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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2003

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 1-13011

COMFORT SYSTEMS USA, INC.
(Exact name of registrant as specified in its charter)

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

777 POST OAK BOULEVARD
SUITE 500
HOUSTON, TEXAS 77056
(Address of Principal Executive Offices) (Zip Code)

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

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

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

The number of shares outstanding of the issuer's common stock, as of August 1, 2003 was 37,919,758.

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COMFORT SYSTEMS USA, INC.

INDEX TO FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2003

COMFORT SYSTEMS USA, INC.

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	DECEMBER 31, 2002	JUNE 30, 2003 (UNAUDITED)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 6,083	$ 11,415
Accounts receivable, less allowance for doubtful accounts of $6,028 and $5,993	167,177	164,423
Other receivables	7,879	5,790
Inventories	12,268	10,692
Prepaid expenses and other	10,612	11,550
Costs and estimated earnings in excess of billings	17,881	15,996
Assets related to discontinued operations	2,643	--
Total current assets	224,543	219,866
PROPERTY AND EQUIPMENT, net	16,072	14,831
GOODWILL	112,545	112,545
OTHER NONCURRENT ASSETS	13,375	12,185
Total assets	$366,535	$359,427
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 1,780	$ 2,166
Accounts payable	56,496	64,215
Accrued compensation and benefits	22,111	21,508
Billings in excess of costs and estimated earnings	26,672	30,271
Income taxes payable	9,797	--
Other current liabilities	29,780	25,949
Liabilities related to discontinued operations	1,017	--
Total current liabilities	147,653	144,109
LONG-TERM DEBT, NET OF CURRENT MATURITIES AND DISCOUNT OF $2,850 AND $2,550	10,604	9,421
OTHER LONG-TERM LIABILITIES	3,192	3,085
Total liabilities	161,449	156,615
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, $.01 par, 5,000,000 shares authorized, none issued and outstanding	--	--
Common stock, $.01 par, 102,969,912 shares authorized, 39,258,913 shares issued	393	393
Treasury stock, 1,341,419 and 1,342,905 shares, at cost	(8,214)	(8,126)
Additional paid-in capital	338,606	338,222
Deferred compensation	(785)	(468)
Other comprehensive income (loss)	--	(52)
Retained earnings (deficit)	(124,914)	(127,157)
Total stockholders' equity	205,086	202,812
Total liabilities and stockholders' equity	$366,535	$359,427

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

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2002	2003	2002	2003
REVENUES	$211,500	$202,355	$ 401,126	$384,769
COST OF SERVICES	172,986	167,553	332,362	322,215
Gross profit	38,514	34,802	68,764	62,554
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	30,480	29,400	62,873	60,349
RESTRUCTURING CHARGES	--	1,112	1,878	2,274
Operating income (loss)	8,034	4,290	4,013	(69)
OTHER INCOME (EXPENSE):				
Interest income	8	37	38	47
Interest expense	(1,102)	(1,095)	(3,001)	(2,469)
Other	804	102	1,116	(147)
Other income (expense)	(290)	(956)	(1,847)	(2,569)
INCOME (LOSS) BEFORE INCOME TAXES	7,744	3,334	2,166	(2,638)
INCOME TAX EXPENSE (BENEFIT)	2,641	728	1,064	(1,241)
INCOME (LOSS) FROM CONTINUING OPERATIONS	5,103	2,606	1,102	(1,397)
DISCONTINUED OPERATIONS:				
Operating income (loss), net of applicable income tax benefit (expense) of $90, $18, $1,813, and $(36)	(166)	(33)	89	66
Estimated loss on disposition, including income tax benefit (expense) of $91, $0, $(25,887) and $(231)	(169)	--	(11,156)	(912)
INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	4,768	2,573	(9,965)	(2,243)
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE, NET OF INCOME TAX BENEFIT OF $26,317	--	--	(202,521)	--
NET INCOME (LOSS)	$ 4,768	$ 2,573	$(212,486)	$ (2,243)
INCOME (LOSS) PER SHARE:				
Basic --				
Income (loss) from continuing operations	$ 0.13	$ 0.07	$ 0.03	$ (0.04)
Discontinued operations --				
Income (loss) from operations	--	--	--	--
Estimated loss on disposition	--	--	(0.30)	(0.02)
Cumulative effect of change in accounting principle	--	--	(5.37)	--
Net income (loss)	$ 0.13	$ 0.07	$ (5.64)	$ (0.06)
Diluted --				
Income (loss) from continuing operations	$ 0.13	$ 0.07	$ 0.03	$ (0.04)
Discontinued operations --				
Income (loss) from operations	--	--	--	--
Estimated loss on disposition	(0.01)	--	(0.29)	(0.02)
Cumulative effect of change in accounting principle	--	--	(5.30)	--
Net income (loss)	$ 0.12	$ 0.07	$ (5.56)	$ (0.06)

SHARES USED IN COMPUTING INCOME (LOSS) PER

SHARE:

Basic	37,839	37,640	37,687	37,631	
	========	========	=========	========	
Diluted	38,476	37,983	38,237	38,804	
	========	========	=========	========	

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)

OTHER COMPRE- TOTAL
COMMON STOCK TREASURY
STOCK ADDITIONAL
DEFERRED HENSIVE
RETAINED STOCK- --------
----------- -----------
--------- PAID-IN
COMPEN- INCOME EARNINGS
HOLDERS' SHARES AMOUNT
SHARES AMOUNT CAPITAL
SATION (LOSS) (DEFICIT)
EQUITY ---------- ------
---------- -------- ----
------ -------- -------
--------- --------
BALANCE AT DECEMBER 31,
2001.....................
39,258,913 $393
(1,749,334) $(10,924)
$340,186 $ -- $ -- $
84,166 $413,821 Issuance
of Treasury Stock:
Issuance of shares for
options exercised.... --
-- 242,146 1,499 (803) -
- -- -- 696 Issuance of
restricted
stock................ --
-- 275,000 1,698 (618)
(1,080) -- -- -- Shares
exchanged in repayment
of notes
receivable.............
-- -- (49,051) (204) --
-- -- -- (204) Shares
received from sale of
business............ --
-- (55,882) (263) -- --
-- -- (263) Shares
received from settlement
with former
owner..................
-- -- (4,298) (20) -- --
-- -- (20) Amortization
of deferred
compensation...........
-- -- -- (159) 295 -- --
136 Net
loss................ --
-- -- -- -- -- --
(209,080) (209,080) ----
------ ---- ---------- -
------- -------- -------
---- --------- --------
BALANCE AT DECEMBER 31,
2002.....................
39,258,913 393
(1,341,419) (8,214)
338,606 (785) --
(124,914) 205,086
Issuance of Treasury
Stock: Issuance of
shares for options
exercised
(unaudited).......... --
-- 31,000 188 (102) -- -
- -- 86 Shares received
from sale of assets
(unaudited)............
-- -- (32,486) (100) --
-- -- -- (100)
Amortization of deferred
compensation

(unaudited)............
-- -- -- -- (282) 317 --
-- 35 Mark-to-market
interest rate swap
derivative
(unaudited)............
-- -- -- -- -- -- (52) -
- (52) Net loss
(unaudited)..... -- -- -
- -- -- -- -- (2,243)
(2,243) ---------- ----
---------- -------- ----
---- ------- ---- ------
--- -------- BALANCE AT
JUNE 30, 2003
(unaudited)..............
39,258,913 $393
(1,342,905) $ (8,126)
$338,222 $ (468) $(52)
$(127,157) $202,812
========== ====
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======== ======= ====
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The accompanying notes are an integral part of these consolidated financial statements.

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

THREE MONTHS ENDED SIX MONTHS ENDED JUNE 30,
JUNE 30, ------------------ ---------------
---- 2002 2003 2002 2003 -------- -------- -
-------- ------- CASH FLOWS FROM OPERATING
ACTIVITIES: Net income
(loss).................................. $
4,768 $ 2,573 $(212,486) $(2,243)
Adjustments to reconcile net income (loss)
to net cash provided by operating activities
-- Cumulative effect of change in accounting
principle..................................
-- -- 202,521 -- Estimated loss on
disposition of discontinued
operations.................................
169 -- 11,156 912 Restructuring
charges......................... -- 1,112
1,878 2,274 Depreciation and amortization
expense........... 1,687 1,387 3,875 2,723
Bad debt
expense............................... 43
661 2,531 1,468 Deferred tax
expense.......................... 2,193
834 1,726 1,213 Amortization of debt
financing costs........... 286 224 1,208
1,279 Loss (gain) on sale of assets or
operations..... (791) (41) (901) 215 Mark-
to-market warrant obligation...............
-- 154 -- (92) Deferred compensation
expense.................. 62 43 62 35
Amortization of debt
discount.................. -- 150 -- 300
Changes in operating assets and liabilities
-- (Increase) decrease in -- Receivables,
net......................... (15,968)
(10,101) 6,512 1,463
Inventories...............................
609 509 1,377 1,433 Prepaid expenses and
other current
assets.................................
3,380 607 3,232 938 Costs and estimated
earnings in excess of
billings...............................
(84) 872 (3,228) 1,755 Other noncurrent
assets................... (60) (53) 426 168
Increase (decrease) in -- Accounts payable
and accrued liabilities... 8,572 10,545
(21,668) 4,607 Billings in excess of costs
and estimated
earnings...............................
6,079 4,449 3,451 3,522 Taxes paid related
to the sale of
businesses............................ --
-- -- (10,371) Other,
net............................... 10 (2)
21 (19) -------- -------- --------- -------
Net cash provided by operating
activities.... 10,955 13,923 1,693 11,580 --
------ -------- --------- ------- CASH FLOWS
FROM INVESTING ACTIVITIES: Purchases of
property and equipment.................
(936) (860) (3,070) (1,947) Proceeds from
sales of property and equipment........ 963
32 1,134 111 Proceeds from businesses sold,
net of cash sold and transaction
costs................................
10,103 (2,674) 154,565 (2,750) -------- ----
---- --------- ------- Net cash provided by
(used in) investing
activities...............................
10,130 (3,502) 152,629 (4,586) -------- ----
---- --------- ------- CASH FLOWS FROM
FINANCING ACTIVITIES: Net payments on

revolving line of credit............
(18,800) (9,213) (150,800) (107) Payments on
other long-term debt....................
(17) (619) (2,322) (1,003) Borrowings of
other long-term debt.................. 20
18 164 18 Debt financing
costs................................ --
(593) -- (677) Proceeds from exercise of
options.................... 481 72 635 86 --
------ -------- --------- ------- Net cash
used in financing activities........
(18,316) (10,335) (152,323) (1,683) --------
-------- --------- ------- NET INCREASE IN
CASH AND CASH EQUIVALENTS.............
2,769 86 1,999 5,311 CASH AND CASH
EQUIVALENTS, beginning of period --
continuing operations and discontinued
operations.... 9,855 11,329 10,625 6,104 ---
----- -------- --------- ------- CASH AND
CASH EQUIVALENTS, end of period --
continuing operations and discontinued
operations.............. $ 12,624 $ 11,415
$ 12,624 $11,415 ======== ======== =========
=======

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

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2003
(UNAUDITED)

1. BUSINESS AND ORGANIZATION

Comfort Systems USA, Inc., a Delaware corporation ("Comfort Systems" and collectively with its subsidiaries, the "Company"), is a national provider of comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services within the mechanical services industry. The Company operates primarily in the commercial and industrial HVAC markets, and performs most of its services within office buildings, retail centers, apartment complexes, manufacturing plants, and healthcare, education and government facilities. In addition to standard HVAC services, the Company provides specialized applications such as building automation control systems, fire protection, process cooling, electronic monitoring and process piping. Certain locations also perform related activities such as electrical service and plumbing. Approximately 53% of the Company's consolidated 2003 revenues to date are attributable to installation of systems in newly constructed facilities, with the remaining 47% attributable to maintenance, repair and replacement services. The Company's consolidated 2003 revenues to date relate to the following service activities: HVAC -- 73%, plumbing -- 11%, building automation control systems -- 7%, and other -- 9%. These service activities are within the mechanical services industry which is the single industry segment served by Comfort Systems.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

These interim statements should be read in conjunction with the historical Consolidated Financial Statements and related notes of Comfort Systems included in the Annual Report on Form 10-K as filed with the Securities and Exchange Commission for the year ended December 31, 2002 (the "Form 10-K").

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

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

USE OF ESTIMATES

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

CASH FLOW INFORMATION

Cash paid for interest for continuing and discontinued operations for the six months ended June 30, 2002 and 2003 was approximately $3.7 million and $0.9 million, respectively. Cash paid for income taxes for continuing and discontinued operations for the six months ended June 30, 2002 and 2003 was approximately

$7.6 million and $9.6 million, respectively. The cash tax payments for the six months ended June 30, 2003 include approximately $10.4 million associated with the sale in 2002 of 19 operations to Emcor Group, Inc. ("Emcor"). These taxes are included in the caption "Taxes paid related to the sale of businesses" in the accompanying Consolidated Statement of Cash Flows.

NEW ACCOUNTING PRONOUNCEMENTS

In July 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS No. 146"). SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities, such as restructurings, involuntarily terminating employees, and consolidating facilities, where those activities were initiated after December 31, 2002. The implementation of SFAS No. 146 does not require the restatement of previously issued financial statements. See Note 5 for a discussion of restructuring charges recorded during 2003 in accordance with SFAS No. 146.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45"). It clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. The objective of the initial measurement of the liability is the fair value of the guarantee at its inception. The initial recognition and initial measurement provisions of FIN 45 are effective for the Company for guarantees issued after December 31, 2002. Although the Company from time to time guarantees the performance of systems or designs it provides, the Company does not currently have any material guarantees.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation -- Transition and Disclosure." SFAS 148 amends FASB Statement No. 123, "Accounting for Transition for Stock-Based Compensation" to provide alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements of the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS 148 is effective for fiscal years ending after December 15, 2002 and the footnote disclosure provisions were adopted by the Company in the fourth quarter of 2002.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). FIN 46 expands upon and strengthens existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. A variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or is entitled to receive a majority of the entity's residual returns or both. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The Company is currently evaluating the effect that adoption of FIN 46 will have on its consolidated financial condition or results of operations.

SEGMENT DISCLOSURE

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

STOCK-BASED COMPENSATION

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

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2002	2003	2002	2003
Net income (loss) as reported	$ 4,768	$ 2,573	$(212,486)	$ (2,243)
Less: Compensation expense per SFAS No. 123, net of tax	(943)	(742)	(1,833)	(1,411)
Pro forma net income (loss)	$ 3,825	$ 1,831	$(214,319)	$ (3,654)
Net Income (Loss) Per Share -- Basic				
Net income (loss) as reported	$ 0.13	$ 0.07	$ (5.64)	$ (0.06)
Less: Compensation expense per SFAS No. 123, net of tax	(0.03)	(0.02)	(0.05)	(0.04)
Pro forma net income (loss) per share	$ 0.10	$ 0.05	$ (5.69)	$ (0.10)
Net Income (Loss) Per Share -- Diluted				
Net income (loss) as reported	$ 0.12	$ 0.07	$ (5.56)	$ (0.06)
Less: Compensation expense per SFAS No. 123, net of tax	(0.02)	(0.02)	(0.05)	(0.04)
Pro forma net income (loss) per share	$ 0.10	$ 0.05	$ (5.61)	$ (0.10)

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

	2002	2003
Expected dividend yield	0.00%	0.00%
Expected stock price volatility	65.32%	62.08%
Risk-free interest rate	5.21% - 5.51%	2.94% - 3.64%
Expected life of options	10 years	7 years

RECLASSIFICATIONS

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

3. DISCONTINUED OPERATIONS

During the second quarter of 2003, the Company sold an operating company. This unit's operating income of $0.1 million, net of taxes, in each of the first six months of 2002 and 2003 has been reported in discontinued operations under "Operating income (loss), net of applicable income taxes" in the Company's statement of operations. In the first quarter of 2003, the Company recorded an estimated loss of $0.9 million, including taxes, related to this transaction in "Estimated loss on disposition, including income taxes" in the Company's statement of operations.

On March 1, 2002, the Company sold 19 operations to Emcor. The total purchase price was $186.25 million, including the assumption by Emcor of approximately $22.1 million of subordinated notes to former owners of certain of the divested companies.

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

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

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

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

Under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which took effect for the Company on January 1, 2002, the operating results of the companies sold to Emcor for all periods presented through the sale, as well as the loss on the sale of these operations, have been presented as discontinued operations in the Company's statements of operations. The Company realized an aggregate loss of $11.8 million, including related tax expense, in connection with the sale of these operations. As a result of the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," the Company also recognized a goodwill impairment charge related to these operations of $32.4 million, net of tax benefit, as of January 1, 2002. The reporting of the Company's aggregate initial goodwill impairment charge in connection with adopting SFAS No. 142 is discussed further in Note 4.

In March 2002, the Company also decided to divest of an additional operating company. In the first quarter of 2002, the Company recorded an estimated loss of $0.4 million, net of tax benefit, from this planned disposition in "Estimated loss on disposition, including income taxes" in the Company's statement of operations. In the fourth quarter of 2002, the Company reversed this estimated loss because the Company decided not to sell this unit.

During the second quarter of 2002, the Company sold a division of one of its operations. The operating loss for this division for the first two quarters of 2002 of $0.3 million, net of tax benefit, has been reported in discontinued operations under "Operating income (loss), net of applicable income taxes" in the Company's statement of operations. The Company realized a loss of $0.2 million, net of tax benefit, on the sale of this division. This loss is included in "Estimated loss on disposition, including income taxes" during the second quarter of 2002 in the Company's statement of operations.

Assets and liabilities related to discontinued operations were as follows (in thousands):

	DECEMBER 31, 2002
Accounts receivable, net	$1,215
Other current assets	278
Property and equipment, net	39
Goodwill, net	882
Other noncurrent assets	229
Total assets	$2,643
Accounts payable	$ 277
Other current liabilities	740
Total liabilities	$1,017

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

	SIX MONTHS ENDED JUNE 30, 2002	SIX MONTHS ENDED JUNE 30, 2003
Revenues	$98,020	$2,081
Pre-tax income (loss)	$(1,724)	$ 102

Interest expense allocated to the discontinued operations in the first quarter of 2002 was $1.5 million. This amount was allocated based upon the Company's net investment in these operations.

4. GOODWILL

In most businesses the Company has acquired, the value paid to buy the business was greater than the value of specifically identifiable net assets in the business. Under generally accepted accounting principles, this excess is termed goodwill and is recognized as an asset at the time the business is acquired. It is generally expected that future net earnings from an acquired business will exceed the goodwill asset recognized at the time the business is bought. Under previous generally accepted accounting principles, goodwill was required to be amortized, or regularly charged to the Company's operating results in its statement of operations.

Effective January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires companies to assess goodwill asset amounts for impairment each year, and more frequently if circumstances suggest an impairment may have occurred. In addition to discontinuing the regular charge, or amortization, of goodwill against income, the new standard also introduces more rigorous criteria for determining how much goodwill should be reflected as an asset in a company's balance sheet.

To perform the transitional impairment testing required by SFAS No. 142 under its new, more rigorous impairment criteria, the Company broke its operations into "reporting units," as prescribed by the new standard, and tested each of these reporting units for impairment by comparing the unit's fair value to its carrying value. The fair value of each reporting unit was estimated using a discounted cash flow model combined with market valuation approaches. Significant estimates and assumptions were used in assessing the fair value of reporting units. These estimates and assumptions involved future cash flows, growth rates, discount rates, weighted average cost of capital and estimates of market valuations for each of the reporting units.

As provided by SFAS No. 142, the transitional impairment loss identified by applying the standard's new, more rigorous valuation methodology upon initial adoption of the standard was reflected as a cumulative effect of a change in accounting principle in the Company's statement of operations. The resulting non-cash charge was $202.5 million, net of tax benefit, and was recorded during the first quarter of 2002. Impairment charges recognized after the initial adoption, if any, generally are to be reported as a component of operating income.

The changes in the carrying amount of goodwill for the year ended December 31, 2002 and the six months ended June 30, 2003 are as follows (in thousands):

Goodwill balance as of January 1, 2002 (a)	$ 438,448
Impairment adjustment	(229,056)
Goodwill related to sale of operations	(95,965)
Goodwill balance as of December 31, 2002(a)	113,427
Goodwill related to sale of operation	(882)
Goodwill balance as of June 30, 2003	$ 112,545

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(a) A portion of this goodwill balance is included in assets related to discontinued operations in the Company's consolidated balance sheet.

5. RESTRUCTURING CHARGES

During the first two quarters of 2003, the Company recorded restructuring charges of approximately $2.3 million pre-tax. These charges included approximately $1.3 million for severance costs and stay bonuses primarily associated with the curtailment of the Company's energy efficiency activities, a reorganization of the Company's national accounts operations as well as a reduction in corporate personnel. The severance costs and stay bonuses related to the termination of 87 employees (81 of these employees had been terminated as of June 30, 2003). In addition, these charges include approximately $0.9 million for remaining lease obligations and $0.1 million of other costs recorded in connection with the actions described above. An additional $0.3 to $0.7 million is expected to be incurred during the second half of 2003 for additional severance costs and remaining lease obligations associated with these restructuring actions.

During the first quarter of 2002, the Company recorded restructuring charges of approximately $1.9 million. These charges included approximately $0.8 million for severance costs primarily associated with the reduction in corporate office overhead in light of the Company's smaller size following the Emcor transaction. The severance costs related to the termination of 33 employees, none of whom were employed as of March 31, 2002. In addition, these charges include approximately $0.7 million for costs associated with decisions to merge or close three smaller divisions and realign regional operating management. These restructuring charges are primarily cash obligations but did include approximately $0.3 million of non-cash writedowns associated with long-lived assets.

During the second half of 2000, the Company recorded restructuring charges of approximately $25.3 million primarily associated with restructuring efforts at certain underperforming operations and its decision to cease its e-commerce activities at Outbound Services, a subsidiary of the Company. As of December 31, 2002 and June 30, 2003, accrued lease termination costs of $0.8 million and $0.6 million, respectively, remain that were associated with these restructuring charges.

The following table shows the remaining liabilities associated with the cash portion of the restructuring charges as of December 31, 2002 and June 30, 2003 (in thousands):

	BALANCE AT BEGINNING OF PERIOD	ADDITIONS	PAYMENTS	BALANCE AT END OF PERIOD
YEAR ENDED DECEMBER 31, 2002:				
SEVERANCE	$ 210	$ 846	$(1,056)	$ --
LEASE TERMINATION COSTS AND OTHER	1,148	704	(852)	1,000
TOTAL	$1,358	$1,550	$(1,908)	$1,000
SIX MONTHS ENDED JUNE 30, 2003:				
Severance	$ --	$1,343	$(1,238)	$ 105
Lease termination costs and other	1,000	931	(424)	1,507
Total	$1,000	$2,274	$(1,662)	$1,612

6. LONG-TERM DEBT OBLIGATIONS

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

	DECEMBER 31, 2002	JUNE 30, 2003
Revolving credit facility	$ 107	$ --
Term loan	14,625	13,675
Other	502	462
Total debt	15,234	14,137
Less -- current maturities	(1,780)	(2,166)
Total long-term portion of debt	13,454	11,971
Less -- discount on Facility	(2,850)	(2,550)
Long-term portion of debt, net of discount	$10,604	$ 9,421

CREDIT FACILITY

The Company's primary current debt financing capacity consists of a $54 million senior credit facility (the "Facility") provided by a syndicate of three financial institutions led by General Electric Capital Corporation ("GE"). The Facility includes a $20 million sublimit for letters of credit. The Facility is secured by substantially all the assets of the Company. The Facility was entered into on October 11, 2002 and replaced the Company's previous revolving credit facility. The Facility consists of two parts: a term loan and a revolving credit facility.

The term loan under the Facility (the "Term Loan") was originally $15 million, which the Company borrowed upon the closing of Facility on October 11, 2002. The Term Loan must be repaid in quarterly installments over five years beginning December 31, 2002. The amount of each quarterly installment increases annually.

The Facility requires prepayments of the Term Loan in certain circumstances. Approximately half of any free cash flow (as defined in the Facility agreement -- primarily cash from operations less capital expenditures) in excess of scheduled principal payments and voluntary prepayments must be used to pay down the Term Loan. This requirement is measured annually based on full-year results. The Company did not have any prepayments of the Term Loan due as of December 31, 2002 under this requirement, primarily as a result of the significant amount of voluntary prepayments of debt made by the Company during 2002. In addition, proceeds in excess of $250,000 from any individual asset sales, or in excess of $1 million for a full year's asset sales, must be used to pay down the Term Loan. Proceeds from asset sales that are less than these individual transaction or annual aggregate levels must also be used to pay down the Term Loan unless they are reinvested in long-term assets within six months of the receipt of such proceeds.

All prepayments under the Term Loan, whether required or voluntary, are applied to scheduled principal payments in inverse order, i.e. to the last scheduled principal payment first, followed by the second-to-last, etc. All principal payments under the Term Loan permanently reduce the original $15 million capacity under this portion of the Facility. As of June 30, 2003, $13.7 million was outstanding under the Term Loan.

The Facility also includes a three-year $40 million revolving credit facility (the "Revolving Loan"). Under this revolving credit facility, the Company can borrow up to $20 million, with the difference between actual borrowings and $40 million available for letter of credit issuance up to a maximum of $20 million in letters of credit. Capacity under the Revolving Loan is also limited by the leverage and fixed charge coverage covenants described below under "Restrictions and Covenants" and "Amounts Outstanding and Capacity." As noted in the latter section, under the most restrictive of these capacity provisions, the Company's current borrowing capacity, on a monthend measurement basis, is $5.0 million. Borrowing capacity can be greater than this amount on an intra-month basis. Letters of credit currently outstanding are $19.7 million.

A common practice in the Company's industry is the posting of payment and performance bonds with customers. These bonds are provided by financial institutions known as sureties, and provide assurance to the customer that in the event the Company encounters significant financial or operational difficulties, the surety will arrange for the completion of the Company's contractual obligations on a project and the payment of the Company's vendors on the project. The Company has reached a preliminary agreement with its surety and GE to grant the surety a secured interest in assets such as receivables, costs incurred in excess of billings, and equipment related to projects for which bonds are outstanding as collateral for potential obligations under bonds. As of June 30, 2003, the amount of these assets is approximately $39.6 million. The Company has also posted a $5 million letter of credit as collateral for potential obligations under bonds.

INTEREST RATES AND FEES

The Company has a choice of two interest rate options for borrowings under the Facility. Under one option, the interest rate is determined based on the higher of the Federal Funds Rate plus 0.5% or the prime rate of at least 75% of the US's 30 largest banks, as published each business day by the Wall Street Journal. An additional margin of 2.25% is then added to the higher of these two rates for borrowings under the Revolving Loan, while an additional margin of 2.75% is added to the higher of these two rates for borrowings under the Term Loan.

Under the other interest rate option, borrowings bear interest based on designated rates that are described in various general business media sources as the London Interbank Offered Rate or "LIBOR." Revolving Loan borrowings using this interest rate option then have 3.25% added to LIBOR, while Term Loan borrowings have 3.75% added to LIBOR.

Commitment fees of 0.5% per annum are payable on the unused portion of the Revolving Loan.

The Company also incurred certain financing and professional costs in connection with the arrangement and the closing of the Facility. These costs will be amortized to interest expense over the term of the Facility in the amount of approximately $0.4 million per quarter. To the extent prepayments of the Term Loan are made or the size of the Facility is reduced, the Company may have to accelerate amortization of these deferred financing and professional costs. During the first quarter of 2003, the Company charged approximately $0.8 million of deferred financing costs to interest expense that were associated with higher levels of capacity under the Facility than the current total of $54 million.

The weighted average interest rate that the Company currently pays on borrowings under the Facility is 5.5% per annum. This reflects a combination of borrowings under both interest rate options described above, as well as the swap of floating rates to a fixed rate described above. This rate does not include amortization of debt financing and arrangement costs, or adjustments for derivatives.

INTEREST RATE DERIVATIVE

The rates underlying the interest rate terms of the Facility are floating interest rates determined by the broad financial markets, meaning they can and do move up and down from time to time. The Facility required that the Company convert these floating interest rate terms on at least half of the original Term Loan to fixed rates for at least a one-year term. In January 2003, the Company converted $10 million of principal value to a fixed LIBOR-based interest rate of 5.62% for an eighteen-month term. This was done via a transaction known as a "swap" under which the Company agreed to pay fixed interest rate payments on $10 million for eighteen months to a bank in exchange for receiving from the bank floating LIBOR interest rate payments on $10 million for the same term.

This transaction is a derivative and has been designated a cash flow hedging instrument under applicable generally accepted accounting principles. Changes in market interest rates in any given period may increase or decrease the valuation of the Company's obligations to the bank under this swap versus the bank's obligations to the Company. So long as the instrument remains "effective" as defined under applicable generally accepted accounting principles, such changes in market valuation are reflected in stockholders' equity as other comprehensive income (loss) for that period, and not in the Company's statement of operations. If the swap is terminated earlier than its eighteen-month term, any gain or loss on settlement will be reflected in the Company's statement of operations. The swap was effective as a hedge for accounting purposes from its inception through June 30, 2003, and the Company expects it to continue to be effective throughout its term.

During the six months ended June 30, 2003, a reduction to stockholders' equity of $0.1 million, net of tax, was recorded through other comprehensive income (loss) and is included in other current liabilities in the Company's consolidated balance sheet. The counterparty to the above derivative agreement is a major bank. Based on its continuing review of the financial position of this bank, the Company believes there is minimal risk that the bank will not meet its obligations to the Company under this swap.

CREDIT FACILITY WARRANT

In connection with the Facility, the Company granted GE a warrant to purchase 409,051 shares of Company common stock for nominal consideration. In addition, GE may "put," or require the Company to repurchase, these shares at the higher of market price, appraised price or book value per share, during the fifth and final year of the Facility -- October 11, 2006 to October 11, 2007. This put may be accelerated under certain circumstances including a change of control of the Company, full repayment of amounts owing under the Facility, or a public offering of shares by the Company. This warrant and put are discussed in greater detail in Note 8, "Stockholders' Equity."

The value of this warrant and put as of the start of the Facility of $2.9 million, less amortization to date of $0.3 million, is reflected as a discount of the Company's obligation under the Facility and is being amortized over the term of the Facility, as described above. This warrant and put obligation are also recorded as a liability in the Company's balance sheet. The value of this warrant and put will change over time, principally in response to changes in the market price of the Company's common stock.

The warrant and put qualify as a derivative for financial reporting purposes. Accordingly, such changes in the value of the warrant and put in any given period will be reflected in interest expense for that period, even though the warrant and put may not have been terminated and settled in cash during the period. Such adjustments are known as mark-to-market adjustments. The gain included in interest expense related to the warrant's mark-to-market obligation during the six months ended June 30, 2003 was $0.1 million.

The table below provides an indication of the potential effect on the valuation of this derivative that might result from changes in the market price for the Company's stock. In this table, the value of the warrant has been calculated based upon the stock price being $1 lower and $1 higher than the Company's closing stock price at June 30, 2003 (value of warrant and put obligation in thousands).

STOCK PRICE	VALUE OF WARRANT AND PUT OBLIGATION
$1.63	$2,892
$2.63(a)	$3,085
$3.63	$3,323

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(a) This was the Company's closing stock price on June 30, 2003.

RESTRICTIONS AND COVENANTS

Borrowings under the Facility are specifically limited by the Company's ratio of total debt to earnings before interest, taxes, depreciation, and amortization ("EBITDA") also known as the leverage covenant, and by the Company's ratio of EBITDA less taxes and capital expenditures to interest expense and scheduled principal payments, also known as the fixed charge coverage ratio. The Facility's definition of debt for purposes of the ratio of total debt to EBITDA includes aggregate letters of credit outstanding less $10 million and excludes cash balances in certain of the Company's bank accounts.

The definition of EBITDA under the Facility excludes certain items, generally non-cash amounts and transactions reported in Other Income and Expense, that are otherwise included in the determination of earnings under generally accepted accounting principles in the Company's financial statements. As such, EBITDA as determined under the Facility's definition could be less than EBITDA as derived from the Company's financial statements in the future.

The financial covenants under the Facility are summarized below. Covenant compliance is measured on a monthly basis. Intra-quarter monthly covenants are at either the same or very similar levels to the quarter-end covenants shown below. EBITDA amounts are in thousands.

FINANCIAL COVENANTS	MINIMUM TRAILING 12 MONTHS EBITDA	MAXIMUM DEBT TO EBITDA	MINIMUM FIXED CHARGE COVERAGE RATIO	MINIMUM INTEREST COVERAGE
FOR THE QUARTER ENDING				
ACTUAL				
June 30, 2003	$16,666	0.96	3.09	8.02
COVENANT				
June 30, 2003	$16,420	2.20	2.50	3.00
September 30, 2003	$17,840	2.10	2.60	3.00
December 31, 2003	$23,565	1.50	2.70	3.00
March 31, 2004	$29,000	1.50	3.00	3.00
June 30, 2004	$29,000	1.50	3.00	3.00
September 30, 2004	$29,000	1.25	3.00	3.00
December 31, 2004	$29,000	1.25	3.00	3.00
All quarters thereafter	$31,000	1.25	3.00	3.00

The Company's trailing twelve months EBITDA as of December 31, 2002 as determined under the Facility did not comply with the covenant then in effect. The Company's lenders waived this violation and agreed to modify the Company's minimum EBITDA, leverage and fixed charge covenants for 2003. Even at these modified levels, these covenants leave only moderate room for variance based on the Company's recent performance. If the Company again violates a covenant under the Facility, the Company may have to negotiate new borrowing terms under the Facility or obtain new financing. While the Company believes that its levels of debt in comparison to its EBITDA and its cash flows would enable the Company to negotiate new borrowing terms under the Facility or to obtain new financing from other sources if necessary, there can be no assurance that the Company would be successful in doing so.

The Facility prohibits payment of dividends, repurchase of shares and acquisitions by the Company. It also limits annual lease expense and non-Facility debt, and restricts outlays of cash by the Company relating to certain investments and subordinate debt.

AMOUNTS OUTSTANDING AND CAPACITY

Apart from the Term Loan, the Company's available credit capacity under the Facility is governed by the nominal limits of the Facility, and by calculated limits based on the leverage and fixed charge coverage covenants described above. Available credit capacity is limited to the most restrictive of these measures. The nominal limits are in effect at all times. The leverage provision limits borrowings that can be outstanding at monthend. The fixed charge provision limits amounts that can be outstanding at monthend, or at any other time that GE requests that this covenant be measured. Even though available credit capacity under the leverage provision is only measured at monthend, it is presented below because it is the most restrictive of these limitations as of recent monthends. Available capacity under the Revolving Loan can be greater than the amount below on an intra-month basis.

The following recaps the Company's debt amounts outstanding and capacity (in thousands):

	AS OF JUNE 30, 2003	AS OF AUGUST 1, 2003	UNUSED CAPACITY AS OF AUGUST 1, 2003
Revolving loan	$ --	$ 9,900	$4,980
Term loan	13,675	13,675	n/a
Other debt	462	457	n/a
Total debt	14,137	24,032	4,980
Less: discount on Facility	(2,550)	(2,500)	n/a
Total debt, net of discount	$11,587	$21,532	$4,980
Letters of credit	$14,146	$19,655	$ 345

OTHER LONG-TERM OBLIGATIONS DISCLOSURES

The Company has generated positive cash flow in most recent periods, and it currently has a moderate level of debt. The Company anticipates that cash flow from operations and credit capacity under the Facility will provide the Company with sufficient liquidity to fund its operations for the foreseeable future. However, the Company does not have a significant amount of excess credit capacity in comparison to expected working capital requirements over the balance of 2003. The Company believes that its levels of debt in comparison to its EBITDA and its cash flows would enable it to obtain new financing if necessary, but there can be no assurance that it would be successful in doing so.

As described above, the financial covenants under the Company's credit facility leave only moderate room for variance based on the Company's recent performance. If the Company again violates a covenant under the Facility, the Company may have to negotiate new borrowing terms under the Facility or obtain new financing. While the Company believes that its levels of debt in comparison to its EBITDA and its cash flows would enable the Company to negotiate new borrowing terms under the Facility or to obtain new financing from other sources if necessary, there can be no assurance that the Company would be successful in doing so.

Certain of the Company's vendors require letters of credit to ensure reimbursement for amounts they are disbursing on the Company's behalf, such as to beneficiaries under its self-funded insurance programs. Some customers also require the Company to post letters of credit to guarantee performance under its contracts and to ensure payment to its subcontractors and vendors under those contracts. Such letters of credit are generally issued by a bank or similar financial institution. The letter of credit commits the issuer to pay specified amounts to the holder of the letter of credit if the holder demonstrates that the Company has failed to perform specified actions. If this were to occur, the Company would be required to reimburse the issuer of the letter of credit. Depending on the circumstances of such a reimbursement, the Company may also have to record a charge to earnings for the reimbursement. To date the Company has not had a claim made against a letter of credit that resulted in payments by the issuer of the letter of credit or by the Company. The Company believes that it is unlikely that it will have to fund claims under a letter of credit in the foreseeable future.

The Company currently has $19.7 million in letters of credit outstanding. The Company self-insures a significant portion of its worker's compensation, auto liability and general liability risks. The Company uses third parties to manage this self-insurance and to retain some of these risks. As is customary under such arrangements, these third parties can require letters of credit as security for amounts they fund or risks they might potentially absorb on the Company's behalf. Under its current self-insurance arrangements, the Company has posted $13.2 million in letters of credit. In addition, the Company may receive other letter of credit requests in the ordinary course of business, and it may have a net increase in the amount of insurance-related letters of credit it must post when it renews its insurance arrangements in the fourth quarter of 2003. Accordingly, the Company's letter of credit requirements over the next year may exceed the current letter of credit sublimits of $20 million under the Company's credit facility. If so, the Company may have to seek additional letter of credit capacity or post different forms of security such as bonds or cash in lieu of letters of credit. The Company believes that its levels of debt in comparison to its EBITDA and its cash flows would enable it to obtain additional letter of credit capacity or to otherwise meet financial security requirements of third parties if necessary, but there can be no assurance that the Company would be successful in doing so.

7. COMMITMENTS AND CONTINGENCIES

CLAIMS AND LAWSUITS

The Company is party to litigation in the ordinary course of business. The Company has estimated and provided accruals for probable losses and related legal fees associated with certain of these actions in the accompanying consolidated financial statements. There are currently no pending legal proceedings that, in management's opinion, would have a material adverse effect on the Company's operating results or financial condition.

SURETY

Many customers, particularly in connection with new construction, require the Company to post performance and payment bonds issued by a financial institution known as a surety. These bonds provide a guarantee to the customer that the Company will perform under the terms of a contract and that the Company will pay subcontractors and vendors who provided goods and services under a contract. If the Company fails to perform under a contract or to pay subcontractors and vendors, the customer may demand that the surety make payments or provide services under the bond. The Company must reimburse the surety for any expenses or outlays it incurs. To date, the Company has not had any significant reimbursements to its surety for bond-related costs. The Company believes that it is unlikely that it will have to fund claims under its surety arrangements in the foreseeable future.

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

SELF-INSURANCE

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

A wholly-owned insurance company subsidiary reinsures a portion of the risk associated with surety bonds that were issued on the Company's behalf from 1998 through 2000 by a third-party insurance company. No significant claims have been made against these bonds and management does not expect any material claims will be made in connection with these bonds in the foreseeable future.

8. STOCKHOLDERS' EQUITY

RESTRICTED STOCK GRANTS

The Company awarded 200,000 shares of restricted stock to its Chief Executive Officer on March 22, 2002 under its 2000 Equity Incentive Plan. The shares are subject to certain performance measures for the twelve-month period ending March 31, 2003 which were met by the Company. The shares are subject to forfeiture if the executive leaves voluntarily or is terminated for cause. Such forfeiture provisions lapse pro rata over a four-year period.

The Company awarded 75,000 shares of restricted stock to its President on November 1, 2002 under its 2000 Equity Incentive Plan. The shares are subject to forfeiture if the Company does not meet certain performance measures for the twelve-month period ending December 31, 2003 or if the executive leaves voluntarily or is terminated for cause. Such forfeiture provisions lapse upon achievement of the performance measures and pro rata over a four-year period.

Compensation expense relating to the grants will be charged to earnings over the four-year period. The initial value of the award was established based on the market price on the date of grant, and was reflected as a reduction of stockholders' equity for unearned compensation. This value, and the related compensation expense, will be adjusted up or down based on the market price of the Company's stock during the first year following each respective grant while the performance conditions are in effect. If the performance conditions are met, the value of the award will then be fixed based on the market price of the Company's stock at that time, and charged to earnings over the remaining three-year vesting period.

WARRANT

In connection with the arrangement of the Company's new debt facility as described above in Note 6, "Long-Term Debt Obligations," the Company granted GE, its lender, a warrant to purchase 409,051 shares of Company common stock for nominal consideration. The warrant agreement also provides for the following:

- In most situations where the Company issues shares, options or warrants, GE may acquire additional shares or warrants on equivalent terms to maintain the proportionate interest its warrant shares represent in comparison to the Company's total shares outstanding.

- GE may require the Company to register its warrant shares.

- GE may include its warrant shares in any public offering of stock by the Company.

- GE may "put," or require the Company to repurchase, some or all of its warrant shares at the higher of market price, appraised price or book value per share, during the fifth and final year of the debt facility -- October 11, 2006 to October 11, 2007. This put may be accelerated under certain circumstances including a change of control of the Company, full repayment of amounts owing under the Facility, or a public offering of shares by the Company.

The initial value of this warrant and put of $2.9 million is reflected as a discount of the Company's obligations under its debt facility with GE, less amortization to date of $0.3 million, and as an obligation in long-term liabilities. The value of this warrant and put will change over time, principally in response to changes in the market price of the Company's common stock. The warrant and the put qualify as a derivative for financial reporting purposes. Accordingly, such changes in the value of the warrant and put in any given period will be reflected in interest expense for that period and in the Company's long-term warrant obligation, even though the warrant and put may not have been terminated and settled in cash during the period. Such adjustments are known as mark-to-market adjustments. The gain included in interest expense related to the warrant's mark-to-market obligation for the six months ended June 30, 2003 was $0.1 million.

RESTRICTED COMMON STOCK

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

Each share of Restricted Voting Common Stock will automatically convert to Common Stock on a share-for-share basis (i) in the event of a disposition of such share of Restricted Voting Common Stock by the holder thereof (other than a distribution which is a distribution by a holder to its partners or beneficial owners, or a transfer to a related party of such holders (as defined in Sections 267, 707, 318 and/or 4946 of the Internal Revenue Code of 1986, as amended)), (ii) in the event any person acquires beneficial ownership of 15% or more of the total number of outstanding shares of Common Stock of the Company, or (iii) in the event any person offers to acquire 15% or more of the total number of outstanding shares of Common Stock of the Company. After July 1, 1998, the Board of Directors may elect to convert any remaining shares of Restricted Voting Common Stock into shares of Common Stock in the event 80% or more of the originally outstanding shares of Restricted Voting Common Stock have been previously converted into shares of Common Stock. As of June 30, 2003, there were 1,127,612 shares of Restricted Voting Common Stock remaining.

EARNINGS PER SHARE

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

The exercise prices for options to purchase 4.8 million shares of the Company's Common Stock ("Common Stock") at prices ranging from $2.875 to $21.44 per share were greater than the average market price of the Common Stock for the three months ended June 30, 2003. Under the calculations normally required by generally accepted accounting principles for determining EPS, including the effect of these options would increase diluted EPS, or have an "anti-dilutive" effect. When this situation occurs, generally accepted accounting principles require that such options or other common stock equivalents be excluded from the determination of diluted EPS. Accordingly, they have been excluded. Options to purchase 2.7 million shares of Common Stock at prices ranging from $6.00 to $21.44 per share were outstanding for the three months and six months ended June 30, 2002, but were not included in the computation of diluted EPS for the same reason.

Options had an anti-dilutive effect for the six months ended June 30, 2003 because the Company reported a loss from continuing operations during this period. Accordingly, options were not included in the diluted EPS calculation for this period. The Company would have included 103,949 shares related to the dilutive impact of options for this period if it were not for the loss from continuing operations during the period.

As noted above, the Company granted GE, its primary lender, a warrant to purchase 409,051 shares of Company common stock for nominal consideration. The dilutive impact of these warrants is computed assuming the issuance of shares required to fulfill the warrant obligation at the end of the reporting period and excluding the effect on the income statement for the period of any mark-to-market adjustments made in connection with valuing the warrants. When this is done for the three months ended June 30, 2003, the warrants have an anti-dilutive effect on diluted EPS and accordingly they are not included in the determination of diluted EPS. Had the warrants not been anti-dilutive, the Company would have included 1,173,183 shares in the diluted EPS calculation for the three months ended June 30, 2003. The after-tax gain related to the warrant's mark-to-market adjustment was $0.1 million for the six months ended June 30, 2003 and this amount is added to net income for purposes of calculating diluted EPS.

The shares associated with contingently issuable restricted stock grants described above are included in the diluted EPS calculation for the three months ended June 30, 2003 because it is probable that the performance requirements for the issuance of these shares will be met. These shares had an anti-dilutive effect for the six months ended June 30, 2003 since the Company had a loss from continuing operations for the period. Accordingly, these shares were not included in the determination of diluted EPS for that period.

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

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2002	2003	2002	2003
Common shares outstanding, end of period (a)	37,821	37,691	37,821	37,691
Effect of using weighted average common shares outstanding	18	(51)	(134)	(60)
Shares used in computing earnings per share -- basic	37,839	37,640	37,687	37,631
Effect of shares issuable under stock option plans based on the treasury stock method	637	118	550	--
Effect of shares issuable related to warrants	--	--	--	1,173
Effect of contingently issuable restricted shares	--	225	--	--
Shares used in computing earnings per share -- diluted	38,476	37,983	38,237	38,804

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(a) Excludes 225,000 shares of contingently issuable restricted stock outstanding as of June 30, 2003 (see "Restricted Stock Grant" paragraphs above).

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

The following discussion should be read in conjunction with our historical Consolidated Financial Statements and related notes thereto included elsewhere in this Form 10-Q and the Annual Report on Form 10-K as filed with the Securities and Exchange Commission for the year ended December 31, 2002 (the "Form 10-K"). This discussion contains "forward-looking statements" regarding our business and industry within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on our current plans and expectations and involve risks and uncertainties that could cause our actual future activities and results of operations to be materially different from those set forth in the forward-looking statements. Important factors that could cause actual results to differ include risks set forth in "Factors Which May Affect Future Results," included in our Form 10-K.

We are a national provider of comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services within the mechanical services industry. We operate primarily in the commercial and industrial 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. The segment of the HVAC industry we serve can be broadly divided into two service functions: installation in newly constructed facilities, which has provided approximately 53% of our 2003 revenues to date, and maintenance, repair and replacement, which has provided the remaining 47% of our 2003 revenues to date. Our consolidated 2003 revenues to date are derived from the following service activities, all of which are in the mechanical services industry, the single industry segment we serve:

SERVICE ACTIVITY	PERCENTAGE OF REVENUE
HVAC	73
Plumbing	11
Building Automation Control Systems	7
Other	9
Total	100

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

PERCENTAGE OF COMPLETION METHOD OF ACCOUNTING

Under the percentage of completion method of accounting as provided by American Institute of Certified Public Accountants Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," contract revenue recognizable at any time during the life of a contract is determined by multiplying expected total contract revenue by the percentage of contract costs incurred at any time to total estimated contract costs. More specifically, as part of the negotiation and bidding process in which we engage in connection with obtaining installation contracts, we estimate our contract costs, which include all direct materials (net of estimated rebates), labor and subcontract costs and indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. Then, as we perform under those contracts, we measure such costs incurred, compare them to total estimated costs to complete the contract, and recognize a corresponding proportion of contract revenue. As a result, contract revenues recognized in the statement of operations can and usually do differ from amounts that can be billed or invoiced to the customer at any point during the contract.

The percentage of completion method of accounting is also affected by changes in job performance, job conditions, and final contract settlements. These factors may result in revisions to estimated costs and, therefore, revenues. Such revisions are frequently based on further estimates and subjective assessments, and we recognize these revisions in the period in which they are determined. If such revisions lead us to conclude that we will recognize a loss on a contract, the full amount of the estimated ultimate loss is recognized in the period we reach that conclusion, regardless of the percentage of completion of the contract. Depending on the size of a project, variations from estimated project costs could have a significant impact on our operating results.

ACCOUNTING FOR ALLOWANCE FOR DOUBTFUL ACCOUNTS

We are required to estimate the collectibility of accounts receivable. Inherent in the assessment of the allowance for doubtful accounts are certain judgments and estimates including, among others, the creditworthiness of the customer, our prior collection history with the customer, the ongoing relationships with 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 our contract. These estimates are re-evaluated and adjusted as additional information is received.

ACCOUNTING FOR SELF-INSURANCE LIABILITIES

We are substantially self-insured for worker's compensation, employer's liability, auto liability, general liability and employee group health claims in view of the relatively high deductibles under our insurance arrangements for these risks. Losses up to deductible amounts are estimated and accrued based upon known facts, historical trends and industry averages. A third-party actuary reviews these estimates annually. We believe such accruals to be 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 and the effectiveness of safety and risk management programs. Therefore, if actual experience differs from the assumptions and estimates used for recording the liabilities, adjustments may be required and would be recorded in the period that the experience becomes known.

ACCOUNTING FOR GOODWILL AND OTHER INTANGIBLE ASSETS

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

Effective January 1, 2002, we adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." This new standard has two effects. First, we are no longer required to amortize goodwill against our operating results. Second, we are required to regularly test the goodwill on our books to determine whether its value has been impaired, and if it has, to immediately write off, as a component of operating income, the amount of the goodwill that is impaired.

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

As part of the adoption of SFAS No. 142, we were required to make a one-time determination of any transitional impairment loss by applying the standard's new, more rigorous valuation methodology. The result of this transitional analysis was a $202.5 million charge, net of tax benefit, reflected as a cumulative effect of a change in accounting principle in our statement of operations in the first quarter of 2002.

RESULTS OF OPERATIONS

	THREE MONTHS ENDED JUNE 30,				SIX MONTHS ENDED JUNE 30,			
	2002		2003		2002		2003	
	(IN THOUSANDS)							
Revenues	$211,500	100.0%	$202,355	100.0%	$ 401,126	100.0%	$384,769	100.0%
Cost of services	172,986	81.8%	167,553	82.8%	332,362	82.9%	322,215	83.7%
Gross profit	38,514	18.2%	34,802	17.2%	68,764	17.1%	62,554	16.3%
Selling, general and administrative expenses	30,480	14.4%	29,400	14.5%	62,873	15.7%	60,349	15.7%
Restructuring charges	--	--	1,112	0.5%	1,878	0.5%	2,274	0.6%
Operating income (loss)	8,034	3.8%	4,290	2.1%	4,013	1.0%	(69)	--
Other expense, net	(290)	(0.1)%	(956)	(0.5)%	(1,847)	(0.5)%	(2,569)	(0.7)%
Income (loss) before income taxes	7,744	3.7%	3,334	1.6%	2,166	0.5%	(2,638)	(0.7)%
Income tax expense (benefit)	2,641		728		1,064		(1,241)	
Income (loss) from continuing operations	5,103	2.4%	2,606	1.3%	1,102	0.3%	(1,397)	(0.4)%
Discontinued operations --								
Operating results, net of tax	(166)		(33)		89		66	
Estimated loss on disposition, including tax	(169)		--		(11,156)		(912)	
Cumulative effect of change in accounting principle, net of tax	--		--					

(202,521) -- -------- ----
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Net income
(loss).......... $ 4,768 $
2,573 $(212,486) $ (2,243)
======== ========
========= ========

Revenues -- Revenues decreased $9.1 million, or 4.3%, to $202.4 million for the second quarter of 2003 and decreased $16.4 million, or 4.1%, to $384.8 million for the first six months of 2003 compared to the same periods in 2002. The 4.3% decline in revenue for the quarter was comprised of a 3.4% decline in revenue at ongoing operations and a 0.9% decline in revenue related to operations that were sold during 2003. The 4.1% decline in revenue for the first six months of 2003 was comprised of a 3.2% decline in revenue at ongoing operations and a 0.9% decline in revenue related to operations that were sold during 2003.

The decline in revenues at ongoing operations in 2003 resulted primarily from continued economic weakness in several markets. In addition, the general economic slowdown in the U.S. which began in 2001 led to deferrals in both new and replacement project activity, and has also resulted in a more competitive pricing environment. This slowdown worsened in late 2002 and early 2003 based on renewed uncertainty about the economy and international events. We and other industry participants believe that there has been a general deferral of maintenance and replacement activity in the installed base of commercial/industrial HVAC equipment in response to the more difficult economy. We and other industry participants believe this trend will not continue indefinitely due to the fundamental operating needs of the equipment, but it is not clear when maintenance and replacement activity might increase. In addition, while we have seen some signs that activity levels in our industry may increase over the next year as compared to current levels, there can be no assurance that this will occur. In view of the decreased economic activity and increased price competition affecting our industry, we may continue to experience only modest revenue growth or revenue declines in upcoming periods. In addition, if general economic activity in the U.S. slows significantly from current levels, we may realize further decreases in revenue and lower operating margins.

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

Backlog associated with continuing operations as of June 30, 2003 was $457.4 million, a 5.1% increase from December 31, 2002 backlog of $435.1 million and a decrease of $3.6 million, or 0.8%, from June 30, 2002 backlog of $461.0 million. During the fourth quarter of 2002, we removed $16.0 million from backlog that related to a project that we now believe will not proceed. This project was first reflected in backlog in the third quarter of 2001. If this project is excluded from June 30, 2002 backlog, our backlog reflected an increase of 2.8% from an adjusted June 30, 2002 backlog of $445.0 million.

Gross Profit -- Gross profit decreased $3.7 million, or 9.6%, to $34.8 million for the second quarter of 2003 and decreased $6.2 million, or 9.0%, to $62.6 million for the first six months of 2003 compared to the same periods in 2002. As a percentage of revenues, gross profit decreased from 18.2% for the three months ended June 30, 2002 to 17.2% for the three months ended June 30, 2003 and decreased from 17.1% for the six months ended June 30, 2002 to 16.3% for the six months ended June 30, 2003.

The decline in gross profit in the second quarter of 2003 as compared to the second quarter of 2002 is primarily due to lower industry activity levels and increased price competition. These factors also contributed to the decline in gross profit for the first six months of 2003 as compared to the same period in 2002, along with adverse cost developments on certain projects in two of our operations during the first quarter of 2003.

Selling, General and Administrative Expenses ("SG&A") -- SG&A decreased $1.1 million, or 3.5%, to $29.4 million for the second quarter of 2003 and decreased $2.5 million, or 4.0%, to $60.3 million for the first six months of 2003 compared to the same periods in 2002. As a percentage of revenues, SG&A increased from 14.4% for the three months ended June 30, 2002 to 14.5% for the three months ended June 30, 2003 and remained flat at 15.7% for the six months ended June 30, 2003 compared to the six months ended June 30, 2002. During the second quarter of 2002, we reversed $0.8 million of the bad debt reserves that were established in the fourth quarter of 2001 related to our receivables with Kmart as a result of a settlement with Kmart. Accordingly, the decrease in normal SG&A from 2002 to 2003 was greater by this amount. The decrease is primarily due to a concerted effort to reduce SG&A throughout our company. This effort included a reduction in corporate overhead at the end of the first quarter of 2002 in response to our smaller size following the sale of 19 units to Emcor as discussed further below under "Discontinued Operations." We also initiated further steps in the second quarter of 2003 to reduce overhead both in our corporate office and in our field operations based on continuing weakness in industry activity levels and pricing.

Restructuring Charges -- During the first two quarters of 2003, we recorded restructuring charges of approximately $2.3 million pre-tax. These charges included approximately $1.3 million for severance costs and stay bonuses primarily associated with the curtailment of our energy efficiency activities, a reorganization of our national accounts operations as well as a reduction in corporate personnel. The severance costs and stay bonuses related to the termination of 87 employees (81 of these employees had been terminated as of June 30, 2003). In addition, these charges include approximately $0.9 million for remaining lease obligations and $0.1 million of other costs recorded in connection with the actions described above. An additional $0.3 to $0.7 million is expected to be incurred during the second half of 2003 for additional severance costs and remaining lease obligations associated with these restructuring actions.

During the first quarter of 2002, we recorded restructuring charges of approximately $1.9 million. These charges included approximately $0.8 million for severance costs primarily associated with the reduction in corporate office overhead in light of our smaller size following the Emcor transaction. The severance costs related to the termination of 33 employees, none of whom were employed as of March 31, 2002. In addition, these charges include approximately $0.7 million for costs associated with decisions to merge or close three smaller divisions and realign regional operating management. These restructuring charges are primarily cash obligations but did include approximately $0.3 million of non-cash writedowns associated with long-lived assets.

Other Expense, Net -- Other expense, net, primarily includes interest expense, and increased $0.7 million to $1.0 million for the second quarter of 2003 and increased $0.7 million to $2.6 million for the first six months of 2003 compared to the same periods in 2002. Interest expense for the first quarter of 2003 includes a charge of $0.8 million for deferred financing costs that were associated with previously higher levels of capacity under our credit facility. In addition, first quarter 2003 includes a loss of $0.3 million on the disposition of a division of one of our operations. A portion of our actual interest expense in the first quarter of 2002 was allocated to the discontinued operations caption based upon our net investment in these operations. Therefore, interest expense relating to continuing operations does not reflect the pro forma reduction of interest expense from applying the proceeds from the sale of these operations to reduce debt in any earlier period. Interest expense allocated to the discontinued operations for the three months ended March 31, 2002 was $1.5 million. In addition, first quarter 2002 interest expense in continuing operations includes a non-cash writedown of $0.6 million, before taxes, of loan arrangement costs in connection with the reduction in our borrowing capacity following the Emcor transaction. Other expense, net, for the second quarter of 2002 also includes a gain of $0.6 million on the sale of the residential portion of one of our operations.

Income Tax Expense (Benefit) -- Our effective tax rates associated with results from continuing operations for the six months ended June 30, 2002 and 2003 were 49.1% and 47.0%, respectively. These effective rates are higher than statutory rates because of the effect of certain expenses that we incur that are not deductible for tax purposes. In addition, since our current pre-tax profit margins are relatively low on a historical and an absolute basis, the impact of these non-deductible expenses on our effective rate is increased.

During the first quarter of 2003, we reported an effective tax rate of only 33.0%, as we incurred a pre-tax loss during that period and believed it more conservative to limit the amount of tax benefit recognized when a loss is incurred early in the year. Because we now believe we will report pre-tax income for the year as a whole, we adjusted our year-to-date effective tax rate to 47.0%, the level we currently expect to be applicable for our full-year results. As a result of this year-to-date adjustment, our effective rate for the second quarter was 21.8%. During quarters in which we report pre-tax profits, it is more typical for our effective tax rate for the quarter to be similar to our current year-to-date effective rate.

Discontinued Operations -- During the second quarter of 2003, we sold an operating company. This unit's operating income of $0.1 million, net of taxes, in each of the first six months of 2002 and 2003 has been reported in discontinued operations under "Operating results, net of tax" in our results of operations. In the first quarter of 2003, we recorded an estimated loss of $0.9 million, including taxes, related to this transaction in "Estimated loss on disposition, including tax" in our results of operations.

On March 1, 2002, we sold 19 operations to Emcor Group. The total purchase price was $186.25 million, including the assumption by Emcor of approximately $22.1 million of subordinated notes to former owners of certain of the divested companies.

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

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

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

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

Under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which took effect for us on January 1, 2002, the operating results of the companies sold to Emcor for all periods presented through the sale, as well as the loss on the sale of these operations, have been presented as discontinued operations in our results of operations. We realized an aggregate loss of $11.8 million, including related tax expense, in connection with the sale of these operations. As a result of the adoption of SFAS No. 142 "Goodwill and Other Intangible Assets," we also recognized a goodwill impairment charge related to these operations of $32.4 million, net of tax benefit, as of January 1, 2002. The reporting of our aggregate initial goodwill impairment charge in connection with adopting SFAS No. 142 is discussed further below under "Cumulative Effect of Change in Accounting Principle."

In March 2002, we also decided to divest of an additional operating company. In the first quarter of 2002, we recorded an estimated loss of $0.4 million, net of tax benefit, from this planned disposition in "Estimated loss on disposition, including tax" in our results of operations. In the fourth quarter of 2002, we reversed this estimated loss because we decided not to sell this unit.

During the second quarter of 2002, we sold a division of one of our operations. The operating loss for this division for the first two quarters of 2002 of $0.3 million, net of tax benefit, has been reported in discontinued operations under "Operating results, net of tax" in our results of operations. We realized a loss of $0.2 million, net of tax benefit, on the sale of this division. This loss is included in "Estimated loss on disposition, including tax" during the second quarter of 2002 in our results of operations.

Cumulative Effect of Change in Accounting Principle -- Effective January 1, 2002, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets," which required a transitional assessment of our goodwill assets.

To perform the transitional impairment testing required by SFAS No. 142 under its new, more rigorous impairment criteria, we broke our operations into "reporting units", as prescribed by the new standard, and tested each of these reporting units for impairment by comparing the unit's fair value to its carrying value. The fair value of each reporting unit was estimated using a discounted cash flow model combined with market valuation approaches. Significant estimates and assumptions were used in assessing the fair value of reporting units. These estimates and assumptions involved future cash flows, growth rates, discount rates, weighted average cost of capital and estimates of market valuations for each of the reporting units.

As provided by SFAS No. 142, the transitional impairment loss identified by applying the standard's new, more rigorous valuation methodology upon initial adoption of the standard was reflected as a cumulative effect of a change in accounting principle in our results of operations. The resulting non-cash charge was $202.5 million, net of tax benefit, and was recorded during the first quarter of 2002.

Outlook -- As noted above, we have reported lower earnings in 2003 than in 2002. This resulted from several factors that coincided with what is traditionally our period of lower seasonal activity during the year. Foremost among these factors, as noted above, were adverse cost developments in certain projects in two of our operations, and reduced activity levels and increased price competition stemming from the general economic slowdown which began in 2001 and which worsened in late 2002 and early 2003 based on renewed uncertainty about the economy and international events.

We and other industry participants believe that there has been a general deferral of maintenance and replacement activity in the installed base of commercial/industrial HVAC equipment in response to the more difficult economy. We and other industry participants believe this trend will not continue indefinitely due to the fundamental operating needs of the equipment, but it is not clear when maintenance and replacement activity might increase. In addition, while we have seen some signs that activity levels in our industry may increase over the next year as compared to current levels, there can be no assurance that this will occur. Based on these indications as well as significant cost reductions we have initiated, we expect to be profitable in 2003 as a whole. Because industry conditions have not improved to the degree we expected when we commented on our 2003 outlook in our first quarter reports, we now believe our full-year 2003 results will be comparable to 2002's results, rather than higher than 2002 results as indicated in our first quarter reports. However, these factors also lead us to expect that our 2004 results will be significantly better than our 2003 results.

LIQUIDITY AND CAPITAL RESOURCES

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2002	2003	2002	2003
	(IN THOUSANDS)			
Cash provided by (used in):				
Operating activities....................	$ 10,955	$ 13,923	$ 1,693	$11,580
Investing activities....................	$ 10,130	$ (3,502)	$ 152,629	$(4,586)
Financing activities....................	$(18,316)	$(10,335)	$(152,323)	$(1,683)
Free cash flow:				
Cash provided by operating activities....	$ 10,955	$ 13,923	$ 1,693	$11,580
Taxes paid related to the sale of businesses...........................	--	--	--	10,371
Purchases of property and equipment......	(936)	(860)	(3,070)	(1,947)
Proceeds from sales of property and equipment............................	963	32	1,134	111
Free cash flow..........................	$ 10,982	$ 13,095	$ (243)	$20,115

Cash Flow -- We define free cash flow as cash provided by operating activities less items related to nonrecurring transactions such as sales of businesses and customary capital expenditures plus the proceeds from asset sales. Positive free cash flow represents funds available to invest in significant operating initiatives, to acquire other companies or to reduce a company's outstanding debt or equity. If free cash flow is negative, additional debt or equity is generally required to fund the outflow of cash. Free cash flow may be defined differently by other companies. Free cash flow is presented because it is a financial measure that is frequently requested by capital market participants in evaluating our company. However, free cash flow is not considered under generally accepted accounting principles to be a primary measure of an entity's financial results, and accordingly free cash flow should not be considered an alternative to operating income, net income, or cash flows as determined under generally accepted accounting principles and as reported by us.

For the three months ended June 30, 2003, we had positive free cash flow of $13.1 million as compared to $11.0 million for the same period in 2002. We have now generated positive free cash flow in eleven of the last thirteen quarters. For the six months ended June 30, 2003, we had positive free cash flow of $20.1 million as compared to negative free cash flow of $0.2 million for the same period in 2002.

For the three months ended March 31, 2003, free cash flow from operations as well as borrowings from the credit facility discussed below, were used to pay final tax payments of $10.4 million associated with the sale of the operations to Emcor. The net proceeds received at the closing of the Emcor transaction in the first quarter of 2002 were all used to reduce our debt.

Credit Facility -- Our primary current debt financing capacity consists of a $54 million senior credit facility, or the Facility, provided by a syndicate of three financial institutions led by General Electric Capital Corporation, or GE. The Facility includes a $20 million sublimit for letters of credit. The Facility is secured by substantially all of our assets. The Facility was entered into on October 11, 2002 and replaced our previous revolving credit facility. The Facility consists of two parts: a term loan and a revolving credit facility.

The term loan under the Facility, or the Term Loan, was originally $15 million, which we borrowed upon the closing of the Facility on October 11, 2002. The Term Loan must be repaid in quarterly installments over five years beginning December 31, 2002. The amount of each quarterly installment increases annually. These scheduled payments are recapped below under Amounts Outstanding, Capacity and Maturities.

The Facility requires prepayments of the Term Loan in certain circumstances. Approximately half of any free cash flow (as defined in the Facility agreement -- primarily cash from operations less capital expenditures) in excess of scheduled principal payments and voluntary prepayments must be used to pay down the Term Loan. This requirement is measured annually based on full-year results. We did not have any prepayments of the Term Loan due as of December 31, 2002 under this requirement, primarily as a result of our significant amount of voluntary prepayments of debt during 2002. In addition, proceeds in excess of $250,000 from any individual asset sales, or in excess of $1 million for a full year's asset sales, must be used to pay down the Term Loan. Proceeds from asset sales that are less than these individual transaction or annual aggregate levels must also be used to pay down the Term Loan unless they are reinvested in long-term assets within six months of the receipt of such proceeds.

All prepayments under the Term Loan, whether required or voluntary, are applied to scheduled principal payments in inverse order, i.e. to the last scheduled principal payment first, followed by the second-to-last, etc. All principal payments under the Term Loan permanently reduce the original $15 million capacity under this portion of the Facility. As of June 30, 2003, $13.7 million was outstanding under the Term Loan.

The Facility also includes a three-year $40 million revolving credit facility, the Revolving Loan. Under this revolving credit facility we can borrow up to $20 million, with the difference between actual borrowings and $40 million available for letter of credit issuance up to a maximum of $20 million in letters of credit. Capacity under the Revolving Loan is also limited by the leverage and fixed charge coverage covenants described below under Restrictions and Covenants and Amounts Outstanding, Capacity, and Maturities. As noted in the latter section, under the most restrictive of these capacity provisions, our current borrowing capacity, on a monthend measurement basis, is $5.0 million. Borrowing capacity can be greater than this amount on an intra-month basis. Letters of credit currently outstanding are $19.7 million.

Interest Rates and Fees -- We have a choice of two interest rate options for borrowings under the Facility. Under one option, the interest rate is determined based on the higher of the Federal Funds Rate plus 0.5% or the prime rate of at least 75% of the U.S.'s 30 largest banks, as published each business day by the Wall Street Journal. An additional margin of 2.25% is then added to the higher of these two rates for borrowings under the Revolving Loan, while an additional margin of 2.75% is added to the higher of these two rates for borrowings under the Term Loan.

Under the other interest rate option, borrowings bear interest based on designated rates that are described in various general business media sources as the London Interbank Offered Rate or "LIBOR." Revolving Loan borrowings using this interest rate option then have 3.25% added to LIBOR, while Term Loan borrowings have 3.75% added to LIBOR.

Commitment fees of 0.5% per annum are payable on the unused portion of the Revolving Loan.

We also incurred certain financing and professional costs in connection with the arrangement and the closing of the Facility. These costs will be amortized to interest expense over the term of the Facility in the amount of approximately $0.4 million per quarter. To the extent prepayments of the Term Loan are made or the size of the Facility is reduced, we may have to accelerate amortization of these deferred financing and professional costs. During the first quarter of 2003, we charged approximately $0.8 million of deferred financing costs to interest expense that were associated with higher levels of capacity under the Facility than the current total of $54 million.

The weighted average interest rate that we currently pay on borrowings under the Facility is 5.5% per annum. This reflects a combination of borrowings under both interest rate options described above, as well as the swap of floating rates to a fixed rate described above. This rate does not include amortization of debt financing and arrangement costs, or adjustments for derivatives.

Interest Rate Derivative -- The rates underlying the interest rate terms of the Facility are floating interest rates determined by the broad financial markets, meaning they can and do move up and down from time to time. The Facility required that we convert these floating interest rate terms on at least half of the original Term Loan to fixed rates for at least a one-year term. In January 2003, we converted $10 million of principal value to a fixed LIBOR-based interest rate of 5.62% for an eighteen-month term. This was done via a transaction known as a "swap" under which we agreed to pay fixed interest rate payments on $10 million for eighteen months to a bank in exchange for receiving from the bank floating LIBOR interest rate payments on $10 million for the same term.

This transaction is a derivative and has been designated a cash flow hedging instrument under applicable generally accepted accounting principles. Changes in market interest rates in any given period may increase or decrease the valuation of our obligations to the bank under this swap versus the bank's obligations to us. So long as the instrument remains "effective" as defined under applicable generally accepted accounting principles, such changes in market valuation are reflected in stockholders' equity as other comprehensive income (loss) for that period, and not in our results of operations. If the swap is terminated earlier than its eighteen-month term, any gain or loss on settlement will be reflected in our statement of operations. The swap was effective as a hedge for accounting purposes from its inception through June 30, 2003, and we expect it to continue to be effective throughout its term.

During the six months ended June 30, 2003, a reduction to stockholders' equity of $0.1 million, net of tax, was recorded through other comprehensive income (loss) and is included in other current liabilities in our consolidated balance sheet. The counterparty to the above derivative agreement is a major bank. Based on our continuing review of the financial position of this bank, we believe there is minimal risk that it will not meet its obligations to us under this swap.

Credit Facility Warrant -- In connection with the Facility, we granted GE a warrant to purchase 409,051 shares of our common stock for nominal consideration. In addition, GE may "put," or require us to repurchase, these shares at the higher of market price, appraised price or book value per share, during the fifth and final year of the Facility -- October 11, 2006 to October 11, 2007. This put may be accelerated under certain circumstances including a change of control of our company, full repayments of amounts owing under the Facility, or a public offering of shares by us. This warrant and put are discussed in greater detail in Note 8, "Stockholders' Equity," to the Consolidated Financial Statements.

The value of this warrant and put as of the start of the Facility of $2.9 million, less amortization to date of $0.3 million, is reflected as a discount of our obligation under the Facility and is being amortized over the term of the Facility, as described above. This warrant and put obligation are also recorded as a liability in the Company's balance sheet. The value of this warrant and put will change over time, principally in response to changes in the market price of our common stock.

The warrant and put qualify as a derivative for financial reporting purposes. Accordingly, such changes in the value of the warrant and put in any given period will be reflected in interest expense for that period, even though the warrant and put may not have been terminated and settled in cash during the period. Such adjustments are known as mark-to-market adjustments. The gain included in interest expense related to the warrant's mark-to-market obligation during the six months ended June 30, 2003 was $0.1 million.

The table below provides an indication of the potential effect on the valuation of this derivative that might result from changes in the market price of our stock. In this table, the value of the warrant has been calculated based upon the stock price being $1 lower and $1 higher than our closing stock price at June 30, 2003 (value of warrant and put obligation in thousands).

STOCK PRICE	VALUE OF WARRANT AND PUT OBLIGATION
$1.63	$2,892
$2.63(a)	$3,085
$3.63	$3,323

- ---------------

(a) This was our closing stock price on June 30, 2003.

Restrictions and Covenants -- Borrowings under the Facility are specifically limited by our ratio of total debt to earnings before interest, taxes, depreciation, and amortization ("EBITDA") also known as the leverage covenant, and by our ratio of EBITDA less taxes and capital expenditures to interest expense and scheduled principal payments, also known as the fixed charge coverage ratio. The Facility's definition of debt for purposes of the ratio of total debt to EBITDA includes aggregate letters of credit outstanding less $10 million and excludes cash balances in certain of our bank accounts.

The definition of EBITDA under the Facility excludes certain items, generally non-cash amounts and transactions reported in Other Income and Expense, that are otherwise included in the determination of earnings under generally accepted accounting principles in our financial statements. As such, EBITDA as determined under the Facility's definition could be less than EBITDA as derived from our financial statements in the future.

The financial covenants under the Facility are summarized below. Covenant compliance is measured on a monthly basis. Intra-quarter monthly covenants are at either the same or very similar levels to the quarter-end covenants shown below. EBITDA amounts are in thousands:

	FINANCIAL COVENANTS			
FOR THE QUARTER ENDING	MINIMUM TRAILING 12 MONTHS EBITDA	MAXIMUM DEBT TO EBITDA RATIO	MINIMUM FIXED CHARGE COVERAGE	MINIMUM INTEREST COVERAGE
ACTUAL June 30, 2003	$16,666	0.96	3.09	8.02
COVENANT June 30, 2003	$16,420	2.20	2.50	3.00
September 30, 2003	$17,840	2.10	2.60	3.00
December 31, 2003	$23,565	1.50	2.70	3.00
March 31, 2004	$29,000	1.50	3.00	3.00
June 30, 2004	$29,000	1.50	3.00	3.00
September 30, 2004	$29,000	1.25	3.00	3.00

December 31, 2004.................	$29,000	1.25	3.00	3.00
All quarters thereafter...........	$31,000	1.25	3.00	3.00

Our trailing twelve months EBITDA as of December 31, 2002 as determined under the Facility did not comply with the covenant then in effect. Our lenders waived this violation and agreed to modify our minimum EBITDA, leverage and fixed charge covenants for 2003. Even at these modified levels, these covenants leave only moderate room for variance based on our recent performance. If we again violate a covenant under the Facility, we may have to negotiate new borrowing terms under the Facility or obtain new financing. While we believe that our levels of debt in comparison to our EBITDA and our cash flows would enable us to negotiate new borrowing terms under the Facility or to obtain new financing from other sources if necessary, there can be no assurance that we would be successful in doing so.

The Facility prohibits us from paying dividends, repurchasing shares, and making acquisitions. It also limits annual lease expense and non-Facility debt, and restricts outlays of cash by us relating to certain investments and subordinate debt.

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. We may decide to cancel or terminate a lease before the end of its term. Typically we are liable to the lessor for 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. Some customers also require us to post letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. Such letters of credit are generally issued by a bank or similar financial institution. The letter of credit commits the issuer 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 issuer of the letter of credit. Depending on the circumstances of such a reimbursement, we may also have to record a charge to earnings for the reimbursement. To date we have not had a claim made against a letter of credit that resulted in payments by the issuer of the letter of credit or by us. We believe that it is unlikely that we will have to fund claims under a letter of credit in the foreseeable future.

Many customers, particularly in connection with new construction, require us to post performance and payment bonds issued by a financial institution known as a surety. These bonds provide a guarantee to the customer that we will perform under the terms of a contract and that we will pay subcontractors and vendors who provided goods and services under a contract. If we fail to perform under a contract or to pay subcontractors and vendors, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the surety for any expenses or outlays it incurs. To date, we have not had any significant reimbursements to our surety for bond-related costs. We believe that it is unlikely that we will have to fund claims under our surety arrangements in the foreseeable future.

We have reached a preliminary agreement with our surety and GE to grant the surety a secured interest in assets such as receivables, costs incurred in excess of billings, and equipment related to projects for which bonds are outstanding as collateral for potential obligations under bonds. As of June 30, 2003, the amount of these assets is approximately $39.6 million. We have also posted a $5 million letter of credit as collateral for potential obligations under bonds.

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

Amounts Outstanding, Capacity and Maturities -- Apart from the Term Loan, our available credit capacity under the Facility is governed by the nominal limits of the Facility, and by calculated limits based on the leverage and fixed charge coverage covenants described above. Available credit capacity is limited to the most restrictive of these measures. The nominal limits are in effect at all times. The leverage provision limits borrowings that can be outstanding at monthend. The fixed charge provision limits amounts that can be outstanding at monthend, or at any other time that GE requests that this covenant be measured. Even though available credit capacity under the leverage provision is only measured at monthend, it is presented below because it is the most restrictive of these limitations as of recent monthends. Available capacity under the Revolving Loan can be greater than the amount below on an intra-month basis.

The following recaps the Company's debt amounts outstanding and capacity (in thousands):

	AS OF JUNE 30, 2003	AS OF AUGUST 1, 2003	UNUSED CAPACITY AS OF AUGUST 1, 2003
Revolving loan	$ --	$ 9,900	$4,980
Term loan	13,675	13,675	n/a
Other debt	462	457	n/a
Total debt	14,137	24,032	4,980
Less: discount on Facility	(2,550)	(2,500)	n/a
Total debt, net of discount	$11,587	$21,532	$4,980
Letters of credit	$14,146	$19,655	$ 345

The following recaps the future maturities of this debt along with other contractual obligations. Debt maturities in this recap are based on amounts outstanding as of August 1, 2003 while operating lease maturities are based on amounts outstanding as of June 30, 2003 (in thousands).

	TWELVE MONTHS ENDED JUNE 30, 2004	2005	2006	2007	2008	THEREAFTER	TOTAL
Revolving loan	$ --	$ --	$ 9,900	$ --	$ --	$ --	$ 9,900
Term loan	2,063	2,812	3,563	4,312	925	--	13,675
Other debt	98	87	63	57	60	92	457
Total debt	$2,161	$2,899	$13,526	$4,369	$ 985	$ 92	24,032
Less: discount on Facility							(2,500)
Total debt, net of discount							$21,532
Operating lease obligations	$9,324	$7,507	$ 6,372	$5,041	$4,197		$13,249 $45,690

As of June 30, 2003, we also have $14.1 million of letter of credit commitments, all of which will expire in 2003.

Outlook -- As noted above, we have generated positive free cash flow in most recent periods, and we currently have a moderate level of debt. We anticipate that free cash flow from operations and credit capacity under the Facility will provide us with sufficient liquidity to fund our operations for the foreseeable future. However, we do not have a significant amount of excess credit capacity in comparison to expected working capital requirements over the balance of 2003. We believe that our levels of debt in comparison to our EBITDA and our cash flows would enable us to obtain new financing if necessary, but there can be no assurance that we would be successful in doing so.

We currently have $19.7 million in letters of credit outstanding. We self-insure a significant portion of our workers compensation, auto liability and general liability risks. We use third parties to manage this self-insurance and to retain some of these risks. As is customary under such arrangements, these third parties can require letters of credit as security for amounts they fund or risks they might potentially absorb on our behalf. Under our current self-insurance arrangements, we have posted $13.2 million in letters of credit. In addition, we may receive other letter of credit requests in the ordinary course of business, and we may have a net increase in the amount of insurance-related letters of credit we must post when we renew our insurance arrangements in the fourth quarter of 2003. Accordingly, our letter of credit requirements over the next year may exceed the current letter of credit sublimits of $20 million under our credit facility. If so, we may have to seek additional letter of credit capacity or post different forms of security such as bonds or cash in lieu of letters of credit. We believe that our levels of debt in comparison to our EBITDA and free cash flows would enable us to obtain additional letter of credit capacity or to otherwise meet financial security requirements of third parties if necessary, but there can be no assurance that we would be successful in doing so.

As described above, the financial covenants under our credit facility leave only moderate room for variance based on our recent performance. If we again violate a covenant under the Facility, we may have to negotiate new borrowing terms under the Facility or obtain new financing. While we believe that our levels of debt in comparison to our EBITDA and cash flows would enable us to negotiate new borrowing terms under the Facility or to obtain new financing from other sources if necessary, there can be no assurance that we would be successful in doing so.

SEASONALITY AND CYCLICALITY

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

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

NEW ACCOUNTING PRONOUNCEMENTS

In July 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS No. 146"). SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities, such as restructurings, involuntarily terminating employees, and consolidating facilities, where those activities were initiated after December 31, 2002. The implementation of SFAS No. 146 does not require the restatement of previously issued financial statements. See Note 5 of the Consolidated Financial Statements for a discussion of restructuring charges recorded during 2003 in accordance with SFAS No. 146.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45"). It clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. The objective of the initial measurement of the liability is the fair value of the guarantee at its inception. The initial recognition and initial measurement provisions of FIN 45 are effective for us for guarantees issued after December 31, 2002. Although we from time to time guarantee the performance of systems or designs we provide, we currently have no material guarantees.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation -- Transition and Disclosure." SFAS 148 amends FASB Statement No. 123, "Accounting for Transition for

Stock-Based Compensation" to provide alternative methods of transition for a voluntary change to the fair value-based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements of the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS 148 is effective for fiscal years ending after December 15, 2002 and the footnote disclosure provisions were adopted by us in the fourth quarter of 2002.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). FIN 46 expands upon and strengthens existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. A variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or is entitled to receive a majority of the entity's residual returns or both. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. We are currently evaluating the effect that adoption of FIN 46 will have on our consolidated financial condition or results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk primarily related to potential adverse changes in interest rates. Management is actively involved in monitoring exposure to market risk and continues to develop and utilize appropriate risk management techniques. In January 2003, we converted $10 million of our Term Loan to a fixed interest rate of 5.62% for an eighteen-month term. This was done via a transaction known as a "swap" under which we agree to pay fixed LIBOR-based interest rate payments on $10 million for eighteen months to a bank in exchange for receiving from the bank floating LIBOR-based interest rate payments on $10 million for the same term. This transaction is a derivative and qualifies for hedge accounting treatment. 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. Management does not use derivative financial instruments for trading or to speculate on changes in interest rates or commodity prices.

ITEM 4. CONTROLS AND PROCEDURES

Within 90 days before the date of this report on Form 10-Q, under the supervision and with the participation of our management, including our Chairman of the Board and Chief Executive Officer (our principal executive officer) and our Chief Financial Officer (our principal financial officer), we evaluated the effectiveness of our disclosure controls and procedures (as defined under Rule 13a-14(c) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on this evaluation, our Chairman of the Board and Chief Executive Officer and our Chief Financial Officer believe that our disclosure controls and procedures are effective to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act fairly represents, in all material respects, our financial condition, results of operations and cash flows.

There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of such evaluation.

PART II -- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 2. RECENT SALES OF UNREGISTERED SECURITIES

None.

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

The Company held its annual meeting of stockholders in Houston, Texas on May 22, 2003. The following sets forth matters submitted to a vote of stockholders:

(a) The following individuals were elected to the Board of Directors as stated in the Company's Proxy Statement dated April 23, 2003, for terms expiring at the next annual stockholders' meeting or until their successors have been elected and qualified -- Fred J. Giardinelli, Vincent J. Costantini, and Norman C. Chambers. Every director was elected by a majority of the outstanding shares of Common Stock of the Company. Out of a potential 36,795,882 shares of Common Stock outstanding, Mr. Giardinelli had 33,457,481 shares voted in favor, with 468,251 shares withheld. Mr. Costantini had 33,456,374 shares voted in favor, with 468,358 shares withheld, and Mr. Chambers had 33,428,885 shares voted in favor, with 496,847 shares withheld.

(b) A majority of the outstanding shares of Common Stock of the Company approved the amendment to the Certificate of Incorporation to eliminate the classification of the Board of Directors. Shares voted in favor 33,762,881, with 589,578 shares withheld, and 20,803 shares abstained.

(c) Stockholder proposal against the Company's use of EBITDA for "performance-based" compensation. Shares voted in favor 3,485,534, with 16,628,540 shares withheld, and 164,892 shares abstained.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

10.1 Employment Agreement between Fred Giardenelli, Jr. and Eastern Heating & Cooling, Inc. dated June 1, 2003. (Filed herewith).

31.1 Certification of William F. Murdy pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002. (Filed herewith).

31.2 Certification of J. Gordon Beittenmiller pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002. (Filed herewith).

32.1 Certification of William F. Murdy, pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002. (Filed herewith).

32.2 Certification of J. Gordon Beittenmiller, pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002. (Filed herewith).

(b) Reports on Form 8-K

(i) The Company filed a report on Form 8-K with the Securities and Exchange Commission on May 6, 2003. Under Item 7 of that report the Company announced that on May 5, 2003, the Company issued a press release, reporting Comfort's financial results for the first quarter of 2003.

SIGNATURES

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

COMFORT SYSTEMS USA, INC.

/s/ WILLIAM F. MURDY

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

August 5, 2003

/s/ J. GORDON BEITTENMILLER

J. Gordon Beittenmiller
Executive Vice President,
Chief Financial Officer and Director

August 5, 2003

INDEX TO EXHIBITS

EXHIBIT NO.	DESCRIPTION
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2002. (Filed
herewith).

EXHIBIT 10.1

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (this "Agreement") between Eastern Heating & Cooling, Inc. (the "Company"), and Fred Giardenelli, Jr. ("Executive") is entered into and effective as of the 1st day of June, 2003. This Agreement supersedes any other employment agreements or understandings, written or oral, between the Company and Executive.

R E C I T A L S

The following statements are true and correct:

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

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

Each of Company and Executive desire to establish Executive's employment by the Company pursuant to this Agreement.

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

A G R E E M E N T S

1. Employment and Duties.

(a) The Company hereby employs Executive in an executive position and Executive hereby accepts this employment upon the terms and conditions herein contained. Executive agrees to devote substantially all of Executive's business time, attention and efforts to promote and further the business of the Company.

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

(c) Executive shall not, during the term of Executive's employment hereunder, be engaged in any other business activity pursued for gain, profit or other pecuniary advantage if such activity interferes in any material respect with Executive's duties and responsibilities hereunder. The foregoing limitations shall not be construed as prohibiting

Executive from making personal investments in such form or manner as will neither require Executive's services in the operation or affairs of the companies or enterprises in which such investments are made nor violate the terms of Section 4.

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

(a) Base Salary. Effective the date hereof, the base salary payable to Executive is $180,000 per year, payable on a regular basis in accordance with the Company's standard payroll procedures, but not less often than monthly. On at least an annual basis, the Company will review Executive's performance and may make adjustments to such base salary if, in its discretion, any such adjustment is warranted.

(b) Executive Perquisites, Benefits and Other Compensation. Executive shall be entitled to receive additional benefits and compensation from the Company in such form and to the extent specified below:

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

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

3. Confidentiality.

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

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

4. Non-Competition Agreement.

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

(i) engage, as an officer, director, shareholder, owner, partner, joint venturer, or in a managerial capacity, whether as an employee, independent contractor, consultant or advisor, or as a sales representative, or make or guarantee loans or invest, in or for any business engaged in Services in competition with the Company Group or any other member of the Comfort Group within seventy-five (75) miles of where any Comfort Group operation or subsidiary conducts business if within the preceding two years Executive has had responsibility for, or material input or participation in, the management or operation of such other operation or subsidiary (the "Territory");

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

(iii) call upon any person or entity which is at that time, or which has been within ONE (1) years prior to that time, a customer of the Company or any other member of the Comfort Group for the purpose of soliciting or selling Services;

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

Notwithstanding the above, the foregoing covenants shall not be deemed to prohibit Executive from acquiring as an investment not more than one percent (1%) of the capital stock of a competing business whose stock is traded on a national securities exchange or on an over-the-counter or similar market.

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

(c) Extension. Notwithstanding the foregoing provisions of this paragraph 4, if this Agreement is terminated pursuant to paragraph 5, then, upon written notice to

Executive not later than 60 days following the date of such termination, the Company may at its option extend by up to twelve additional months the agreements and covenants contained in this paragraph 4 by paying to Executive a number of months of base salary equal to the length of the extension specified in such notice, any such amounts to be payable during such extension period in a manner consistent with the Company's standard pay practices.

5. Term; Termination; Rights on Termination. The term of this Agreement shall begin on the date hereof and continue for a term of two (2) years, unless renewed or terminated under this Paragraph 5. At the end of the initial term described in the preceding sentence, this Agreement shall automatically renew for succeeding terms of one (1) year each (subject to termination under this Paragraph), unless either party shall, at least 10 days prior to the expiration of any term, give written notice of an intention not to renew this Agreement. This Agreement and Executive's employment may be terminated in any one of the following ways:

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

(b) Disability. If, as a result of incapacity due to physical or mental illness or injury, Executive shall have been absent from Executive's full-time duties hereunder for four (4) consecutive months, then thirty (30) days after receiving written notice (which notice may occur before or after the end of such four (4) month period, but which shall not be effective earlier than the last day of such four (4) month period), the Company may terminate Executive's employment hereunder, provided Executive is unable to resume Executive's full-time duties at the conclusion of such notice period. In the event this Agreement is terminated as a result of Executive's disability, Executive shall receive from the Company Executive's base salary at the rate then in effect for six (6) months, and such amount shall be payable during such period in a manner consistent with Company's standard pay practices. The amount payable hereunder shall be decreased by the amount of benefits otherwise actually paid by the Company to Executive or on Executive's behalf or under any insurance procured by the Company.

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

(d) Without Cause. At any time after the commencement of Executive's employment, Executive or the Company may, without cause, terminate this Agreement and Executive's employment, effective fifteen (15) days after receipt of written notice. Should Executive be terminated by the Company without cause, Executive shall receive from the Company Executive's base salary at the rate then in effect for one year, and such amount shall be payable during such period in a manner consistent with the Company's standard pay practices. If Executive resigns or otherwise terminates Executive's employment, Executive shall receive no severance compensation.

(e) Change of Control, Change of Duties, Change of Compensation or Change of Location.

(i) At any time during the SIX-MONTH period following a change of control of Comfort Systems USA, Inc. and/or Eastern Heating and Cooling, Inc., a change of duties of Executive, a change of compensation of Executive or a change of location of Executive (collectively "Change Events"), Executive may elect by written notice to receive a lump-sum payment equal to his annual base salary as of the date of such Change Event, provided, however, if Executive receives such Change Event payment, then for the remaining term of this Agreement he shall not be entitled to receive separation payments as otherwise provided under this Section 5. Notwithstanding the preceding sentence, in the event that in connection with a change of control of Comfort Systems USA, Inc., any former owners of the twelve original founding companies of Comfort Systems USA, Inc. receives a change of control payment under his Employment Agreement dated July 2, 1997 that is more than his annual base salary, Executive may instead elect to resign and receive the same multiple of his base salary as such other founding company owner has received, and such payment, if elected by Executive, shall be in lieu of, and in cancellation of, all of Executive rights under this and any preceding Employment Agreement.

(ii) For purposes of subparagraph (e)(i), the term "change of control" shall include with respect to Comfort Systems USA, Inc. and/or Eastern Heating and Cooling, Inc. a sale of a majority of either corporation's capital stock, a sale of substantially all of either corporation's assets, a merger pursuant to which the ultimate shareholders of either corporation do not hold a majority of voting interest subsequent to said merger, or any other transaction of similar effect.

(iii) For purposes of subparagraph (e)(i), the term "change of duties" with respect to Executive shall include any permanent and material adverse change, other than by the Executive himself, in the nature or scope of Executive's responsibilities and authorities from such responsibilities and authorities immediately prior to such change of duty.

(iv) For purposes of subparagraph (e)(i), the term "change of compensation" of Executive shall include a decrease in the annual base salary in effect as of the date of the change of compensation payable by the Company thereof to Executive, other than as a result of the comparable change in compensation payable to substantially all other executive officers of the Company on the basis of the Company's or any subsidiary's financial performance.

(v) For purposes of subparagraph (e)(i), the term "change of location" of Executive shall include a relocation, other than by the Executive himself, of more than 25 miles from Executive's work location immediately prior to the change of location where such location is also more than 10 additional miles from Executive's home.

6. Return of Company Property. All records, plans, manuals, "field guides", memoranda, lists, documents, statements and other property delivered to Executive by or on behalf of the Company or any other member of the Comfort Group, by any customer of the Company or any other member of the Comfort Group (including, but not limited to, any such customers obtained by Executive), by any acquisition candidate of the Company or any other member of the Comfort Group, and all records compiled by Executive which pertain to the business or activities of the Company or any other member of the Comfort Group shall be and remain the property of the Company and shall be subject at all times to its discretion and control. Likewise, all correspondence with customers, representatives or acquisition candidates, reports, records, charts, advertising materials, and any data collected by Executive or by or on behalf of the Company or any other member of the Comfort Group or any representative of any of them shall be delivered promptly to the Company without request by it upon termination of Executive's employment with the Company.

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

8. Trade Secrets. Executive agrees that Executive will not, during or after the Term, disclose the specific terms of the Company's or any other member of the Comfort Group's relationships or agreements with significant vendors or customers or any other significant and material trade secret of the Company or any other member of the Comfort Group, whether in existence or proposed, to any person, firm, partnership, corporation or business for any reason or purpose whatsoever.

9. Prior Agreements. This Agreement supercedes any prior documents or understandings with respect to Executive's employment with the Company. Executive warrants to the Company that the execution of this Agreement by Executive and Executive's employment by the Company and the performance of Executive's duties hereunder will not violate or be a breach of any agreement with a former employer, client or any other person or entity.

10. Assignment; Binding Effect. Executive understands that Executive has been selected for employment by the Company on the basis of Executive's personal qualifications, experience and skills. Executive agrees, therefore, that Executive cannot assign all or any portion of Executive's performance under this Agreement. Executive, Executive's spouse and the estate of

each shall not have any right to encumber or dispose of any right to receive payments hereunder, it being understood that such payments and the right thereto are nonassignable and nontransferable; provided, however, that in the event of the death of Executive, any payments that Executive is entitled to receive may be assigned to the beneficiaries of Executive's estate. Subject to the preceding three (3) sentences and the express provisions of Section 11, this Agreement shall be binding upon, inure to the benefit of and be enforceable by the parties hereto and their respective heirs, legal representatives, successors and assigns.

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

12. Amendment; Waiver. This Agreement may not be modified except in a writing signed by the parties, and no term of this Agreement may be waived except by a writing signed by the party waiving the benefit of such term. No waiver by the parties hereto of any default or breach of any term, condition or covenant of this Agreement shall be deemed to be a waiver of any subsequent default or breach of the same or any other term, condition or covenant contained herein.

13. Notice. Whenever any notice is required hereunder, it shall be given in writing addressed as follows:

To the Company: Comfort Systems USA, Inc.
777 Post Oak, Suite 500
Houston, TX 77056
Attention: General Counsel

To Executive: Fred Giardenelli, Jr.
1240 Milton Keynes Dr.
Niskayuna, NY 12309

Notice shall be deemed given and effective on the earlier of five (5) 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. Either party may change the address for notice by notifying the other party of such change in accordance with this Section 13.

14. Severability; Enforceability. If any portion of this Agreement is held invalid or inoperative, the other portions of this Agreement shall be deemed valid and operative and, so far as is reasonable and possible, effect shall be given to the intent manifested by the portion held invalid or inoperative. Moreover, in the event any court of competent jurisdiction shall determine that the scope, time or territorial restrictions set forth in any covenant contained herein are unreasonable, then it is the intention of the parties that such restrictions be enforced to the fullest extent which the court deems reasonable, and this Agreement shall thereby be reformed. Each of the covenants contained in this Agreement shall be construed as an agreement independent of any other provision in this Agreement, and the existence of any claim or cause of action of Executive against the Company,

whether predicated on this Agreement or otherwise, shall not constitute a defense to the enforcement by the Company of such covenants.

15. Survival. The provisions and covenants of Sections 3, 4, 6, 7 and 8 shall survive termination of this Agreement.

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

17. Governing Law. This Agreement shall be governed by and construed in accordance with the internal laws of the State of New York.

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

EXECUTIVE:	COMPANY:
	EASTERN HEATING & COOLING, INC.
/s/ Fred Giardenelli, Jr.	/s/ William George
Fred Giardenelli, Jr.	Name: William George
	Title: Vice President

EXHIBIT 31.1

CERTIFICATION

I, William F. Murdy, Chairman of the Board and Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Comfort Systems USA, Inc;

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

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

4. The registrant's other certifying officer 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)) for the registrant and we 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 quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this quarterly report; and

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

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

a) all significant deficiencies and material weaknesses in the design or operation of internal controls 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: August 5, 2003

/s/ William F. Murdy

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

EXHIBIT 31.2

CERTIFICATION

I, J. Gordon Beittenmiller, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Comfort Systems USA, Inc;

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

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

4. The registrant's other certifying officer 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)) for the registrant and we 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 quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this quarterly report; and

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

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

a) all significant deficiencies and material weaknesses in the design or operation of internal controls 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: August 5, 2003

/s/ J. Gordon Beittenmiller

J. Gordon Beittenmiller
Chief Financial Officer

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

In connection with the Quarterly Report on Form 10-Q for the period ending June 30, 2003 of Comfort Systems USA, Inc. (the "Company") as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William F. Murdy, Chairman of the Board and Chief Executive Officer of the Company, certify that, to my knowledge, (i) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ William F. Murdy

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

August 5, 2003

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

In connection with the Quarterly Report on Form 10-Q for the period ending June 30, 2003 of Comfort Systems USA, Inc. (the "Company") as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, J. Gordon Beittenmiller, Vice President and Chief Financial Officer of the Company, certify that, to my knowledge, (i) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ J. Gordon Beittenmiller

J. Gordon Beittenmiller
Vice President and
Chief Financial Officer
(Principal Financial Officer)

August 5, 2003