COMFORT SYSTEMS USA INC
Form 10-K
February 23, 2016



# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-K

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

**For the Fiscal Year Ended December 31, 2015**
**Commission file number: 1-13011**

# Comfort Systems USA, Inc.

(Exact name of registrant as specified in its charter)

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

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

(Address and telephone number of Principal Executive Offices)

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

| Title of Each Class | Name of Each Exchange on which Registered |
|---|---|
| Common Stock, $.01 par value | New York Stock Exchange |

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

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

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 ý

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 ý No o

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

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer ý | Accelerated filer o | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

The aggregate market value of the voting stock held by non-affiliates of the registrant at June 30, 2015 was approximately $843.5 million, based on the $22.95 last sale price of the registrant's common stock on the New York Stock Exchange on June 30, 2015.

As of February 17, 2016, 37,324,555 shares of the registrant's common stock were outstanding (excluding treasury shares of 3,798,810).

**DOCUMENTS INCORPORATED BY REFERENCE**

The information required by Part III (other than the required information regarding executive officers) is incorporated by reference from the registrant's definitive proxy statement, which will be filed with the Commission not later than 120 days following December 31, 2015.

Table of Contents

**TABLE OF CONTENTS**

Table of Contents

## *FORWARD-LOOKING STATEMENTS*

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

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

# PART I

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

## ITEM 1. *Business*

Comfort Systems USA, Inc., a Delaware corporation, was established in 1997. We provide comprehensive mechanical contracting services, which principally includes heating, ventilation and air conditioning ("HVAC"), plumbing, piping and controls, as well as off-site construction, electrical, monitoring and fire protection. We install, maintain, repair and replace products and systems throughout our 35 operating units in 81 cities and 89 locations throughout the United States.

We operate primarily in the commercial, industrial and institutional HVAC markets and perform most of our services in industrial, healthcare, education, office, technology, retail and government facilities. Approximately 99% of our consolidated 2015 revenue was derived from commercial, industrial and institutional customers and multi-family residential projects. Approximately 44% of our revenue was attributable to installation services in newly constructed facilities and 56% was attributable to renovation, expansion, maintenance, repair and replacement services in existing buildings. Our consolidated 2015 revenue was derived from the following service activities, substantially all of which are in the mechanical services industry, the single industry segment we serve:

| Service Activity | Percentage of Revenue |
|---|---|
| HVAC | 77% |
| Plumbing | 14% |
| Building Automation Control Systems | 5% |
| Other | 4% |
| Total | 100% |

Table of Contents

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

**Industry Overview**

We believe that the commercial, industrial, and institutional mechanical contracting generates annual revenue in the United States of approximately $100 billion. Mechanical systems are necessary to virtually all commercial, industrial and institutional buildings. Because most buildings are sealed, HVAC systems provide the primary method of circulating fresh air in such buildings. In many instances, replacing an aging building's existing systems with modern, energy-efficient systems significantly reduces a building's operating costs while improving air quality and overall system effectiveness. Older commercial, industrial and institutional facilities often have poor air quality as well as inadequate air conditioning, and older HVAC systems result in significantly higher energy costs than do modern systems.

Many factors positively affect mechanical services industry growth, particularly (i) population growth, which increases the need for commercial, industrial and institutional space, (ii) an aging installed base of buildings and equipment, (iii) increasing sophistication, complexity and efficiency of mechanical systems, and (iv) growing emphasis on environmental and energy efficiency.

Our industry can be broadly divided into two categories:

- construction of and installation in new buildings, which provided approximately 44% of our revenue in 2015, and
- renovation, expansion, maintenance, repair and replacement in existing buildings, which provided the remaining 56% of our 2015 revenue.

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

Table of Contents

*Maintenance, Repair and Replacement Services* These services include maintaining, repairing, replacing, reconfiguring and monitoring previously installed systems and building automation controls. The growth and aging of the installed base of HVAC and related systems, and the demand for more efficient and sophisticated systems and building automation controls have fueled growth in these services. The increasing complexity of these systems is leading many commercial, industrial and institutional building owners and property managers to increase attention to maintenance and to outsource maintenance and repair, often through service agreements with service providers. State-of-the-art control and monitoring systems feature electronic sensors and microprocessors. These systems require specialized training to install, maintain and repair. Increasingly, mechanical systems in commercial, industrial and institutional buildings are being remotely monitored to improve energy efficiency and expedite problem diagnosis and correction, thereby allowing us to provide maintenance and repair services at a lower cost.

**Strategy**

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

*Achieve Excellence in Core Competencies* We have identified six core competencies that we believe are critical to attracting and retaining customers, increasing operating income and cash flow and maximizing the productivity of our increasingly valuable skilled labor force. The six core competencies are: (i) customer cultivation and rapport, (ii) design and build expertise, (iii) estimating, (iv) job and cost tracking, (v) safety, and (vi) service excellence.

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

*Attract, Retain and Invest in our Employees* We seek to attract and retain quality employees by providing them an enhanced career path from working for a larger company, the opportunity to realize a more stable income and attractive benefits packages. We have increased our already substantial investments in training, including programs for project managers, field superintendents, service managers, sales managers, estimators, and leadership and development of key managers and leaders.

*Focus on Commercial, Industrial and Institutional Markets* We primarily focus on the commercial, industrial and institutional markets, including construction, maintenance, repair and replacement services. We believe that the commercial, industrial and institutional HVAC markets are attractive because of their growth opportunities, large and diverse customer base, attractive margins and potential for long-term relationships with building owners, property managers, general contractors and architects. Approximately 99% of our consolidated 2015 revenue was derived from commercial, industrial and institutional customers and large multi-family residential projects.

*Leveraging Resources and Capabilities* We believe significant operating efficiencies can be achieved by leveraging resources among our operating locations. For example, we have shifted certain fabrication activities into centralized locations in order to increase asset utilization. We opportunistically allocate our engineering, field and supervisory labor from one operation to another to more fully use our

Table of Contents

employee base, meet our customers' needs and share expertise. We believe we have realized scale benefits from combining purchasing, insurance, benefits, bonding and financing activities across our operations.

*Maintain a Diverse Customer, Geographic and Project Base* We have a distribution of revenue across end-use sectors that we believe reduces our exposure to negative developments in any given sector. We also have significant geographical diversification across all regions of the United States, again reducing our exposure to negative developments in any given region. Our distribution of revenue in 2015 by end-use sector was as follows:

| | |
|---|---|
| Industrial and Manufacturing | 21% |
| Education | 15% |
| Office Buildings | 13% |
| Healthcare | 11% |
| Government | 10% |
| Retail and Restaurants | 7% |
| Technology | 7% |
| Multi-Family | 5% |
| Lodging and Entertainment | 5% |
| Distribution | 2% |
| Religious and Not for profit | 1% |
| Residential | 1% |
| Other | 2% |
| Total | 100% |

Approximately 82% of our revenue is earned on a project basis for installation of systems in newly constructed or existing facilities. As of December 31, 2015, we had 3,843 projects in process with an aggregate contract value of approximately $1,966.4 million. Our average project takes six to nine months to complete, with an average contract price of approximately $512,000. This average project size, when taken together with the approximately 18% of our revenue derived from maintenance and service, provides us with a broad base of work in the construction services sector. A stratification of projects in progress as of December 31, 2015, by contract price, is as follows:

| Contract Price of Project | No. of Projects | Aggregate Contract Price Value (millions) |
|---|---|---|
| Under $1 million | 3,460 | $ 401.4 |
| $1 million - $5 million | 286 | 638.7 |
| $5 million - $10 million | 64 | 428.5 |
| $10 million - $15 million | 21 | 252.0 |
| Greater than $15 million | 12 | 245.8 |
| Total | 3,843 | $ 1,966.4 |

*Strategic Service Initiative.* Over the last two years we have made substantial incremental investments to expand our service and maintenance revenue by increasing the value we can offer to service and maintenance customers. We are actively concentrating existing and new managerial and sales resources on training and hiring experienced employees to sell and profitably perform service work. In many locations we have added or upgraded our capability, and we believe our investments and efforts are providing a compelling customer value offering that will ultimately stimulate growth in all aspects of our construction, renovation, service, and maintenance and repair businesses.

Table of Contents

*Seek Growth through Expansion and Acquisitions* We believe that we can increase our cash flow and operating income by opportunistically entering new markets or service lines through expansion and acquisition. We have dedicated a significant portion of our cash flow to seeking opportunities to acquire businesses that have attractive capabilities and meet other criteria involving valuation, financial, operational, management, growth and geographic considerations.

**Operations and Services Provided**

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

*Construction and Installation Services for New Buildings* Our installation business related to newly constructed facilities, which comprised approximately 44% of our consolidated 2015 revenue, involves the design, engineering, integration, installation and start-up of mechanical and related systems. We provide "design and build" and "plan and spec" installation services for office buildings, retail centers, apartment complexes, manufacturing plants, healthcare, education and government facilities and other commercial, industrial and institutional facilities. In a "design and build" installation, working with the customer, we determine the needed capacity and energy efficiency of the HVAC system that best suits the proposed facility. We estimate the amount of time, labor, materials and equipment needed to build the specified system. The final design, terms, price and timing of the project are then negotiated with the customer or its representatives, after which any necessary modifications are made to the system plan. In "plan and spec" installation, we participate in a bid process to provide labor, equipment, materials and installation based on the end user's plans and engineering specifications.

Once an agreement has been reached, we order the necessary materials and equipment for delivery to meet the project schedule. In many instances, we fabricate ductwork and piping and assemble certain components for the system based on the mechanical drawing specifications, eliminating the need to subcontract ductwork or piping fabrication. Finally, we install the system at the project site, working closely with the owner or general contractor. Our average project takes six to nine months to complete, with an average contract price of approximately $512,000. We also perform larger project work, with 383 contracts in progress at December 31, 2015 with contract prices in excess of $1 million. Our largest project in progress at December 31, 2015 had a contract price of $24.7 million. Project contracts typically provide for periodic billings to the customer as we meet progress milestones or incur cost on the project. Project contracts in our industry also frequently allow for a small portion of progress billings or contract price to be withheld by the customer until after we have completed the work, typically for six months. Amounts withheld under this practice are known as retention or retainage.

*Renovation, Expansion, Maintenance, Repair and Replacement Services for Existing Buildings* Our renovation, expansion, maintenance, repair and replacement services in existing buildings comprised approximately 56% of our consolidated 2015 revenue and include the maintenance, repair, replacement, renovation, expansion, reconfiguration and monitoring of mechanical systems including HVAC systems and industrial process piping. Approximately 68% of our maintenance, repair and replacement revenue were derived from renovation, expansion, replacement and reconfiguration of existing systems for commercial, industrial and institutional customers. Renovation, expansion, replacement and reconfiguration services are typically performed on a project basis and frequently use consultative expertise similar to that provided in the "design and build" installation market.

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

**Sources of Supply**

The raw materials and components we use include HVAC system components, ductwork, steel, sheet metal and copper tubing and piping. These raw materials and components are generally available from a variety of domestic or foreign suppliers at competitive prices. Delivery times are typically short for most raw materials and standard components, but during periods of peak demand, may extend to one month or more. We estimate that direct purchase of commodities and finished products comprises between 10% and 15% of our average project cost. We have procedures to reduce commodity cost exposure; early buying of commodities for particular projects, or for general inventory, as well as including escalation and escape provisions in project bids and contracts wherever possible.

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

**Cyclicality and Seasonality**

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

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

**Sales and Marketing**

We have a diverse customer base, with no single customer accounting for more than 3% of consolidated 2015 revenue. Management and a dedicated sales force are responsible for developing and maintaining successful long-term relationships with key customers. Customers generally include building owners and developers and property managers, as well as general contractors, architects and consulting engineers. We intend to continue our emphasis on developing and maintaining long-term relationships with our customers by providing superior, high-quality service in a professional manner. We believe we can continue to leverage the diverse technical and marketing strengths at individual locations to expand the services offered in other local markets. With respect to multi-location service opportunities, we maintain a national sales force in our national accounts group.

**Employees**

As of December 31, 2015, we had 7,301 employees. We have collective bargaining agreements covering eleven employees. We have not experienced and do not expect any significant strikes or work stoppages and believe our relations with employees covered by collective bargaining agreements are good.

**Recruiting, Training and Safety**

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

We have established comprehensive safety programs throughout our operations to ensure that all technicians comply with safety standards we have established and that are established under federal, state and local laws and regulations. Additionally, we have implemented a "best practices" safety program throughout our operations, which provides employees with incentives to improve safety performance and decrease workplace accidents. Safety leadership establishes safety programs and benchmarking to improve safety across the Company. Finally, our employment screening process seeks to determine that prospective employees have requisite skills, sufficient background references and acceptable driving records, if applicable. Our rate of incidents recordable under the standards of the Occupational Safety and Health Administration ("OSHA") per one hundred employees per year, also known as the OSHA recordable rate, was 1.99 during 2015. This level was 26% better than the most recently published OSHA rate for our industry.

**Insurance and Litigation**

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

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

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

Table of Contents

**Competition**

The HVAC industry is highly competitive and consists of thousands of local and regional companies. We believe that purchasing decisions in the commercial, industrial and institutional markets are based on (i) competitive price, (ii) long-term customer relationships, (iii) quality, timeliness and reliability of services provided, (iv) an organization's perceived stability based on years in business, financial strength and access to bonding, (v) range of services provided, and (vi) scale of operation. To improve our competitive position we focus on both the consultative "design and build" installation market and the maintenance, repair and replacement market to promote first the development and then the strengthening of long-term customer relationships. In addition, we believe our ability to provide multi-location coverage, access to project financing and specialized technical skills for facilities owners gives us a strategic advantage over smaller competitors who may be unable to provide these services to customers at a competitive price.

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

**Vehicles**

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

**Governmental Regulation and Environmental Matters**

Our operations are subject to various federal, state and local laws and regulations, including: (i) licensing requirements applicable to engineering, construction and service technicians, (ii) building and HVAC codes and zoning ordinances, (iii) regulations relating to consumer protection, including those governing residential service agreements, (iv) special bidding and procurement requirements on government projects, (v) wage and hour regulations, and (vi) regulations relating to worker safety and protection of the environment. For example, our operations are subject to the requirements of the Occupational Safety and Health Act, or OSHA, and comparable state laws directed towards protection of employees. We believe we have all required licenses to conduct our operations and are in substantial compliance with applicable regulatory requirements. If we fail to comply with applicable regulations we could be subject to substantial fines or revocation of our operating licenses.

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

Our operations are subject to the federal Clean Air Act, as amended, which governs air emissions and imposes specific requirements on the use and handling of ozone-depleting refrigerants generally classified as chlorofluorocarbons (CFCs) or hydrochlorofluorocarbons (HCFCs). Clean Air Act regulations promulgated by the United States Environmental Protection Agency (USEPA) require the certification of service technicians involved in the service or repair of equipment containing these

Table of Contents

refrigerants and also regulate the containment and recycling of these refrigerants. These requirements have increased our training expenses and expenditures for containment and recycling equipment. The Clean Air Act is intended ultimately to eliminate the use of ozone-depleting substances such as CFCs and HCFCs in the United States and to require alternative refrigerants to be used in replacement HVAC systems. Some replacement refrigerants, already in use, and classified as hydrofluorocarbons (HFCs) are not ozone-depleting substances. HFCs are considered by USEPA to have high global warming potential. USEPA may at some point require the phase-out of HFCs and expand existing technician certification requirements to cover the handling of HFCs. We do not believe the existing regulations governing technician certification requirements for the handling of ozone-depleting substances or possible future regulations applicable to HFCs will materially affect our business on the whole because, although they require us to incur modest ongoing training costs, our competitors also incur such costs, and such regulations may encourage or require our customers to update their HVAC systems.

## ITEM 1A. *Risk Factors*

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

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

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

The industries and markets we operate in have always been and will continue to be vulnerable to macroeconomic downturns because they are cyclical in nature. When there is a reduction in demand, it often leads to greater price competition as well as decreased revenue and profit. The lasting effects of a recession can also increase economic instability with our vendors, subcontractors, developers, and general contractors, which can cause us greater liability exposure and can result in us not being paid on some projects, as well as decreasing our revenue and profit. Further, to the extent some of our vendors, subcontractors, developers, or general contractors seek bankruptcy protection, the bankruptcy will likely force us to incur additional costs in attorneys' fees, as well as other professional consultants, and will result in decreased revenue and profit. Additionally, a reduction in federal, state, or local government spending in our industries and markets could result in decreased revenue and profit for us.

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

Our contract prices are established largely upon estimates and assumptions of our projected costs, including assumptions about: future economic conditions; prices, including commodities prices; availability of labor, including the costs of providing labor, equipment, and materials; and other factors outside our control. If our estimates or assumptions prove to be inaccurate, if circumstances change in

Table of Contents

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

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

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

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

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

***Our recent and future acquisitions may not be successful.***

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

We may choose to finance future acquisitions with debt, equity, cash or a combination of the three. Future acquisitions could dilute earnings or disrupt the payment of a stockholder dividend. To the extent we succeed in making acquisitions, a number of risks will result, including:

- the assumption of material liabilities (including for environmental-related costs);

Table of Contents

- failure of due diligence to uncover situations that could result in legal exposure or to quantify the true liability exposure from known risks;

- the diversion of management's attention from the management of daily operations to the integration of operations;

- difficulties in the assimilation and retention of employees, in the assimilation of different cultures and practices, in the assimilation of broad and geographically dispersed personnel and operations, and the retention of employees generally;

- the risk of additional financial and accounting challenges and complexities in areas such as tax planning, treasury management, financial reporting and internal controls; and

- we may not be able to realize the cost savings or other financial benefits we anticipated prior to the acquisition.

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

***Information technology system failures, network disruptions or cyber security breaches could adversely affect our business.***

We use sophisticated information technology systems, networks, and infrastructure in conducting some of our day-to-day operations and providing services to certain customers. Information technology system failures, including suppliers' or vendors' system failures, could disrupt our operations by causing transaction errors, processing inefficiencies, the loss of customers, other business disruptions or the loss of employee personal information. In addition, these systems, networks, and infrastructure may be vulnerable to deliberate cyber-attacks that interfere with their functionality or the confidentiality of our information or our customers' data. These events could impact our customers, employees and reputation and lead to financial losses from remediation actions, loss of business or potential liability or an increase in expense, all of which may have a material adverse effect on our business.

***Third parties contribute significantly to our completion of many projects.***

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

***Earnings for future periods may be impacted by impairment charges for goodwill and intangible assets.***

We carry a significant amount of goodwill and identifiable intangible assets on our consolidated balance sheets. Goodwill is the excess of purchase price over the fair value of the net assets of acquired businesses. We assess goodwill for impairment each year, and more frequently if circumstances suggest an impairment may have occurred. We have determined in the past and may again determine in the future that a significant impairment has occurred in the value of our unamortized intangible assets or fixed assets, which could require us to write off a portion of our assets and could adversely affect our financial condition or our reported results of operations.

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

We are likely to continue to be named as a defendant in legal proceedings claiming damages from us in connection with the operation of our business. These actions and proceedings may involve claims for, among other things, compensation for alleged personal injury, workers' compensation, employment

Table of Contents

discrimination, breach of contract or property damage. In addition, we may be subject to class action lawsuits involving allegations of violations of the Fair Labor Standards Act and state wage and hour laws. Due to the inherent uncertainties of litigation, we cannot accurately predict the ultimate outcome of any such actions or proceedings. We also are, and are likely to continue to be, from time to time a plaintiff in legal proceedings against customers, in which we seek to recover payment of contractual amounts we are owed as well as claims for increased costs we incur. When appropriate, we establish provisions against possible exposures, and we adjust these provisions from time to time according to ongoing exposure. If our assumptions and estimates related to these exposures prove to be inadequate or inaccurate, we could experience a reduction in our profitability and liquidity and a weakening of our financial condition. In addition, claims, lawsuits and proceedings may harm our reputation or divert management resources away from operating our business.

We typically warrant the services we provide, guaranteeing the work performed against defects in workmanship and the material we supply. Historically, warranty claims have not been material as our customers evaluate much of the work we perform for defects shortly after work is completed. However, if warranty claims occur, we could be required to repair or replace warrantied items at our cost. In addition, our customers may elect to repair or replace the warrantied item by using the services of another provider and require us to pay for the cost of the repair or replacement. Costs incurred as a result of warranty claims could adversely affect our operating results and financial condition.

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

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

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

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

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

We believe that our practice of placing significant decision making powers with local management is important to our successful growth and allows us to be responsive to opportunities and to our customers' needs. However, this practice presents certain risks, including the risk that we may be slower or less effective in our attempts to identify or react to problems affecting an important business than we would under a more centralized structure or that we would be slower to identify a misalignment between a subsidiary's and the Company's overall business strategy. Further, if a subsidiary location fails to follow the Company's compliance policies, we could be made party to a contract, arrangement or situation that requires the assumption of large liabilities or has less advantageous terms than is typically found in the market.

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

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

Additionally, we typically are contractually required to provide proof of insurance on projects we work on. Historically insurance market conditions become more difficult for insurance consumers during periods when insurance companies suffer significant investment losses as well as casualty losses. Consequently, it is possible that insurance markets will become more expensive and restrictive. Also,

Table of Contents

our prior casualty loss history might adversely affect our ability to procure insurance within commercially reasonable ranges. As such, we may not be able to maintain commercially reasonable levels of insurance coverage in the future, which could preclude our ability to work on many projects. Our insurance providers are under no commitment to renew our existing insurance policies in the future; therefore, our ability to obtain necessary levels or kinds of insurance coverage is subject to market forces outside our control. If we were unable to obtain necessary levels of insurance, it is likely we would be unable to compete for or work on most projects.

***Failure to remain in compliance with covenants under our credit agreement, service our indebtedness, or fund our other liquidity needs could adversely impact our business.***

Our credit agreement and related restrictive and financial covenants are more fully described in Note 9 of "Notes to the Consolidated Financial Statements." Our failure to comply with any of these covenants, or to pay principal, interest or other amounts when due thereunder, would constitute an event of default under the credit agreement. Default under our credit agreement could result in (1) us no longer being entitled to borrow under the agreement; (2) termination of the agreement; (3) acceleration of the maturity of outstanding indebtedness under the agreement; and/or (4) foreclosure on any collateral securing the obligations under the agreement. If we are unable to service our debt obligations or fund our other liquidity needs, we could be forced to curtail our operations, reorganize our capital structure (including through bankruptcy proceedings) or liquidate some or all of our assets in a manner that could cause holders of our securities to experience a partial or total loss of their investment in us.

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

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

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

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

***Our inability to properly utilize our workforce could have a negative impact on our profitability***

The extent to which we utilize our workforce affects our profitability. Underutilizing our workforce could result in lower gross margins and, consequently, a decrease in short-term profitability. On the other hand, overutilization of our workforce could negatively impact safety, employee satisfactions and project execution, leading to a potential decline in future project awards. The utilization of our workforce is impacted by numerous factors, including:

- our estimate of headcount requirements and our ability to manage attrition;
- efficiency in scheduling projects and our ability to minimize downtime between project assignments; and
- productivity.

***Misconduct by our employees, subcontractors or partners or our overall failure to comply with laws or regulations could harm our reputation, damage our relationships with customers, reduce our revenue and profits, and subject us to criminal and civil enforcement actions.***

Misconduct, fraud, non-compliance with applicable laws and regulations, or other improper activities by one or more of our employees, subcontractors or partners could have a significant negative impact on our business and reputation. Examples of such misconduct include employee or subcontractor theft, the failure to comply with safety standards, laws and regulations, customer requirements, environmental laws and any other applicable laws or regulations. While we take precautions to prevent and detect these activities, such precautions may not be effective and are subject to inherent limitations, including human error and fraud. Our failure to comply with applicable laws or regulations or acts of misconduct could subject us to fines and penalties, harm our reputation, damage our relationships with customers, reduce our revenue and profits and subject us to criminal and civil enforcement actions.

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

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

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

Our 89 locations are located in 27 states, which exposes us to a variety of different state and local laws and regulations, particularly those pertaining to contractor licensing requirements. These laws and regulations govern many aspects of our business, and there are often different standards and requirements in different locations. In addition, our subsidiaries that perform work for federal government entities are subject to additional federal laws and regulatory and contractual requirements. Changes in any of these laws, or any of our subsidiaries' material failure to comply with them, can adversely impact our operations by, among other things, increasing costs, distracting management's time and attention from other items, and harming our reputation.

Table of Contents

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

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

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

HVAC systems are subject to various environmental statutes and regulations, including the Clean Air Act and those regulating the production, servicing and disposal of certain ozone-depleting refrigerants used in HVAC systems. There can be no assurance that the regulatory environment in which we operate will not change significantly in the future. Various local, state and federal laws and regulations impose licensing standards on technicians who install and service HVAC systems. And additional laws, regulations and standards apply to contractors who perform work that is being funded by public money, particularly federal public funding. Our failure to comply with these laws and regulations could subject us to substantial fines, the loss of our licenses or potentially debarment from future publicly funded work. It is impossible to predict the full nature and effect of judicial, legislative or regulatory developments relating to health and safety regulations and environmental protection regulations applicable to our operations.

***Unsatisfactory safety performance may subject us to penalties, affect customer relationships, result in higher operating costs, negatively impact employee morale and result in higher employee turnover.***

Our projects are conducted at a variety of sites including construction sites and industrial facilities. Each location is subject to numerous safety risks, including electrocutions, fires, explosions, mechanical failures, weather-related incidents, transportation accidents and damage to equipment. These hazards can cause personal injury and loss of life, severe damage to or destruction of property and equipment and other consequential damages and could lead to suspension of operations, large damage claims and, in extreme cases, criminal liability. While we have taken what we believe are appropriate precautions to minimize safety risks, we have experienced serious accidents, including fatalities, in the past and may experience additional accidents in the future. Serious accidents may subject us to penalties, civil litigation or criminal prosecution. Claims for damages to persons, including claims for bodily injury or loss of life, could result in significant costs and liabilities, which could adversely affect our financial condition and results of operations. Poor safety performance could also jeopardize our relationships with our customers and harm our reputation.

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

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

***We are susceptible to adverse weather conditions, which may harm our business and financial results.***

Our business may be adversely affected by severe weather in areas where we have significant operations. Repercussions of severe weather conditions may include:

- curtailment of services;
- suspension of operations;
- inability to meet performance schedules in accordance with contracts and potential liability for liquidated damages;
- injuries or fatalities;
- weather related damage to our facilities;
- disruption of information systems;
- inability to receive machinery, equipment and materials at jobsites; and
- loss of productivity.

***Future climate change could adversely affect us.***

Climate change may create physical and financial risk. Physical risks from climate change could, among other things, include an increase in extreme weather events (such as floods or hurricanes), rising sea levels and limitations on water availability and quality. Such extreme weather conditions may limit the availability of resources, increasing the costs of our projects, or may cause projects to be delayed or cancelled.

Legislation, nationwide protocols, regulation or other restrictions related to climate change could negatively impact our operations or our customers' operations. Such legislation or restrictions could increase the costs of projects for our customers or, in some cases, prevent a project from going forward, which could in turn have an adverse effect on our financial condition and results of operations.

***Force majeure events, including natural disasters and terrorists' actions, could negatively impact our business, which may affect our financial condition, results of operations or cash flows.***

Force majeure or extraordinary events beyond the control of the contracting parties, such as natural and man-made disasters, as well as terrorist actions, could negatively impact us. We typically negotiate contract language where we are allowed certain relief from force majeure events in private client contracts and review and attempt to mitigate force majeure events in both public and private client contracts. We remain obligated to perform our services after most extraordinary events subject to relief that may be available pursuant to a force majeure clause. If we are not able to react quickly to force majeure events, our operations may be affected significantly, which would have a negative impact on our financial position, results of operations, cash flows and liquidity.

***Deliberate, malicious acts, including terrorism and sabotage, could damage our facilities, disrupt our operations or injure employees, contractors, customers or the public and result in liability to us.***

Intentional acts of destruction could damage or destroy our facilities, reducing our operational production capacity and requiring us to repair or replace our facilities at substantial cost. Additionally, employees, contractors and the public could suffer substantial physical injury from acts of terrorism for which we could be liable. Governmental authorities may also impose security or other requirements that could make our operations more difficult or costly. The consequences of any such actions could adversely affect our financial condition and results of operations.

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

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

***We are required to assess and report on our internal controls each year. Findings of inadequate internal controls could reduce investor confidence in the reliability of our financial information.***

As directed by the Sarbanes-Oxley Act, the SEC adopted rules generally requiring public companies, including us, to include in their annual reports on Form 10-K a report of management that contains an assessment by management of the effectiveness of our internal control over financial reporting. In addition, the independent registered public accounting firm auditing our financial statements must report on the effectiveness of our internal control over financial reporting. A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the company are being made only in accordance with authorizations of management and records of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

We may discover in the future that we have deficiencies in the design and operation of our internal controls. If any of the deficiencies in our internal control, either by itself or in combination with other deficiencies, becomes a "material weakness", such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis, we may be unable to conclude that we have effective internal control over financial reporting. In such event, investors could lose confidence in the reliability of our financial statements,

Table of Contents

which may significantly harm our business and cause our stock price to decline. In addition, the failure to maintain effective internal controls could also result in unauthorized transactions.

***Future sales of our common stock may depress our stock price.***

Sales of a substantial number of shares of our common stock in the public market or otherwise, either by us, a member of management or a major stockholder, or the perception that these sales could occur, could depress the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.

***Increases in our health insurance costs could adversely impact our results of operations and cash flows.***

The costs of employee health care insurance have been increasing in recent years due to rising health care costs, legislative changes, and general economic conditions. Additionally, we may incur additional costs as a result of the Patient Protection and Affordable Care Act (the "Affordable Care Act") that was signed into law in March 2010. A continued increase in health care costs or additional costs incurred as a result of the Affordable Care Act could have a negative impact on our financial position and results of operations.

***Rising inflation and/or interest rates could have an adverse effect on our business, financial condition and results of operations.***

Economic factors, including inflation and fluctuations in interest rates, could have a negative impact on our business. If our costs were to become subject to significant inflationary pressures or interest rate increases, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our financial position and results of operations.

***Our effective tax rate may increase.***

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

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

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

Table of Contents

**ITEM 1B.** ***Unresolved Staff Comments***

None.

**ITEM 2.** ***Properties***

As of December 31, 2015, we owned five properties. Other than these five owned properties, we lease the real property and buildings from which we operate. Our facilities are located in 27 states and consist of offices, shops and fabrication, maintenance and warehouse facilities. Generally, leases range from three to ten years and are on terms we believe to be commercially reasonable. A majority of these premises are leased from individuals or entities with whom we have no other business relationship. In certain instances these leases are with current or former employees. To the extent we renew, enter into leases or otherwise change leases with current or former employees, we enter into such agreements on terms that reflect a fair market valuation for the properties. Leased premises range in size from approximately 1,000 square feet to 110,000 square feet. To maximize available capital, we generally intend to continue to lease our properties, but may consider further purchases of property where we believe ownership would be more economical. We believe that our facilities are sufficient for our current needs.

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

**ITEM 3.** ***Legal Proceedings***

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

**ITEM 4.** ***Mine Safety Disclosures***

Not applicable.

**ITEM 4A.** ***Executive Officers of the Registrant***

Executive officers are appointed by our Board of Directors and hold office until their successors are elected and duly qualified. The following persons serve as executive officers of the Company.

*Brian Lane,* age 58, has served as our Chief Executive Officer and President since December 2011 and as a director since November 2010. Mr. Lane served as our President and Chief Operating Officer from March 2010 until December 2011. Mr. Lane joined the Company in October 2003 and served as Vice President and then Senior Vice President for Region One of the Company until he was named Executive Vice President and Chief Operating Officer in January 2009. Prior to joining the Company, Mr. Lane spent fifteen years at Halliburton, the global service and equipment company devoted to energy, industrial, and government customers. During his tenure at Halliburton, he held various positions in business development, strategy, and project initiatives. He departed as the Regional Director of Europe and Africa. Mr. Lane's additional experience included serving as a Regional Director of Capstone Turbine Corporation, a distributed power manufacturer. He also was a Vice President of Kvaerner, an international engineering and construction company where he focused on the chemical industry.

*William George,* age 51, has served as our Executive Vice President and Chief Financial Officer since May 2005, was our Senior Vice President, General Counsel and Secretary from May 1998 to

Table of Contents

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

*Julie S. Shaeff,* age 50, has served as our Senior Vice President and Chief Accounting Officer since May 2005, was our Vice President and Corporate Controller from March 2002 to May 2005, and was our Assistant Corporate Controller from September 1999 to February 2002. From 1996 to August 1999, Ms. Shaeff was Financial Accounting Manager Corporate Controllers Group for Browning-Ferris Industries, Inc., a publicly-traded waste services company. From 1987 to 1995, she held various positions with Arthur Andersen LLP. Ms. Shaeff is a Certified Public Accountant.

*Trent T. McKenna*, age 43, has served as our Senior Vice President, General Counsel and Secretary since August 2013, was our Vice President, General Counsel and Secretary from May 2005 to August 2013, and was our Associate General Counsel from August 2004 to May 2005. From February 1999 to August 2004, Mr. McKenna was a practicing attorney in the area of complex commercial litigation in the Houston, Texas office of Akin Gump Strauss Hauer & Feld LLP, an international law firm.

*James Mylett,* age 52, has served as our Senior Vice President of Service since October 2013. Prior to joining the Company, Mr. Mylett spent fourteen years at Johnson Controls, which manufactures, installs, and services automatic temperature regulation systems for buildings. During his time at Johnson Controls, Mr. Mylett held various positions, including that of Vice President and General Manager North America Service Operations from August 2011 to October 2013. From October 2010 to August 2011, he served as Vice President and General Manager West Region, and from December 2005 to September 2010, he served as Vice President of Service and Solutions South Region. Previously, Mr. Mylett worked for Carrier Corporation, where he established and developed the Company's national accounts service business.

## PART II

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

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

| | High | Low | Cash Dividends Declared |
|---|---|---|---|
| Fourth Quarter, 2015 | $ 33.71 | $ 27.47 | $ 0.065 |
| Third Quarter, 2015 | $ 30.12 | $ 22.98 | $ 0.065 |
| Second Quarter, 2015 | $ 23.90 | $ 20.11 | $ 0.060 |
| First Quarter, 2015 | $ 21.18 | $ 15.87 | $ 0.060 |
| Fourth Quarter, 2014 | $ 17.42 | $ 12.81 | $ 0.060 |
| Third Quarter, 2014 | $ 16.38 | $ 13.55 | $ 0.055 |
| Second Quarter, 2014 | $ 17.14 | $ 14.61 | $ 0.055 |
| First Quarter, 2014 | $ 19.62 | $ 15.24 | $ 0.055 |

As of February 17, 2016 there were approximately 273 stockholders of record of our Common Stock, and the last reported sale price on that date was $26.20 per share.

We expect to continue paying cash dividends quarterly, although there is no assurance as to future dividends because they depend on future earnings, capital requirements, and financial condition. In

Table of Contents

addition, our revolving credit agreement may limit the amount of dividends we can pay at any time that our Net Leverage Ratio exceeds 1.0.

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

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN***

Among Comfort Systems USA, Inc., the S&P 500 Index, and the Russell 2000 Index

*

$100 invested on 12/31/10 in stock or index, including reinvestment of dividends.
Fiscal year ending December 31.



**Recent Sales of Unregistered Securities**

None.

**Issuer Purchases of Equity Securities**

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from time to time approved extensions of the program to acquire additional shares. Since the inception of the repurchase program, the Board has approved 7.6 million shares to be repurchased. As of December 31, 2015, we have repurchased a cumulative total of 6.9 million shares at an average price of $11.99 per share under the repurchase program.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. During the twelve months ended December 31, 2015, we repurchased 0.3 million shares for approximately $8.3 million at an average price of $26.36 per share.

23

Table of Contents

During the year ended December 31, 2015, we purchased our common shares in the following amounts at the following weighted-average prices:

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| January 1 - January 31 | | $ | 6,566,368 | 994,815 |
| February 1 - February 28 | | $ | 6,566,368 | 994,815 |
| March 1 - March 31 | | $ | 6,566,368 | 994,815 |
| April 1 - April 30 | 43,750 | $ 20.61 | 6,610,118 | 951,065 |
| May 1 - May 31 | 29,283 | $ 21.28 | 6,639,401 | 921,782 |
| June 1 - June 30 | | $ | 6,639,401 | 921,782 |
| July 1 - July 31 | | $ | 6,639,401 | 921,782 |
| August 1 - August 31 | 40,439 | $ 27.74 | 6,679,840 | 881,343 |
| September 1 - September 30 | 82,361 | $ 27.71 | 6,762,201 | 798,982 |
| October 1 - October 31 | 37,002 | $ 26.51 | 6,799,203 | 761,980 |
| November 1 - November 30 | 4,058 | $ 31.38 | 6,803,261 | 757,922 |
| December 1 - December 31 | 79,060 | $ 28.99 | 6,882,321 | 678,862 |
| | 315,953 | $ 26.36 | 6,882,321 | 678,862 |

Table of Contents

## ITEM 6. *Selected Financial Data*

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

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2012 | 2011 |
| | (in thousands, except per share amounts) | | | | |
| **STATEMENT OF OPERATIONS DATA:** | | | | | |
| Revenue | $ 1,580,519 | $ 1,410,795 | $ 1,357,272 | $ 1,331,185 | $ 1,216,654 |
| Operating income (loss)(a) | $ 90,044 | $ 42,222 | $ 46,258 | $ 22,303 | $ (42,641) |
| Income (loss) from continuing operations | $ 57,440 | $ 28,614 | $ 28,632 | $ 11,494 | $ (32,474) |
| Discontinued operations | | | | | |
| Operating income (loss), net of tax | $ | $ (15) | $ (76) | $ 355 | $ (4,018) |
| Net income (loss) including noncontrolling interests | $ 57,440 | $ 28,599 | $ 28,556 | $ 11,849 | $ (36,492) |
| Net income (loss) attributable to Comfort Systems USA, Inc. | $ 49,364 | $ 23,063 | $ 27,269 | $ 13,463 | $ (36,830) |
| Income (loss) per share attributable to Comfort Systems USA, Inc.: | | | | | |
| Basic | | | | | |
| Income (loss) from continuing operations | $ 1.32 | $ 0.61 | $ 0.73 | $ 0.35 | $ (0.88) |
| Discontinued operations | | | | | |
| Income (loss) from operations | | | | 0.01 | (0.11) |
| Net income (loss) | $ 1.32 | $ 0.61 | $ 0.73 | $ 0.36 | $ (0.99) |
| Diluted | | | | | |
| Income (loss) from continuing operations | $ 1.30 | $ 0.61 | $ 0.73 | $ 0.35 | $ (0.88) |
| Discontinued operations | | | | | |
| Income (loss) from operations | | | | 0.01 | (0.11) |
| Net income (loss) | $ 1.30 | $ 0.61 | $ 0.73 | $ 0.36 | $ (0.99) |
| Cash dividends per share | $ 0.250 | $ 0.225 | $ 0.210 | $ 0.200 | $ 0.200 |
| **BALANCE SHEET DATA:** | | | | | |
| Working capital | $ 118,882 | $ 111,433 | $ 109,618 | $ 84,349 | $ 90,800 |
| Total assets | $ 691,594 | $ 655,942 | $ 592,789 | $ 573,461 | $ 589,947 |
| Total debt | $ 11,507 | $ 40,346 | $ 2,000 | $ 7,400 | $ 15,381 |
| Total stockholders' equity | $ 365,005 | $ 321,393 | $ 314,022 | $ 287,306 | $ 283,106 |
| Total Comfort Systems USA, Inc. stockholders' equity | $ 346,721 | $ 306,281 | $ 295,834 | $ 270,405 | $ 264,591 |

(a) Included in operating income are goodwill impairment charges of \$0.7 million and \$57.3 million for 2014 and 2011, respectively. There were no goodwill impairment charges for 2015, 2013 or 2012.

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

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

Table of Contents

**Introduction and Overview**

We are a national provider of comprehensive mechanical installation, renovation, maintenance, repair and replacement services within the mechanical services industry. We operate primarily in the commercial, industrial and institutional HVAC markets and perform most of our services within office buildings, retail centers, apartment complexes, manufacturing plants, and healthcare, education and government facilities.

***Nature and Economics of Our Business***

Approximately 82% of our revenue is earned on a project basis for installation of mechanical systems in newly constructed facilities or for replacement of systems in existing facilities. Customers hire us to ensure such systems deliver specified or generally expected heating, cooling, conditioning and circulation of air in a facility. This entails installing core system equipment such as packaged heating and air conditioning units, or in the case of larger facilities, separate core components such as chillers, boilers, air handlers, and cooling towers. We also typically install connecting and distribution elements such as piping and ducting. Our responsibilities usually require conforming the systems to pre-established engineering drawings and equipment and performance specifications, which we frequently participate in establishing. Our project management responsibilities include staging equipment and materials to project sites, deploying labor to perform the work, and coordinating with other service providers on the project, including any subcontractors we might use to deliver our portion of the work.

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

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

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

Table of Contents

margin, although such projects are sometimes subject to a guaranteed maximum cost. These margins are frequently less than fixed-price contract margins because there is less risk of unrecoverable cost overruns in cost-plus or time and materials work.

As of December 31, 2015, we had 3,843 projects in process. Our average project takes six to nine months to complete, with an average contract price of approximately $512,000. Our projects generally require working capital funding of equipment and labor costs. Customer payments on periodic billings generally do not recover these costs until late in the job. Our average project duration together with typical retention terms as discussed above generally allow us to complete the realization of revenue and earnings in cash within one year. We have what we believe is a well-diversified distribution of revenue across end-use sectors that we believe reduces our exposure to negative developments in any given sector. Because of the integral nature of HVAC and related controls systems to most buildings, we have the legal right in almost all cases to attach liens to buildings or related funding sources when we have not been fully paid for installing systems, except with respect to some government buildings. The service work that we do, which is discussed further below, usually does not give rise to lien rights.

We also perform larger projects. As of December 31, 2015, we had 12 projects in process with a contract price greater than $15 million, 21 projects between $10 million and $15 million, 64 projects between $5 million and $10 million, and 286 projects between $1 million and $5 million. Taken together, projects with contract prices of $1 million or more totaled $1,565.0 million of aggregate contract value as of December 31, 2015, or approximately 80%, out of a total contract value for all projects in progress of $1,966.4 million. Generally, projects closer in size to $1 million will be completed in one year or less. It is unusual for us to work on a project that exceeds two years in length.

In addition to project work, approximately 18% of our revenue represents maintenance and repair service on already installed HVAC and controls systems. This kind of work usually takes from a few hours to a few days to perform. Prices to the customer are usually based on the equipment and materials used in the service as well as technician labor time. We usually bill the customer for service work when it is complete, typically with payment terms of up to thirty days. We also provide maintenance and repair service under ongoing contracts. Under these contracts, we are paid regular monthly or quarterly amounts and provide specified service based on customer requirements. These agreements typically cover periods ranging from one to three years with thirty- to sixty-day cancellation notice periods.

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

***Profile and Management of Our Operations***

We manage our 35 operating units based on a variety of factors. Financial measures we emphasize include profitability, and use of capital as indicated by cash flow and by other measures of working capital principally involving project cost, billings and receivables. We also monitor selling, general, administrative and indirect project support expense, backlog, workforce size and mix, growth in revenue and profits, variation of actual project cost from original estimate, and overall financial performance in

Table of Contents

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

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

***Operating Environment and Management Emphasis***

Nonresidential building construction and renovation activity, as reported by the federal government, declined over the four year period from 2009 to 2012, and 2013 and 2014 activity levels were relatively stable at the low levels of the preceding years. While we expect that activity levels and the underlying environment for nonresidential construction activity will remain below prior peaks, we have seen industry conditions improve during 2015.

As a result of our continued strong emphasis on cash flow, at December 31, 2015 we had modest indebtedness under our revolving credit facility and substantial uncommitted cash balances, as discussed further in "Liquidity and Capital Resources" below. We have a credit facility in place with considerably less restrictive terms than those of our previous facilities; this facility does not expire until October 2019. We have strong surety relationships to support our bonding needs, and we believe our relationships with the surety markets are strong and benefit from our solid current results and financial position. We have generated positive free cash flow in each of the last seventeen calendar years and will continue our emphasis in this area. We believe that the relative size and strength of our balance sheet and surety support as compared to most companies in our industry represent competitive advantages for us.

As discussed at greater length in "Results of Operations" below, we expect price competition to continue as our customers and local and regional competitors respond cautiously to changing conditions. We will continue our efforts to expand and improve our service business, to find the more active sectors in our markets, and to increase our regional and national account business. Our primary

Table of Contents

emphasis for 2016 will be on execution and cost control, but we are seeking growth based on our belief that industry conditions are beginning to improve, and we believe that activity levels will permit us to earn improved profits while preserving and developing our workforce. We continue to focus on project qualification, estimating, pricing and management; and we are investing in service growth and improved performance.

***Critical Accounting Policies***

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

*Percentage of Completion Method of Accounting*

Approximately 82% of our revenue was earned on a project basis and recognized through the percentage of completion method of accounting during 2015. Under this method, contract revenue recognizable at any time during the life of a contract is determined by multiplying expected total contract revenue by the percentage of contract costs incurred at any time to total estimated contract costs. More specifically, as part of the negotiation and bidding process in connection with obtaining installation contracts, we estimate our contract costs, which include all direct materials (exclusive of rebates), labor and subcontract costs and indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. These contract costs are included in our results of operations under the caption "Cost of Services." Then, as we perform under those contracts, we measure costs incurred, compare them to total estimated costs to complete the contract, and recognize a corresponding proportion of contract revenue. Labor costs are considered to be incurred as the work is performed. Subcontractor labor is recognized as the work is performed, but is generally subjected to approval as to milestones or other evidence of completion. Non-labor project costs consist of purchased equipment, prefabricated materials and other materials. Purchased equipment on our projects is substantially produced to job specifications and is a value added element to our work. The costs are considered to be incurred when title is transferred to us, which typically is upon delivery to the worksite. Prefabricated materials, such as ductwork and piping, are generally performed at our shops and recognized as contract costs when fabricated for the unique specifications of the job. Other materials costs are not significant and are generally recorded when delivered to the worksite. This measurement and comparison process requires updates to the estimate of total costs to complete the contract, and these updates may include subjective assessments.

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

Table of Contents

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

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

Revisions to project costs and conditions can give rise to change orders under which the customer agrees to pay additional contract price. Revisions can also result in claims we might make against the customer to recover project variances that have not been satisfactorily addressed through change orders with the customer. Except in certain circumstances, we do not recognize revenue or margin based on change orders or claims until they have been agreed upon with the customer. The amount of revenue associated with unapproved change orders and claims was immaterial for the year ended December 31, 2015.

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

*Accounting for Allowance for Doubtful Accounts*

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

*Accounting for Self-Insurance Liabilities*

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

We believe these accruals are adequate. However, insurance liabilities are difficult to estimate due to unknown factors, including the severity of an injury, the determination of our liability in proportion to other parties, timely reporting of occurrences, ongoing treatment or loss mitigation, general trends in litigation recovery outcomes and the effectiveness of safety and risk management programs. Therefore,

Table of Contents

if actual experience differs from the assumptions and estimates used for recording the liabilities, adjustments may be required and would be recorded in the period that such experience becomes known.

*Accounting for Deferred Tax Assets*

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

*Acquisitions*

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

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

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

*Recoverability of Goodwill and Identifiable Intangible Assets*

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

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

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

In the evaluation of goodwill for impairment, we have the option to first assess qualitative factors to determine whether the existence of events or circumstances lead to a determination that it is more likely than not that the fair value of one of our reporting units is greater than its carrying value. If,

Table of Contents

after completing such assessment, we determine it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then there is no need to perform any further testing. If we conclude otherwise, then we perform the first step of a two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying value of the reporting unit.

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

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

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

Table of Contents

**Results of Operations (in thousands):**

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | 2013 | |
| Revenue | $ 1,580,519 | 100.0% | $ 1,410,795 | 100.0% | $ 1,357,272 | 100.0% |
| Cost of services | 1,262,390 | 79.9% | 1,161,024 | 82.3% | 1,117,389 | 82.3% |
| Gross profit | 318,129 | 20.1% | 249,771 | 17.7% | 239,883 | 17.7% |
| Selling, general and administrative expenses | 228,965 | 14.5% | 207,652 | 14.7% | 194,214 | 14.3% |
| Goodwill impairment | | | 727 | 0.1% | | |
| Gain on sale of assets | (880) | (0.1)% | (830) | (0.1)% | (589) | |
| Operating income | 90,044 | 5.7% | 42,222 | 3.0% | 46,258 | 3.4% |
| Interest income | 72 | | 18 | | 23 | |
| Interest expense | (1,753) | (0.1)% | (1,858) | (0.1)% | (1,351) | (0.1)% |
| Changes in the fair value of contingent earn-out obligations | 225 | | (245) | | 1,646 | 0.1% |
| Other income | 76 | | 91 | | 204 | |
| Income before income taxes | 88,664 | 5.6% | 40,228 | 2.9% | 46,780 | 3.4% |
| Income tax expense | 31,224 | | 11,614 | | 18,148 | |
| Income from continuing operations | 57,440 | 3.6% | 28,614 | 2.0% | 28,632 | 2.1% |
| Loss from discontinued operations, net of tax | | | (15) | | (76) | |
| Net income including noncontrolling interests | 57,440 | | 28,599 | | 28,556 | |
| Less: Net income attributable to noncontrolling interests | 8,076 | | 5,536 | | 1,287 | |
| Net income attributable to Comfort Systems USA, Inc. | $ 49,364 | | $ 23,063 | | $ 27,269 | |

***2015 Compared to 2014***

We had 37 operating locations as of December 31, 2014. During 2015, we completed two acquisitions in the first quarter, one in the third quarter and one in the fourth quarter. These acquisitions were not material and were "tucked-in" with existing operations. In addition, we merged two operating locations during the first quarter and closed one operating location during the third quarter. As of December 31, 2015, we had 35 operating locations. Acquisitions are included in our results of operations from the respective acquisition date. The same-store comparison from 2015 to 2014, as described below, excludes four months of results for our Northern Texas operation, which was acquired in May 2014. An operating location is included in the same-store comparison on the first day it has comparable prior year operating data. An operating location is excluded from the same-store comparison in the current year and comparable prior years when it is properly characterized as a discontinued operation under applicable accounting standards.

*Revenue* Revenue increased $169.7 million, or 12.0% to $1,580.5 million in 2015 compared to 2014. The increase included a 10.6% increase in revenue related to same-store activity and a 1.4% increase related to the acquisition of our Northern Texas operation. The same-store revenue increase is primarily due to our Environmental Air Systems, LLC ("EAS") operation ($61.3 million), our Arizona operation ($17.7 million), our large operation headquartered in Virginia ($12.2 million) and one of our Maryland operations ($12.1 million). These operations, as well as many of our other operating

Table of Contents

locations, experienced increased project work compared to the prior year in multiple markets, but primarily the industrials sector due to improved market conditions.

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

Backlog as of December 31, 2015 was $711.6 million, a 6.8% increase from September 30, 2015 backlog of $666.3 million and a 6.1% decrease from December 31, 2014 backlog of $757.8 million. Sequential backlog increased primarily due to increased project bookings at our EAS operation ($16.8 million), our Michigan operation ($13.6 million) and one of our Florida operations ($12.0 million). The year-over-year backlog decrease was primarily due to our EAS operation ($22.2 million), which had unusually large jobs booked in the fourth quarter of 2014, and due to completion of project work during the year at our California operation ($19.7 million) and our Arkansas operation ($17.9 million). This was partially offset by increased project bookings at our Michigan operation ($16.8 million).

*Gross Profit* Gross profit increased $68.4 million, or 27.4%, to $318.1 million in 2015 as compared to 2014. The increase included a $3.4 million, or 1.3%, increase related to the acquisition of our Northern Texas operation and a $65.0 million, or 26.1%, increase on a same-store basis. The same-store increase in gross profit was due to overall increased margins at a majority of operating locations. Specifically, increases were due to job underperformance at our Southern California operation in 2014 ($9.0 million), improved project execution at our large operation headquartered in Virginia ($7.0 million), and improved market conditions, which resulted in an increase in volumes at our EAS operation ($5.8 million). In addition, in the fourth quarter of 2015, we came to an agreement with customers on multiple jobs and received approved change orders, which resulted in additional revenue with minimal additional costs. The resulting impact to the current year was an increase to gross profit of approximately $3.4 million. As a percentage of revenue, gross profit increased from 17.7% in 2014 to 20.1% in 2015 primarily due to the factors discussed above.

*Selling, General and Administrative Expenses ("SG&A")* SG&A increased $21.3 million, or 10.3%, to $229.0 million for 2015 as compared to 2014. On a same-store basis, excluding amortization expense, SG&A increased $19.4 million, or 9.7%. This increase is primarily due to increased compensation accruals based on operating results ($13.3 million) and expanded service activities at certain locations ($4.8 million). Amortization expense remained relatively flat. As a percentage of revenue, SG&A decreased from 14.7% in 2014 to 14.5% in 2015, primarily due to the higher revenue base caused by the increase in market activity in 2015.

We have included same-store SG&A, excluding amortization, because we believe it is an effective measure of comparative results of operations. However, same-store SG&A, excluding amortization, is not considered under generally accepted accounting principles to be a primary measure of an entity's

Table of Contents

financial results, and accordingly, should not be considered an alternative to SG&A as shown in our consolidated statements of operations.

| | Year Ended December 31, | |
|---|---|---|
| | 2015 | 2014 |
| | (in thousands) | |
| SG&A | $ 228,965 | $ 207,652 |
| Less: SG&A from companies acquired | (1,843) | |
| Less: Amortization expense | (6,897) | (6,825) |
| Same-store SG&A, excluding amortization expense | $ 220,225 | $ 200,827 |

*Interest Expense* Interest expense decreased $0.1 million, or 5.7%, in 2015. The decrease is due to lower net borrowings on the revolving credit facility in 2015.

*Goodwill Impairment* No goodwill impairment was recorded in 2015. We recorded a goodwill impairment charge of $0.7 million during the second quarter of 2014. Based on market activity declines and write-downs incurred on several jobs, we determined that the operating environment, conditions and performance at our operating unit based in Southern California could no longer support the related goodwill balance.

*Changes in the Fair Value of Contingent Earn-out Obligations* The contingent earn-out obligations are measured at fair value each reporting period and changes in estimates of fair value are recognized in earnings. Income from changes in the fair value of contingent earn-out obligations increased $0.5 million in 2015 compared to 2014. Based on updated measurements of estimated future cash flows for our contingent obligations, we decreased our obligations related to prior year acquisitions resulting in the current year gain of $0.2 million. The $0.3 million loss from changes in the fair value of contingent earn-out obligations in the prior year was due to updated measurements of estimated future cash flows for our contingent obligation related to the EAS acquisition.

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

Our effective tax rate for 2015 was 35.2%, as compared to 28.9% in 2014. The effective rate for 2015 is slightly higher than the federal statutory rate of 35.0% primarily due to an increase in state income taxes (3.9%) which was partially offset by a decrease from the impact of the noncontrolling interest of EAS which for tax purposes is treated as a partnership (3.2%). The effective rate for 2014 is lower than the federal statutory rate of 35.0% primarily due to a decrease in the valuation allowance primarily associated with our operations in Maryland and Virginia (4.8%), by the impact of the noncontrolling interest of EAS which for tax purposes is treated as a partnership (4.8%) and the effect of the production activity deduction (1.7%). Refer to Note 10 in the Consolidated Financial Statements for a reconciliation of the federal statutory income tax rate to the effective tax rate reflected in our financial statements. The increase in the effective tax rate from 2014 to 2015 is primarily due to the impact on the rate from state income taxes and the valuation allowance, which is partially offset by the impact of our noncontrolling interests. We currently estimate our effective tax rate for 2016 will be between 36% and 42%. We generally expect our tax rate in 2016 to be higher than 2015 due to our

Table of Contents

purchase of the noncontrolling interest in EAS on January 1, 2016 since the noncontrolling interest was treated as a partnership for tax purposes.

*Net Income Attributable to Noncontrolling Interests* Net income attributable to noncontrolling interests increased $2.5 million in 2015 to income of $8.1 million as compared to $5.5 million in 2014. This increase reflects the impact of higher earnings at EAS, our non-wholly owned consolidated subsidiary, which was due primarily to increased revenue in the current year resulting from large project work at this location in 2015. Due to our acquisition of the remaining 40% noncontrolling interest in EAS on January 1, 2016, we do not expect to continue to have income attributable to noncontrolling interests in 2016. EAS was the only entity in which we reported a noncontrolling interest for financial statement purposes as of December 31, 2015.

***2014 Compared to 2013***

We had 36 operating locations as of December 31, 2013. We completed one acquisition in the first quarter of 2014. This acquisition was not material and was "tucked-in" with existing operations. We completed two acquisitions in the second quarter of 2014, one of which was "tucked-in" with existing operations and the second reports as a separate operating location in northern Texas. No acquisitions were completed in the third quarter of 2014. An immaterial acquisition was completed and "tucked-in" with existing operations in the fourth quarter of 2014. As of December 31, 2014, we had 37 operating locations. Acquisitions are included in our results of operations from the respective acquisition date. The same-store comparison from 2014 to 2013, as described below, excludes eight months of results for our Northern Texas operation, which was acquired in May 2014. An operating location is included in the same-store comparison on the first day it has comparable prior year operating data. An operating location is excluded from the same-store comparison in the current year and comparable prior years when it is properly characterized as a discontinued operation under applicable accounting standards.

*Revenue* Revenue increased $53.5 million, or 3.9% to $1,410.8 million in 2014 compared to 2013. The increase included a 0.6% increase in revenue related to same-store activity and a 3.3% increase related to the acquisition of our Northern Texas operation. The same-store revenue increase is primarily due to our Arkansas operation ($16.1 million) and one of our Virginia operations ($12.9 million), both of which performed a significant amount of project work for the institutional sector during 2014. This increase was partially offset by lower revenues at our Arizona operation ($23.8 million), which performed a significant amount of project work during 2013 that did not reoccur in 2014 due to its completion.

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

Backlog as of December 31, 2014 was $757.8 million, a 15.4% increase from September 30, 2014 backlog of $656.8 million and a 25.5% increase from December 31, 2013 backlog of $603.6 million. Sequential backlog increased primarily due to our EAS operation ($37.3 million) and one of our Virginia operations ($17.2 million), which had increased project bookings. The year-over-year backlog increase was primarily due to a same-store increase of 17.1% largely related to increased project bookings at many of our operating locations, including our EAS operation ($30.6 million) and one of our Maryland operations ($25.4 million). In addition, an 8.4% increase was due to the aforementioned acquisition of our Northern Texas operation ($50.8 million) during the current year.

*Gross Profit* Gross profit increased $9.9 million, or 4.1%, to $249.8 million in 2014 as compared to 2013. The increase included a $5.6 million, or 2.3%, increase related to the acquisition of our Northern Texas operation and a $4.3 million, or 1.8%, increase on a same-store basis. The same-store increase in gross profit was primarily due to a $9.8 million increase in profitability at our EAS operation due to improved project execution. This was partially offset by a decrease in project volumes at our Arizona operation ($4.2 million) and job underperformance at our Southern California operation ($3.9 million), which included a revision in contract estimate on a project in a loss position resulting in a $4.4 million writedown. As a percentage of revenue, gross profit was stable at 17.7% in 2014 compared to 2013 primarily due to the factors discussed above.

*Selling, General and Administrative Expenses ("SG&A")* SG&A increased $13.4 million, or 6.9%, to $207.7 million for 2014 as compared to 2013. On a same-store basis, excluding amortization expense, SG&A increased $9.4 million, or 5.0%. This increase was primarily due to higher compensation expense ($6.5 million) primarily as a result of our increased investment in service growth and information technology, higher training costs ($2.6 million) and a $1.3 million increase in bad debt expense as a result of a $0.8 million gain recorded in the prior year as a result of a receivable settlement. Amortization expense decreased $0.2 million, or 2.4%. As a percentage of revenue, SG&A increased from 14.3% in 2013 to 14.7% in 2014, primarily due to the factors discussed above.

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

| | Year Ended December 31, 2014 | Year Ended December 31, 2013 |
|---|---|---|
| | (in thousands) | |
| SG&A | $ 207,652 | $ 194,214 |
| Less: SG&A from companies acquired | (4,204) | |
| Less: Amortization expense | (6,825) | (6,992) |
| Same-store SG&A, excluding amortization expense | $ 196,623 | $ 187,222 |

*Interest Expense* Interest expense increased $0.5 million, or 37.5%, in 2014. The increase was due to the increase in borrowings on the revolving credit facility.

*Goodwill Impairment* We recorded a goodwill impairment charge of $0.7 million during the second quarter of 2014. Based on market activity declines and write-downs incurred on several jobs, we determined that the operating environment, conditions and performance at our operating unit based in Southern California could no longer support the related goodwill balance. No goodwill impairment was recorded in 2013.

*Changes in the Fair Value of Contingent Earn-out Obligations* The contingent earn-out obligations are measured at fair value each reporting period and changes in estimates of fair value are recognized in earnings. Income from changes in the fair value of contingent earn-out obligations decreased $1.9 million in 2014 compared to 2013. The primary reason for the decrease was an overall reduction of estimated future cash flows in 2013 related to the 2010 acquisition of ColonialWebb and the 2011 acquisition of EAS. This change in estimate was the result of a writedown of $1.6 million, which did not reoccur in the current year. In addition, based on updated measurements of estimated future cash flows in the current year, primarily for our EAS location, we recorded a $0.3 million increase to the earn-out obligation.

Table of Contents

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

Our effective tax rate for 2014 was 28.9%, as compared to 38.8% in 2013. The effective rate for 2014 was lower than the federal statutory rate of 35.0% primarily due to a decrease in the valuation allowance primarily associated with our operations in Maryland and Virginia (4.8%), by the impact of the noncontrolling interest of EAS, which for tax purposes is treated as a partnership (4.8%), and the effect of the production activity deduction (1.7%). The effective rate for 2013 was higher than the federal statutory rate of 35.0% primarily due to state income taxes (4.1%), the effect of non-deductible expenses (1.3%) and an increase in the valuation allowance primarily associated with our operations in Puerto Rico (3.1%). These increases were partially offset by the impact of the noncontrolling interest of EAS, which for tax purposes is treated as a partnership (1.0%), the effect of the production activity deduction (1.1%) and the effect of purchase accounting adjustments (1.0%). Refer to Note 10 in the Consolidated Financial Statements for a reconciliation of the federal statutory income tax rate to the effective tax rate reflected in our financial statements. The decrease in the effective tax rate from 2013 to 2014 was primarily due to impact on the rate from valuation allowance and from noncontrolling interests.

*Discontinued Operations* During the fourth quarter of 2012, we substantially completed the shutdown of our operation located in Delaware. The after tax loss of less than $0.1 million for the year ended December 31, 2014 and the after tax loss of $0.1 million for the year ended December 31, 2013 have been recorded in discontinued operations under "Operating income (loss), net of tax expense (benefit)."

*Net Income (Loss) Attributable to Noncontrolling Interests* Net income (loss) attributable to noncontrolling interests increased $4.2 million in 2014 to income of $5.5 million as compared to income of $1.3 million in 2013. This increase reflects the impact of higher earnings at EAS, our non-wholly owned consolidated subsidiary, which was due primarily to increased margins on jobs performed in the current year.

***Outlook***

We have seen industry conditions improve during 2015. Our emphasis for 2016 will be on execution, including a focus on cost discipline and efficient project performance, labor force development, and investing in growth, particularly in service and small projects. Based on our backlog, and in light of economic conditions for our industry, we expect that revenue and profitability in 2016 will be similar to or above the levels that we experienced in 2015.

Table of Contents

**Liquidity and Capital Resources**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2015 | 2014 | 2013 |
| | (in thousands) | | |
| Cash provided by (used in): | | | |
| Operating activities | $ 97,867 | $ 42,552 | $ 38,423 |
| Investing activities | (25,628) | (74,142) | (16,253) |
| Financing activities | (47,839) | 11,600 | (10,873) |
| Net increase (decrease) in cash and cash equivalents | $ 24,400 | $ (19,990) | $ 11,297 |

| | | | |
|---|---|---|---|
| Free cash flow: | | | |
| Cash provided by operating activities | $ 97,867 | $ 42,552 | $ 38,423 |
| Purchases of property and equipment | (20,808) | (19,183) | (17,403) |
| Proceeds from sales of property and equipment | 1,338 | 1,355 | 1,107 |
| Free cash flow | $ 78,397 | $ 24,724 | $ 22,127 |

***Cash Flow***

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

***2015 Compared to 2014***

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

We generated $97.9 million of cash flow from operating activities during 2015 compared with $42.6 million during 2014. The $55.3 million increase primarily relates to higher net income in the current year ($57.4 million) compared to the prior year ($28.6 million). In addition, there was an increase in accounts payable and accrued liabilities of $15.7 million compared to the prior year, primarily caused by higher compensation accruals and a decrease in net receivables of $14.8 million compared to the prior year, primarily due to the timing of customer billings and payments. This was partially offset by an increase in costs and estimated earnings in excess of billings of $6.4 million compared to the prior year due to the timing of customer billings.

Table of Contents

*Cash Used in Investing Activities* Cash used in investing activities was $25.6 million for 2015 compared to $74.1 million during 2014. The $48.5 million decrease in cash used primarily relates to cash paid for the four acquisitions that were completed in 2014.

*Cash Provided by (Used in) Financing Activities* Cash used in financing activities was $47.8 million for 2015 compared to cash provided by financing activities of $11.6 million during 2014. The $59.4 million decrease in cash provided by financing activities primarily relates to $28.5 million of net payments on the revolving line of credit in 2015 compared to $38.5 million of net borrowings in 2014. This decrease in cash provided was partially offset by increases due to decreased distributions to noncontrolling interests of $3.7 million, increased proceeds from options exercised of $2.5 million and a $2.0 million payment of other debt that occurred in 2014.

***2014 Compared to 2013***

*Cash Provided by Operating Activities* We generated $42.6 million of cash flow from operating activities during 2014 compared with $38.4 million during 2013. The $4.1 million increase was primarily due to billings in excess of costs and estimated earnings, which had a positive impact of $16.8 million on the comparison of cash flows due to the achievement of contract milestones that affected the timing of customer billings. This was partially offset by a $10.9 million negative impact related to on accounts payables and accrued liabilities. During the year ended December 31, 2014, accounts payable balances decreased due to timing of payments as compared to accrued compensation due to higher earnings for the year ended December 31, 2013.

*Cash Used in Investing Activities* Cash used in investing activities was $74.1 million for 2014 compared to $16.3 million during 2013. The $57.9 million increase in cash used primarily relates to cash paid for four acquisitions that were completed in 2014 ($52.1 million) and deferred purchase price costs related to previous acquisitions that were completed in 2012 and 2011 ($4.3 million).

*Cash Provided by (Used in) Financing Activities* Cash provided by financing activities was $11.6 million for 2014 compared to cash used in financing activities of $10.9 million during 2013. The $22.5 million increase in cash provided by financing activities primarily related to $38.5 million of net borrowings on the revolving line of credit in 2014 compared to no net borrowings in 2013. This was partially offset by cumulative cash distributions of $8.6 million to our noncontrolling partners as well as an incremental increase of $6.1 million related to share repurchases.

*Free Cash Flow*

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

***Share Repurchase Program***

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

Table of Contents

time to time approved extensions of the program to acquire additional shares. Since the inception of the repurchase program, the Board has approved 7.6 million shares to be repurchased. As of December 31, 2015, we have repurchased a cumulative total of 6.9 million shares at an average price of $11.99 per share under the repurchase program.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. During the twelve months ended December 31, 2015, we repurchased 0.3 million shares for approximately $8.3 million at an average price of $26.36 per share.

***Debt***

*Revolving Credit Facility*

We have a $250.0 million senior credit facility (the "Facility") provided by a syndicate of banks, which is available for borrowings and letters of credit. The Facility expires in October 2019 and is secured by a first lien on substantially all of our personal property except for assets related to projects subject to surety bonds and assets held by certain unrestricted subsidiaries and a second lien on our assets related to projects subject to surety bonds. In 2014, we incurred approximately $0.6 million in financing and professional costs in connection with an amendment to the Facility, which combined with the previous unamortized costs of $1.3 million, are being amortized on a straight-line basis as a non-cash charge to interest expense over the remaining term of the Facility. As of December 31, 2015, we had $10.0 million of outstanding borrowings, $41.5 million in letters of credit outstanding and $198.5 million of credit available.

There are two interest rate options for borrowings under the Facility, the Base Rate Loan option and the Eurodollar Rate Loan option. These rates are floating rates determined by the broad financial markets, meaning they can and do move up and down from time to time. Additional margins are then added to these two rates. The weighted average interest rate applicable to the borrowings under the Facility was approximately 1.7% as of December 31, 2015.

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

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

Table of Contents

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2015 | 2014 | 2013 |
| Interest expense on notes to former owners | $ 25 | $ 38 | $ 97 |
| Interest expense on borrowings and unused commitment fees | 692 | 790 | 278 |
| Letter of credit fees | 719 | 747 | 731 |
| Amortization of debt financing costs | 317 | 283 | 245 |
| Total | $ 1,753 | $ 1,858 | $ 1,351 |

The Facility contains financial covenants defining various measures and the levels of these measures with which we must comply. Covenant compliance is assessed as of each quarter end. Credit Facility Adjusted EBITDA is defined under the Facility for financial covenant purposes as net earnings for the four quarters ending as of any given quarterly covenant compliance measurement date, plus the corresponding amounts for (a) interest expense; (b) income taxes; (c) depreciation and amortization; (d) other non-cash charges; and (e) pre-acquisition results of acquired companies. The following is a reconciliation of Credit Facility Adjusted EBITDA to net income for 2015 (in thousands):

| | |
|---|---|
| Net income including noncontrolling interests | $ 57,440 |
| Income taxes continuing operations | 31,224 |
| Interest expense, net | 1,681 |
| Depreciation and amortization expense | 23,416 |
| Stock compensation expense | 5,609 |
| Goodwill impairment | |
| EBITDA attributable to noncontrolling interests | (9,027) |
| Pre-acquisition results of acquired companies, as defined under the Facility | 373 |
| Credit Facility Adjusted EBITDA | $ 110,716 |

The Facility's principal financial covenants include:

*Leverage Ratio* The Facility requires that the ratio of our Consolidated Total Indebtedness to our Credit Facility Adjusted EBITDA not exceed 2.75 through maturity. The leverage ratio as of December 31, 2015 was 0.10.

*Fixed Charge Coverage Ratio* The Facility requires that the ratio of Credit Facility Adjusted EBITDA, less non-financed capital expenditures, tax provision, dividends and amounts used to repurchase stock to the sum of interest expense and scheduled principal payments of indebtedness be at least 2.00; provided that the calculation of the fixed charge coverage ratio excludes stock repurchases and the payment of dividends at any time that the Company's Net Leverage Ratio does not exceed 1.50. The Facility also allows the fixed charge coverage ratio not to be reduced for stock repurchases through September 30, 2015 in an aggregate amount not to exceed $25 million if at the time of and after giving effect to such repurchase the Company's Net Leverage Ratio was less than or equal to 1.50. Capital expenditures, tax provision, dividends and stock repurchase payments are defined under the Facility for purposes of this covenant to be amounts for the four quarters ending as of any given quarterly covenant compliance measurement date. The fixed charge coverage ratio as of December 31, 2015 was 27.45.

*Other Restrictions* The Facility permits acquisitions of up to $25.0 million per transaction, provided that the aggregate purchase price of such an acquisition and of acquisitions in the same fiscal year does not exceed $60.0 million. However, these limitations only apply when the Company's Net Leverage Ratio is equal to or greater than 2.00.

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

We were in compliance with all of our financial covenants as of December 31, 2015.

*Notes to Former Owners*

In conjunction with an immaterial acquisition in the fourth quarter of 2014, we issued a subordinated note to the former owners of the acquired company as part of the consideration used to acquire the company. This note had an outstanding balance of $1.0 million as of December 31, 2015 and bears interest, payable quarterly, at a weighted average interest rate of 2.5%. The principal is due in equal installments on October 2016 and 2017.

*Other Debt*

In conjunction with one of our acquisitions, we acquired capital lease obligations. As of December 31, 2015, $0.5 million of capital lease obligations were outstanding, of which $0.3 million was considered current.

Our majority owned subsidiary, Environmental Air Systems, LLC, has a revolving $2.5 million credit line that is available for temporary working capital needs and expires May 31, 2016. As of December 31, 2015, we had no outstanding borrowings and, therefore, $2.5 million of credit available. We estimate that the weighted average interest rate applicable to borrowings under this variable rate credit line would be approximately 2.2% as of December 31, 2015.

***Outlook***

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

**Off-Balance Sheet Arrangements and Other Commitments**

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

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

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

Table of Contents

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.

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 20% to 30% of our business has required bonds. While we currently have strong surety relationships to support our bonding needs, future market conditions or 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 would enable us to ultimately respond effectively to an interruption in the availability of bonding capacity, such an interruption would likely cause our revenue and profits to decline in the near term.

**Contractual Obligations**

The following recaps the future maturities of our contractual obligations as of December 31, 2015 (in thousands):

| | Twelve Months Ended December 31, | | | | | | |
|---|---|---|---|---|---|---|---|
| | **2016** | **2017** | **2018** | **2019** | **2020** | **Thereafter** | **Total** |
| Revolving credit facility | $ | $ | $ | $ 10,000 | $ | $ | $ 10,000 |
| Notes to former owners | 500 | 500 | | | | | 1,000 |
| Interest payable | 195 | 182 | 170 | 142 | | | 689 |
| Capital lease obligations | 251 | 163 | 71 | 22 | | | 507 |
| Operating lease obligations | 11,819 | 10,647 | 9,066 | 7,004 | 4,949 | 6,068 | 49,553 |
| Total | $ 12,765 | $ 11,492 | $ 9,307 | $ 17,168 | $ 4,949 | $ 6,068 | $ 61,749 |

As discussed in Note 10 "Income Taxes", included in our Consolidated Balance Sheet at December 31, 2015 is approximately $0.2 million of liabilities associated with uncertain tax positions. Due to the uncertain and complex application of tax regulations, combined with the difficulty in predicting when tax audits may be concluded, we cannot make reliable estimates of the timing of cash outflows relating to these liabilities.

Table of Contents

As of December 31, 2015, we also have $41.5 million in letter of credit commitments, of which $17.3 million will expire in 2016 and $24.2 million will expire in 2017. The substantial majority of these letters of credit are posted with insurers who disburse funds on our behalf in connection with our workers' compensation, auto liability and general liability insurance program. These letters of credit provide additional security to the insurers that sufficient financial resources will be available to fund claims on our behalf, many of which develop over long periods of time, should we ever encounter financial duress. Posting of letters of credit for this purpose is a common practice for entities that manage their self-insurance programs through third-party insurers as we do. While many of these letter of credit commitments expire in 2016, we expect nearly all of them, particularly those supporting our insurance programs, will be renewed annually.

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

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

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

We have exposure to changes in interest rates under our revolving credit facility and the EAS credit line. We have a modest level of indebtedness under our debt facility and our indebtedness could increase in the future. Our debt with fixed interest rates consists of notes to former owners of acquired companies.

The following table presents principal amounts (stated in thousands) and related average interest rates by year of maturity for our debt obligations and their indicated fair market value at December 31, 2015:

| | Twelve Months Ended December 31, | | | | | | |
|---|---|---|---|---|---|---|---|
| | **2016** | **2017** | **2018** | **2019** | **2020** | **Thereafter** | **Total** |
| Fixed Rate Debt | $ 500 | $ 500 | $ | $ | $ | $ | $ 1,000 |
| Average Interest Rate | 2.5% | 2.5% | | | | | 2.5% |
| Variable Rate Debt | $ | $ | $ | $ 10,000 | $ | $ | $ 10,000 |

The weighted average interest rate applicable to the borrowings under the Facility was approximately 1.7% as of December 31, 2015.

We measure certain assets at fair value on a nonrecurring basis. These assets are recognized at fair value when they are deemed to be other-than-temporarily impaired. We did not recognize any impairments, in the current year, on those assets required to be measured at fair value on a nonrecurring basis.

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

Table of Contents

**ITEM 8.** ***Financial Statements and Supplementary Data***

## INDEX TO FINANCIAL STATEMENTS

Table of Contents

**Management's Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2015 based on the framework in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO 2013 framework). Based on that evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2015.

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

Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included elsewhere herein, has issued an attestation report auditing the effectiveness of our internal control over financial reporting as of December 31, 2015.

Table of Contents

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

We have audited the accompanying consolidated balance sheets of Comfort Systems USA, Inc. as of December 31, 2015 and 2014, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2015. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Comfort Systems USA, Inc. at December 31, 2015 and 2014, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Comfort Systems USA, Inc.'s internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control  Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework)* and our report dated February 23, 2016 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Houston, Texas
February 23, 2016

Table of Contents

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders
Comfort Systems USA, Inc.

We have audited Comfort Systems USA, Inc.'s internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework)* (the COSO criteria). Comfort Systems USA, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Comfort Systems USA, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Comfort Systems USA, Inc. as of December 31, 2015 and 2014, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2015 of Comfort Systems USA, Inc. and our report dated February 23, 2016 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Houston, Texas
February 23, 2016

Table of Contents

**COMFORT SYSTEMS USA, INC.**

**CONSOLIDATED BALANCE SHEETS**

**(In Thousands, Except Share Amounts)**

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 56,464 | $ 32,064 |
| Accounts receivable, less allowance for doubtful accounts of $5,158 and $4,379, respectively | 302,052 | 303,575 |
| Other receivables | 20,642 | 15,520 |
| Inventories | 7,941 | 8,646 |
| Prepaid expenses and other | 5,836 | 6,168 |
| Costs and estimated earnings in excess of billings | 31,338 | 27,620 |
| Assets related to discontinued operations | | 176 |
| Total current assets | 424,273 | 393,769 |
| PROPERTY AND EQUIPMENT, NET | 60,813 | 55,759 |
| GOODWILL | 143,874 | 140,341 |
| IDENTIFIABLE INTANGIBLE ASSETS, NET | 41,079 | 45,666 |
| OTHER NONCURRENT ASSETS | 21,555 | 20,407 |
| Total assets | $ 691,594 | $ 655,942 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Current maturities of long-term debt | $ 500 | $ |
| Current maturities of long-term capital lease obligations | 251 | 317 |
| Accounts payable | 106,684 | 106,211 |
| Accrued compensation and benefits | 54,079 | 44,683 |
| Billings in excess of costs and estimated earnings | 85,397 | 77,446 |
| Accrued self-insurance expense | 29,803 | 28,903 |
| Other current liabilities | 28,677 | 24,513 |
| Liabilities related to discontinued operations | | 263 |
| Total current liabilities | 305,391 | 282,336 |
| LONG-TERM DEBT | 10,500 | 39,500 |
| LONG-TERM CAPITAL LEASE OBLIGATIONS | 256 | 529 |
| DEFERRED INCOME TAX LIABILITIES | 1,810 | 1,310 |
| OTHER LONG-TERM LIABILITIES | 8,632 | 10,874 |
| Total liabilities | 326,589 | 334,549 |
| COMMITMENTS AND CONTINGENCIES | | |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, $.01 par, 5,000,000 shares authorized, none issued and outstanding | | |
| Common stock, $.01 par, 102,969,912 shares authorized, 41,123,365 and 41,123,365 shares issued, respectively | 411 | 411 |
| Treasury stock, at cost, 3,696,781 and 3,853,586 shares, respectively | (46,845) | (43,598) |
| Additional paid-in capital | 323,765 | 320,084 |
| Retained earnings | 69,390 | 29,384 |
| Comfort Systems USA, Inc. stockholders' equity | 346,721 | 306,281 |
| Noncontrolling interests | 18,284 | 15,112 |

| | | | | |
|---|---|---|---|---|
| Total stockholders' equity | | 365,005 | | 321,393 |
| Total liabilities and stockholders' equity | $ | 691,594 | $ | 655,942 |

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

Table of Contents

**COMFORT SYSTEMS USA, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In Thousands, Except Per Share Data)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2015** | **2014** | **2013** |
| REVENUE | $ 1,580,519 | $ 1,410,795 | $ 1,357,272 |
| COST OF SERVICES | 1,262,390 | 1,161,024 | 1,117,389 |
| Gross profit | 318,129 | 249,771 | 239,883 |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES | 228,965 | 207,652 | 194,214 |
| GOODWILL IMPAIRMENT | | 727 | |
| GAIN ON SALE OF ASSETS | (880) | (830) | (589) |
| Operating income | 90,044 | 42,222 | 46,258 |
| OTHER INCOME (EXPENSE): | | | |
| Interest income | 72 | 18 | 23 |
| Interest expense | (1,753) | (1,858) | (1,351) |
| Changes in the fair value of contingent earn-out obligations | 225 | (245) | 1,646 |
| Other | 76 | 91 | 204 |
| Other income (expense) | (1,380) | (1,994) | 522 |
| INCOME BEFORE INCOME TAXES | 88,664 | 40,228 | 46,780 |
| INCOME TAX EXPENSE | 31,224 | 11,614 | 18,148 |
| INCOME FROM CONTINUING OPERATIONS | 57,440 | 28,614 | 28,632 |
| Income (loss) from discontinued operations, net of income tax expense (benefit) of $ , $(10) and $(119) | | (15) | (76) |
| NET INCOME INCLUDING NONCONTROLLING INTERESTS | 57,440 | 28,599 | 28,556 |
| Less: Net income attributable to noncontrolling interests | 8,076 | 5,536 | 1,287 |
| NET INCOME ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC | $ 49,364 | $ 23,063 | $ 27,269 |
| INCOME PER SHARE ATTRIBUTABLE TO COMFORT SYSTEMS USA, INC.: | | | |
| Basic | | | |
| Income from continuing operations | $ 1.32 | $ 0.61 | $ 0.73 |
| Income from discontinued operations | | | |
| Net income | $ 1.32 | $ 0.61 | $ 0.73 |
| Diluted | | | |
| Income from continuing operations | $ 1.30 | $ 0.61 | $ 0.73 |
| Income from discontinued operations | | | |
| Net income | $ 1.30 | $ 0.61 | $ 0.73 |

| | | | |
|---|---|---|---|
| SHARES USED IN COMPUTING INCOME PER SHARE: | | | |
| Basic | 37,442 | 37,547 | 37,245 |
| Diluted | 37,868 | 37,797 | 37,536 |
| DIVIDENDS PER SHARE | $ 0.250 | $ 0.225 | $ 0.210 |

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

Table of Contents

**COMFORT SYSTEMS USA, INC.**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

**(In Thousands, Except Share Amounts)**

| | Common Stock | | Treasury Stock | | Additional Paid-In Capital | Retained Earnings (Deficit) | Non-Controlling Interests | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | | | | |
| BALANCE AT DECEMBER 31, 2012 | 41,123,365 | 411 | (3,879,299) | (41,012) | 317,534 | (6,528) | 16,901 | 287,306 |
| Net income | | | | | | 27,269 | 1,287 | 28,556 |
| Issuance of Stock: | | | | | | | | |
| Issuance of shares for options exercised including tax benefit | | | 439,762 | 4,711 | 522 | | | 5,233 |
| Issuance of restricted stock | | | 122,375 | 1,301 | (1,301) | | | |
| Shares received in lieu of tax withholding payment on vested restricted stock | | | (45,266) | (631) | | | | (631) |
| Tax benefit from vesting of restricted stock | | | | | 184 | | | 184 |
| Forfeiture of unvested restricted stock | | | (469) | (5) | 5 | | | |
| Stock-based compensation expense | | | | | 3,041 | | | 3,041 |
| Dividends | | | | | (1,862) | (5,973) | | (7,835) |
| Share repurchase | | | (125,541) | (1,832) | | | | (1,832) |
| BALANCE AT DECEMBER 31, 2013 | 41,123,365 | 411 | (3,488,438) | (37,468) | 318,123 | 14,768 | 18,188 | 314,022 |
| Net income | | | | | | 23,063 | 5,536 | 28,599 |
| Issuance of Stock: | | | | | | | | |
| Issuance of shares for options exercised including tax benefit | | | 103,619 | 1,132 | 79 | | | 1,211 |
| Issuance of restricted stock | | | 115,044 | 1,243 | (1,243) | | | |
| Shares received in lieu of tax withholding payment on vested restricted stock | | | (34,657) | (531) | | | | (531) |
| Tax benefit from vesting of restricted stock | | | | | 133 | | | 133 |
| Stock-based compensation expense | | | | | 2,992 | | | 2,992 |
| Dividends | | | | | | (8,447) | | (8,447) |
| Distribution to noncontrolling interest | | | | | | | (8,612) | (8,612) |
| Share repurchase | | | (549,154) | (7,974) | | | | (7,974) |
| BALANCE AT DECEMBER 31, 2014 | 41,123,365 | 411 | (3,853,586) | (43,598) | 320,084 | 29,384 | 15,112 | 321,393 |
| Net income | | | | | | 49,364 | 8,076 | 57,440 |
| Issuance of Stock: | | | | | | | | |
| Issuance of shares for options exercised including tax benefit | | | 317,333 | 3,728 | 966 | | | 4,694 |
| Issuance of restricted stock & performance stock | | | 200,015 | 2,292 | (626) | | | 1,666 |
| Shares received in lieu of tax withholding payment on vested restricted stock | | | (44,590) | (937) | | | | (937) |
| Tax benefit from vesting of restricted stock | | | | | 284 | | | 284 |
| Stock-based compensation expense | | | | | 3,057 | | | 3,057 |
| Dividends | | | | | | (9,358) | | (9,358) |
| Distribution to noncontrolling interest | | | | | | | (4,904) | (4,904) |
| Share repurchase | | | (315,953) | (8,330) | | | | (8,330) |
| BALANCE AT DECEMBER 31, 2015 | 41,123,365 | $ 411 | (3,696,781) | $ (46,845) | $ 323,765 | $ 69,390 | $ 18,284 | $ 365,005 |

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

Table of Contents

**COMFORT SYSTEMS USA, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In Thousands)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2015** | **2014** | **2013** |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income including noncontrolling interests | $ 57,440 | $ 28,599 | $ 28,556 |
| Adjustments to reconcile net income to net cash provided by operating activities | | | |
| Amortization of identifiable intangible assets | 7,481 | 7,653 | 7,132 |
| Depreciation expense | 15,935 | 13,683 | 11,440 |
| Goodwill impairment | | 727 | |
| Bad debt expense | 1,552 | 1,275 | 19 |
| Deferred tax expense (benefit) | (414) | (4,579) | 4,514 |
| Amortization of debt financing costs | 317 | 283 | 245 |
| Gain on sale of assets | (880) | (830) | (589) |
| Changes in the fair value of contingent earn-out obligations | (225) | 245 | (1,646) |
| Stock-based compensation expense | 5,609 | 4,806 | 3,974 |
| Changes in operating assets and liabilities, net of effects of acquisitions and divestitures | | | |
| (Increase) decrease in | | | |
| Receivables, net | (3,584) | (18,339) | (12,427) |
| Inventories | 956 | 281 | 1,208 |
| Prepaid expenses and other current assets | 364 | 1,494 | (109) |
| Costs and estimated earnings in excess of billings | (3,630) | 2,744 | (1,918) |
| Other noncurrent assets | (479) | (321) | (491) |
| Increase (decrease) in | | | |
| Accounts payable and accrued liabilities | 11,617 | (4,078) | 6,776 |
| Billings in excess of costs and estimated earnings | 7,908 | 7,545 | (9,226) |
| Other long-term liabilities | (2,100) | 1,364 | 965 |
| Net cash provided by operating activities | 97,867 | 42,552 | 38,423 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Purchases of property and equipment | (20,808) | (19,183) | (17,403) |
| Proceeds from sales of property and equipment | 1,338 | 1,355 | 1,107 |
| Proceeds from businesses sold | | | 43 |
| Cash paid for acquisitions, earn-outs and intangible assets, net of cash acquired | (6,158) | (56,314) | |
| Net cash used in investing activities | (25,628) | (74,142) | (16,253) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Proceeds from revolving line of credit | 24,500 | 128,500 | 43,000 |
| Payments on revolving line of credit | (53,000) | (90,000) | (43,000) |
| Payments on other long-term debt | | (2,000) | (5,400) |
| Payments on capital lease obligations | (443) | (115) | |
| Debt financing costs | | (568) | (552) |
| Payments of dividends to stockholders | (9,358) | (8,444) | (7,875) |
| Share repurchase program | (8,330) | (7,974) | (1,832) |
| Shares received in lieu of tax withholding | (937) | (531) | (631) |
| Excess tax benefit of stock-based compensation | 1,240 | 115 | 534 |
| Proceeds from exercise of options | 3,738 | 1,229 | 4,883 |
| Distributions to noncontrolling interests | (4,904) | (8,612) | |
| Payments for contingent consideration arrangements | (345) | | |
| Net cash provided by (used in) financing activities | (47,839) | 11,600 | (10,873) |

| | | | |
|---|---|---|---|
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 24,400 | (19,990) | 11,297 |
| CASH AND CASH EQUIVALENTS, beginning of year continuing operations and discontinued operations | 32,064 | 52,054 | 40,757 |
| CASH AND CASH EQUIVALENTS, end of year continuing operations and discontinued operations | $ 56,464 | $ 32,064 | $ 52,054 |

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

Table of Contents

**COMFORT SYSTEMS USA, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2015**

## 1. Business and Organization

Comfort Systems USA, Inc., a Delaware corporation, provides comprehensive mechanical contracting services, which principally includes heating, ventilation and air conditioning ("HVAC"), plumbing, piping and controls, as well as off-site construction, electrical, monitoring and fire protection. We install, maintain, repair and replace products and systems throughout the United States. Approximately 44% of our consolidated 2015 revenue is attributable to installation of systems in newly constructed facilities, with the remaining 56% attributable to maintenance, repair and replacement services.

Our consolidated 2015 revenue was derived from the following service activities, all of which are in the mechanical services industry, the single industry segment we serve:

| Service Activity | Revenue $ in thousands | % |
|---|---|---|
| HVAC | $ 1,216,999 | 77% |
| Plumbing | 221,273 | 14% |
| Building Automation Control Systems | 79,026 | 5% |
| Other | 63,221 | 4% |
| Total | $ 1,580,519 | 100% |

## 2. Summary of Significant Accounting Policies

***Principles of Consolidation***

These financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The accompanying consolidated financial statements include our accounts and those of our subsidiaries in which we have a controlling interest. All significant intercompany accounts and transactions have been eliminated. Certain amounts in prior periods may have been reclassified to conform to the current period presentation. The effects of the reclassifications were not material to the consolidated financial statements.

***Use of Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions by management in determining the reported amounts of assets and liabilities, revenue and expenses and disclosures regarding contingent assets and liabilities. Actual results could differ from those estimates. The most significant estimates used in our financial statements affect revenue and cost recognition for construction contracts, the allowance for doubtful accounts, self-insurance accruals, deferred tax assets, warranty accruals, fair value accounting for acquisitions and the quantification of fair value for reporting units in connection with our goodwill impairment testing. In 2015, two operating locations came to an agreement with customers on multiple jobs and received approved change orders, which resulted in the recognition of additional revenue with minimal additional costs resulting in a project gain of $3.4 million, on a pre-tax basis. In the twelve months ended December 31, 2014, one of our operating locations recorded a revision in contract estimate on a project in a loss position resulting in a writedown to this individual project of $4.4 million, on a pre-tax basis.

Table of Contents

**COMFORT SYSTEMS USA, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**December 31, 2015**

**2. Summary of Significant Accounting Policies (Continued)**

***Cash Flow Information***

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

Cash paid (in thousands) for:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2015 | 2014 | 2013 |
| Interest | $ 1,408 | $ 1,764 | $ 799 |
| Income taxes | 35,538 | 15,366 | 15,821 |