UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q/A

(Amendment No. 1)

(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, 2006

OR

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

For the transition period from to

Commission file number: **1-13011**

COMFORT SYSTEMS USA, INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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 o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

The number of shares outstanding of the issuer's common stock, as of July 31, 2006 was 40,656,958.

Explanatory Note

This Amendment No. 1 to Form 10-Q for the period ended June 30, 2006 is being filed to provide a revision to Part I, Item 4. *Controls and Procedures*. The revision includes a statement that our internal controls were evaluated as of the end of the fiscal quarter as required by Rules 13a —15(b) of the Securities Exchange Act of 1934. Additionally, Part II, Item 6. *Exhibits*, of this Amendment has been revised to contain currently-dated certifications from our Chief Executive Officer and Chief Financial Officer, as required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. No other information in this filing has been updated for events or information subsequent to the date of filing of the original Form 10-Q.

COMFORT SYSTEMS USA, INC.
INDEX TO FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2006

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

	December 31, 2005	June 30, 2006 (Unaudited)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 55,593	$ 67,091
Accounts receivable, less allowance for doubtful accounts of $3,538 and $3,248, respectively	195,025	229,685
Receivable from sale of operations	23,800	—
Other receivables	5,784	4,171
Inventories	8,083	9,569
Costs and estimated earnings in excess of billings	22,512	28,923
Prepaid expenses and other	11,282	11,056
Assets related to discontinued operations	3,996	992
Total current assets	326,075	351,487
PROPERTY AND EQUIPMENT, net	12,705	14,063
GOODWILL	62,954	62,954
OTHER NONCURRENT ASSETS	6,949	6,421
Total assets	$ 408,683	$ 434,925
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ —	$ —
Accounts payable	71,922	76,231
Accrued compensation and benefits	29,347	25,729
Billings in excess of costs and estimated earnings	53,279	70,942
Accrued self insurance expense	17,350	19,093
Income taxes payable	7,615	—
Other current liabilities	14,338	14,480
Liabilities related to discontinued operations	1,309	678
Total current liabilities	195,160	207,153
LONG-TERM DEBT, NET OF CURRENT MATURITIES	—	—
Total liabilities	195,160	207,153
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, 39,979,867 and 40,656,958 shares issued, respectively	400	407
Treasury stock, at cost, zero and 22,638 shares, respectively	—	(306)
Additional paid-in capital	340,264	341,429
Deferred compensation	(1,135)	—
Retained earnings (deficit)	(126,006)	(113,758)
Total stockholders' equity	213,523	227,772
Total liabilities and stockholders' equity	$ 408,683	$ 434,925

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, 2005	Three Months Ended June 30, 2006	Six Months Ended June 30, 2005	Six Months Ended June 30, 2006
REVENUES	$ 229,547	$ 264,390	$ 423,647	$ 500,775
COST OF SERVICES	191,296	221,926	357,279	421,543
Gross profit	38,251	42,464	66,368	79,232
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	28,565	30,414	54,348	60,157
GAIN ON SALE OF ASSETS	(25)	(49)	(103)	(69)
Operating income	9,711	12,099	12,123	19,144
OTHER INCOME (EXPENSE):				
Interest income	129	562	257	1,208
Interest expense	(383)	(146)	(758)	(301)
Write off of debt costs	(870)	—	(870)	—
Other	65	(1)	75	18
Other income (expense)	(1,059)	415	(1,296)	925
INCOME BEFORE INCOME TAXES	8,652	12,514	10,827	20,069
INCOME TAX EXPENSE	3,769	4,797	4,664	7,818
INCOME FROM CONTINUING OPERATIONS	4,883	7,717	6,163	12,251
DISCONTINUED OPERATIONS:				
Operating loss, net of income tax benefit (expense) of $25, $(6), $414, and $105	(342)	(5)	(1,093)	(212)
Estimated gain on disposition, including income tax benefit (expense) of $(82), $209, $(82), and $209	137	209	137	209
NET INCOME	$ 4,678	$ 7,921	$ 5,207	$ 12,248
INCOME PER SHARE:				
Basic—				
Income from continuing operations	$ 0.12	$ 0.19	$ 0.16	$ 0.31
Discontinued operations—				
Loss from operations	—	—	(0.03)	(0.01)
Estimated gain on disposition	—	0.01	—	0.01
Net income	$ 0.12	$ 0.20	$ 0.13	$ 0.31
Diluted—				
Income from continuing operations	$ 0.12	$ 0.19	$ 0.15	$ 0.30
Discontinued operations—				
Loss from operations	—	—	(0.02)	(0.01)
Estimated gain on disposition	—	—	—	0.01
Net income	$ 0.12	$ 0.19	$ 0.13	$ 0.30
SHARES USED IN COMPUTING INCOME PER SHARE:				
Basic	39,173	40,244	39,082	40,060
Diluted	40,107	41,209	40,131	41,045

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

COMFORT SYSTEMS USA, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In Thousands, Except Share Amounts)

	Common Stock Shares	Common Stock Amount	Treasury Stock Shares	Treasury Stock Amount	Additional Paid-In Capital	Deferred Compensation	Retained Earnings (Deficit)	Total Stockholders' Equity
BALANCE AT DECEMBER 31, 2004	39,258,913	$ 393	(24,462)	$ (148)	$ 337,719	$ (1,587)	$ (119,780)	$ 216,597
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit	650,954	6	114,959	835	2,987	—	—	3,828
Issuance of restricted stock	82,500	1	—	—	574	(575)	—	—
Shares received in lieu of tax witholding payment on vested restricted stock	—	—	(40,797)	(318)	—	—	—	(318)
Forfeiture of unvested restricted Stock	(12,500)	—	(50,000)	(372)	(74)	360	—	(86)
Dividends	—	—	—	—	(999)	—	—	(999)
Amortization of deferred compensation	—	—	—	—	60	667	—	727
Other	—	—	300	3	(3)	—	—	—
Net loss	—	—	—	—	—	—	(6,226)	(6,226)
BALANCE AT DECEMBER 31, 2005	39,979,867	400	—	—	340,264	(1,135)	(126,006)	213,523
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit (unaudited)	539,591	6	38,722	480	3,661	—	—	4,147
Issuance of restricted stock (unaudited)	137,500	1	—	—	(1)	—	—	—
Shares received in lieu of tax witholding payment on vested restricted stock (unaudited)	—	—	(46,985)	(597)	—	—	—	(597)
FAS 123 (R) adoption (unaudited)	—	—	—	—	(1,135)	1,135	—	—
Stock-based compensation expense, (unaudited)	—	—	—	—	999	—	—	999
Forfeiture of unvested restricted stock (unaudited)	—	—	(14,375)	(189)	151	—	—	(38)
Tax benefit from vesting of restricted stock (unaudited)	—	—	—	—	316	—	—	316
Dividends (unaudited)	—	—	—	—	(2,826)	—	—	(2,826)
Net income (unaudited)	—	—	—	—	—	—	12,248	12,248

BALANCE AT JUNE 30, 2006 (UNAUDITED)	40,656,958	$ 407	(22,638)	$ (306)	$ 341,429	$ —	$ (113,758)	$ 227,772

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

COMFORT SYSTEMS USA, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
CASH FROM OPERATING ACTIVITIES:				
Net income	$ 4,678	$ 7,921	$ 5,207	$ 12,248
Adjustments to reconcile net income to net cash provided by (used in) operating activities—				
Estimated gain on disposition of discontinued operations	(137)	(209)	(137)	(209)
Depreciation and amortization expense	1,153	1,313	2,218	2,571
Bad debt expense	943	148	669	222
Write off of debt costs	870	—	870	—
Deferred tax expense	838	496	1,107	1,284
Tax benefit of stock-based compensation (pre-FAS 123R)	159	—	507	—
Amortization of debt financing costs	126	25	246	50
Gain on sale of assets or operations	(25)	(53)	(59)	(69)
Stock-based compensation expense	5	646	192	961
Changes in operating assets and liabilities, net of effects of acquisitions and divestitures—				
(Increase) decrease in—				
Receivables, net	(22,533)	(23,944)	(21,228)	(33,307)
Inventories	296	(1,351)	399	(1,520)
Prepaid expenses and other current assets	(3)	1,392	967	602
Costs and estimated earnings in excess of billings	(614)	(3,674)	248	(5,931)
Other noncurrent assets	(56)	36)	56	164)
Increase (decrease) in—				
Accounts payable and accrued liabilities	20,412	12,048	6,572	530
Billings in excess of costs and estimated earnings	5,817	13,792	8,554	17,502
Taxes paid related to the sale of businesses	—	—	—	(7,020)
Net cash provided by (used in) operating activities	11,929	8,586	6,388	(11,922)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of property and equipment	(1,184)	(1,994)	(3,227)	(4,043)
Proceeds from sales of property and equipment	63	170	211	279
Proceeds from businesses sold, net of cash sold and transaction costs	918	979	1,123	25,574
Cash paid for acquisition, including cash acquired	—	—	(2,943)	—
Net cash provided by (used in) investing activities	(203)	(845)	(4,836)	21,810
CASH FLOWS FROM FINANCING ACTIVITIES:				
Net borrowings on revolving line of credit	—	—	—	—
Payments on other long-term debt	(8,019)	—	(8,538)	—
Payments of dividends to shareholders	—	(1,422)	—	(2,826)
Tax benefit of stock-based compensation	—	1,314	—	2,283
Proceeds from exercise of options	294	1,097	865	2,153
Net cash provided by (used in) financing activities	(7,725)	989	(7,673)	1,610
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,001	8,730	(6,121)	11,498
CASH AND CASH EQUIVALENTS, beginning of period—continuing operations and discontinued operations	22,454	58,361	32,576	55,593
CASH AND CASH EQUIVALENTS, end of period—continuing operations and discontinued operations	$ 26,455	$ 67,091	$ 26,455	$ 67,091

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

COMFORT SYSTEMS USA, INC.
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2006
(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, industrial and institutional HVAC markets, and performs most of its services within office buildings, retail centers, apartment complexes, manufacturing plants, and healthcare, education and government facilities. In addition to standard HVAC services, the Company provides specialized applications such as building automation control systems, fire protection, process cooling, electronic monitoring and process piping. Certain locations also perform related activities such as electrical service and plumbing. Approximately 61% of the Company's consolidated 2006 revenues to date are attributable to installation of systems in newly constructed facilities, with the remaining 39% attributable to maintenance, repair and replacement services. The following service activities account for the Company's consolidated 2006 revenues to date: HVAC—74%, plumbing—18%, building automation control systems—3%, and other—5%. These service activities are within the mechanical services industry which is the single industry segment served by Comfort Systems.

2. Summary of Significant Accounting Policies

Basis of Presentation

These interim statements should be read in conjunction with the historical Consolidated Financial Statements and related notes of Comfort Systems included in the Annual Report on Form 10-K as filed with the Securities and Exchange Commission ("SEC") for the year ended December 31, 2005 (the "Form 10-K").

There were no significant changes in the accounting policies of the Company during the current period except for the adoption of Financial Accounting Standards Board ("FASB") Statement 123 (revised 2004) "Share-Based Payment" ("Statement 123R"), as further discussed in Note 8. For a description of the significant accounting policies of the Company, refer to Note 2 of Notes to Consolidated Financial Statements of Comfort Systems included in the Form 10-K.

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

Cash Flow Information

Cash paid for interest for the three months ended June 30, 2005 and 2006 was approximately $0.5 million and $0.1 million, respectively. Cash paid for income taxes for continuing operations for the three months ended June 30, 2005 and 2006 was approximately $0.6 million and $5.2 million, respectively. Cash paid for income taxes for discontinued operations for the three months ended June 30, 2005 and 2006 was less than $0.1 million for both periods, respectively.

Cash paid for interest for the six months ended June 30, 2005 and 2006 was approximately $0.7 million and $0.2 million, respectively. Cash paid for income taxes for continuing operations for the six months ended June 30, 2005 and 2006 was approximately $3.7 million and $5.8 million, respectively. Cash paid for income taxes for discontinued operations for the six months ended June 30, 2005 and 2006 was less than $0.1 million and $7.0 million, respectively. The taxes paid for discontinued operations for 2006 related to the sale in 2005 of two operations to Automated Logic Corporation and Automated Logic Contracting Services, Inc. These taxes are included in the caption "Taxes paid related to the sale of businesses" in the accompanying consolidated statement of cash flows.

During the three months ended June 30, 2006, the Company paid a quarterly cash dividend of $1.4 million, or $0.035 per share. The Company paid $2.8 million in cash dividends, or $0.070 per share, for the six months ended June 30, 2006. There were no dividends paid during the first six months of 2005.

Segment Disclosure

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

Use of Estimates

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

Income Taxes

The Company files a consolidated return for federal income tax purposes. Income taxes are provided for under the liability method in accordance with SFAS No. 109, "Accounting for Income Taxes," which takes into account differences between financial statement treatment and tax treatment of certain transactions. Deferred tax assets represent the tax effect of activity that has been reflected in the financial statements but which will not be deductible for tax purposes until future periods. Deferred tax liabilities represent the tax effect of activity that has been reflected in the financial statements but which will not be taxable until future periods.

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

The effective tax rate associated with results from continuing operations for the first six months of 2006 was 39.0%, compared to 43.1% in 2005. The Company's effective tax rate is generally higher than statutory rates because of the effect of certain expenses that are not deductible for tax purposes. In

addition, adjustments to tax reserves are analyzed quarterly as events occur to warrant such changes. Adjustments to tax reserves are a component of the effective tax rate.

New Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 is an interpretation of FASB Statement No. 109, "Accounting for Income Taxes," and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN 48 requires expanded disclosure with respect to the uncertainty in income taxes and is effective January 1, 2007 for the Company. The Company is currently evaluating the impact, if any, that FIN 48 will have on the financial statements.

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

Sale of Companies to ALC—On December 31, 2005, the Company sold 2 operations to Automated Logic Corporation and Automated Logic Contracting Services, Inc. (together, "ALC") for approximately $22.9 million in cash, net of transaction costs and a purchase price adjustment based upon the closing balance sheet for the transferred assets. The receivable related to this sale was paid during the first quarter of 2006. The Company paid $7.0 million in taxes related to this transaction during the first quarter of 2006. The after-tax income of these companies of $0.5 million for the first six months of 2005 has been reported in discontinued operations under "Operating loss, net of income tax benefit (expense)."

Sale of Assets to MESA Energy Systems, Inc.—On June 1, 2006, the Company along with its wholly-owned subsidiary, ARC Comfort Systems USA, Inc. ("ARC"), entered into an asset purchase agreement to sell certain assets of ARC to Mesa Energy Systems, Inc. (a subsidiary of EMCOR Group, Inc.) for approximately $0.7 million in cash. These assets were sold at book value. The Company recorded a tax benefit of $0.2 million during the second quarter of 2006. This is included under the caption "Estimated gain on disposition, net of income tax benefit (expense)." The Company is in the process of shutting down the remaining operations of ARC. The after-tax loss of this company of $0.9 million and $0.2 million, for the first six months of 2005 and 2006, respectively, has been reported in discontinued operations under "Operating loss, net of income tax benefit (expense)."

Individual Sales of Operating Companies—During the second quarter of 2005, the Company sold a small operating company. The Company recorded a gain on the sale of this unit of $0.1 million, including taxes, in the second quarter of 2005 in discontinued operations under "Estimated gain on disposition, including income tax benefit (expense)." During the third quarter of 2005, the Company sold one small operating company and shutdown the operations of another small operating company. The after-tax loss of these three companies of $0.7 million for the first six months of 2005, has been reported in discontinued operations under "Operating loss, net of income tax benefit (expense)."

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

	December 31, 2005	June 30, 2006
Accounts receivable, net	$ 2,457	$ 842
Other current assets, net	238	6
Costs and estimated earnings in excess of billings	480	—
Property, plant, and equipment, net	139	—
Other noncurrent assets	682	144
Total assets	$ 3,996	$ 992
Accounts payable.	$ 232	$ 245
Billings in excess of cost in earnings	161	77
Other current liabilities	916	356
Total liabilities	$ 1,309	$ 678

Revenues and pre-tax loss related to the operations discontinued in 2005 and 2006 were as follows (in thousands):

	Six Months Ended June 30, 2005	Six Months Ended June 30, 2006
Revenues	$21,875	$ 2,518

Pre-tax loss	$ (1,507)	$ (317)

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

Sale of Companies to Emcor—In March 2002, the Company sold 19 operations to Emcor Group, Inc. ("Emcor"). The total purchase price was $186.25 million, including the assumption by Emcor of approximately $22.1 million of subordinated notes to former owners of certain of the divested companies. 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. 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.

There are ongoing open matters relating to this transaction that the Company continues to address with Emcor. The Company does not believe these open matters, either individually or in the aggregate, will have a material effect on the Company's financial position when ultimately resolved. The Company maintains reserves for these matters, net of amounts receivable from escrow that it believes will ultimately be applied in settling these matters.

4. Restructuring Charges

The Company recorded restructuring charges of approximately $3.2 million pre-tax in 2003. These charges included approximately $1.5 million for severance costs and retention bonuses primarily associated with the curtailment of the Company's energy efficiency marketing activities, a reorganization of the Company's national accounts operations as well as a reduction in corporate personnel. The restructuring charges for this period also included approximately $1.6 million for remaining lease obligations and $0.1

million of other costs recorded in connection with the actions described above. The Company increased its accrual for these remaining lease obligations by $0.6 million in 2004 and $0.3 million in 2005 based on revised estimates of when and to what extent it believes it can sublease the related facilities. These increases to the accrual were included in "Cost of Services" and in "Selling, General and Administrative Expenses" in the Company's consolidated statement of operations. Accrued lease termination costs remaining from past restructuring charges are expected to be completed by 2009.

The following table shows the remaining liabilities associated with the cash portion of the restructuring charges as of December 31, 2005 and June 30, 2006 (in thousands):

	Balance at Beginning of Period	Additions	Payments	Balance at End of Period
Year Ended December 31, 2005:				
Lease termination costs and other	$ 1,281	$ 273(a)	$ (593)	$ 961
Six Months Ended June 30, 2006:				
Lease termination costs and other	$ 961	$ —	$ (163)	$ 798

(a) These charges were included in "Cost of Services" and in "Selling, General and Administrative Expenses" in the Company's consolidated statement of operations.

5. Long-Term Debt Obligations

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

	December 31, 2005	June 30, 2006
Revolving credit facility	$ —	$ —
Other	—	—
Total debt	$ —	$ —

In June 2005, the Company entered into a $75.0 million senior credit facility (the "Facility") which is available for borrowings and letters of credit. The Facility is secured by substantially all of the assets of the Company except for assets related to projects subject to surety bonds. The Facility will expire on June 30, 2009. The Company's borrowing and letter of credit capacity under the Revolving Loan portion of the Facility at any given time is $75.0 million less borrowings and letters of credit outstanding, subject to a borrowing base. As of June 30, 2006, the total of the Facility was $75.0 million, with no outstanding borrowings, $22.1 million in letters of credit outstanding, and $52.9 million of credit available.

The Company has a choice of two interest rate options for borrowings under the Facility; these rates are floating rates determined by the broad financial markets, meaning they can and do move up and down from time to time. The Company estimates that the interest rate applicable to borrowings under the Facility would be approximately 7.33% as of June 30, 2006. Commitment fees of 0.25% per annum are payable on the portion of Revolving Loan capacity not in use for borrowings or letters of credit at any given time.

The Facility contains financial covenants defining various financial measures and the levels of these measures with which the Company must comply. The Facility limits capital expenditures to $20.0 million per year. The Facility also limits payment of dividends and repurchase of shares by the Company to a combined maximum of $20.0 million per year, and otherwise limits non-Facility debt, capital lease obligations, acquisitions, investments, and sales of assets. The Company is in compliance by a substantial margin with all its financial covenants as of June 30, 2006.

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6. Commitments and Contingencies

Claims and Lawsuits

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

In addition to the matters described above, the Company is defending a dispute arising out of an alleged delay related to a multi-family construction project. If the Company is not successful in this dispute, it could have a material adverse effect on the Company's operating results. However, management believes the likelihood of an adverse result of this magnitude is remote, and management believes the accruals relating to the matter appropriately reflect a probable outcome.

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. If the Company fails to perform under the terms of a contract or to pay subcontractors and vendors who provided goods or services under a contract, the customer may demand that the surety make payments or provide services under the bond. The Company must reimburse the sureties for any expenses or outlays they incur. To date, the Company is not aware of any losses to its sureties in connection with bonds the sureties have posted on the Company's behalf, and does not expect such losses to be incurred in the foreseeable future.

Surety market conditions remain challenging as a result of significant losses incurred by many sureties in recent periods, both in the construction industry as well as in certain larger corporate bankruptcies. As a result, less bonding capacity is available in the market and terms have become more restrictive. Further, under standard terms in the surety market, sureties issue bonds on a project-by-project basis, and can decline to issue bonds at any time. Historically, approximately 30% of the Company's business has required bonds. While the Company has enjoyed a longstanding relationship with its primary surety and has added another surety to further support its bonding needs, current market conditions as well as changes in the sureties' assessment of the Company's operating and financial risk could cause the sureties 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 characteristics, including a significant amount of cash on its balance sheet, would enable it to ultimately respond effectively to an interruption in the availability of bonding capacity, such an interruption would likely cause the Company's revenues and profits to decline in the near term.

Self-Insurance

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

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estimates associated with the larger and longer-developing risks—worker's compensation, auto liability and general liability—are reviewed by a third-party actuary quarterly.

The Company's self-insurance arrangements currently are as follows:

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

General and Employer's Liability—For general liability and employer's liability, the Company self-insures the first $500,000 of each loss, is fully insured for the next $500,000 of each loss, then has a single, aggregate excess loss insurance policy that covers losses up to $50 million across both these risk areas (as well as auto liability noted below).

Auto Liability—For auto liability, the Company self-insures the first $500,000 of each loss, is fully insured for the next $1.5 million of each loss, then has a single aggregate excess loss insurance policy that covers losses up to $50 million.

Employee Medical—The Company's per-incident deductible for employee group health claims is $300,000. Insurance then covers any Company responsibility for medical claims in excess of the deductible amount.

It is important to note that the Company's $50 million of aggregate excess loss coverage above applicable per-incident deductibles represents one policy limit that applies to all lines of risk. In other words, the Company does not have a separate $50 million of excess loss coverage for each of general liability, employer's liability and auto liability.

7. Stockholders' Equity

Long-Term Incentive Plans

In May 2006, the Company's stockholders approved the Company's 2006 Equity Incentive Plan (the "2006 Plan") which provides for the granting of incentive or non-qualified stock options, stock appreciation rights, restricted or deferred stock, dividend equivalents or other incentive awards to directors, employees and consultants to the Company. The number of shares authorized and reserved for issuance under the 2006 Plan is 3,200,000 shares. The number of shares available under this plan varies with the total number of shares of Common Stock outstanding. As of June 30, 2006, there were 3,200,000 shares available for issuance under this plan. The 2006 Plan will expire in May 2016.

The Company will make all future grants under the 2006 Plan after June 30, 2006.

Stock Options/SAR Plan for Non-Employee Directors

In May 2006, the Company's stockholders approved the Company's 2006 Stock Options/SAR Plan for Non-Employee Directors (the "Directors Plan"), which provides for the granting of stock options or stock appreciation rights to non-employees. The number of shares authorized and reserved for issuance under the Directors Plan is 500,000 shares. Outstanding options may be canceled and reissued under terms specified in the plan. The number of shares available under this plan varies with the total number of shares of Common Stock outstanding. As of June 30, 2006, there were 500,000 shares available for issuance under this plan. The Directors Plan will expire in May 2016.

Under the Directors Plan, each participant who has served since at least the previous annual meeting and is continuing in office and each newly elected non-employee director will be awarded an award covering 10,000 shares (which will be the maximum number of shares of Common Stock subject to awards that may be granted to any participant in the aggregate in any calendar year). All options will be granted with an exercise price equal to the fair market value at the date of grant and immediately vest upon grant.

The Company will make all future grants under the Directors Plan after June 30, 2006.

Earnings Per Share

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

Under EPS calculation methods established by generally accepted accounting principles, including the effect of options whose exercise price exceeds the average market price of the Common Stock for a given period would increase calculated EPS. This impact is called "anti-dilutive." Generally accepted accounting principles for determining EPS require that any options or other common stock equivalents whose inclusion in determining EPS would have an anti-dilutive effect be excluded. Accordingly, options to purchase less than 0.1 million shares of Common Stock at prices ranging from $16.313 to $21.125 per share which were outstanding for the three months ended June 30, 2006 and options to purchase less than 0.1 million shares at prices ranging from $12.900 to $21.125 per share which were outstanding for the six months ended June 30, 2006, were not included in the computation of diluted EPS because they were anti-dilutive.

Options to purchase 0.7 million shares of Common Stock at prices ranging from $6.97 to $21.438 per share which were outstanding for the three months ended June 30, 2005, and options to purchase 0.5 million shares at prices ranging from $7.625 to $21.438 per shares which were outstanding for the six months ended June 30, 2005, were not included in the computation of diluted EPS because they were anti-dilutive.

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,	
	2005	2006	2005	2006
Common shares outstanding, end of period (a)	39,248	40,387	39,248	40,387
Effect of using weighted average common shares outstanding	(75)	(143)	(166)	(327)
Shares used in computing earnings per share—basic	39,173	40,244	39,082	40,060
Effect of shares issuable under stock option plans based on the treasury stock method	884	858	945	873
Effect of contingently issuable restricted shares	50	107	104	112
Shares used in computing earnings per share—diluted	40,107	41,209	40,131	41,045

a) Excludes 295,000 and 248,000 shares of unvested contingently issuable restricted stock outstanding as of June 30, 2005 and 2006, respectively.

8. Stock-Based Compensation

The Company has various stock-based compensation plans which are administered by the compensation committee of the board of directors. For additional information regarding these plans, refer to "Note 14—Stock Option Plans" of the Notes to the Consolidated Financial Statements contained in the Form 10-K. Prior to January 1, 2006, the Company accounted for those plans under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock-Based Compensation." No stock-based employee compensation cost was recognized in the Consolidated Statements of Operations for the six months ended June 30, 2005, except with respect to the amortization of the intrinsic value of restricted stock grants totaling $0.2 million. Options granted under the Company's equity compensation plans had an exercise price equal to the market value of the underlying common stock on the date of grant and all terms were fixed, accordingly, no expense was recognized under APB Opinion No. 25. Effective January 1, 2006, the Company adopted the fair value recognition provisions of Financial Accounting Standards Board Statement No. 123(R), Share-Based Payment (FAS 123R), using the modified-prospective-transition method. Results for prior periods have not been restated.

The impact of the adoption of FAS 123R resulted in compensation expense of $0.6 million ($0.4 million after-tax or $0.01 per basic share and $0.01 per diluted share) for the three months ended June 30, 2006. For the first half of 2006, the Company recorded share-based compensation expense of $1.0 million ($0.6 million after-tax or $0.01 per basic share and $0.01 per diluted share).

The following table sets forth pro forma information as if compensation expense for the three and six months ended June 30, 2005 had been determined consistent with the requirements of Statement No. 123. For purposes of this pro forma disclosure, the value of the stock options was estimated using a Black-Scholes option-pricing formula and amortized to expense over the options' vesting periods (in thousands, except per share amounts):

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net Income as reported	$ 4,678	$ 5,207
Add: Stock-based compensation included in reported net income, net of tax	3	125
Less: Compensation expense per Statement 123, net of tax	(384)	(751)
Pro Forma Net Income	$ 4,297	$ 4,581
Net Income per share—Basic		
Net Income per share as reported	$ 0.12	$ 0.13
Pro Forma Net Income per share	$ 0.11	$ 0.12
Net Income per share—Diluted		
Net Income per share as reported	$ 0.12	$ 0.13
Pro Forma Net Income per share	$ 0.11	$ 0.11

Prior to adopting Statement 123R, the Company presented the benefits of tax deductions in excess of recognized compensation costs (excess tax benefits) as operating cash flows in the consolidated statements of cash flows. Statement 123R requires these excess tax benefits to be reported as financing cash flows.

Stock Options—

A summary of option activity under the Company's stock compensation plans as of June 30, 2006 and changes during the six months ended June 30, 2006 is presented below:

Stock Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at December 31, 2005	2,667,863	$ 4.18		
Granted	50,000	$ 12.90		
Exercised	(578,313)	$ 3.70		
Forfeited	(91,125)	$ 6.44		
Expired	(51,500)	$ 12.73		
Outstanding at June 30, 2006	1,996,925	$ 4.21	6.12	$ 10.08
Vested or expected to vest at June 30, 2006	1,890,048	$ 4.19	6.02	$ 10.10
Exercisable at June 30, 2006	1,476,300	$ 3.94	5.46	$ 10.35

The total intrinsic value of options exercised during the six months ended June 30, 2006 was $5.3 million and the related tax benefit was $2.0 million.

The fair value of each option award is estimated, based on several assumptions, on the date of grant using the Black-Scholes option valuation model. Upon adoption of SFAS No. 123R, the Company modified its methods used to determine these assumptions based on the Securities and Exchange Commission's Staff Accounting Bulletin No. 107. The fair value and the assumptions used for the 2006 grant are shown in the table below.

Fair value per share of options granted	$ 5.44
Fair value assumptions:	
Expected dividend yield	1.09%
Expected stock price volatility	45%
Risk-free interest rate	4.94%
Expected term	5 years

Stock options are accounted for as equity instruments, and compensation cost is recognized using straight-line vesting over the four-year vesting period. As of June 30, 2006, the unrecognized compensation cost related to stock options was $1.4 million, which is expected to be recognized over a weighted-average period of 1.5 years. The total fair value of shares vested during the six months ended June 30, 2006 was $0.9 million.

The following table summarizes information about nonvested stock option awards as of June 30, 2006 and changes for the six months ended June 30, 2006:

Stock Options	Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2005	872,750	$ 2.99
Granted	50,000	5.44
Vested	(319,000)	2.78
Forfeited	(83,125)	3.97
Nonvested at June 30, 2006	520,625	$ 3.19

The Company generally issues new shares for stock options and restricted stock, unless treasury shares are available.

Restricted Stock—

A summary of restricted stock activity under the Company's stock compensation plans as of June 30, 2006 and changes during the six months ended June 30, 2006 is presented below:

Restricted Stock	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at December 31, 2005	242,917	$ —		
Granted	45,833	$ —		
Vested	(118,333)	$ —		
Forfeited	(14,375)	$ —		
Expired	—	$ —		
Outstanding at June 30, 2006	156,042	$ —	2.1	$ 14.29
Vested or expected to vest at June 30, 2006	156,042	$ —	2.1	$ 14.29
Exercisable at June 30, 2006	—	$ —	—	—

Approximately $1.0 million of compensation expense related to restricted stock will be recognized over a weighted-average period of 2.1 years. The total fair value of shares vested during the three and six months ended June 30, 2006 was $0.4 million and $0.6 million, respectively.

The fair value of restricted stock shares awarded during the first six months of 2005 and 2006 was $5.58 and $11.07, respectively. The total intrinsic value of restricted stock vested during the six months ended June 30, 2006 was $1.5 million.

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

The following discussion should be read in conjunction with our historical Consolidated Financial Statements and related notes thereto included elsewhere in this Form 10-Q and the Annual Report on Form 10-K as filed with the Securities and Exchange Commission for the year ended December 31, 2005 (the "Form 10-K"). This discussion contains "forward-looking statements" regarding our business and industry within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on our current plans and expectations and involve risks and uncertainties that could cause our actual future activities and results of operations to be materially different from those set forth in the forward-looking statements. Important factors that could cause actual results to differ include risks set forth in "Item 1A. Company Risk Factors," included in our Form 10-K.

Introduction and Overview

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

Nature and Economics of Our Business

Approximately 87% of our revenues are earned on a project basis for installation of HVAC systems in newly constructed facilities or for replacement of HVAC systems in existing facilities. Customers hire us to ensure such systems deliver specified or generally expected heating, cooling, conditioning and circulation of air in a facility. This entails installing core system equipment such as packaged heating and air conditioning units, or in the case of larger facilities, separate core components such as chillers, boilers, air handlers, and cooling towers. We also typically install connecting and distribution elements such as piping and ducting. Our responsibilities usually require conforming the systems to pre-established engineering drawings and equipment and performance specifications, which we frequently participate in establishing. Our project management responsibilities include staging equipment and materials to project sites, deploying labor to perform the work, and coordinating with other service providers on the project, including any subcontractors we might use to deliver our portion of the work.

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

After a customer accepts our bid, we generally enter into a contract with the customer that specifies what we will deliver on the project, what our related responsibilities are, and how much and when we will

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

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

Our average project takes six to nine months to complete, with an average contract price of approximately $250,000. Our projects generally require working capital funding of equipment and labor costs. Customer payments on periodic billings generally do not recover these costs until late in the job. Our average project duration together with typical retention terms as discussed above generally allow us to complete the realization of revenue and earnings in cash within one year. Because of the integral nature of HVAC and related controls systems to most buildings, we have the legal right in almost all cases to attach liens to buildings or related funding sources when we have not been fully paid for installing systems, except with respect to some government buildings. The service work that we do, which is discussed further below, usually does not give rise to lien rights.

We also perform larger HVAC projects. As of June 30, 2006, we had 4 projects in process with a contract price of between $15 and $25 million, 7 projects between $10 million and $15 million, 48 projects between $5 million and $10 million, and 205 projects between $1 million and $5 million. Taken together, projects with contract prices of $1 million or more totaled $907.3 million of aggregate contract value as of June 30, 2006, or approximately 55%, out of a total contract value for all projects in progress of $1,663.5 million. Generally, projects closer in size to $1 million will be completed in one year or less. It is unusual for us to work on a project that exceeds two years in length.

In addition to project work, approximately 13% of our revenues represent maintenance and repair service on already-installed HVAC and controls systems. This kind of work usually takes from a few hours to a few days to perform. Prices to the customer are usually based on the equipment and materials used in the service as well as technician labor time. We usually bill the customer for service work when it is complete, typically with payment terms of up to thirty days. We also provide maintenance and repair service under ongoing contracts. Under these contracts, we are paid regular monthly or quarterly amounts and provide specified service based on customer requirements. These agreements typically cover periods ranging from one to three years and are cancelable on 30 to 60 days notice.

A relatively small but growing portion of our revenues comes from national and regional account customers. These customers typically have multiple sites, and contract with us to perform maintenance and repair service. These contracts may also provide for us to perform new or replacement systems installation. We operate a national call center to dispatch technicians to sites requiring service. We perform the majority of this work with our own employees, with the balance being subcontracted to third parties that meet our performance qualifications. We will also typically use proprietary information systems to maintain information on the customer’s sites and equipment, including performance and service records, and related cost data. These systems track the status of ongoing service and installation work, and may also

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monitor system performance data. Under these contractual relationships, we usually provide consolidated billing and credit payment terms to the customer.

Profile and Management of Our Operations

We manage our 38 operating units based on a variety of factors. Financial measures we emphasize include profitability, and use of capital as indicated by cash flow and by other measures of working capital principally involving project cost, billings and receivables. We also monitor selling, general, administrative and indirect project support expense, backlog, workforce size and mix, growth in revenues and profits, variation of actual project cost from original estimate, and overall financial performance in comparison to budget and updated forecasts. Operational factors we emphasize include project selection, estimating, pricing, management and execution practices, labor utilization, safety, training, and the make-up of both existing backlog as well as new business being pursued, in terms of project size, technical application and facility type, end-use customers and industries, and location of the work.

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

Economic and Industry Factors

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

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

Operating Environment and Management Emphasis

Nonresidential building construction and renovation activity, as reported by the federal government, declined over the three year period of 2001 to 2003, and expanded moderately during 2004 and 2005, and has been relatively strong during the first half of 2006. During the decline and through 2003, we responded to market challenges by pursuing work in sectors less affected by this downturn, such as government, educational, and health care facilities, and by establishing marketing initiatives that take advantage of our size and range of expertise. We also responded to declining gross profits over those years by reducing our selling, general, and administrative expenses, and our indirect project and service overhead costs. We

believe our efforts in these areas partially offset the decline in our profitability over that period. We have experienced notable improvements in both industry activity as well as our own results throughout 2004 and 2005, and during the first six months of 2006, as discussed further under “Results of Operations” below.

As a result of our sale of certain assets and our continued strong emphasis on cash flow, our debt outstanding is now zero, and we have substantial uncommitted cash balances, as discussed further in “Liquidity and Capital Resources” below. In June 2005, we put a new credit facility in place with considerably less restrictive terms than those of our previous facilities. In addition, we have added a second surety to further support our bonding needs, and we believe our relationships with the surety markets are positive in light of our strong current results and financial position. We have generated positive free cash flow in each of the last seven calendar years and will continue our emphasis in this area. See “Liquidity and Capital Resources” below for further discussion of free cash flow. We believe that the relative size and strength of our balance sheet and surety support as compared to most companies in our industry represent competitive advantages for us.

As discussed at greater length in “Results of Operations” below, we have seen increased activity levels in our industry in 2004 and throughout 2005. We expect price competition to continue to be strong, as local and regional competitors respond cautiously to changing conditions. We will continue our efforts to find the more active sectors in our markets, and to increase our regional and national account business. However, our primary emphasis for 2006 will be on internal execution and margin improvement, rather than on revenue growth. In addition to the work we have done on our underperforming units, we have increased our focus on project qualification, estimating, pricing and management, and on service performance. This focus includes significant increases in unit level training.

Based on indications of stabilizing industry conditions and on our emphasis on internal execution and margin improvement, we expect that our 2006 results will be better than our 2005 results, although there can be no assurance that we will achieve this outcome. Over the longer term, if industry conditions are stable to improving, we believe we will experience more periods of increased revenues. In addition, given the size and fragmentation of our industry, we believe it makes sense for us to consider acquisition possibilities. However, we plan to do so on a very selective, opportunistic basis, and expect our growth in 2006 will largely be generated internally.

Critical Accounting Policies

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

Percentage of Completion Method of Accounting

Approximately 87% of our revenues were earned on a project basis and recognized through the percentage of completion method of accounting. Under this method as provided by American Institute of Certified Public Accountants Statement of Position 81-1, "Accounting for Performance of

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

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

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

Revisions to project costs and conditions can give rise to change orders under which the customer agrees to pay additional contract price. Revisions can also result in claims we might make against the customer to recover project variances that have not been satisfactorily addressed through change orders with the customer. Except in certain circumstances, we do not recognize revenues or margin based on change orders or claims until they have been agreed upon with the customer. The amount of revenue associated with unapproved change orders and claims is currently immaterial. Variations from estimated project costs could have a significant impact on our operating results, depending on project size, and the recoverability of the variation via additional customer payments.

Accounting for Allowance for Doubtful Accounts

We are required to estimate the collectibility of accounts receivable and provide an allowance for doubtful accounts for receivable amounts we believe we will not ultimately collect. This requires us to

make certain judgments and estimates involving, among others, the creditworthiness of the customer, our prior collection history with the customer, ongoing relationships with the customer, the aging of past due balances, our lien rights, if any, in the property where we performed the work, and the availability, if any, of payment bonds applicable to our contract. These estimates are re-evaluated and adjusted as additional information is received.

Accounting for Self-Insurance Liabilities

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

Accounting for Deferred Tax Assets

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

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.

Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" requires us to assess our goodwill asset amounts for impairment each year, and more frequently if circumstances suggest an impairment may have occurred. Impairment must be reflected when the value of a given business unit in excess of its tangible net assets falls below the goodwill asset balance carried for that unit on our books. If other business units have had increases in the value of their respective goodwill balances, such increases may not be recorded under SFAS No. 142. Accordingly, such increases may not be netted against impairments at other business units. The requirements for assessing whether goodwill assets have been impaired involve market-based information. This information, and its use in assessing goodwill, entails some degree of subjective assessment.

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

management of them. These reporting units are tested 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 are 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.

Results of Operations (in thousands):

Table 1—Historical Results

	Three Months Ended June 30,				Six Months Ended June 30,			
	2005	%	2006	%	2005	%	2006	%
Revenues	$ 229,547	100.0%	$ 264,390	100.0%	$ 423,647	100.0%	$ 500,775	100.0%
Cost of services	191,296	83.3%	221,926	83.9%	357,279	84.3%	421,543	84.2%
Gross profit	38,251	16.7%	42,464	16.1%	66,368	15.7%	79,232	15.8%
Selling, general and administrative expenses	28,565	12.4%	30,414	11.5%	54,348	12.8%	60,157	12.0%
Gain on sale of assets	(25)	—	(49)	—	(103)	—	(69)	—
Operating income	9,711	4.2%	12,099	4.6%	12,123	2.9%	19,144	3.8%
Interest income (expense), net	(254)	(0.1)%	416	0.2%	(501)	(0.1)%	907	0.2%
Write off of debt costs	(870)	(0.4)%	—	—	(870)	(0.2)%	—	—
Other income (expense)	65	—	(1)	—	75	—	18	—
Income before income taxes	8,652	3.8%	12,514	4.7%	10,827	2.6%	20,069	4.0%
Income tax expense	3,769		4,797		4,664		7,818	
Income from continuing operations	4,883	2.1%	7,717	2.9%	6,163	1.5%	12,251	2.4%
Discontinued operations—								
Operating results, net of tax	(342)		(5)		(1,093)		(212)	
Estimated gain on disposition, net of tax	137		209		137		209	
Net income	$ 4,678		$ 7,921		$ 5,207		$ 12,248	

Table 2—Supplemental Non-GAAP Disclosure—Operating Results of Continuing Operations Excluding Certain Items

The following table presents information excluding the write off of debt costs incurred in the second quarter of 2005. We have included this table because we believe it offers an additional view of the core results of our continuing operations in a way that we find useful in managing these operations, and in a way which also responds to frequent questions we receive about the Company from third parties. However, this presentation of operating results is not in accordance with generally accepted accounting principles, and should not be considered an alternative to income as determined under generally accepted accounting principles and presented above in Table 1—Historical Results.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2005	%	2006	%	2005	%	2006	%
Income from continuing operations(after tax)	$ 4,883		$ 7,717		$ 6,163		$ 12,251	
Write off of debt costs (after tax)	479		—		479		—	
Income from continuing operations(after tax), excluding the write-off of debt costs	$ 5,362	2.3%	$ 7,717	2.9%	$ 6,642	1.6%	$ 12,251	2.4%
Diluted earnings per share—income from continuing operations (after tax), excluding the write off of debt costs	$ 0.13		$ 0.19		$ 0.17		$ 0.30	

Revenues—Revenues increased $34.8 million, or 15.2%, to $264.4 million for the second quarter of 2006 as compared to the same period in 2005. The revenue growth stemmed primarily from generally

improving nonresidential and multi-family facilities markets throughout the United States especially in the multi-family sector (approximately $26.5 million) and office buildings (approximately $12.3 million), which were offset to a lesser degree by lower revenues in the hotel sector (approximately $5.9 million). We have seen increased activity, resulting from the start-up of several large multi-family projects associated with one of our larger operations and improved revenues in our Southern California operations.

Revenues for the first six months of 2006 increased $77.1 million, or 18.2%, to $500.8 million compared to the same period in 2005. Again, this growth was from generally improving nonresidential and multi-family facilities' markets throughout the United States especially in the multi-family sector (approximately $50.9 million) and office buildings (approximately $29.2 million), which were offset to a lesser degree by lower revenues in the hotel sector (approximately $6.0 million). In addition, the increase in revenues for the six months of 2006 stemmed from the activities described above in the second quarter of 2006 as well as an overall increase in market activity in the Gulf Coast area.

Backlog reflects revenues still to be recognized under contracted or committed installation and replacement project work. Project work generally lasts less than one year. Service agreement revenues and service work and short duration projects which are generally billed as performed do not flow through backlog. Accordingly, backlog represents only a portion of our 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, 2006 was $690.0 million, a 5.1% decrease from March 31, 2006 backlog of $726.7 million, and a 11.5% increase from June 30, 2005 backlog of $618.7 million (all on a same-store basis). The decrease in backlog from the prior quarterend is primarily from one of our larger multi-family operations working through its existing backlog. Additional bookings are anticipated from this location in the third quarter of 2006.

Following the three-year period of industry activity declines from 2001-2003 noted previously, we saw modest year-over-year revenue increases at our ongoing operations beginning in mid-2003 and continuing throughout 2004 and 2005 and during the first six months of 2006. We continue to see signs that activity levels in our industry may continue to increase during the remainder of 2006. These observations are based on nonresidential construction spending trends, shipment data from HVAC equipment manufacturers, forecasts from construction industry analysts, and anecdotal indications of renewed project consideration.

Along with the indications noted above that suggest industry activity is improving, there remain the following cautionary factors in the industry environment, each of which is discussed at greater length in the *Introduction* above. Since HVAC and related installation and replacement decisions are capital decisions usually involving some amount of discretion, they tend to be affected to a greater degree by macroeconomic or geopolitical uncertainty. Negative developments or events in these arenas, should they occur, will likely cause end users to defer HVAC and related spending decisions, thereby reducing our revenues.

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

While we believe we will see increased industry activity levels through the remainder of 2006, in view of all of the foregoing factors, we may continue to experience only modest revenue growth or revenue declines in upcoming periods. In addition, if general economic activity in the US slows significantly from current levels, we may realize decreases in revenue and lower operating margins.

Gross Profit—Gross profit increased $4.2 million, or 11.0%, to $42.5 million for the second quarter of 2006 as compared to the same period in 2005. As a percentage of revenues, historical gross profit for the

second quarter of 2006 was 16.1%, down from 16.7% in the second quarter of 2005. The decrease in gross profit percentage resulted primarily from an increased proportion of new construction work due to stronger activity levels, and from decreased profitability in one of our larger multi-family operations (approximately $0.9 million) and by job underperformance at our Connecticut operations (approximately $0.6 million).

Gross profit for the first six months of 2006 increased $12.9 million, or 19.4%, to $79.2 million, as compared to the same period in 2005. As a percentage of revenues, historical gross profit for the first six months of 2006 was 15.8%, up from 15.7% in the first six months of 2005. The increase in gross profit percentage resulted primarily from increased profitability in our Arizona operations (approximately $1.6 million) and improved margins in our Southern California operations (approximately $0.8 million). These gains were partially offset by job underperformance at our Connecticut operations (approximately $1.0 million).

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

Selling, General and Administrative Expenses ("SG&A")—SG&A increased $1.8 million, or 6.5%, to $30.4 million for the second quarter of 2006 as compared to the same period in 2005. As a percentage of revenues, SG&A declined from 12.4% in the second quarter of 2005 to 11.5% in the second quarter of 2006. SG&A increased $5.8 million, or 10.7%, to $60.2 million for the first six months ended June 30, 2006 as compared to the same period in 2005. As a percentage of revenues, SG&A declined from 12.8% in the first six months of 2005 to 12.0% in the first six months ended 2006. This decrease is consistent with an increased proportion of new construction work due to stronger activity levels, and also reflects our effort to control our SG&A expenses as we experience internal revenue growth.

Interest Income (Expense), Net—Interest expense, net was $0.3 million and $0.5 million, respectively, for the three and six months ended June 30, 2005. Interest income, net was $0.4 million and $0.9 million , respectively, for the three and six months ended June 30, 2006, respectively. The decrease in interest (expense), net is a result of no outstanding debt throughout 2006, and interest income earned from higher cash balances in the current year.

Write off of debt costs—The second quarter of 2005 included a non-cash write off of $0.9 million of deferred financing costs resulting from the replacement of our previous credit facility.

Income Tax Expense—The effective tax rate associated with results from continuing operations for the first six months of 2006 was 39.0%, as compared to 43.1% in 2005. Our effective tax rate is generally higher than statutory rates because of the effect of certain expenses that are not deductible for tax purposes. In addition, adjustments to tax reserves are analyzed and adjusted quarterly as events occur to warrant such changes. Adjustments to tax reserves are a component of the effective tax rate. The decrease in the effective tax rate is primarily due to an improvement in operating results which dilutes the impact of non-deductible expenses and adjustments to our tax reserves. Furthermore, our state tax rate is lower due to the change in where our income is being earned.

During 2004, the American Jobs Creation Act of 2004 was signed into law. The primary effect of this legislation was to permit us to claim a deduction for 3% of earnings related to certain of our construction-related activities beginning in 2005. This deduction modestly decreased our effective tax rate. We currently estimate that our effective tax rate for full-year 2006 will be between 38% and 41%.

Discontinued Operations

Sale of Companies to ALC—On December 31, 2005, we sold two operations to Automated Logic Corporation and Automated Logic Contracting Services, Inc. (together, "ALC") for approximately $22.9 million in cash, net of transaction costs and a purchase price adjustment based upon the closing balance sheet for the transferred assets. We paid $7.0 million in taxes related to this transaction during the first quarter of 2006. The after-tax income of these companies of $0.5 million for the first six months of 2005 has been reported in discontinued operations under "Operating loss, net of income tax benefit (expense)."

Sale of Assets to MESA Energy Systems, Inc.—On June 1, 2006, we, along with our wholly-owned subsidiary, ARC Comfort Systems USA, Inc. ("ARC"), entered into an asset purchase agreement to sell certain assets of ARC to Mesa Energy Systems, Inc. (a subsidiary of EMCOR Group, Inc.) for approximately $0.7 million in cash. These assets were sold at book value. We recorded a tax benefit of $0.2 million during the second quarter of 2006. This is included under the caption "Estimated gain on disposition, net of income tax benefit (expense)." We are in the process of shutting down the remaining operations of ARC. The after-tax loss of this company of $0.9 million and $0.2 million, for the first six months of 2005 and 2006, respectively, has been reported in discontinued operations under "Operating loss, net of income tax benefit (expense)."

Individual Sales of Operating Companies—During the second quarter of 2005, we sold a small operating company. We recorded a gain on the sale of this unit of $0.1 million, including taxes, in the second quarter of 2005 in discontinued operations under "Estimated gain on disposition including income tax benefit (expense)." During the third quarter of 2005, the Company sold one small operating company and shutdown the operations of another small operating company. The after-tax loss of these three companies of $0.7 million for the first six months of 2005, has been reported in discontinued operations under "Operating loss, net of income tax benefit (expense)."

Outlook—As noted earlier in this review, while we see signs that industry activity levels are continuing to increase in 2006, our primary emphasis for this year is on margin improvement more so than revenue growth. Our ongoing margin efforts include a focus on improving the results of units that incurred losses or subpar income in 2005, and on intensified project and service performance training at the unit level. Based on these margin improvement efforts and developments, on our increased level of backlog as compared to recent periods, and on our belief that industry and economic conditions are improving, we expect that our full-year 2006 results will be better than our 2005 results.

Liquidity and Capital Resources:

	Three Months Ended June 30, 2005	Three Months Ended June 30, 2006	Six Months Ended June 30, 2005	Six Months Ended June 30, 2006
	(in thousands)		(in thousands)	
Cash provided by (used in):				
Operating activities	$ 11,929	$ 8,586	$ 6,388	$ (11,922)
Investing activities	$ (203)	$ (845)	$ (4,836)	$ 21,810
Financing activities	$ (7,725)	$ 989	$ (7,673)	$ 1,610
Free cash flow:				
Cash provided by operating activities	$ 11,929	$ 8,586	$ 6,388	$ (11,922)
Taxes paid related to the sale of businesses	—	—	—	7,020
Purchases of property and equipment	(1,184)	(1,994)	(3,227)	(4,043)
Proceeds from sales of property and equipment	63	170	211	279
Free cash flow	$ 10,808	$ 6,762	$ 3,372	$ (8,666)

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

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

For the three months ended June 30, 2006, we had positive free cash flow of $6.8 million, as compared to positive free cash flow of $10.8 million during the second quarter of 2005. For the six months ended June 30, 2006, we had negative free cash flow of $8.7 million, as compared to positive free cash flow of $3.4 million during the first six months of 2005. This decrease primarily resulted from an investment in working capital due to higher activity levels and the funding of yearend compensation accruals.

During the first six months of 2006, we collected approximately $25.6 million, primarily related with the sale of two operations to Automated Logic Corporation and Automated Logic Contracting Services, Inc. of $23.8 million and $0.7 million related to the sale of ARC to Mesa Energy Systems, Inc.

Credit Facility—In June 2005, we entered into a $75.0 million senior credit facility (the "Facility") which is available for borrowings and letters of credit. The Facility is secured by substantially all of our assets except for assets related to projects subject to surety bonds. The Facility will expire on June 30, 2009. Our borrowings and letter of credit capacity under the Revolving Loan portion of the Facility at any given time is $75.0 million less borrowings and letters of credit outstanding, subject to a borrowing base. As of June 30, 2006, the total of the Facility was $75.0 million, with no outstanding borrowings, $22.1 million in letters of credit outstanding, and $52.9 million of credit available.

We have a choice of two interest rate options for borrowings under the Facility; these rates are floating rates determined by the broad financial markets, meaning they can and do move up and down from time to time. The Company estimates that the interest rate applicable to borrowings under the Facility would be approximately 7.33% as of June 30, 2006. Commitment fees of 0.25% per annum are payable on the portion of Revolving Loan capacity not in use for borrowings or letters of credit at any given time.

The Facility contains financial covenants defining various financial measures and the levels of these measures with which we must comply. The Facility limits capital expenditures to $20.0 million per year. The Facility also limits payment of dividends and repurchase of shares by the Company to a combined maximum of $20.0 million per year, and otherwise limits non-Facility debt, capital lease obligations, acquisitions, investments, and sales of assets. We are in compliance by a substantial margin with all the financial covenants as of June 30, 2006.

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

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

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

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

Surety market conditions remain challenging as a result of significant losses incurred by many sureties in recent periods, both in the construction industry as well as in certain larger corporate bankruptcies. As a result, less bonding capacity is available in the market and terms have become more restrictive. Further, under standard terms in the surety market, sureties issue bonds on a project-by-project basis, and can decline to issue bonds at any time. Historically, approximately 30% of our business has required bonds. While we have enjoyed a longstanding relationship with our primary surety and we have added another surety to further support our bonding needs, current market conditions as well as changes in our sureties' assessment of our operating and financial risk could cause our sureties to decline to issue bonds for our work. If that were to occur, our alternatives include doing more business that does not require bonds, posting other forms of collateral for project performance such as letters of credit or cash, and seeking bonding capacity from other sureties. We would likely also encounter concerns from customers, suppliers and other market participants as to our creditworthiness. While we believe our general operating and financial characteristics, including a significant amount of cash on our balance sheet, would enable us to ultimately respond effectively to an interruption in the availability of bonding capacity, such an interruption would likely cause our revenues and profits to decline in the near term.

The following recaps the future maturities of our contractual obligations as of June 30, 2006 (in thousands):

	Twelve Months Ended June 30,						
	2007	2008	2009	2010	2011	Thereafter	Total
Operating lease obligations	$ 8,641	$ 7,372	$ 5,637	$ 3,507	$ 1,804	$ 5,440	$ 32,401

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

As of June 30, 2006 we also have $22.1 million of letter of credit commitments, of which $20.6 million expire in 2006 and $1.5 million expire in 2007. The substantial majority of these letters of credit are posted with insurers who disburse funds on our behalf in connection with our worker's compensation, auto liability and general liability insurance program. These letters of credit provide additional security to the insurers that sufficient financial resources will be available to fund claims on our behalf, many of which develop over long periods of time, should we ever encounter financial duress. Posting of letters of credit for this purpose is a common practice for entities that manage their self-insurance programs through third-party insurers as we do. While the majority of these letter of credit commitments expire in 2006, we expect nearly all of them, particularly those supporting our insurance programs, will be renewed annually.

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

Outlook—We have generated positive net free cash flow in each of the last seven calendar years, most of which occurred during challenging economic and industry conditions. We also expect to have no debt, significant borrowing capacity under our credit facility, and substantial uncommitted cash balances. We believe these factors will provide us with sufficient liquidity to fund our operations for the foreseeable future.

Seasonality and Cyclicality

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

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

Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 is an interpretation of FASB Statement No. 109, "Accounting for Income Taxes," and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN 48 requires expanded disclosure with respect to the uncertainty in income taxes and is effective January 1, 2007. We are currently evaluating the impact, if any, that FIN 48 will have on our financial statements.

We have various stock-based compensation plans. Prior to January 1, 2006, we accounted for those plans under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock-Based Compensation." No stock-based employee compensation cost was recognized in the Consolidated Statements of Operations for the six months ended June 30, 2005, except with respect to the amortization of the intrinsic value of restricted stock grants totaling $0.2 million. Options granted under our equity compensation plans had an exercise price equal to the market value of the underlying common stock on the date of grant and all terms were fixed, accordingly, no expense was recognized under APB Opinion No. 25. Effective January 1, 2006, we adopted the fair value recognition provisions of Financial Accounting Standards Board Statement No. 123(R), Share-Based Payment (FAS 123R), using the modified-prospective-transition method. Results for prior periods have not been restated.

The impact of the adoption of FAS 123R resulted in compensation expense of $0.6 million ($0.4 million after-tax or $0.01 per basic share and $0.01 per diluted share) for the three months ended June 30, 2006. For the first half of 2006, we recorded share-based compensation expense of $1.0 million ($0.6 million after-tax or $0.01 per basic share and $0.01 per diluted share).

Prior to adopting Statement 123R, we presented the benefits of tax deductions in excess of recognized compensation costs (excess tax benefits) as operating cash flows in the consolidated statements of cash flows. Statement 123R requires these excess tax benefits to be reported as financing cash flows.

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

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

We have limited exposure to changes in interest rates due to our lack of indebtedness for borrowed money. We have a debt facility under which we may borrow funds in the future. We do not currently foresee any borrowing needs.

ITEM 4. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during the three months ended June 30, 2006 that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

COMFORT SYSTEMS USA, INC.
PART II—OTHER INFORMATION

Item 1. ***Legal Proceedings***

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

In addition to the matters described above, we are defending a dispute arising out of an alleged delay related to a multi-family construction project. If we are not successful in this dispute, it could have a material adverse effect on us. However, management believes the likelihood of an adverse result of this magnitude is remote, and management believes our accruals relating to the matter appropriately reflect a probable outcome.

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 18, 2006, which meeting was duly noticed in the Company's Proxy Statement dated April 7, 2006. All of the Company's incumbent directors were elected by a majority of the outstanding shares eligible to vote with respect to such election, each for a term expiring at the next annual meeting. Out of a potential of 39,337,792 shares of Common Stock outstanding, William F. Murdy had 32,950,899 shares voted in favor of election, with 611,705 shares withheld. Herman E. Bulls had 32,435,825 shares voted in favor of election, with 1,126,779 shares withheld. Alfred J. Giardinelli, Jr. had 33,138,227 shares voted in favor of election, with 424,377 shares withheld. Franklin Myers had 33,350,265 shares voted in favor of election, with 212,339 shares withheld. James H. Schultz had 32,435,959 shares voted in favor of election, with 1,126,645 shares withheld. Robert D. Wagner, Jr. had 33,350,082 shares voted in favor of election, with 212,522 shares withheld. With respect to the individual director designated for election by the holders of the Restricted Voting Common Stock, out of a potential of 900,691 shares of Restricted Voting Common Stock outstanding, Steven S. Harter had 827,035 shares voted in favor of election, with no shares withheld.

The Company's 2006 Equity Incentive Plan was approved by the following vote: 19,328,044 votes for; 5,855,897 votes against; 1,134,252 abstentions; and 7,244,411 broker non-votes. The Company's 2006 Stock Options/SAR Plan for Non-Employee Directors was approved by the following vote: 20,423,410 votes for; 4,747,748 votes against; 1,147,035 abstentions; and 7,244,411 broker non-votes. The selection of Ernst & Young LLP as the Company's independent auditors for the year 2006 was ratified by the following vote: 31,923,082 votes for; 101,178 votes against; and 1,538,342 abstentions.

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

(a) Exhibits

10.1 Description of Comfort Systems USA, Inc. 2006 Incentive Compensation Plan for Executive Officers.
10.2 Comfort Systems USA, Inc. 2006 Equity Incentive Plan
10.3 Comfort Systems USA, Inc. 2006 Stock Options / SAR Plan for Non-Employee Directors
31.1 Rule 13a-14(a) Certification of William F. Murdy pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 Rule 13a-14(a) Certification of William George pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 Section 1350 Certification of William F. Murdy pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 Section 1350 Certification of William George pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K during the quarter ended June 30, 2006.

(i) The Company filed a report on Form 8-K with the Securities and Exchange Commission on April 6, 2006 under Item 1.01. The report related to the Company's adoption of the 2006 Incentive Compensation Plan for Executive Officers.

(ii) The Company filed a report on Form 8-K with the Securities and Exchange Commission on May 4, 2006 under Items 2.02, 8.01, and 9.01. The report related to the Company's announcement of a press release describing the Company's financial results for the first quarter of 2006.

(iii) The Company filed a report on Form 8-K with the Securities and Exchange Commission on June 2, 2006 under Items 7.01 and 9.01. The report related to the Company's posting of an investor presentation slideshow on its Internet website (www.comfortsystemsusa.com) in the "Investor" section of such website.

(iv) The Company filed a report on Form 8-K with the Securities and Exchange Commission on June 5, 2006 under Items 2.01 and 9.01. The report related to the Company's sale of certain assets of ARC Comfort Systems USA, Inc. to Mesa Energy Systems, Inc. (a subsidiary of Emcor Group, Inc.) for approximately $0.7 million in cash, subject to a purchase price adjustment based upon the closing balance sheet for the transferred assets.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

November 13, 2006	By:	/s/ William F. Murdy William F. Murdy *Chairman of the Board and* *Chief Executive Officer*
November 13, 2006	By:	/s/ William George William George *Executive Vice President and* *Chief Financial Officer*
November 13, 2006	By:	/s/ Julie S. Shaeff Julie S. Shaeff *Senior Vice President and* *Chief Accounting Officer*

Exhibit 10.1

Description of Comfort Systems USA, Inc. 2006 Incentive
Compensation Plan for Executive Officers

Effective April 1, 2006, the Compensation Committee (the “Compensation Committee”) of the Board of Directors of Comfort Systems USA, Inc. (the “Company”) adopted the 2006 Incentive Compensation Plan for Executive Officers. Under the plan, the maximum bonus payable to Messrs., Murdy, George, and Tanner is 100% of their respective base salaries, and the maximum amount payable to Ms. Shaeff is 50% of her base salary. Messrs. Murdy, George and Tanner along with Ms. Shaeff are named executive officers of the Company. A portion of each officer’s bonus is based upon a discretionary assessment of such executive’s performance. For Messrs. Murdy, George and Tanner, the discretionary maximum is equal to 10% of their base salary; for Ms. Shaeff, the discretionary maximum is equal to 20% of her base salary. The remaining portion of each officer’s bonus is subject to the Company achieving a minimum cash flow amount and is then calculated based upon the Company’s earnings before interest, taxes, depreciation and amortization. The calculation begins once a minimum threshold is obtained and is then proportional to the amount by which the Company exceeds that threshold. For Messrs. Murdy, George and Tanner, the calculated amount is equal to up to 90% of their base salary; for Ms. Shaeff, the calculated amount is equal to up to 30% of her base salary.

Effective April 1, 2006, the Equity Plans Committee of the Board of Directors of the Company approved awards of restricted stock to certain executive officers (the “2006 Awards”). The 2006 Awards were granted pursuant to the 1997 Long-Term Incentive Plan and will vest pursuant to the positive earning goals stated within the Restricted Stock Award Agreements over a three year term.

The 2006 Awards were granted to the following executives for the purpose of providing an incentive for those individuals to work for the Company’s long term success:

Name/Title	**Stock Award Amount**
William F. Murdy Chairman and Chief Executive Officer	50,000
William George, III Executive Vice President and Chief Financial Officer	25,000
Thomas N. Tanner Executive Vice President and Chief Operating Officer	25,000
Julie S. Shaeff Senior Vice President and Chief Accounting Officer	5,000

The exact number of shares of restricted stock that will be issued to each of the executive officers listed above will depend upon whether certain performance thresholds are achieved during the 12-month periods preceding the scheduled vesting dates in 2006, 2007 and 2008, which vesting percentages range from 0% to 100% of the target number of shares specified above.

Effective April 1, 2006, the Compensation Committee increased the base salary of Messrs. Murdy, George and Tanner and Ms. Shaeff. Mr. Murdy’s annual base salary was increased to $525,000. Messrs. George’s and Tanner’s annual base salaries were increased to $275,000. Ms. Shaeff’s annual base salary was increased to $180,000.

COMFORT SYSTEMS USA, INC.
2006 EQUITY INCENTIVE PLAN

1. Purpose; Term

This Comfort Systems USA, Inc. 2006 Equity Incentive Plan (the "Plan") provides for the grant of incentive awards consisting of or based on the Common Stock of the Company. The purpose of the Plan is to attract and retain key employees, directors and consultants of the Company and its Affiliates, to provide an incentive for them to achieve performance goals, and to enable them to participate in the growth of the Company by granting Awards with respect to the Company's Common Stock. No Awards may be granted under the Plan more than ten years after the effective date of the Plan, but Awards granted prior to that date may continue in accordance with their terms. Certain capitalized terms used herein are defined in Section 3 below.

2. Administration

The Plan shall be administered by the Committee. Except to the extent action by the Committee is required under Section 162(m) of the Code in the case of Awards intended to qualify for performance-based compensation exception thereto, the Board may in any instance perform any of the functions of the Committee hereunder. The Committee shall select the Participants to receive Awards and shall determine the terms and conditions of the Awards. The Committee shall have authority, not inconsistent with the express provisions of the Plan: (a) to administer the issuance of Awards granted in accordance with the formula set forth in this Plan to such Participants as are eligible to receive Awards; (b) to prescribe the form or forms of instruments evidencing Awards and any other instruments required under the Plan and to change such forms from time to time; (c) to adopt, amend and rescind rules and regulations for the administration of the Plan; and (d) to interpret the Plan and to decide any questions and settle all controversies and disputes that may arise in connection with the Plan. Such determinations of the Committee shall be conclusive and shall bind all parties. Notwithstanding anything else, transactions under this Plan, to the extent they would otherwise be subject to Section 16 of the Securities Exchange Act of 1934, are intended to comply with all applicable conditions of Rule 16b-3 or its successors under Section 16 of the Securities Exchange Act of 1934 ("Rule 16b-3"). To the extent any provision of the Plan or action by the Committee fails to so comply, it shall be deemed null and void, to the extent permitted by law and deemed advisable by the Committee. In the case of an Award intended to be eligible for the performance-based compensation exception under Section 162(m) of the Code, the Plan and such Award shall be construed to the maximum extent permitted by law in a manner consistent with qualifying the Award for such exception. Consistent with the above requirements, the Committee may delegate such of its duties, powers and responsibilities as it may determine (and in the event of any such delegation, references herein to the Committee shall include the person or persons so delegated to the extent of such delegation).

In the case of an Award intended to be eligible for the performance-based compensation exception under Section 162(m) of the Code, the Committee shall establish in writing Performance Criteria (in such fashion and with such specificity so that they qualify as "preestablished objective goals" within the meaning of Treas. Regs. Section 1-162-27(e)(2)) for any fiscal year **not later than 90 days after the commencement of such year** (or such earlier time as is required to qualify Awards as performance-based under Code Section 162(m) of the Code); provided, however, that the amount so established by the Committee may be adjusted by the Committee after the initial determination of the amount to reflect any significant change of circumstance, including without limitation, the acquisition or disposition of any business by the Company or any of its Subsidiaries.

3. Certain Definitions

"Affiliate" means any corporation or other entity that stands in a relationship to the Company that would result in the Company and such corporation or other entity being treated as one employer under Section 414(b) or Section 414(c) of the Code. The Company may at any time by amendment provide that different ownership thresholds (consistent with Section 409A of the Code) apply but any such change shall not be effective for twelve (12) months.

"Award" means any Option, SAR, Restricted Stock, Unrestricted Stock, Restricted Stock Unit, Unrestricted Stock Unit), Performance Award (including a cash Performance Award) and other award convertible into or otherwise based on stock, granted under the Plan.

"Board" means the Board of Directors of the Company.

"Code" means the Internal Revenue Code of 1986, as amended from time to time, or any successor law.

"Committee" means one or more committees each comprised of not less than two members of the Board appointed by the Board to administer the Plan or a specified portion thereof. Unless otherwise determined by the Board, if a Committee is authorized to grant Awards to a Reporting Person or a Covered Employee, each member shall be a "non-employee director" within the meaning of Rule 16b-3 under the Exchange Act or, respectively, an "outside director" within the meaning of Section 162(m) of the Code, respectively.

"Common Stock" or "Stock" means the Common Stock, $0.01 par value, of the Company.

"Company" means Comfort Systems USA, Inc., a Delaware corporation.

"Corporate Transaction" means any of the following: any sale of all or substantially all of the assets of the Company, change in the ownership of the capital stock of the

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Company, reorganization, recapitalization, merger (whether or not the Company is the surviving entity), consolidation, exchange of capital stock of the Company or other restructuring involving the Company, *provided*, that, in each case, to the extent any amount constituting "nonqualified deferred compensation" subject to Section 409A of the Code would become payable under an Award by reason of a Corporate Transaction, it shall become payable only if the event or circumstances constituting the Corporate Transaction would also constitute a change in the ownership or effective control of the Company, or a change in the ownership of a substantial portion of the Company's assets, within the meaning of subsection (a)(2)(A)(v) of Section 409A of the Code.

"Covered Employee" means a "covered employee" within the meaning of Section 162(m) of the Code.

"Designated Beneficiary" means the beneficiary designated by a Participant, in a manner determined by the Committee, to receive amounts due or exercise rights of the Participant in the event of the Participant's death. In the absence of an effective designation by a Participant, "Designated Beneficiary" means the Participant's estate.

"Exchange Act" means the Securities Exchange Act of 1934, as amended from time to time, or any successor law.

"Fair Market Value" means, (i) with respect to Stock, (A) for so long as such Stock is readily tradeable on an established securities market (within the meaning of Section 409A), the closing price on the trading day of the grant, and (B) otherwise, the fair market value of such Stock determined by the Committee by a reasonable application of a reasonable valuation method (within the meaning of Section 409A); and, (ii) with respect to any other property, the fair market value of such property as determined by the Committee in good faith in the manner established by the Committee from time to time.

"ISO" has the meaning set forth in Section 6(a).

"NSO" has the meaning set forth in Section 6(a).

"Option" has the meaning set forth in Section 6(a).

"Participant" means a person selected by the Committee to receive an Award under the Plan.

"Performance Award" means an Award subject to Performance Criteria. The Committee in its discretion may grant Performance Awards that are intended to qualify for the performance-based compensation exception under Section 162(m) of the Code and Performance Awards that are not intended so to qualify.

"Performance Criteria" means specified criteria the satisfaction of which is a condition to the grant, exercisability, vesting, payment or full enjoyment of an Award. For purposes of Performance Awards that are intended to qualify for the performance-based

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compensation exception under Section 162(m) of the Code, a Performance Criterion shall mean an objectively determinable measure of performance relating to any of or to any combination of the following (determined either on a consolidated basis or, as the context permits, on a divisional, subsidiary, line of business, project or geographical basis or in combinations thereof): (i) sales; revenues; assets; expenses; earnings before or after deduction for all or any portion of interest, taxes, depreciation, amortization or other items, whether or not on a continuing operations or an aggregate or per share basis; return on equity, investment, capital or assets; one or more operating ratios; borrowing levels, leverage ratios or credit rating; market share; capital expenditures; cash flow; stock price; stockholder return; network deployment; sales of particular products or services; customer acquisition, expansion and retention; or any combination of the foregoing; or (ii) acquisitions and divestitures (in whole or in part); joint ventures and strategic alliances; spin-offs, split-ups and the like; reorganizations; recapitalizations, restructurings, financings (issuance of debt or equity), or refinancings; transactions that would constitute a change of control; or any combination of the foregoing. A Performance Criterion measure and targets with respect thereto determined by the Committee need not be based upon an increase, a positive or improved result or avoidance of loss. Prior to the grant, exercisability, vesting, payment or full enjoyment of the Performance Award, as the case may be, the Committee will determine whether the Performance Criteria have been attained and such determination will be conclusive. If the Performance Criteria are not attained, no other Award will be provided in substitution of the Performance Award with respect to which such Performance Criteria have not been met.

"Reporting Person" means a person subject to Section 16 of the Exchange Act.

"Restricted Period" has the meaning set forth in Section 8(a).

"Restricted Stock" has the meaning set forth in Section 8(a).

"Restricted Stock Unit" has the meaning set forth in Section 8(b).

"Stock Appreciation Right" or "SAR" has the meaning set forth in Section 7(a).

"Stock Unit Award" has the meaning set forth in Section 8(b).

"Unrestricted Stock" has the meaning set forth in Section 8(a).

"Unrestricted Stock Unit" has the meaning set forth in Section 8(b).

4. <u>Eligibility</u>

All key employees, all directors and all consultants of the Company (or of any Affiliate) whom the Committee considers to be capable of contributing to the successful performance of the Company are eligible to be Participants in the Plan, provided that, ISOs may be granted only to employees of the Company or of any parent or subsidiary corporation of the Company, as those terms are used in Section 424 of the Code.

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5. <u>Stock Available for Awards</u>

(a) *Amount.* Subject to the other subsections of this Section 5 and to Section 10, no more than 3,200,000 shares of Common Stock in the aggregate may be delivered under or in satisfaction of Awards. Shares issued under the Plan may consist of authorized but unissued shares or treasury shares. No fractional shares will be issued under the Plan.

(b) *Fungible Share Plan.* Each share of Stock subject to an Award consisting of Options and/or SARs shall be counted against the limits set forth in Section 5(a) as one (1) share. Each share of Stock subject to any Award other than an award consisting of Options and/or SARs shall be counted against the limits set forth in Section 5(a) as one and six-tenths (1.6) shares.

(c) *Reversion to the Plan.* For the avoidance of doubt, if an outstanding Award for any reason expires or is terminated or canceled without having been exercised or settled in full, or if shares of Stock acquired pursuant to an Award subject to forfeiture or repurchase are forfeited or repurchased by the Company for an amount not greater than the Participant’s purchase price, the shares of Stock allocable to the terminated portion of such Award or such forfeited or repurchased shares of Stock shall again be available for issuance under the Plan. Shares of Stock shall not be deemed to have been issued pursuant to the Plan with respect to any portion of an Award that is settled in cash or other property (other than shares of Stock). Upon payment in shares of Stock pursuant to the exercise of an SAR, the number of shares available for issuance under the Plan shall be reduced as provided in Section 7(c).

(d) *Certain Other Company Awards.* Common Stock issued under awards granted by another company (“other company awards”) and assumed by the Company in connection with a merger, consolidation, stock purchase or similar transaction, or issued by the Company under awards substituted for other company awards in connection with a merger, consolidation, stock purchase or similar transaction, shall not reduce the shares available for Awards under the Plan; *provided*, that the maximum number of shares that may be issued pursuant to ISOs (as defined below) shall be determined in a manner consistent with Section 422 of the Code and the rules thereunder.

(e) *Limit on Individual Grants.* In the case of an Award intended to be eligible for the performance-based compensation exception under Section 162(m) of the Code: (i) the maximum number of shares of Common Stock subject to Options and SARs that may be granted to any Participant in the aggregate in any calendar year shall not exceed, in each case, 1,000,000, and the maximum number of shares of Common Stock that may be granted as Stock Awards pursuant to Section 8 to any Participant in the aggregate in any calendar year shall not exceed 625,000, subject in each case to adjustment under Section 10 (for purposes of the preceding sentence, the repricing of an Option or SAR shall be treated as a new grant to the extent required under Section 162(m) of the Code).

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6. <u>Stock Options</u>

(a) *Grant of Options.* Subject to the provisions of the Plan, the Committee may grant both (i) options (“Options”) to purchase shares of Common Stock that are intended to comply with the requirements of Section 422 of the Code and the rules thereunder (“ISOs”) and (ii) Options that are not intended to comply with such requirements (“NSOs”). The Committee shall determine the number of shares subject to each Option and the exercise price therefor, which shall not be less than 100% of the Fair Market Value of the Common Stock on the date of grant. An ISO granted to an employee described in Section 422(b)(6) of the Code must have an exercise price that is not less than 110% of such fair market value. In no event, however, shall the exercise price be less, in the case of an original issue of authorized stock, than par value per share.

(b) *Terms and Conditions.* Each Option shall be exercisable at such times and subject to such terms and conditions as the Committee may specify in the applicable grant or thereafter. An ISO may not be exercised after the period provided in Treas. Reg. Section 1.422-2(a)(2)(iii) and Treas. Reg. Section 1.422-2(d). The Committee may impose such conditions with respect to the exercise of Options, including conditions relating to applicable federal or state securities laws, as it considers necessary or advisable.

(c) *Payment.* No shares shall be delivered pursuant to any exercise of an Option until payment in full of the exercise price therefor is received by the Company. Such payment may be made in whole or in part in cash or, to the extent legally permissible and expressly permitted by the Committee at or after the grant of the Option, by delivery of other property such as shares of Common Stock that have been owned by the optionee for at least six months (or such other period as the Committee may determine), valued at their Fair Market Value on the date of delivery or such other lawful consideration, including a payment commitment of a financial or brokerage institution, as the Committee may determine; or any combination of the foregoing permitted forms of payment.

7. <u>Stock Appreciation Rights</u>

(a) *Grant of SARs.* Subject to the provisions of the Plan, the Committee may grant rights to receive any excess in value of shares of Common Stock over the exercise price (“Stock Appreciation Rights” or “SARs”). The Committee shall determine at the time of grant or thereafter whether SARs are settled in cash, Common Stock or other securities of the Company, Awards or other property, and may define the manner of determining the excess in value of the shares of Common Stock. The Committee shall fix the exercise price of each SAR, which shall not be less than 100% of the Fair Market Value of the Common Stock at the date of grant.

(b) *Terms and Conditions.* Each SAR shall be exercisable at such times and subject to such terms and conditions as the Committee may specify in the applicable grant or thereafter. The Committee may impose such conditions with respect to the exercise of SARs, including conditions relating to applicable federal or state securities laws, as it considers necessary or advisable.

(c) *No Net Share Counting.* SARs to be settled in shares of Common Stock shall be counted in full against the number of shares available for award under the Plan under Section 5(a), regardless of the number of shares of Common Stock issued upon settlement of the SAR.

8. <u>Stock, Units, Other Awards and Performance Criteria</u>

(a) *Restricted or Unrestricted Stock Awards.* The Committee may grant shares of Common Stock subject to forfeiture (“Restricted Stock”) and determine the duration of the period (the “Restricted Period”) during which, and the conditions under which, the shares may be forfeited to the Company and the other terms and conditions of such Awards. Shares of Restricted Stock may not be sold, assigned, transferred, pledged or otherwise encumbered, except as permitted by the Committee, during the Restricted Period. Shares of Restricted Stock shall be evidenced in such manner as the Committee may determine. Any certificates issued in respect of shares of Restricted Stock shall be registered in the name of the Participant and unless otherwise determined by the Committee, deposited by the Participant, together with a stock power endorsed in blank, with the Company. At the expiration of the Restricted Period, the Company shall deliver such certificates to the Participant or if the Participant has died, to the Participant's Designated Beneficiary. The Committee also may make Awards of shares of Common Stock that are not subject to restrictions or forfeiture, on such terms and conditions as the Committee may determine from time to time ("Unrestricted Stock"). Shares of Restricted Stock or Unrestricted Stock may be issued for such consideration, if any, as the Committee may determine consistent with applicable law.

(b) *Restricted or Unrestricted Stock Unit Awards.* The Committee may grant Awards ("Stock Unit Awards") consisting of units representing shares of Common Stock. Each Stock Unit Award shall represent the unfunded and unsecured commitment of the Company to deliver to the Participant at a specified future date or dates one or more shares of Common Stock (including, if so provided with respect to the Award, shares of Restricted Stock), subject to the satisfaction of any vesting or other terms and conditions established with respect to the Award as the Committee may determine. No Participant or Designated Beneficiary holding a Stock Unit Award shall be treated as a stockholder with respect to the shares of Common Stock subject to the Award unless and until such shares are actually delivered under the Award. Stock Unit Awards may not be sold, assigned, transferred, pledged or otherwise encumbered except as permitted by the Committee. The Committee may make Awards of Stock Units that are subject to restrictions or forfeiture ("Restricted Stock Units") or Stock Units that are not subject to such restrictions ("Unrestricted Stock Units"), in each case on such terms and conditions as the Committee may determine from time to time.

(c) *Other Awards.* The Committee may grant Awards (including Performance Awards) other than Options, SARs, Restricted Stock, Unrestricted Stock or Stock Unit Awards.

(d) *Performance Goals.* The Committee may establish Performance Criteria on which the granting of Performance Awards, Restricted Stock, Unrestricted Stock, or Stock Unit Awards, or the vesting of Restricted Stock or Restricted Stock Unit Awards, will be subject. The Committee shall determine whether any Performance Criteria so established have been achieved, and if so to what extent, and its determination shall be binding on all persons.

9. <u>General Provisions Applicable to Awards</u>

(a) *Documentation and Legal Conditions on Delivery of Stock.* Each Award shall be evidenced by a writing delivered to the Participant or agreement executed by the Participant specifying the terms and conditions thereof and containing such other terms and conditions not inconsistent with the provisions of the Plan as the Committee considers necessary or advisable to achieve the purposes of the Plan or to comply with applicable tax and regulatory laws and accounting principles. The Company will not be obligated to deliver any shares of Stock pursuant to the Plan or to remove any restriction from shares of Stock previously delivered under the Plan until: the Company's counsel has approved all legal matters in connection with the issuance and delivery of such shares; if the outstanding Stock is at the time of delivery listed on any stock exchange or national market system, the shares to be delivered have been listed or authorized to be listed on such exchange or system upon official notice of issuance; and all conditions of the Award have been satisfied or waived. If the sale of Stock has not been registered under the Securities Act of 1933, as amended, the Company may require, as a condition to exercise of the Award, such representations or agreements as counsel for the Company may consider appropriate to avoid violation of such Act. The Company may require that certificates evidencing Stock issued under the Plan bear an appropriate legend reflecting any restriction on transfer applicable to such Stock.

(b) *Application of Code Section 409A.* Awards under the Plan are intended either to be exempt from the rules of Section 409A of the Code or to satisfy those rules, and shall be construed accordingly. Granted Awards may be modified at any time, in the Committee's discretion, so as to increase the likelihood of exemption from or compliance with the rules of Section 409A of the Code.

(c) *Committee Discretion.* Awards may be made alone or in combination with other Awards, including Awards of other types. The terms of Awards of the same type need not be identical, and the Committee need not treat Participants uniformly (subject to the requirements of applicable law). Except as otherwise expressly provided by the Plan or a particular Award, any determination with respect to an Award may be made by the Committee at the time of grant or at any time thereafter.

(d) *Dividends and Cash Awards.* In the discretion of the Committee, any Award under the Plan may provide the Participant with (i) dividends or dividend equivalents payable (in cash or in the form of Awards under the Plan) currently or deferred with or without interest and (ii) cash payments in lieu of or in addition to an Award.

(e) *Termination of Service.* Unless the Committee expressly provides otherwise, the following rules shall apply in connection with the cessation of a Participant's employment or other service relationship with the Company and its Affiliates. Immediately upon the cessation of the Participant's employment or other service relationship with the Company and its Affiliates an Award requiring exercise will cease to be exercisable and all Awards to the extent not already fully vested will be forfeited, except that:

(i) All Options and SARs held by a Participant immediately prior to his or her death, to the extent then exercisable, will remain exercisable by such Participant's executor or administrator or the person or persons to whom the Option or SAR is transferred by will or the applicable laws of descent and distribution, in each case for the lesser of (i) the one year period ending with the first anniversary of the Participant's death or (ii) the period ending on the latest date on which such Option or SAR could have been exercised without regard to this subsection (e), and shall thereupon terminate; and

(ii) all Options and SARs held by the Participant immediately prior to the cessation of the Participant's employment or other service relationship for reasons other than death and except as provided in (iii) below, to the extent then exercisable, will remain exercisable for the lesser of (1) a period of three months or (2) the period ending on the latest date on which such Option or SAR could have been exercised without regard to this subsection (e), and shall thereupon terminate.

(iii) Unless the Committee expressly provides otherwise, a Participant's "employment or other service relationship with the Company and its Affiliates" will be deemed to have ceased, in the case of an employee Participant, upon termination of the Participant's employment with the Company and its Affiliates (whether or not the Participant continues in the service of the Company or its Affiliates in some capacity other than that of an employee of the Company or its Affiliates), and in the case of any other Participant, when the service relationship in respect of which the Award was granted terminates (whether or not the Participant continues in the service of the Company or its Affiliates in some other capacity).

(f) *Transferability.* No Award may be transferred other than by will or the laws of descent and distribution and may be exercised, during the life of the Participant, only by the Participant, except that, as to Awards other than ISOs, the Committee may permit certain transfers to the Participant's family members or to certain entities controlled by the Participant or his or her family members.

(g) *Withholding Taxes.* The Participant shall pay to the Company, or make provision satisfactory to the Committee for payment of, any taxes or social insurance contributions required by law to be withheld in respect of Awards under the Plan no later than the date of the event creating the tax liability. The Company and its Affiliates may, to the extent permitted by law, deduct any such tax (or social insurance) obligations from any payment of any kind due to the Participant hereunder or otherwise. In the Committee's

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discretion, the minimum tax (or social insurance) obligations required by law to be withheld in respect of Awards may be paid in whole or in part in shares of Common Stock, including shares retained from the Award creating the obligation, valued at their Fair Market Value on the date of retention or delivery.

(h) *Amendment of Award.* Except as otherwise expressly provided in the Plan, the Committee may amend, modify, or terminate any outstanding Award, including substituting therefor another Award of the same or a different type, changing the date of exercise or realization and converting an ISO to an NSO. Any such action shall require the Participant's consent unless the Committee determines that the action would not materially and adversely affect the Participant.

(i) *Foreign Nationals.* The Committee may take any action consistent with the terms of the Plan, either before or after an Award has been granted, which the Committee deems necessary or advisable to comply with government laws or regulatory requirements of any foreign jurisdiction, including but not limited to modifying or amending the terms and conditions governing any Awards, establishing sub-plans under the Plan, or adopting such procedures as the Committee may determine to be appropriate in response to differences in laws, rules, regulations or customs of such foreign jurisdictions with respect to tax, securities, currency, employment, accounting or other matters.

(j) *Option or SAR Repricing.* Without the affirmative vote of holders of a majority of the shares of Stock cast in person or by proxy at a meeting of the stockholders of the Company at which a quorum representing a majority of all outstanding shares of Stock is present or represented by proxy, neither the Board nor the Committee shall approve either (a) the cancellation of outstanding Options or SARs and the grant in substitution therefor of new Options or SARs having a lower exercise price or (b) the amendment of outstanding Options or SARs to reduce the exercise price thereof. This paragraph shall not be construed to apply to: (i) "issuing or assuming a stock option in a transaction to which section 424(a) applies," within the meaning of Section 424 of the Code or (ii) the substitution or assumption of an Award by reason of or pursuant to a corporate transaction, to the extent such substitution or assumption would not be treated as a grant of a new stock right or a change in the form of payment for purposes of Section 409A of the Code within the meaning of Prop. Treas. Reg. Section 1.409A-1(b)(5)(iii)(D)(3), Notice 2005-1, A-4(d) and any subsequent Section 409A guidance (whether administrative or regulatory, or (iii) adjustments made pursuant to Section 10.

10. <u>Effect of Certain Transactions</u>

(a) *Assumptions or Substitutions.* Except as otherwise expressly provided in an Award Agreement:

(i) In the event of a Corporate Transaction in which there is an acquiring or surviving entity, the Committee may, unless the Committee determines that doing so is inappropriate or unfeasible, provide for the continuation or assumption of some or all outstanding Awards, or for the grant of new awards in

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substitution therefor, by the acquiror or survivor or an entity controlling, controlled by or under common control with the acquiror or survivor, in each case on such terms and subject to such conditions (including vesting or other restrictions) as the Committee determines are appropriate. Unless the Committee determines otherwise, the continuation or assumption shall be done on terms and conditions consistent with Section 409A of the Code.

(ii) In the event of a Corporate Transaction (whether or not there is an acquiring or surviving entity), the Committee may provide (unless the Committee determines otherwise, on terms and conditions consistent with Section 409A of the Code) for (A) treating as satisfied any vesting condition on any such Award or for (B) the accelerated delivery of shares of Stock issuable under each such Award consisting of Restricted Stock Units.

(iii) Except as otherwise expressly provided in an Award agreement, each Award (unless assumed pursuant to the Section 10(a)(i) above), will terminate upon consummation of the Corporate Transaction, provided that Restricted Stock Units accelerated pursuant to clause (B) of Section 10(a)(ii) shall be treated in the same manner as other shares of Stock (subject to Section 10(a)(iv))).

(iv) Any share of Stock delivered pursuant to Section 10(a)(ii) above with respect to an Award may, in the discretion of the Committee, contain such restrictions, if any, as the Committee deems appropriate to reflect any performance or other vesting conditions to which the Award was subject and that did not lapse in connection with the Corporate Transaction. In the case of Restricted Stock, the Committee may require that any amounts delivered, exchanged or otherwise paid in respect of Stock in connection with the Corporate Transaction be placed in escrow or otherwise made subject to such restrictions as the Committee deems appropriate to carry out the intent of the Plan.

(v) If the Corporate Transaction is one in which holders of Stock will receive upon consummation a payment (whether cash, non-cash or a combination of the foregoing), the Committee may provide for payment (a "cash-out"), with respect to some or all Awards, equal in the case of each affected Award to the excess, if any, of (A) the Fair Market Value of one share of Stock times the number of shares of Stock subject to the Award, over (B) the aggregate exercise price, if any, under the Award, in each case on such payment terms (which need not be the same as the terms of payment to holders of Stock) and other terms, and subject to such conditions, as the Committee determines.

(b) *Changes In, Distributions With Respect To And Redemptions Of The Stock*

(i) In the event of any stock dividend or other similar distribution of stock or other securities of the Company, stock split or combination of shares (including a reverse stock split), recapitalization, conversion, reorganization, consolidation, split-up, spin-off, combination, merger, exchange of stock, redemption or repurchase of all or part of the shares of any class of stock or any change in the capital structure of the Company or an Affiliate or other transaction or event, the Committee may, as appropriate in order to prevent enlargement or dilution of benefits intended to be made available under the Plan, make adjustments to the maximum number of shares that may be delivered as per Section 5 and may also make appropriate adjustments to the number and kind of shares of stock or securities subject to Awards then outstanding or subsequently granted, any exercise prices relating to Awards and any other provision of Awards affected by such change.

(ii) The Committee may also make adjustments of the type described in Section 10(a) and 10(b)(i) above to take into account distributions to stockholders other than stock dividends or normal cash dividends, material changes in accounting practices or principles, extraordinary dividends, mergers, consolidations, acquisitions, dispositions or similar transactions involving Stock, or any other event, if the Committee determines that adjustments are appropriate to avoid distortion in the operation of the Plan and to preserve the value of Awards made hereunder, having due regard for: the qualification of ISOs under Section 422 of the Code, the continued exemption of the Awards from (or satisfaction by the Awards of the rules of) Section 409A of the Code, where applicable and, in the case of Awards intended to qualify for the performance-based compensation exception Section 162(m) of the Code, having due regard continued qualification for that exception.

(iii) References in the Plan to shares of Stock will be construed to include any stock or securities resulting from an adjustment pursuant to this Section 10.

11. <u>Miscellaneous</u>

(a) *No Right To Employment.* No person shall have any claim or right to be granted an Award. Neither the adoption, maintenance, nor operation of the Plan nor any Award hereunder shall constitute a contract of employment or confer upon any employee, director or consultant of the Company or of any Affiliate any right with respect to the continuance of his/her employment by or other service with the Company or any such Affiliate nor shall it or they be construed as affecting the rights of the Company (or Affiliate) to terminate the service of any person at any time or otherwise change the terms of such service, including, without limitation, the right to promote, demote or otherwise re-assign any employee or other service provider from one position to another within the Company or any Affiliate.

(b) *No Rights As Stockholder.* Subject to the provisions of the applicable Award, no Participant or Designated Beneficiary shall have any rights as a stockholder with respect to any shares of Common Stock to be issued under the Plan until he or she becomes the holder thereof. A Participant to whom Restricted Stock or Unrestricted Stock is awarded shall be considered a stockholder of the Company at the time of the Award except as otherwise expressly provided in the applicable Award.

(c) *Effective Date.* The Plan shall be effective on the date it is approved by the stockholders.

(d) *Amendment of Plan.* The Board may amend, suspend, or terminate the Plan or any portion thereof at any time, subject to such stockholder approval as the Board determines to be necessary or advisable. Further, under all circumstances, the Committee may, but shall not be required to, make non-substantive administrative changes to the Plan as to conform with or take advantage of governmental requirements, statutes or regulations. Except as provided in Section 9(h), no such amendment, modification or termination will adversely affect the rights of any Participant (without his or her consent) under any Award previously granted and no amendment will, without the approval of the stockholders of the Company, effectuate a change for which stockholder approval is required in order for the Plan to qualify or to continue to qualify under Rule 16b-3 or for the Plan to qualify or to continue to qualify under Section 422 of the Code or for Awards intended to be eligible for the performance-based exception under Section 162(m) of the Code to qualify as such or continue such eligibility.

(e) *Governing Law.* The provisions of the Plan shall be governed by and interpreted in accordance with the laws of the State of Delaware.

Exhibit 10.3

COMFORT SYSTEMS USA, INC.
2006 STOCK OPTIONS/SAR PLAN FOR NON-EMPLOYEE DIRECTORS

1. Purpose; Term

The purpose of this 2006 Stock Options/SAR Plan for Non-Employee Directors (the "Plan") is to advance the interests of Comfort Systems USA, Inc. (the "Company") by increasing the proprietary interest in the Company of non-employee members of the Company's Board of Directors by providing a portion of their compensation in options to acquire shares ("Shares") of the Company's common stock ("Common Stock") and rights to receive any excess in value of shares of Common Stock over the exercise price ("Stock Appreciation Rights" or "SARs" and together with options, the "Awards"). No Awards may be granted under the Plan more than ten years after the effective date of the Plan, but Awards granted prior to that date may continue in accordance with their terms.

2. Administration and Definitions

The Plan shall be administered by the Committee. Except to the extent action by the Committee is required under Section 162(m) of the Code in the case of Awards intended to qualify for performance-based compensation exception thereto, the Board may in any instance perform any of the functions of the Committee hereunder. The Committee shall select the participants to receive Awards ("Participants") and shall determine the terms and conditions of the Awards. The Committee shall have authority, not inconsistent with the express provisions of the Plan: (a) to administer the issuance of Awards granted in accordance with the formula set forth in this Plan to such Participants as are eligible to receive Awards; (b) to prescribe the form or forms of instruments evidencing Awards and any other instruments required under the Plan and to change such forms from time to time; (c) to adopt, amend and rescind rules and regulations for the administration of the Plan; and (d) to interpret the Plan and to decide any questions and settle all controversies and disputes that may arise in connection with the Plan. Such determinations of the Committee shall be conclusive and shall bind all parties. Notwithstanding anything else, transactions under this Plan, to the extent they would otherwise be subject to Section 16 of the Securities Exchange Act of 1934, are intended to comply with all applicable conditions of Rule 16b-3 or its successors under Section 16 of the Securities Exchange Act of 1934 ("Rule 16b-3"). To the extent any provision of the Plan or action by the Committee fails to so comply, it shall be deemed null and void, to the extent permitted by law and deemed advisable by the Committee. In the case of an Award intended to be eligible for the performance-based compensation exception under Section 162(m), the Plan and such Award shall be construed to the maximum extent permitted by law in a manner consistent with qualifying the Award for such exception.

Consistent with the above requirements, the Committee may delegate (consistent with such of its duties, powers and responsibilities as it may determine (and in the event of

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any such delegation, references herein to the Committee shall include the person or persons so delegated to the extent of such delegation).

As used herein, "Committee" means one or more committees each comprised of not less than two members of the Board of Directors (the "Board") appointed by the Board to administer the Plan or a specified portion thereof. Unless otherwise determined by the Board, if a Committee is authorized to grant Awards to a Reporting Person or a Covered Employee, each member shall be a "non-employee director" within the meaning of Rule 16b-3 under the Exchange Act or, respectively, an "outside director" within the meaning of Section 162(m) of the Code, respectively. "Covered Employee" means a "covered employee" within the meaning of Section 162(m) of the Code. "Reporting Person" means a person subject to Section 16 of the Exchange Act.

3. Effective Date

The Plan shall be effective on the date it is approved by the stockholders.

4. Shares Subject to the Plan

(a) *Number of Shares.* Subject to the other terms of the Plan, no more than 500,000 shares of Common Stock in the aggregate may be delivered under or in satisfaction of Awards. Each share of Common Stock subject to an Award shall be counted against the limit as one (1) share. However, SARs to be settled in shares of Common Stock shall be counted in full against this limit, regardless of the number of shares of Common Stock issued upon settlement of the SAR.

(b) *No Fractional Shares to be Delivered.* Shares delivered under the Plan may be authorized but unissued common stock, or previously issued common stock that we acquire and hold in our treasury. No fractional Shares shall be delivered under the Plan.

(c) *Reversion to the Plan.* For the avoidance of doubt, if an outstanding Award for any reason expires or is terminated or canceled without having been exercised or settled in full, or if shares of Common Stock acquired pursuant to an Award subject to forfeiture or repurchase are forfeited or repurchased by the Company for an amount not greater than the Participant's purchase price, the shares of Common Stock allocable to the terminated portion of such Award or such forfeited or repurchased shares of Stock shall again be available for issuance under the Plan. Shares of Common Stock shall not be deemed to have been issued pursuant to the Plan (a) with respect to any portion of an Award that is settled in cash or other property (other than shares of Stock) or (b) to the extent such shares are withheld or reacquired by the Company in satisfaction of tax withholding obligations. Upon payment in shares of Stock pursuant to the exercise of an SAR, the number of shares available for issuance under the Plan shall be reduced as provided in Section 4(a).

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5. Eligibility

Directors eligible to receive Awards under the Plan ("Non-Employee Directors") shall be those directors who are not present or former employees of the Company or of any subsidiary or other affiliate of the Company.

6. Terms and Conditions of Awards

(a) *Individual Award Limits.* On the date of each annual meeting, each Non-Employee Director who has served since at least the previous annual meeting and is continuing in office and each newly elected Non-Employee Director shall be awarded an Award covering 10,000 Shares (which shall be the maximum number of shares of Common Stock subject to Awards that may be granted to any Participant under the Plan in the aggregate in any calendar year). For purposes of this paragraph, each Non-Employee Director elected to office by the Board since the then last annual meeting shall be treated as a newly elected Non-Employee Director.

(b) *Exercise Price.* The exercise price of each Award shall be 100% of the Fair Market Value per Share at the time the Award is granted. In no event, however, shall the exercise price be less, in the case of an original issue of authorized stock, than par value per share. For all purposes hereunder, "Fair Market Value" means, (i) with respect to Common Stock, (A) for so long as such Stock is readily tradeable on an established securities market (within the meaning of Section 409A), the closing price on the trading day of the grant, and (B) otherwise, the fair market value of such Stock determined by the Committee by a reasonable application of a reasonable valuation method (within the meaning of Section 409A); and, (ii) with respect to any other property, the fair market value of such property as determined by the Committee in good faith in the manner established by the Committee from time to time.

(c) *Grant of Options and SARs.* Subject to the provisions of the Plan, the Committee may grant options and SARs. The Committee shall determine at the time of grant or thereafter whether SARs are settled in cash, Common Stock or other securities of the Company or other property, and may define the manner of determining the excess in value of the shares of Common Stock. Each option and SAR shall be exercisable at such times and subject to such terms and conditions as the Committee may specify in the applicable grant or thereafter. The Committee may impose such conditions with respect to the grant and exercise of an option or SARs, including conditions relating to applicable federal or state securities laws, as it considers necessary or advisable.

(d) *Duration.* The latest date on which an Award may be exercised (the "Final Exercise Date") shall be the date which is ten years from the date the Award was granted.

(e) *Exercise.*

(i) Each Award shall become exercisable to the full extent of all Shares covered thereby one year after the date of the grant.

(ii) Any exercise of an Award shall be in writing, signed by the proper person and delivered or mailed to the Company, accompanied by (i) any documentation required by the Committee and (ii) payment in full for the number of Shares for which the Award is exercised.

(iii) The Participant shall pay to the Company, or make provision satisfactory to the Committee for payment of, any taxes (including any FICA or similar taxes) required by law to be withheld in respect of Awards under the Plan no later than the date of the event creating the tax liability. The Company and its affiliates may, to the extent permitted by law, deduct any such tax (including any FICA or similar tax) obligations from any payment of any kind due to the Participant hereunder or otherwise. In the Committee's discretion, the minimum tax (including any FICA or similar taxes) obligations required by law to be withheld in respect of Awards may be paid in whole or in part in shares of Stock, including shares retained from the Award creating the obligation, valued at their Fair Market Value on the date of retention or delivery.

(iv) If an Award is exercised by the executor or administrator of a deceased director, or by the person or persons to whom the Award has been transferred by the director's will or the applicable laws of descent and distribution, the Company shall be under no obligation to deliver Shares pursuant to such exercise until the Company is satisfied as to the authority of the person or persons exercising the Award.

(f) *Payment.* No shares shall be delivered pursuant to any exercise of an option until payment in full of the exercise price therefor is received by the Company. Such payment may be made in whole or in part in cash or, to the extent legally permissible and expressly permitted by the Committee at or after the grant of the option, by delivery of other property such as shares of Common Stock that have been owned by the optionee for at least six months (or such other period as the Committee may determine), valued at their Fair Market Value on the date of delivery or such other lawful consideration, including a payment commitment of a financial or brokerage institution, as the Committee may determine; or any combination of the foregoing permitted forms of payment.

(g) *No Rights As Stockholder.* An Award holder shall not have the rights of a shareholder with regard to awards under the Plan except as to Stock actually received by him or her under the Plan.

(h) *Documentation and Legal Conditions on Delivery of Stock.* Each Award shall be evidenced by a writing delivered to the Participant or agreement executed by the Participant specifying the terms and conditions thereof and containing such other terms and conditions not inconsistent with the provisions of the Plan as the Committee considers necessary or advisable to achieve the purposes of the Plan or to comply with applicable tax and regulatory laws and accounting principles. The Company will not be obligated to deliver any shares of Stock pursuant to the Plan or to remove any restriction from shares of Stock previously delivered under the Plan until: the Company's counsel has approved all

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legal matters in connection with the issuance and delivery of such shares; if the outstanding Stock is at the time of delivery listed on any stock exchange or national market system, the shares to be delivered have been listed or authorized to be listed on such exchange or system upon official notice of issuance; and all conditions of the Award have been satisfied or waived. If the sale of Stock has not been registered under the Securities Act of 1933, as amended, the Company may require, as a condition to exercise of the Award, such representations or agreements as counsel for the Company may consider appropriate to avoid violation of such Act. The Company may require that certificates evidencing Stock issued under the Plan bear an appropriate legend reflecting any restriction on transfer applicable to such Stock.

(i) *Nontransferability.* No Award may be transferred other than by will or the laws of descent and distribution and may be exercised, during the life of the Participant, only by the Participant, except that the Committee may permit certain transfers to the Participant's family members or to certain entities controlled by the Participant or his or her family members.

(j) *Termination of Service.* Unless the Committee expressly provides otherwise, the following rules shall apply affiliates. Immediately upon the cessation of the Participant's service relationship with the Company and its affiliates an Award requiring exercise will cease to be exercisable and all Awards to the extent not already fully vested will be forfeited, except that:

(i) All Awards held by a Participant immediately prior to his or her death, to the extent then exercisable, will remain exercisable by such Participant's executor or administrator or the person or persons to whom the Award is transferred by will or the applicable laws of descent and distribution, in each case for the lesser of (i) the one year period ending with the first anniversary of the Participant's death or (ii) the period ending on the latest date on which such Award could have been exercised without regard to this subsection (g), and shall thereupon terminate; and

(ii) all Awards held by the Participant immediately prior to the cessation of the Participant's employment or other service relationship for reasons other than death and except as provided in (iii) below, to the extent then exercisable, will remain exercisable for the lesser of (1) a period of six months or (2) the period ending on the latest date on which such Award could have been exercised without regard to this subsection (g), and shall thereupon terminate.

(iii) Unless the Committee expressly provides otherwise, a Participant's "service relationship with the Company and its affiliates" will be deemed to have ceased when the service relationship in respect of which the Award was granted terminates (whether or not the Participant continues in the service of the Company or its affiliates in some other capacity).

(k) *Amendment of Award.* Except as otherwise expressly provided in the Plan, the Committee may amend, modify, or terminate any outstanding Award, including

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substituting therefor another Award of the same or a different type, changing the date of exercise or realization. Any such action shall require the Participant's consent unless the Committee determines that the action would not materially and adversely affect the Participant.

7. <u>Effect, Termination, Amendment and Governing Law</u>

The Board of Directors may amend, suspend, or terminate the Plan or any portion thereof at any time, subject to such stockholder approval as the Board determines to be necessary or advisable. Further, under all circumstances, the Committee may, but shall not be required to, make non-substantive administrative changes to the Plan as to conform with or take advantage of governmental requirements, statutes or regulations. Except as provided in Section 6(k), no such amendment, modification or termination will adversely affect the rights of any Participant (without his or her consent) under any Award previously granted and no such amendment will, without the approval of the stockholders of the Company, effectuate a change for which stockholder approval is required in order for the Plan to qualify or to continue to qualify under Rule 16b-3 or for Awards intended to be eligible for the performance-based exception under Section 162(m) to continue such eligibility. Except as otherwise provided by the express terms of an Award Agreement, the provisions of the Plan and of Awards under the Plan shall be governed by and interpreted in accordance with the laws of the State of Delaware.

8. <u>Application of Code Section 409A</u>

Awards under the Plan are intended either to be exempt from the rules of Section 409A of the Code or to satisfy those rules, and shall be construed accordingly. Granted Awards may be modified at any time, in the Committee's discretion, so as to increase the likelihood of exemption from or compliance with the rules of Section 409A of the Code.

9. <u>Option or SAR Repricing</u>

Without the affirmative vote of holders of a majority of the shares of Common Stock cast in person or by proxy at a meeting of the stockholders of the Company at which a quorum representing a majority of all outstanding shares of Common Stock is present or represented by proxy, neither the Board nor the Committee shall approve either (a) the cancellation of outstanding Options or SARs and the grant in substitution therefor of new Options or SARs having a lower exercise price or (b) the amendment of outstanding Options or SARs to reduce the exercise price thereof. This paragraph shall not be construed to apply to: (i) the substitution or assumption of an Award by reason of or pursuant to a corporate transaction, to the extent such substitution or assumption would not be treated as a grant of a new stock right or a change in the form of payment for purposes of Section 409A of the Code within the meaning of Prop. Treas. Reg. Section 1.409A-1(b)(5)(iii)(D)(3), Notice 2005-1, A-4(d) and any subsequent Section 409A guidance (whether administrative or regulatory); or (ii) adjustments made pursuant to Section 10(b).

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10. <u>Effect of Certain Transactions</u>

(a) *Assumptions or Substitutions.* Except as otherwise expressly provided in an Award Agreement:

(i) In the event of a Corporate Transaction in which there is an acquiring or surviving entity, the Committee may, unless the Committee determines that doing so is inappropriate or unfeasible, provide for the continuation or assumption of some or all outstanding Awards, or for the grant of new awards in substitution therefor, by the acquiror or survivor or an entity controlling, controlled by or under common control with the acquiror or survivor, in each case on such terms and subject to such conditions (including vesting or other restrictions) as the Committee determines are appropriate. Unless the Committee determines otherwise, the continuation or assumption shall be done on terms and conditions consistent with Section 409A of the Code.

(ii) In the event of a Corporate Transaction (whether or not there is an acquiring or surviving entity), the Committee may provide (unless the Committee determines otherwise, on terms and conditions consistent with Section 409A of the Code) for treating as satisfied any vesting condition on any such Award.

(iii) Except as otherwise expressly provided in an Award agreement, each Award (unless assumed pursuant to the Section 10(a)(i) above), will terminate upon consummation of the Corporate Transaction.

(iv) If the Corporate Transaction is one in which holders of Stock will receive upon consummation a payment (whether cash, non-cash or a combination of the foregoing), the Committee may provide for payment (a "cash-out"), with respect to some or all Awards, equal in the case of each affected Award to the excess, if any, of (A) the Fair Market Value of one share of Common Stock times the number of shares of Common Stock subject to the Award, over (B) the aggregate exercise price, if any, under the Award, in each case on such payment terms (which need not be the same as the terms of payment to holders of Common Stock) and other terms, and subject to such conditions, as the Committee determines.

For this purpose, "Corporate Transaction" means any of the following: any sale of all or substantially all of the assets of the Company, change in the ownership of the capital stock of the Company, reorganization, recapitalization, merger (whether or not the Company is the surviving entity), consolidation, exchange of capital stock of the Company or other restructuring involving the Company, *provided*, that, in each case, to the extent any amount constituting "nonqualified deferred compensation" subject to Section 409A of the Code would become payable under an Award by reason of a Corporate Transaction, it shall become payable only if the event or circumstances constituting the Corporate Transaction would also constitute a change in the ownership or effective control of the Company, or a

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change in the ownership of a substantial portion of the Company's assets, within the meaning of subsection (a)(2)(A)(v) of Section 409A of the Code.

(b) *Changes In, Distributions With Respect To And Redemptions Of The Stock*

(i) In the event of any stock dividend or other similar distribution of stock or other securities of the Company, stock split or combination of shares (including a reverse stock split), recapitalization, conversion, reorganization, consolidation, split-up, spin-off, combination, merger, exchange of stock, redemption or repurchase of all or part of the shares of any class of stock or any change in the capital structure of the Company or an affiliate or other transaction or event, the Committee may, as appropriate in order to prevent enlargement or dilution of benefits intended to be made available under the Plan, make adjustments to the maximum number of shares that may be delivered and may also make appropriate adjustments to the number and kind of shares of stock or securities subject to Awards then outstanding or subsequently granted, any exercise prices relating to Awards and any other provision of Awards affected by such change.

(ii) The Committee may also make adjustments of the type described in Section 10(a) and 10(b)(i) above to take into account distributions to stockholders other than stock dividends or normal cash dividends, material changes in accounting practices or principles, extraordinary dividends, mergers, consolidations, acquisitions, dispositions or similar transactions involving Stock, or any other event, if the Committee determines that adjustments are appropriate to avoid distortion in the operation of the Plan and to preserve the value of Awards made hereunder, having due regard for the continued exemption of the Awards from (or satisfaction by the Awards of the rules of) Section 409A of the Code, where applicable and, in the case of Awards intended to qualify for the performance-based compensation exception Section 162(m) of the Code, having due regard continued qualification for that exception.

(iii) References in the Plan to shares of Common Stock will be construed to include any stock or securities resulting from an adjustment pursuant to this Section 10.

Exhibit 31.1

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

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

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

2. Based on my knowledge, this amended 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 amended report;

3. Based on my knowledge, the financial statements, and other financial information included in this amended 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 amended report;

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

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

   (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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

   (d) disclosed in this amended 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(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

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

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

Date: November 13, 2006

By: /s/ WILLIAM F. MURDY

William F. Murdy

Chairman of the Board and Chief Executive Officer

Exhibit 31.2

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

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

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

2. Based on my knowledge, this amended 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 amended report;

3. Based on my knowledge, the financial statements, and other financial information included in this amended 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 amended report;

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

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

   (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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

   (d) disclosed in this amended 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(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

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

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

Date: November 13, 2006

By: /s/ WILLIAM GEORGE
William George
Executive Vice President and Chief Financial Officer

Exhibit 32.1

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

In connection with the Amended Quarterly Report of Comfort Systems USA, Inc. (the “Company”) on Form 10-Q for the quarter ended June 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the “Amended Report”), I, William F. Murdy, Chairman of the Board and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

November 13, 2006

By: /s/ WILLIAM F. MURDY
William F. Murdy
Chairman of the Board and Chief Executive Officer

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

Exhibit 32.2

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

In connection with the Amended Quarterly Report of Comfort Systems USA, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Amended Report"), I, William George, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

November 13, 2006

By: /s/ WILLIAM GEORGE
William George
Executive Vice President and Chief Financial Officer

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