestation Report on the effectiveness of our internal controls over financial reporting can also be found in Item 8 of this report.

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the three months ended December 31, 2013 that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

ITEM 9B. *Other Information*

None.

PART III

ITEM 10. *Directors, Executive Officers and Corporate Governance*

We have adopted a code of ethics that applies to our principal executive officer, our principal financial officer, and our principal accounting officer, as well as to our other employees. This code of ethics consists of our Corporate Compliance Policy. The Company has made this code of ethics available on our website, as described in Item 1 of this annual report on Form 10-K. If we make substantive amendments to this code of ethics or grant any waiver, including any implicit waiver, we will disclose the nature of such amendment or waiver on our website or in a report on Form 8-K within four business days of such amendment or waiver.

The other information called for by this item has been omitted in accordance with the instructions to Form 10-K. The Company will file with the Commission a definitive proxy statement including the other information to be disclosed under this item in the 120 days following December 31, 2013 and such information is hereby incorporated by reference.

ITEMS 11, 12, 13 AND 14.

These items have been omitted in accordance with the instructions to Form 10-K. The Company will file with the Commission a definitive proxy statement including the information to be disclosed

under the items in the 120 days following December 31, 2013 and such information is hereby incorporated by reference.

PART IV

ITEM 15. Exhibits and Financial Statement Schedules

(a) *The following documents are filed as part of this annual report on Form 10-K:*

- (1) Consolidated Financial Statements (Included Under Item 8): The Index to the Consolidated Financial Statements is included on page 44 of this annual report on Form 10-K and is incorporated herein by reference.
- (2) Financial Statement Schedules:
None.

(b) *Exhibits*

Reference is made to the Index of Exhibits immediately following the signature page thereof, which is incorporated herein by reference.

(c) *Excluded financial statements:*

None.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<hr/> <i>/s/ ALAN P. KRUSI</i>		
Alan P. Krusi	Director	February 27, 2014
<hr/> <i>/s/ FRANKLIN MYERS</i>		
Franklin Myers	Director	February 27, 2014
<hr/> <i>/s/ JAMES H. SCHULTZ</i>		
James H. Schultz	Director	February 27, 2014
<hr/> <i>/s/ CONSTANCE E. SKIDMORE</i>		
Constance E. Skidmore	Director	February 27, 2014
<hr/> <i>/s/ VANCE W. TANG</i>		
Vance W. Tang	Director	February 27, 2014
<hr/> <i>/s/ ROBERT D. WAGNER, JR.</i>		
Robert D. Wagner, Jr.	Director	February 27, 2014

INDEX OF EXHIBITS

Exhibit Number	Description of Exhibits	Incorporated by Reference to the Exhibit Indicated Below and to the Filing with the Commission Indicated Below	
		Exhibit Number	Filing or File Number
3.1	Second Amended and Restated Certificate of Incorporation of the Registrant	3.1	333-24021
3.2	Certificate of Amendment dated May 21, 1998	3.2	1998 Form 10-K
3.3	Certificate of Amendment dated July 9, 2003	3.3	2003 Form 10-K
3.4	Amended and Restated Bylaws of Comfort Systems USA, Inc.	3.1	March 26, 2012 Form 8-K
4.1	Form of certificate evidencing ownership of Common Stock of the Registrant	4.1	333-24021
*10.1	Comfort Systems USA, Inc. 1997 Long-Term Incentive Plan	10.1	333-24021
*10.2	Comfort Systems USA, Inc. 1997 Non-Employee Directors' Stock Plan	10.2	333-24021
*10.3	Amendment to the 1997 Non-Employee Directors' Stock Plan dated May 23, 2002	10.3	Second Quarter 2002 Form 10-Q/A
*10.4	Comfort Systems USA, Inc. 2006 Equity Incentive Plan	4.5	333-138377
*10.5	Form of Option Award under the Comfort Systems USA, Inc. 2006 Equity Incentive Plan	10.6	2006 Form 10-K
*10.6	Form of Option Award under the Comfort Systems USA, Inc. 2006 Stock Options/SAR Plan for Non-Employee Directors	10.7	2006 Form 10-K
*10.7	Employment Agreement between the Company, Eastern Heating & Cooling, Inc. and Alfred J. Giardinelli, Jr.	10.1	Second Quarter 2003 Form 10-Q
*10.8	Amended and Restated 2006 Equity Compensation Plan for Non-Employee Directors	A	Proxy Statement April 10, 2008
*10.9	2008 Senior Management Annual Performance Plan	B	Proxy Statement April 10, 2008
*10.10	Form of Change in Control Agreement	10.2	First Quarter 2008 Form 10-Q
*10.11	Form of Comfort Systems USA, Inc. Executive Severance Policy	10.3	First Quarter 2008 Form 10-Q
*10.12	Form of Directors and Officers Indemnification Agreement	10.1	May 19, 2009 Form 8-K

Exhibit Number	Description of Exhibits	Incorporated by Reference to the Exhibit Indicated Below and to the Filing with the Commission Indicated Below	
		Exhibit Number	Filing or File Number
10.13	Second Amended and Restated Credit Agreement by and among Comfort Systems USA, Inc., as Borrower and Wells Fargo Bank, National Association, as Administrative Agent/Wells Fargo Securities LLC, as Sole Lead Arranger and Sole Lead Book Runner/Bank of Texas, N.A., Capital One, N.A., and Regions Bank as Co-Syndication Agent/and Certain Financial Institutions as Lenders	10.1	July 22, 2010 Form 8-K/A
10.14	Stock Purchase Agreement, dated July 28, 2010	10.1	July 30, 2010 Form 8-K
*10.15	Summary of 2011 Incentive Compensation Plan	10.1	First Quarter 2011 Form 10-Q
*10.16	Form of Performance Restricted Stock Award Agreement dated March 24, 2011	10.1	March 28, 2011 Form 8-K
*10.17	First Amendment to Comfort Systems USA, Inc. Amended and Restated 2006 Equity Compensation Plan for Non-Employee Directors	10.1	Second Quarter 2011 Form 10-Q
10.18	Amendment No. 1 to Second Amended and Restated Credit Agreement, Second Amended and Restated Security Agreement, and Second Amended and Restated Pledge Agreement	10.1	Third Quarter 2011 Form 10-Q
*10.19	Summary of 2012 Incentive Compensation Plan	10.1	First Quarter 2012 Form 10-Q
*10.20	Form of 2012 Restricted Stock Unit Agreement	10.1	March 30, 2012 Form 8-K
*10.21	Form of 2012 Dollar-denominated Performance Vesting Restricted Stock Unit Agreement	10.2	March 30, 2012 Form 8-K
*10.22	2012 Equity Incentive Plan	A	Proxy Statement April 9, 2012
*10.23	2012 Senior Management Annual Performance Plan	B	Proxy Statement April 9, 2012
*10.24	Summary of 2013 Incentive Compensation Plan	10.1	First Quarter 2013 Form 10-Q
*10.25	Form of 2013 Restricted Stock Unit Agreement	10.2	March 22, 2013 Form 8-K
*10.26	Form of 2013 Dollar-denominated Performance Vesting Restricted Stock Unit Agreement	10.3	March 22, 2013 Form 8-K

Exhibit Number	Description of Exhibits	Incorporated by Reference to the Exhibit Indicated Below and to the Filing with the Commission Indicated Below	
		Exhibit Number	Filing or File Number
10.27	Amendment No. 2 to Second Amended and Restated Credit Agreement and Amendment to Other Loan Documents	10.1	Second Quarter 2013 Form 10-Q
*10.28	Letter Agreement between the Company and James Mylett		Filed Herewith
*10.29	Form of Change in Control Agreement (2013)		Filed Herewith
21.1	List of subsidiaries of Comfort Systems USA, Inc.		Filed Herewith
23.1	Consent of Ernst & Young LLP		Filed Herewith
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002		Filed Herewith
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002		Filed Herewith
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002		Furnished Herewith
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002		Furnished Herewith
**101.INS	XBRL Instance Document		
**101.SCH	XBRL Taxonomy Extension Schema Document		
**101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document		
**101.LAB	XBRL Taxonomy Extension Label Linkbase Document		
**101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document		
**101.DEF	XBRL Taxonomy Extension Definition Linkbase Document		

* Management contract or compensatory plan.

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



675 Bering Drive, Suite 400
Houston, Texas 77057
Phone: 713-830-9600
Fax: 713-830-9646

August 27, 2013

RE: Senior Vice President—Service

Dear James:

I am pleased to offer you the position of Senior Vice President—Service of Comfort Systems USA (Texas), L.P (the "Company") a wholly owned subsidiary of Comfort Systems USA, Inc. ("Comfort").

The detailed aspects of this offer are as follows:

- *Base Salary*—The base salary payable to you will be \$300,000 per year, payable on a regular basis in accordance with the Company's standard payroll procedures, but not less often than monthly.
 - *Incentive Compensation*—You will be eligible to receive annual incentive compensation based off a bonus range from 0 to 132.5% of your annual base salary, adjusted proportionately for the percentage of the year you are employed by the Company. Although this plan is subject to change from year to year, in 2013 you will be eligible for a bonus based on the following formula (as adjusted proportionately for period of employment): (1) from 0 to 67.5% of your annual base salary based on the EPS performance of Comfort as it relates to EPS targets set by Comfort's board of directors; (2) from 0 to 45% of your annual base salary based on achievement of specified metrics relating to Comfort's overall service business; and (3) from 0 to 20% based on meeting certain individual annual performance goals.
 - *Guaranteed Minimum Bonus Levels*.—Notwithstanding the foregoing, and assuming you become a full-time employee of Comfort on or before November 18, 2013, for each of 2013, 2014, and 2015 your bonus will be the greater of: (i) the amount calculated in accordance with the plan then in effect, or (ii) \$200,000.
 - *Equity Compensation*.—We will recommend that you be included in Comfort's grants of equity at a level of 100% of base salary. Assuming the plan continues to be administered in the same manner it was administered in 2013, you would receive 100% of your base salary in equity, which would consist of (i) 30% of Comfort's stock in time-vested restricted shares subject to three-year time vesting; (ii) 30% of options subject to three-year time vesting with the strike price being based on the date of grant and the number of options being calculated using the Black-Scholes method; (iii) 20% of dollar-denominated performance stock based on Comfort's EPS performance that is subject to performance vest in three years; and (iv) 20% of dollar-denominated performance stock based on Comfort's relative total shareholder return that is subject to performance vest in three years. The issuance of this equity is at the complete discretion of, and subject to annual approval by, the independent members of Comfort's Board of Directors' Compensation Committee and is subject to change at any time.
 - *Severance*—Subject to the approval of Comfort's Board of Directors' Compensation Committee, we shall recommend that should you be terminated without cause in the first thirty-six (36) months of employment you would be entitled to receive, subject to the execution of a reasonable release of any employment claims, severance payments equal to \$150,000.
-

- *Relocation*—The Company will not require that you relocate to Houston, Texas in the first eighteen (18) months of employment.
- *Perquisites, Benefits, and Other Compensation*—You will receive additional benefits and compensation as specified below:
 - Coverage, subject to contributions required of employees generally, for you and your dependent family members under health, hospitalization, disability, dental, life, and other insurance plans that may be in effect from time to time for the benefit of the Company's employees. I will provide you with the Company's 2013 Benefits Summary for your review.
 - Invitation to participate in Comfort's 401(k) plan.
 - Reimbursement for all business travel and other out-of-pocket expenses reasonably incurred by you in the performance of your employment. Reimbursable expenses shall be appropriately documented in reasonable detail by you, and shall be in a format consistent with the Company's expense reporting policy.

Please note that the Company's employee benefits are periodically reviewed as part of the Company's ongoing effort to provide competitive benefits to all employees. Changes to specific benefits may occur in the future.

- *Paid Time Off*—You will be entitled to twenty (20) days of Paid Time Off per annum, adjusted proportionately for the first year. Days do not accumulate from year to year.
- *No Conflicting Agreements*—Should you accept this offer, you represent and warrant that employment by the Company does not and will not violate, conflict with, or constitute a default under any contract, commitment, adjudication, order, injunction, or any other agreement of any kind, including but not limited to, any previous employment agreements to which you were a party.

If you are in agreement with the terms of our offer, please email your acceptance to me and also send me a signed copy of this letter. Please note that this is an initial offer of employment and is not intended to create a continuing right of employment. Because you will be transferring employment from your current employer to the Company, you will also be subject to appropriate I-9 documentation, a background check, and you passing a drug-screening test.

I am very pleased to offer this position to you. I believe your capabilities, experience and knowledge will cause you to be very effective in this new position. I, along with all of our Senior Leadership Team, look forward to having you become a key member of our team.

Sincerely,

/s/ BRIAN LANE

Brian Lane
President and Chief Executive Officer

/s/ JAMES MYLETT

Accepted: James Mylett

October 4, 2013

Date

QuickLinks

[Exhibit 10.28](#)

**Comfort Systems USA, Inc.
Change in Control Agreement**

This Change in Control Agreement (this "**Agreement**") by and among Comfort Systems USA, Inc., a Delaware corporation (the "**Company**"), and [EMPLOYEE'S NAME] ("**Employee**") is hereby entered into and effective as of the day of , 20 .

R E C I T A L S

A. The Company recognizes that during Employee's service with the Company the possibility of a change in control of the Company may arise and that such possibility, and the uncertainty it may create, may result in the departure or distraction of Employee to the detriment of the Company and its shareholders.

B. The Company desires to provide the benefits set forth in this Agreement to help assure the Company of the continuation of Employee's service and to encourage Employee's attention and dedication to Employee's assigned duties without distraction in circumstances arising from the possibility of a change in control, and Employee desires to evidence his or her acceptance of such benefits.

NOW, THEREFORE, in consideration of the mutual promises and covenants set forth herein, it is hereby agreed as follows:

A G R E E M E N T S

1. **DEFINED TERMS.** In addition to the capitalized terms defined elsewhere in this Agreement, the following capitalized terms shall have the meanings set forth below:

(a) "**Beneficial Ownership**" and its derivatives are defined in Section 13(d) of the Securities Exchange Act of 1934, as amended.

(b) "**Cause**" means (i) Employee's gross negligence in the performance of or intentional nonperformance of any of Employee's material duties and responsibilities; (ii) Employee's willful dishonesty, fraud or misconduct with respect to the business or affairs of Company or any of its subsidiaries or affiliates which materially and adversely affects the operations or reputation of Company or any of its subsidiaries or affiliates; (iii) Employee's conviction of a felony crime; (iv) Employee's confirmed positive illegal drug test result; (v) confirmed sexual harassment by Employee; or (vi) Employee's material and willful violation of the Company's Corporate Compliance Policy Standards and Procedures Regarding Business Practices.

(c) A "**Change in Control**" shall be deemed to have occurred if:

(i) any person (including any "person" within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended, and more than one person acting as a group), other than the Company, or an employee benefit plan of the Company, or any entity controlled by either, acquiring directly or indirectly the Beneficial Ownership of any voting security of the Company if immediately after such acquisition such person is, directly or indirectly, the Beneficial Owner of voting securities representing 50% or more of the total voting power of all of the then-outstanding voting securities of the Company, provided that if any one person, or more than one person acting as a group, owned more than 50% of the total fair market value or total voting power of Company stock as of the date of this Agreement, the acquisition of additional stock by the same person or persons shall not be deemed to be a Change in Control;

(ii) the date a majority of the following individuals are replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the members of the Company's Board of Directors before the date of the appointment or election: (A) the individuals who, as of the date hereof, constitute the Board of Directors of the Company (the "**Original Directors**"); (B) the individuals who thereafter are elected to the Board of Directors of the Company and whose election, or nomination for election, to the Board of Directors of the Company was approved by a vote of at least two-thirds of the Original Directors then still in office (such directors becoming "**Additional Original Directors**" immediately following their election); and (C) the individuals who are elected to the Board of Directors of the Company and whose election, or nomination for election, to the Board of Directors of the Company was approved by a vote of at least two-thirds of the Original Directors and Additional Original Directors then still in office (such directors also becoming "**Additional Original Directors**" immediately following their election); or

(iii) any one person, or more than one person acting as a group, acquiring (or who has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) assets from the Company that have a total gross fair market value equal to or more than 50% of the total gross fair market value of the assets of the Company immediately before such acquisition or acquisitions.

(d) "**Good Reason**" means (i) Employee is demoted to a position of materially less stature or importance within the Company which reflects a material diminution in Employee's authority, duties, or responsibilities or a material diminution in the authority, duties, or responsibilities of the supervisor to whom Employee is required to report, or (ii) the Company breaches this Agreement in any material respect; provided, in either case, that the Employee provides notice to the Company of the existence of the condition described in (i) or (ii) within 90 days of the initial existence of the condition, and the Company has had at least 30 days to remedy the condition.

2. **TERM.** The term of this Agreement will begin on the date hereof and continue in full force and effect as long as Employee remains in his or her current position with the Company or any other position of equal or higher grade; provided that this Agreement shall terminate and cease to be in full force and effect upon Employee giving notice of his or her intent to terminate employment with the Company for any reason other than Good Reason, whether by retirement, early retirement, or otherwise.

3. CHANGE IN CONTROL.

(a) Employee must be notified in writing by Company or any of its subsidiaries or affiliates at any time that either Company or any of its subsidiaries or affiliates anticipates that a Change in Control may take place.

(b) Upon a Change in Control, the following shall apply, provided that Employee satisfies the condition specified in Section 3(c) below:

(i) if Employee is terminated by Company without Cause at any time during the 12 months immediately following the closing of the transaction giving rise to the Change in Control, or Employee terminates his or her employment with the Company for Good Reason at any time during the 12 months immediately following the closing of the transaction giving rise to the Change in Control, Employee shall be entitled to receive in a lump-sum payment, due within 60 days after the effective date of termination (or in the case of any amount determined with reference to the annual bonus for the year of termination, as soon as practicable after such bonus is determined), the amount equal to the greater of (A) his or her annual base salary then in effect plus bonus (bonus being the average of the prior three years' bonuses paid to Employee or the current annual incentive bonus payable determined pursuant

to the goals and objectives established for such bonus, whichever is greater) times [FACTOR]; or (B) his or her annual base salary in effect immediately prior to the closing of the transaction giving rise to the Change in Control plus bonus (bonus being the average of the prior three years' bonuses paid to Employee or the current annual incentive bonus payable determined following completion of the annual bonus period pursuant to the goals and objectives established for such bonus, whichever is greater) times [FACTOR]; provided, however, if the 60-day period covers two calendar years, the payment will be made in the second calendar year;

(ii) notwithstanding anything to the contrary herein, if at the time of the Employee's separation from service with the Company the Employee is a "specified employee," as defined below, any and all amounts payable under this Agreement in connection with such separation from service that constitute deferred compensation subject to Section 409A of the Internal Revenue Code of 1986, as amended (the "**Code**"), as determined by the Company in its reasonable discretion, and that would (but for this clause) be payable to the Employee within the six months immediately following the date of such separation from service, shall instead be paid on the date that follows the date of such separation from service by six months (or, if earlier, the date of the Employee's death); provided, that for purposes of the preceding, "separation from service" shall be determined in a manner consistent with Section 409A(a)(2)(A)(i) of the Code and the term "specified employee" shall mean an individual determined by the Company to be a specified employee as defined in Section 409A(a)(2)(B)(i) of the Code; and

(iii) notwithstanding anything herein to the contrary, if Employee is a "disqualified individual" (as defined in Section 280G(c) of the Code), and the payments and benefits provided for in this Agreement, together with any other payments and benefits which Employee has the right to receive from the Company or any other person, would constitute a "parachute payment" (as defined in Section 280G(b)(2) of the Code), then the payments and benefits provided for in this Agreement shall be either (a) reduced (but not below zero) so that the present value of such total amounts and benefits received by Employee from the Company and/or such person(s) will be \$1.00 less than three (3) times Employee's "base amount" (as defined in Section 280G(b)(3) of the Code) and so that no portion of such amounts and benefits received by Employee shall be subject to the excise tax imposed by Section 4999 of the Code or (b) paid in full, whichever produces the better "net after-tax position" to Employee (taking into account any applicable excise tax under Section 4999 of the Code and any other applicable taxes). The reduction of payments and benefits hereunder, if applicable, shall be made by reducing, first, payments or benefits to be paid in cash hereunder in the order in which such payment or benefit would be paid or provided (beginning with such payment or benefit that would be made last in time and continuing, to the extent necessary, through to such payment or benefit that would be made first in time) and, then, reducing any benefit to be provided in-kind hereunder in a similar order. The determination as to whether any such reduction in the amount of the payments and benefits provided hereunder is necessary shall be made by the Company in good faith. If a reduced payment or benefit is made or provided and through error or otherwise that payment or benefit, when aggregated with other payments and benefits from the Company (or its affiliates) used in determining if a "parachute payment" exists, exceeds \$1.00 less than three (3) times Employee's base amount, then Employee shall immediately repay such excess to the Company upon notification that an overpayment has been made. Nothing in this paragraph shall require the Company to be responsible for, or have any liability or obligation with respect to, Employee's excise tax liabilities under Section 4999 of the Code.

(c) As a condition to receipt of the benefits specified in Section 3(b) above, Employee will execute and deliver a release of claims in a form provided by the Company (which will include a release of all claims against the Company, its affiliates, and all related parties) and any applicable revocation period will have lapsed without revocation.

4. **BINDING EFFECT.** This Agreement shall be binding upon, inure to the benefit of and be enforceable by the parties hereto and their respective heirs, legal representatives, successors and assigns. In the event any Successor (as defined below) does not assume this Agreement by operation of law, the Company will seek to have such Successor, by agreement in form and substance satisfactory to Employee, expressly assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it. If there has been a Change in Control prior to, or if a Change in Control will result from, any such succession, then failure of the Company to obtain at Employee's request such agreement prior to or upon the effectiveness of any such succession (unless assumption occurs by operation of law) shall constitute Good Reason for termination by Employee of his or her employment. "**Successor**" means any Person that succeeds to, or has the ability to control, the Company's business as a whole, directly by merger, consolidation, spin-off or similar transaction, or indirectly by purchase of the Company's voting securities or acquisition of all or substantially all of the assets of the Company.

5. **COMPLETE AGREEMENT.** This Agreement sets forth the entire agreement of the parties hereto relating to the subject matter hereof and supersedes any other employment agreements or understandings, written or oral, between the Company and Employee. This Agreement is the final, complete and exclusive statement and expression of the agreement between Company and Employee and of all the terms of this Agreement, and it cannot be varied, contradicted or supplemented by evidence of any prior or contemporaneous oral or written agreements. This Agreement may not be later modified except by a further writing signed by a duly authorized officer of Company and Employee, and no term of this Agreement may be waived except in writing signed by the party waiving the benefit of such term.

6. **NOTICE.** Whenever any notice is required hereunder, it shall be given in writing addressed as follows:

To Company:	Comfort Systems USA, Inc. 675 Bering Drive, Suite 400 Houston, Texas 77057 Attention: Law Department
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To Employee:	[ADDRESS]
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Notice shall be deemed given and effective on the earlier of three days after the deposit in the U.S. mail of a writing addressed as above and sent first class mail, certified, return receipt requested, or when actually received by means of hand delivery, delivery by Federal Express or other courier service, or by facsimile transmission. Either party may change the address for notice by notifying the other party of such change in accordance with this *Section 6*.

7. **SEVERABILITY; HEADINGS.** If any portion of this Agreement is held invalid or inoperative, the other portions of this Agreement shall be deemed valid and operative and, so far as is reasonable and possible, effect shall be given to the intent manifested by the portion held invalid or inoperative. The headings herein are for reference purposes only and are not intended in any way to describe, interpret, define or limit the extent or intent of this Agreement or of any part hereof.

8. **ARBITRATION.** Any unresolved dispute or controversy arising under or in connection with this Agreement shall be settled exclusively by arbitration, conducted before a panel of three arbitrators in Houston, Texas, in accordance with the National Rules for the Resolution of Employment Disputes

of the American Arbitration Association ("AAA") then in effect, provided that Employee shall comply with Company's grievance procedures in an effort to resolve such dispute or controversy before resorting to arbitration, and provided further that the parties may agree to use arbitrators other than those provided by the AAA. The arbitrators shall not have the authority to add to, detract from, or modify any provision hereof nor to award punitive damages to any injured party. The arbitrators shall have the authority to order back-pay, severance compensation, vesting of options or restricted stock (or cash compensation in lieu of vesting of options or restricted stock), reimbursement of costs, including those incurred to enforce this Agreement, and interest thereon in the event the arbitrators determine that Employee was terminated without disability or Cause, or that Company has breached this Agreement in any material respect. A decision by a majority of the arbitration panel shall be final and binding. Judgment may be entered on the arbitrators' award in any court having jurisdiction. The direct expense of any arbitration proceeding shall be borne by Company.

9. SECTION 409A COMPLIANCE. This Agreement is intended to comply with Section 409A of the Code ("**Section 409A**") or an exemption thereunder and shall be construed and administered in accordance with Section 409A. Notwithstanding any other provision of this Agreement, payments provided under this Agreement may only be made upon an event and in a manner that complies with Section 409A or an applicable exemption. Any payments under this Agreement that may be excluded from Section 409A either as separation pay due to an involuntary separation from service or as a short-term deferral shall be excluded from Section 409A to the maximum extent possible. Any payments to be made under this Agreement upon a termination of employment shall only be made if such termination of employment constitutes a "separation from service" under Section 409A. Notwithstanding the foregoing, the Company makes no representations that the payments and benefits provided under this Agreement comply with Section 409A and in no event shall the Company be liable for all or any portion of any taxes, penalties, interest or other expenses that may be incurred by the Employee on account of non-compliance with Section 409A.

10. GOVERNING LAW. This Agreement shall in all respects be construed according to the laws of the State of Texas, to the extent not preempted by federal law.

11. COUNTERPARTS. This Agreement may be executed simultaneously in two or more counterparts, each of which shall be deemed an original and all of which together shall constitute but one and the same instrument.

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

COMFORT SYSTEMS USA, INC.

By: _____

EMPLOYEE:

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[Exhibit 10.29](#)

[Comfort Systems USA, Inc. Change in Control Agreement](#)

[RECITALS](#)

[AGREEMENTS](#)

SUBSIDIARIES OF COMFORT SYSTEMS USA, INC.

<u>ENTITY NAME</u>	<u>DOMESTIC JURISDICTION</u>	<u>FORMATION DATE</u>
ACI Mechanical, Inc.	Delaware	06/26/1998
ARC Comfort Systems USA, Inc.	Delaware	03/17/1998
Accu-Temp GP, Inc.	Delaware	05/21/1998
Accu-Temp LP, Inc.	Delaware	05/20/1998
Acorn Industrial, LLC	North Carolina	01/03/1997
Air Systems Engineering, Inc.	Washington	05/18/1973
AirTemp, Inc.	Maine	10/15/1998
Atlas-Accurate Holdings, L.L.C.	Delaware	12/28/1998
Atlas Comfort Systems USA, Inc.	California	07/31/2007
Atlas Comfort Systems USA, L.L.C.	Delaware	06/08/2007
Batchelor's Mechanical Contractors, LLC	Alabama	03/16/1981
BCM Controls Corporation	Massachusetts	10/03/1984
California Comfort Systems USA, Inc.	California	05/18/1983
ColonialWebb Contractors Company	Virginia	03/30/1972
Comfort Systems USA (Arkansas), Inc.	Delaware	03/17/1998
Comfort Systems USA (Baltimore), LLC	Delaware	10/15/1998
Comfort Systems USA (Bristol), Inc.	Delaware	08/25/1997
Comfort Systems USA (Carolinas), LLC	North Carolina	01/01/2011
Comfort Systems USA Energy Services, Inc.	Delaware	08/25/1997
Comfort Systems USA G.P., Inc.	Delaware	08/12/1998
Comfort Systems USA (Intermountain), Inc.	Utah	05/06/1969
Comfort Systems USA (Kentucky), Inc.	Kentucky	02/10/1981
Comfort Systems USA (MidAtlantic), LLC	Virginia	01/01/2010
Comfort Systems USA (Midwest), LLC	Iowa	10/13/2009
Comfort Systems USA National Accounts, LLC	Indiana	07/28/1998
Comfort Systems USA (Ohio), Inc.	Ohio	10/10/1979
Comfort Systems USA (Pasadena), Inc.	Texas	06/28/2007
Comfort Systems USA Puerto Rico, Inc.	Puerto Rico	08/09/1991
Comfort Systems USA (South Central), Inc.	Texas	06/22/2007
Comfort Systems USA (Southeast), Inc.	Delaware	03/24/1998
Comfort Systems USA (Southwest), Inc.	Arizona	12/23/1977
Comfort Systems USA (Syracuse), Inc.	New York	03/08/1965
Comfort Systems USA (Texas), L.P.	Texas	08/14/1998
Comfort Systems USA (Western Michigan), Inc.	Michigan	07/21/1989
Control Concepts, LLC	Georgia	12/16/1996
Control Concepts Mechanical Services, LLC	Georgia	01/17/2008
CS53 Acquisition Corp.	Delaware	01/26/1999
Delcard Associates, LLC	Delaware	06/23/2000
Design Mechanical Incorporated	Delaware	10/30/1997
Dillingham & Smith Mechanical and Sheet Metal Contractors, LLC	Tennessee	12/31/2003
Eastern Heating & Cooling, Inc.	New York	12/19/1988
Eastern Refrigeration Co., Inc.	New York	01/30/1990
Environmental Air Systems, LLC	North Carolina	10/07/2011
Envirotrol, LLC	North Carolina	10/27/2011
Granite State Holdings Company, Inc.	Delaware	11/02/2005
Granite State Plumbing & Heating, LLC	Delaware	07/31/2001
H & M Mechanical, Inc.	Delaware	06/25/1998
Helm Corporation	Colorado	10/26/1972

<u>ENTITY NAME</u>	<u>DOMESTIC JURISDICTION</u>	<u>FORMATION DATE</u>
Hess Mechanical Corporation	Delaware	03/17/1998
Hudson River Heating and Cooling, Inc.	Delaware	08/19/2005
H-VAC Supply, L.L.C.	Puerto Rico	10/18/2006
Mechanical Technical Services, Inc.	Texas	06/22/2007
Merit Mechanical, Inc.	Washington	02/14/1984
MJ Mechanical Services, Inc.	Delaware	12/12/1997
North American Mechanical, Inc.	Delaware	03/17/1998
Plant Services Incorporated	Iowa	07/02/1986
Quality Air Heating and Cooling, Inc.	Michigan	09/10/1980
Riddleberger Brothers, Inc.	Virginia	12/22/1958
S.I. Goldman Company, Inc.	Florida	10/04/1976
S.M. Lawrence Company, Inc.	Tennessee	03/08/1973
SA Associates, Inc.	Utah	03/27/1984
Salmon & Alder, LLC	Utah	07/08/1996
Seasonair, Inc.	Maryland	10/28/1966
Temp-Right Service, Inc.	Delaware	09/25/1997
The Capital Refrigeration Company	Delaware	08/06/1998

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[EXHIBIT 21.1](#)

[SUBSIDIARIES OF COMFORT SYSTEMS USA, INC.](#)

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the following Registration Statements:

- (1) Registration Statement (Form S-8 No. 333-38011) pertaining to the 1997 Long-Term Incentive Plan, 1997 Non-Employee Director's Stock Plan, and 1998 Employee Stock Purchase Plan of Comfort Systems USA, Inc.
- (2) Registration Statement (Form S-8 No. 333-44354) pertaining to the 2000 Incentive Plan of Comfort Systems USA, Inc.
- (3) Registration Statement (Form S-8 No. 333-138377) pertaining to the 2006 Equity Incentive Plan and 2006 Stock Options/SAR Plan for Non-Employee Directors of Comfort Systems USA, Inc.
- (4) Registration Statement (Form S-8 No. 333-188302) pertaining to the Comfort Systems USA, Inc. 2012 Equity Incentive Plan.

of our reports dated February 27, 2014, with respect to the consolidated financial statements of Comfort Systems USA, Inc. and the effectiveness of internal control over financial reporting of Comfort Systems USA, Inc., included in this Annual Report (Form 10-K) for the year ended December 31, 2013.

/s/ Ernst & Young, LLP

Houston, Texas
February 27, 2014

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[Exhibit 23.1](#)

[Consent of Independent Registered Public Accounting Firm](#)

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Brian E. Lane, certify that:

1. I have reviewed this annual report on Form 10-K of Comfort Systems USA, Inc.;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) 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
 - d) 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 (the registrant's fourth fiscal quarter in the case of an annual report) 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 the 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: February 27, 2014

/s/ BRIAN E. LANE

Brian E. Lane
President and Chief Executive Officer

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[Exhibit 31.1](#)

[CERTIFICATION OF CHIEF EXECUTIVE OFFICER Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002](#)

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, William George, certify that:

1. I have reviewed this annual report on Form 10-K of Comfort Systems USA, Inc.;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. 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
 - d. 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 (the registrant's fourth fiscal quarter in the case of an annual report) 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 the 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: February 27, 2014

/s/ WILLIAM GEORGE

William George
Executive Vice President and Chief Financial Officer

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[Exhibit 31.2](#)

[CERTIFICATION OF CHIEF FINANCIAL OFFICER Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002](#)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED 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-K for the fiscal year ended December 31, 2013, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Brian E. Lane, President 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 results of operations of the Company.

Date: February 27, 2014

/s/ BRIAN E. LANE

Brian E. Lane
President and Chief Executive Officer

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

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[Exhibit 32.1](#)

[CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002](#)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED 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-K for the fiscal year ended December 31, 2013, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William George, 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 results of operations of the Company.

Date: February 27, 2014

/s/ WILLIAM GEORGE

William George
Executive Vice President and Chief Financial Officer

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

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[Exhibit 32.2](#)

[CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002](#)