
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, 2003

Commission file number: 1-13011

Comfort Systems USA, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction
of Incorporation or Organization)

76-0526487
(I.R.S. Employer
Identification No.)

**777 Post Oak Blvd.
Suite 500
Houston, Texas 77056
(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 whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

As of February 24, 2004, the aggregate market value of the 36,610,585 shares of the registrant's common stock held by non-affiliates of the registrant was \$96,285,839, based on the \$2.63 last sale price of the registrant's common stock on the New York Stock Exchange on June 30, 2003.

As of February 24, 2004, 38,338,774 shares of the registrant's common stock were outstanding.

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, 2003.

FORWARD-LOOKING STATEMENTS

This report contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended ("Securities Act") and Section 21E of the Exchange Act. Such forward-looking statements are made only as of the date of this report and involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of the Company, or industry results, to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Such risks, uncertainties and other important factors include, among others, the lack of a combined operating history and the difficulty of integrating formerly separate businesses, retention of key management, national or regional weakness in non-residential construction activity, difficulty in obtaining or increased costs associated with debt financing or bonding,

shortages of labor and specialty building materials, seasonal fluctuations in the demand for HVAC systems and the use of incorrect estimates for bidding a fixed price contract. Important factors that could cause actual results to differ are discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations—Factors Which May Affect Future Results."

PART I

ITEM 1. Business

Comfort Systems USA, Inc., a Delaware corporation, provides comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services within the mechanical services industry in 51 cities and 63 locations throughout the United States.

We operate primarily in the commercial, industrial and institutional HVAC markets, and perform most of our services within office buildings, retail centers, apartment complexes, manufacturing plants, and healthcare, education and government facilities. In addition to standard HVAC services, we provide specialized applications such as building automation control systems, fire protection, process cooling, electronic monitoring and process piping. Certain locations also perform related activities such as electrical service and plumbing. Approximately 96% of our consolidated 2003 revenues were derived from commercial, industrial and institutional customers with approximately 52% of the revenues attributable to installation services in newly constructed facilities and 48% attributable to maintenance, repair and replacement services. Our consolidated 2003 revenues were derived from the following service activities, all of which are in the mechanical services industry, the single industry segment we serve:

Service Activity	Percentage of Revenue
HVAC	74
Plumbing	11
Building Automation Control Systems	6
Other	9
Total	100

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Our distribution of revenues in 2003 by geographic region was as follows:

Southeast	38%
West (a)	23%
Northeast	20%
Midwest	16%
National Accounts	3%
Total	100%

(a) We have no significant activity in the Pacific Northwest.

We were originally formed in 1997 through an initial public offering, or IPO, and simultaneous acquisition of 12 companies engaged in our business. From the time we completed our IPO through December 1999, we acquired 107 HVAC and complementary businesses, of which 26 were "tuck-in" operations that were integrated upon acquisition with existing operations. Since we suspended our acquisition program in late 1999, we have sold or ceased operations at 34 companies through 2003. We have consolidated another 16 companies into other operations, such that today we have 43 operating units.

Significantly, on March 1, 2002, we sold 19 operations to Emcor Group, Inc. for \$186.25 million, including Emcor's assumption of approximately \$22.1 million of subordinated notes to former owners of certain of the divested companies. These 19 operations provided \$657.9 million of our revenue in 2001. We used the proceeds from this sale to reduce debt. We recognized a loss of \$11.8 million and a goodwill impairment charge prior to the sale of \$32.4 million, net of taxes, related to the sold operations. For a further discussion of this sale, see "Item 8—Financial Statements and Supplemental Data—Notes 3 and 4."

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 SEC. The Company's website also includes our code of ethics, titled "Corporate Compliance Policy: Standards and Procedures Regarding Business Practices," together with other governance materials including our corporate governance guidelines and our Board committee charters. Printed versions of our code of ethics and our corporate governance guidelines may be obtained upon written request to our Corporate Compliance Officer at the Company's headquarters address.

Industry Overview

We believe that the HVAC industry as a whole generates annual revenues in excess of \$75 billion, over \$40 billion of which is in the commercial, industrial, and institutional markets. HVAC systems are necessary to virtually all commercial, industrial and institutional buildings as well as homes. Because most buildings are sealed, HVAC systems provide the primary method of circulating fresh air in such buildings. In many instances, replacing an aging system with a modern, energy-efficient HVAC system significantly reduces a building's operating costs and improves air quality and HVAC system effectiveness. Older commercial, industrial and institutional facilities often have poor air quality as well as inadequate air conditioning, and older HVAC systems result in significantly higher energy costs than do modern systems. These factors cause many facility owners to consider replacing older systems early.

Many factors positively affect HVAC industry growth, particularly (i) population growth, which has increased the need for commercial, industrial and institutional space, (ii) an aging installed base, (iii) increasing sophistication, complexity, and efficiency of HVAC systems, (iv) growing emphasis on

indoor air quality, and (v) reduction or elimination of the refrigerants commonly used in older HVAC systems. We believe these factors should increase demand for the reconfiguration or replacement of existing HVAC systems and may also mitigate, to some extent, the effect on the HVAC industry of the cyclicity inherent in the traditional construction industry.

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

- installation in newly constructed facilities, which provided approximately 52% of our revenues in 2003, and
- maintenance, repair and replacement, which provided the remaining 48% of our 2003 revenues.

Installation Services. Installation services consist of "design and build" and "plan and spec" projects. In "design and build" projects, the commercial HVAC firm is responsible for designing, engineering and installing a cost-effective, energy-efficient system customized to the specific needs of the building owner. Costs and other project terms are normally negotiated between the building owner or its representative and the HVAC firm. Firms 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 firms 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 where a third-party architect or consulting engineer designs the HVAC systems and the installation project is "put out for bid." We believe that "plan and spec" projects usually take longer to complete than "design and build" projects because the system design and installation process generally are not integrated, thus resulting in more frequent adjustments to the technical specifications of the project and corresponding changes in work requirements and schedules. These adjustments can occur during the bid process or during the project itself, in either case adding weeks or months to the project schedule. Furthermore, in "plan and spec" projects, the HVAC firm is not responsible for project design and other parties must also approve any changes, thereby increasing overall project time and cost.

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

Strategy

We focus on strengthening operating competencies and on increasing profit margins. The key elements of our operating strategy are:

Achieve Excellence in Core Competencies. We have identified six core competencies, which we believe are critical to attracting and retaining customers, increasing operating income and cash flow and creating additional employment opportunities. The six core competencies are: (i) customer cultivation

and intimacy, (ii) design and build expertise, (iii) estimating, (iv) job costing and job measurements, (v) safety, and (vi) service capability.

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

Focus on Commercial, Industrial, and Institutional Markets. We primarily focus on the commercial, industrial and institutional markets, with particular emphasis on "design and build" installation services, and on maintenance, repair and replacement services. We believe that the commercial, industrial, and institutional HVAC markets are attractive because of their growth opportunities, large and diverse customer base, reduced weather exposure as compared to residential markets, attractive margins and potential for long-term relationships with building owners, property managers, general contractors and architects. Approximately 96% of our consolidated 2003 revenues were derived from commercial and industrial customers.

Maintain a Diverse Customer, Geographic and Project Base. We have what we believe is a well-diversified distribution of revenues across end-use sectors that reduces our exposure to negative developments in any given sector. We also believe we have a reasonable degree of geographical diversification, again reducing our exposure to negative developments in any given region. Our distribution of revenues in 2003 by end-use sector was as follows:

Manufacturing	15%
Healthcare	14%
Schools	12%
Office Buildings	11%
Multi-Family	11%
Government	9%

Retail	9%
Residential	4%
Hotels	3%
Distribution	2%
Banks	1%
Other	9%
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Total	100%

Approximately 80% of our revenues are earned on a project basis for installation of HVAC systems in newly constructed facilities or for replacement of HVAC systems in existing facilities. As of December 31, 2003, we had 4,166 projects in process with an aggregate contract value of approximately \$908.1 million. Our average project takes three to six months to complete, with an average contract price of approximately \$218,000. This relatively small average project size, when taken together with the approximately 20% of our revenues derived from maintenance and service, provides us with what we believe is a reasonably broad base of work for a company involved in the construction services sector. Projects with contract prices of \$5 million or less accounted for \$775.0 million, or 85%, of aggregate

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contract value of projects in process at December 31, 2003. A stratification of projects in progress as of December 31, 2003, by contract price is as follows:

Contract Price of Project	No. of Projects	Aggregate Contract Price Value (millions)
Under \$1 million	3,991	\$ 453.0
\$1 million - \$5 million	160	322.0
\$5 million - \$10 million	10	64.7
\$10 million - \$15 million	4	48.4
\$15 million - \$20 million	1	20.0
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Total	4,166	\$ 908.1

Expand National Service Capabilities. We believe larger regional and national commercial, industrial, and institutional entities can benefit from consolidating their HVAC needs with HVAC service companies that are capable of providing those services regionally or nationally. In response to this opportunity, we operate a national call center to dispatch technicians to regional and national sites requiring service. We also use web-based 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. We also provide consolidated billing and credit payment terms to regional and national account customers. We are devoting increased marketing resources to expanding our customer base in regional and national service coverage.

Leveraging Resources. We believe significant operating efficiencies can be achieved by leveraging resources among our operating locations. For example, we have shifted certain prefabrication activities into centralized locations thereby increasing asset utilization in these centralized locations and redirecting prefabrication employees into other operational areas. We also allocate our engineering, field and supervisory labor from one operation to another to more fully use our employee base, meet our customers' needs, and share expertise. We believe we have realized scale benefits from combining purchasing, insurance, benefits, bonding, and financing activities across our operations.

Attract and Retain Quality Employees. We seek to attract and retain quality employees by providing them (i) an enhanced career path from working for a larger company, (ii) additional training and education to allow talented employees to advance to higher-paying positions, (iii) the opportunity to realize a more stable income, and (iv) attractive benefits packages.

Operations and Services Provided

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

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Installation Services. Our installation business related to newly constructed facilities, which comprised approximately 52% of our consolidated 2003 revenues involves the design, engineering, integration, installation and start-up of HVAC, building automation controls and related systems. We provide "design and build" and "plan and spec" installation services for office buildings, retail centers, apartment complexes, manufacturing plants, health care, education and government facilities and other commercial, industrial, and institutional facilities. In a "design and build" installation, working with the customer, we determine the needed capacity and energy efficiency of the HVAC system that best suits the proposed facility. We then estimate the amount of time, labor, materials and equipment needed to build the specified system. The final design, terms, price and timing of the project are then negotiated with the customer or its

representatives, after which any necessary modifications are made to the system plan. In "plan and spec" installation, we participate in a bid process to provide labor, equipment, materials and installation based on plans and engineering specifications provided by a customer, general contractor or consulting engineer.

Once an agreement has been reached, we order the necessary materials and equipment for delivery to meet the project schedule. In many instances, we fabricate the ductwork and piping and assemble certain components for the system based on the mechanical drawing specifications, eliminating the need to subcontract ductwork or piping fabrication. Then we install the system at the project site, working closely with the general contractor. Our average project takes three to six months to complete, with an average contract price of approximately \$218,000. We also perform larger project work, with 175 contracts in progress at December 31, 2003 with contract prices in excess of \$1 million. Our largest project currently in progress has a contract price of \$20 million. Project contracts typically provide for periodic billings to the customer as we meet progress milestones or incur cost on the project. Project contracts in our industry also frequently allow for a small portion of progress billings or contract price to be withheld by the customer until after we have completed the work, typically for six months. Amounts withheld under this practice are known as retention or retainage.

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

Maintenance, Repair and Replacement Services. Our maintenance, repair and replacement services comprised approximately 48% of our consolidated 2003 revenues and include the maintenance, repair, replacement, reconfiguration and monitoring of HVAC systems and industrial process piping. Approximately two-thirds of our maintenance, repair and replacement revenues were derived from replacing and reconfiguring existing HVAC systems for commercial, industrial, and institutional customers. Replacement and reconfiguration are usually performed on a project basis and often use consultative expertise similar to that provided in the "design and build" installation market.

Maintenance and repair services are provided either in response to service calls or under a service agreement. Service calls are coordinated by customer service representatives or dispatchers that use computer and communication technology to process orders, arrange service calls, communicate with customers, dispatch technicians and invoice customers. Service technicians work from service vehicles equipped with commonly used parts, supplies and tools to complete a variety of jobs. Commercial,

industrial and institutional service agreements usually have terms of one to three years, with automatic annual renewals. 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 a month or more. Many steel products, in particular, have experienced significant price fluctuation and some constrained availability. 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 York, Carrier, Trane and Lennox. 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.

We administer a portion of our procurement activities with EMCOR Group, a larger publicly-held provider of electrical and mechanical services and facilities management. This coordination includes contractual arrangements with EMCOR under which certain EMCOR employees provide procurement management services to us.

Sales and Marketing

We have a diverse customer base, with no single customer accounting for more than 3% of consolidated 2003 revenues. 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, 2003, we had 5,549 employees. We have collective bargaining agreements covering approximately 141 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 coordinate our recruiting efforts via the Internet and at local technical schools and community colleges

where students focus on learning basic industry skills. Additionally, we provide on-the-job training, technical training, apprenticeship programs, attractive benefit packages and career advancement opportunities within our company.

We have established comprehensive safety programs throughout our operations to ensure that all technicians comply with safety standards we have established and that are established under federal, state and local laws and regulations. Additionally, we have implemented a "best practices" safety program throughout our operations, which provides employees with incentives to improve safety performance and decrease workplace accidents. Regional safety directors establish safety programs and benchmarking to improve safety within their region. Finally, our employment screening process seeks to determine that prospective employees have requisite skills, sufficient background references and acceptable driving records, if applicable. Our rate of incidents recordable under the standards of the Occupational Safety and Health Administration per 100 employees per year, also known as the OSHA recordable rate, was 4.03 during 2003. This level was 55% better than the most recently published OSHA rate for our industry. We have improved our OSHA recordable rate every year since we first began tracking it company-wide six years ago.

Risk Management, Insurance and Litigation

The primary risks in our operations are bodily injury, property damage and injured workers' compensation. We retain the risk for worker's 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 utilizing 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 legal fees associated with certain of these actions in our consolidated financial statements. In some cases, we have project-related claims and liabilities that are individually significant, including one claim that will be subject to arbitration in the first half of 2004. With respect to this claim, and as with all such matters, we have accruals that reflect our judgment of the outcome. Because of this, we do not believe uninsured losses resulting from the ultimate resolution of these matters will have a material adverse effect on our financial position or results of operations.

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 30 days after servicing of existing HVAC systems. We do not expect warranty claims to have a material adverse effect on our financial position or results of operations.

Competition

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

We believe that we are larger than most of our competitors, which are generally small, owner-operated companies that typically operate in a limited geographic area. However, there are divisions of

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

Vehicles

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

Governmental Regulation and Environmental Matters

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

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

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

Executive Officers

We have five executive officers.

William F. Murdy, age 62, has served as our Chairman of the Board and Chief Executive Officer since June 2000. Prior to this he was Interim President and Chief Executive Officer of Club Quarters, a privately-owned chain of membership hotels. From January 1998 through July 1999, Mr. Murdy served as President, Chief Executive Officer and Chairman of the Board of LandCare USA, a publicly-traded commercial landscape and tree services company. He was primarily responsible for organizing LandCare USA and its listing as a publicly-traded company on the New York Stock Exchange in July 1998. LandCare USA was acquired in July 1999 by another publicly-traded company specializing in services to homeowners and commercial facilities. From 1989 through December 1997, Mr. Murdy was

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President and Chief Executive Officer of General Investment and Development Company, a privately-held real estate operating company. From 1981 to 1989, Mr. Murdy served as the Managing General Partner of the Morgan Stanley Venture Capital Fund. From 1974 to 1981, Mr. Murdy served as the Senior Vice President, among other positions, of Pacific Resources, Inc., a publicly-traded company involved primarily in petroleum refining and marketing.

Norman C. Chambers, age 54, has served as our President and as a director since November 2002. Prior to this, Mr. Chambers was Chief Operating Officer of Capstone Turbine Corporation, a manufacturer of distributed electrical generation technology. From April 2000 to September 2001, Mr. Chambers served as President and Chief Executive Officer of Petrocosm Corporation, a privately held e-commerce business serving as a procurement portal for the energy industry. From June 1985 to April 2000, Mr. Chambers served in various positions with the Halliburton Companies. His responsibilities included construction, service, and business development at the Halliburton Company, including President of Halliburton Energy Development, Senior Vice President of the Halliburton Company and Managing Director of Brown & Root.

J. Gordon Beittenmiller, age 44, has served as our Executive Vice President, Chief Financial Officer and a director since May 1998, and was our Senior Vice President, Chief Financial Officer and a director from February 1997 to April 1998. From 1994 to February 1997, Mr. Beittenmiller was Corporate Controller of Keystone International, Inc., a publicly-traded multi-national manufacturer of industrial valves and actuators, and served Keystone in other financial positions from 1991 to 1994. From 1987 to 1991, he was Vice President-Finance of Critical Industries, Inc., a publicly-traded manufacturer and distributor of specialized safety equipment. From 1982 to 1987, he held various positions with Arthur Andersen LLP. Mr. Beittenmiller is a Certified Public Accountant.

William George III, age 39, has served as our Senior Vice President, General Counsel and Secretary since May 1998, 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.

Thomas N. Tanner, age 54, has served as our Senior Vice President, Operations since January 2004. From May 2001 to December 2003, Mr. Tanner was our East Region Vice President and from May 1999 to May 2001 was our East Region Controller. From September 1980 until May 1999, Mr. Tanner was Vice President and Chief Financial Officer of three related companies that were ultimately acquired by Comfort Systems USA: Armani Plumbing and Mechanical, Inc., Woodcock & Associates, Inc., and abj Fire Protection Co., Inc.

ITEM 2. Properties

We lease the real property and buildings from which we operate. Our facilities are located in over twenty-five states and consist of offices, shops, maintenance and warehouse facilities. Generally, leases range from five 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 the Company has no other business relationship. In certain instances these leases are with employees who are also the former owners of companies we purchased from 1997 through 1999. These leases were entered into in connection with the acquisition of the companies these individuals owned. To the extent we renew these leases or otherwise change them, 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 130,000 square feet. To maximize available capital, we generally intend to continue to lease our properties. We believe that our facilities are sufficient for our current needs.

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

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ITEM 3. Legal Proceedings

We are subject to certain claims and lawsuits arising in the ordinary 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 legal fees associated with certain of these actions in our consolidated financial statements. In some cases, we have project-related claims and liabilities that are individually significant, including one claim that will be subject to arbitration in the first half of 2004. With respect to this claim, and as with all such matters, we have accruals that reflect our judgment of the outcome.

Because of this, in the opinion of our management, uninsured losses resulting from the ultimate resolution of these matters will not have a material adverse effect on our financial position or results of operations.

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

PART II

ITEM 5. Market for Registrant's Common Equity and Related Stockholder Matters

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
First Quarter, 2002	\$ 4.56	\$ 3.50
Second Quarter, 2002	\$ 5.00	\$ 3.90
Third Quarter, 2002	\$ 4.97	\$ 2.50
Fourth Quarter, 2002	\$ 3.60	\$ 2.65
First Quarter, 2003	\$ 3.45	\$ 2.12
Second Quarter, 2003	\$ 3.45	\$ 1.65
Third Quarter, 2003	\$ 4.19	\$ 2.60
Fourth Quarter, 2003	\$ 5.72	\$ 3.78
January 1 - February 24, 2004	\$ 7.00	\$ 5.19

As of February 24, 2004, there were approximately 468 stockholders of record of our Common Stock, and the last reported sale price on that date was \$6.48 per share.

We have never declared or paid a dividend on our Common Stock. We currently expect to retain future earnings to repay debt and finance growth and, consequently, we have no plans to declare any dividends on our Common Stock. In addition, our revolving credit agreement restricts our ability to pay dividends without the lenders' consent. Our Restricted Voting Common Stock is virtually identical to ordinary Common Stock except that it may only vote on one director that is designated to it, it has diminished voting rights on most matters, and it converts to Common Stock upon transfer or sale and under certain other conditions.

Recent Sales of Unregistered Securities

During 2003, we did not issue any unregistered shares of our Common Stock.

ITEM 6. Selected Financial Data

The following selected historical financial data has been derived from the audited financial statements of the Company. The historical financial statement data reflects the acquisitions of businesses accounted for as purchases as of their respective acquisition dates. The selected historical financial data below should be read in conjunction with the historical Consolidated Financial Statements and related notes.

	Year Ended December 31,				
	1999	2000	2001	2002	2003
	(in thousands)				
STATEMENT OF OPERATIONS DATA:					
Revenues	\$ 787,620	\$ 886,780	\$ 864,222	\$ 800,485	\$ 784,976
Operating income (loss)	\$ 50,717	\$ (23,034)	\$ 11,931	\$ 12,328	\$ 6,058
Income (loss) from continuing operations	\$ 22,186	\$ (30,680)	\$ (1,971)	\$ 4,513	\$ (1,024)
Discontinued operations—					
Operating results, net of tax	\$ 20,136	\$ 13,827	\$ 15,095	\$ 930	\$ 655
Estimated loss on disposition, including tax	\$ —	\$ —	\$ —	\$ (12,002)	\$ (5,210)
Cumulative effect of change in accounting principle, net of tax	\$ —	\$ —	\$ —	\$ (202,521)	\$ —
Net income (loss)	\$ 42,322	\$ (16,853)	\$ 13,124	\$ (209,080)	\$ (5,579)
Income (loss) per Share:					
Basic—					
Income (loss) from continuing operations	\$ 0.58	\$ (0.82)	\$ (0.05)	\$ 0.12	\$ (0.03)
Discontinued operations—					
Income (loss) from operations	0.52	0.37	0.40	0.02	0.02
Estimated loss on disposition	—	—	—	(0.32)	(0.14)

Cumulative effect of change in accounting principle	—	—	—	(5.38)	—
Net income (loss)	\$ 1.10	\$ (0.45)	\$ 0.35	\$ (5.56)	\$ (0.15)
Diluted—					
Income (loss) from continuing operations	\$ 0.57	\$ (0.82)	\$ (0.05)	\$ 0.12	\$ (0.05)
Discontinued operations—					
Income (loss) from operations	0.52	0.37	0.40	0.02	0.02
Estimated loss on disposition	—	—	—	(0.31)	(0.14)
Cumulative effect of change in accounting principle	—	—	—	(5.31)	—
Net income (loss)	\$ 1.09	\$ (0.45)	\$ 0.35	\$ (5.48)	\$ (0.17)

BALANCE SHEET DATA:

Working capital	\$ 315,575	\$ 314,686	\$ 284,471	\$ 82,314	\$ 83,638
Total assets	\$ 934,530	\$ 929,008	\$ 876,625	\$ 366,535	\$ 351,110
Total debt, excluding discount	\$ 260,405	\$ 244,884	\$ 180,868	\$ 15,234	\$ 10,403
Total stockholders' equity	\$ 418,965	\$ 400,239	\$ 413,821	\$ 205,086	\$ 200,660

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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 Form 10-K. Also see "Forward-Looking Statements" discussion.

Introduction and Overview

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

Nature and Economics of Our Business

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

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

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

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completed the work, typically for six months. Amounts withheld under this practice are known as retention or retainage.

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

As of December 31, 2003, we had 4,166 projects in process. Our average project takes three to six months to complete, with an average contract price of approximately \$218,000. Our projects generally require working capital funding of equipment and labor costs. Customer payments on periodic billings generally do not recover this investment until late in the job. Our average project duration together with typical retention terms as discussed above generally allow us to complete the realization of revenue and earnings in cash within one year. Because of the integral nature of HVAC and related controls systems to most buildings, we have the legal right in almost all cases to attach liens to buildings or related funding sources when we have not been fully paid for installing systems, except with respect to some government buildings. The service work that we do, which is discussed further below, usually does not give rise to lien rights.

We also perform larger HVAC projects. As of December 31, 2003, we had one project in process with a contract price of between \$15 and \$20 million, four projects between \$10 million and \$15 million, ten projects between \$5 million and \$10 million, and 160 projects between \$1 million and \$5 million. Taken together, projects with contract prices of \$1 million or more totaled \$455.1 million of aggregate contract value as of December 31, 2003, out of a total contract value for all projects in progress of \$908.1 million. Generally, projects closer in size to \$1 million will be completed in a year or less. It is unusual for us to work on a project that exceeds two years in length.

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

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

Profile and Management of Our Operations

Our company was originally formed in 1997 through an initial public offering, or IPO, and simultaneous acquisition of 12 companies engaged in our business. From the time we completed our

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IPO through December 1999, we acquired 107 HVAC and complementary businesses, of which 26 were "tuck-in" operations that were integrated upon acquisition with existing operations. Since we suspended our acquisition program in late 1999, we have sold or ceased operations at 34 companies through 2003. We have consolidated another 16 companies into other operations, such that today we have 43 operating units.

Beginning in the fourth quarter of 1999, we shifted our strategy from an emphasis on acquisition-based growth to a focus on improving the performance of our existing operations. Significantly, on March 1, 2002, we sold 19 operations to Emcor Group, Inc. for \$186.25 million, including Emcor's assumption of approximately \$22.1 million of subordinated notes to former owners of certain of the divested companies. These 19 operations provided \$657.9 million of our revenue in 2001. We used the proceeds from this sale to reduce debt. The operating results of companies sold to Emcor have been reported under discontinued operations in the accompanying consolidated statements of operations. We recognized a loss of \$11.8 million and a goodwill impairment charge prior to the sale of \$32.4 million, net of taxes, related to the sold operations. For a further discussion of this sale, see "Item 8—Financial Statements and Supplemental Data—Notes 3 and 4."

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

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

Economic and Industry Factors

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

Spending decisions for building construction, renovation and system replacement are generally made on a project basis, usually with some degree of discretion as to when and if projects proceed. With larger amounts of capital, time, and discretion involved, spending decisions are affected to a greater degree by uncertainty, particularly concerns about macroeconomic and geopolitical trends. We

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have experienced periods of time, such as after the terrorist incidents on September 11, 2001 in the US, and prior to and during the war in Iraq that occurred in early 2003, when uncertainty caused a significant slowdown in decisions to proceed with installation or replacement project work.

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

Operating Environment and Management Emphasis

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

In addition to addressing revenues and costs more broadly, we also evaluate our operations on a by-unit and by-market basis. A number of our units have experienced significantly lower results at various points over the last three years, including ten units that incurred operating losses in 2003. While the difficult market conditions over this period of time certainly influenced the performance of these units, we also experienced operational execution shortfalls that contributed to lower results. The majority of such underperforming operations have been closed, sold, merged with stronger operations, or reduced in size or operating scope. We also replaced management at most ongoing operations in this group. We currently have 43 operating units. While it would be unusual in a group of this size to have no underperforming units even in better market conditions, we expect to have fewer units with significantly decreased operating results or losses in 2004 than we had in 2003.

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With the difficult market conditions in our industry over recent years along with the integration challenges we encountered following our substantial acquisition growth of the late 90s, we also operated in an environment of relatively tight credit restrictions from our lenders. In addition, we have had to more actively manage our relationships with the surety market, through which we procure payment and performance bonds required for approximately 25% of our work. Accordingly, cash flow and debt reduction have been particularly high priorities for us over this period of time. As a result of our sale of certain operations to Emcor in early 2002 as well as our continued strong emphasis on cash flow, our debt outstanding, net of cash, as of yearend 2003 was virtually zero. At the end of 2003, we put a new credit facility in place with considerably less restrictive and more traditional terms than those of our previous facilities. Further, our surety relationships, while generally strong in the past, have improved. We have generated positive free cash flow in twelve of the last fifteen quarters, and will continue our emphasis in this area. However, we expect that we will have to devote noticeably fewer management and organizational resources to debt and capital structure matters in 2004 than we have in recent years.

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

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

Critical Accounting Policies

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

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Percentage of Completion Method of Accounting

Approximately 80% of our revenues were earned on a project basis and recognized through the percentage of completion method of accounting. Under this method as provided by American Institute of Certified Public Accountants Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," contract revenue recognizable at any time during the life of a contract is determined by multiplying expected total contract revenue by the percentage of contract costs incurred at any time to total estimated contract costs. More specifically, as part of the negotiation and bidding process

in which we engage in connection with obtaining installation contracts, we estimate our contract costs, which include all direct materials (net of estimated rebates), labor and subcontract costs and indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. Then, as we perform under those contracts, we measure such costs incurred, compare them to total estimated costs to complete the contract, and recognize a corresponding proportion of contract revenue. This measurement and comparison process requires updates to the estimate of total costs to complete the contract, and these updates may include subjective assessments. Our contracts typically provide for a schedule of billings or invoices to the customer based on reaching agreed upon milestones or as we incur costs, although the billing schedule usually does not precisely match the schedule on which we incur costs. As a result, contract revenues recognized in the statement of operations can and usually do differ from amounts that can be billed or invoiced to the customer at any point during the contract.

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

Accounting for Allowance for Doubtful Accounts

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

Accounting for Self-Insurance Liabilities

We are substantially self-insured for worker's compensation, employer's liability, auto liability, general liability and employee group health claims in view of the relatively high per-incident deductibles we absorb under our insurance arrangements for these risks. Losses up to deductible amounts are estimated and accrued based upon known facts, historical trends and industry averages. A third party actuary reviews these estimates annually. We believe such accruals to be adequate. However, insurance

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

Accounting for Deferred Tax Assets

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

Accounting for Goodwill and Other Intangible Assets

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

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

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

As part of the adoption of SFAS No. 142, we were required to make a one-time determination of any transitional impairment loss by applying the standard's new, more rigorous valuation methodology. The result of this transitional analysis was a \$202.5 million charge, net of tax benefit, reflected as a cumulative effect of a change in accounting principle in our statement of operations in the first quarter of 2002. Additional impairment charges of \$0.2 million and \$2.7 million were recorded in operating results during the fourth quarter of 2002 and 2003, respectively. The impairment charge during 2003 primarily resulted from changes in operating plans that were identified in the fourth quarter for certain of our reporting units as part of our annual budgeting and business planning process.

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Table 1—Historical Results

	Year Ended December 31,					
	2001		2002		2003	
Revenues	\$ 864,222	100.0%	\$ 800,485	100.0%	\$ 784,976	100.0%
Cost of services	702,880	81.3%	661,781	82.7%	658,427	83.9%
Gross profit	161,342	18.7%	138,704	17.3%	126,549	16.1%
Selling, general and administrative expenses	141,077	16.3%	124,280	15.5%	114,542	14.6%
Goodwill amortization and impairment	8,096	0.9%	218	—	2,726	0.3%
Restructuring charges	238	—	1,878	0.2%	3,223	0.4%
Operating income	11,931	1.4%	12,328	1.5%	6,058	0.8%
Interest expense, net	(8,006)	(0.9)%	(4,263)	(0.5)%	(3,827)	(0.5)%
Other income (expense)	462	—	1,748	0.2%	(178)	—
Write-off of debt costs and discount, net	—	—	(987)	(0.1)%	(4,172)	(0.5)%
Income (loss) before income taxes	4,387	0.5%	8,826	1.1%	(2,119)	(0.3)%
Income tax expense (benefit)	6,358		4,313		(1,095)	
Income (loss) from continuing operations	(1,971)	(0.2)%	4,513	0.6%	(1,024)	(0.1)%
Discontinued operations—						
Operating results, net of tax	15,095		930		655	
Estimated loss on disposition, including tax	—		(12,002)		(5,210)	
Cumulative effect of change in accounting principle, net of tax	—		(202,521)		—	
Net income (loss)	\$ 13,124		\$ (209,080)		\$ (5,579)	

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

The following table presents operating income excluding operations we have sold or shut down that did not qualify for presentation as discontinued operations under generally accepted accounting principles in our historical income statement. This table also excludes from operating income (a) restructuring charges; (b) amounts relating to the resolution of our receivables with Kmart in connection with that company's 2002 bankruptcy; and (c) goodwill impairment charges in 2002 and 2003, and goodwill amortization for 2001 prior to the change in accounting rules that eliminated regular goodwill amortization.

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

expected to occur periodically as goodwill recognized in connection with the acquisition of businesses responds over time to changes in those businesses' markets and operations.

	Year Ended December 31,					
	2001		2002		2003	
Revenues	\$ 864,222		\$ 800,485		\$ 784,976	
Divested units not reflected in discontinued operations	(35,078)		(25,948)		(4,041)	
Revenues from ongoing operations	829,144	100.0%	774,537	100.0%	780,935	100.0%
Cost of services	702,880		661,781		658,427	
Divested units not reflected in discontinued operations	(31,356)		(22,501)		(4,046)	
Cost of services from ongoing operations	671,524	81.0%	639,280	82.5%	654,381	83.8%
Gross profit from ongoing operations	157,620	19.0%	135,257	17.5%	126,554	16.2%
Selling, general and administrative expenses	141,077		124,280		114,542	
Divested units not reflected in discontinued operations	(6,383)		(4,539)		(754)	
Kmart reserves and settlement	(3,500)		800		—	

Selling, general and administrative expenses from ongoing operations, excluding Kmart items	131,194	15.8%	120,541	15.6%	113,788	14.6%
Operating income from ongoing operations, excluding Kmart items, goodwill amortization and impairment and restructuring charges	\$ 26,426	3.2%	\$ 14,716	1.9%	\$ 12,766	1.6%

2003 Compared to 2002

Revenues—Revenues decreased \$15.5 million, or 1.9%, to \$785.0 million in 2003 compared to 2002. The 1.9% decline in revenue was comprised of a 0.8% increase in revenue at ongoing operations and a 2.7% decline in revenue related to operations that were sold during 2003.

The modest increase in year-to-date revenues at ongoing operations in 2003 resulted primarily from a continuation of mixed economic conditions in numerous markets. These conditions originated with the general economic slowdown in the US which began in 2001. This slowdown led to deferral of both new and replacement project activity, and has also resulted in a more competitive pricing environment. Activity levels in our industry worsened in late 2002 and early 2003 based on renewed uncertainty about the economy and international events. We have seen some stabilization in the second half of 2003 as revenue at ongoing operations showed small year-over-year increases in the third and fourth quarters.

We have seen some signs that activity levels in our industry may increase over the next year as compared to current levels. These observations are based on nonresidential construction spending trends, shipment data from HVAC equipment manufacturers, and anecdotal indications of renewed project consideration. In addition, we and other industry participants believe that there has been a general deferral of maintenance and replacement activity in the installed base of commercial, industrial, and institutional HVAC equipment, in response to the more difficult economy. We and other industry participants believe this trend will not continue indefinitely due to the fundamental operating needs of the equipment, but it is not clear when maintenance and replacement activity might increase. While we believe these trends and expectations are positive, there can be no assurance that industry activity levels

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will actually increase over the coming year. In view of the challenging economic environment and price competition affecting our industry, we may continue to experience only modest revenue growth or revenue declines in upcoming periods. In addition, if general economic activity in the US slows significantly from current levels, we may realize further decreases in revenue and lower operating margins.

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

Backlog associated with continuing operations as of December 31, 2003 was \$403.9 million, a 6.7% decrease from December 31, 2002 backlog of \$432.9 million. Backlog has increased modestly in January and early February from yearend 2003 levels.

Gross Profit—Gross profit decreased \$12.2 million, or 8.8%, to \$126.5 million in 2003 compared to 2002. As a percentage of revenues, historical gross profit decreased from 17.3% in 2002 to 16.1% in 2003, and posted a similar decline in ongoing operations.

The decline in gross profit in 2003 as compared to 2002 is primarily due to lower industry activity levels, increased price competition, and moderate execution shortfalls in five of our operations, offset to a lesser degree by improved efficiency at three of our operations. Two of the operations with shortfalls this year are being combined with other units. The other three are more established operations at which such shortfalls are expected to be temporary.

Selling, General and Administrative Expenses ("SG&A")—SG&A decreased \$9.7 million, or 7.8%, to \$114.5 million in 2003 compared to 2002. As a percentage of revenues, SG&A decreased from 15.5% in 2002 to 14.6% in 2003. During the second quarter of 2002, we reversed \$0.8 million of the bad debt reserves that were established in the fourth quarter of 2001 related to our receivables with Kmart as a result of a bankruptcy-related settlement with Kmart. Accordingly, the decrease in normal SG&A from 2002 to 2003 was greater by this amount. The decrease in SG&A resulted from the following: (a) the sale or closure of certain units that did not qualify for discontinued operations presentation; (b) the substantial downsizing in the first quarter of 2003 of our marketing initiative emphasizing energy efficiency; (c) decreased outlays for medical costs; and (d) a concerted effort to reduce SG&A throughout our company.

Goodwill Amortization and Impairment—We no longer amortize goodwill via regular charges to our income statement due to our adoption of SFAS 142. See "Cumulative Effect of Change in Accounting Principle" below for further discussion. Additional goodwill impairment charges of \$0.2 million and \$2.7 million were recorded during the fourth quarter of 2002 and 2003, respectively. The impairment charge in 2003 primarily resulted from changes in operating plans that were identified for certain of our reporting units in the fourth quarter as part of our annual budgeting and business planning process.

Restructuring Charges—During the first three quarters of 2003, we recorded restructuring charges of approximately \$3.2 million pre-tax. These charges included approximately \$1.5 million for severance costs and retention bonuses primarily associated with the curtailment of our energy efficiency marketing activities, a reorganization of our national accounts operations as well as a reduction in corporate personnel. The severance costs and retention bonuses related to the termination of 88 employees, all of whom had left the Company by December 31, 2003. The restructuring charges for this period also

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included approximately \$1.6 million for remaining lease obligations and \$0.1 million of other costs recorded in connection with the actions described above.

During the first quarter of 2002, we recorded restructuring charges of approximately \$1.9 million. These charges included approximately \$0.8 million for severance costs primarily associated with the reduction in corporate office overhead in light of our smaller size following the Emcor transaction described below under "Discontinued Operations." The severance costs related to the termination of 33 employees, all of whom had left the Company by March 31, 2002. These restructuring charges also included approximately \$0.7 million for costs associated with decisions to merge or close three smaller divisions and realign regional operating management.

Interest Expense, Net—Interest expense, net, decreased \$0.4 million to \$3.8 million in 2003. This decline resulted from lower average borrowing levels and market interest rates in 2003, offset to a lesser degree by increased letter of credit fees and mark-to-market adjustments associated with a warrant and put that were issued in connection with the original establishment of the credit facility we had in effect in 2003. Interest expense for 2002 and 2003 included the following primary elements (in thousands):

	2002	2003
Interest expense on borrowings and unused commitment fees	\$ 2,889	\$ 1,397
Letter of credit fees	— (a)	512
Amortization of deferred debt arrangement costs	1,248	1,496
Mark-to-market adjustments on derivatives	180	488
Interest income	(54)	(66)
Total	\$ 4,263	\$ 3,827

(a) In 2002, letter of credit amounts outstanding and related fees were significantly lower. These fees were treated as an element of bank service charges in selling, general and administrative expenses during this period.

Other Income (Expense)—Other expense was \$0.2 million for 2003, and other income was \$1.7 million for 2002. First quarter 2003 includes a loss of \$0.3 million on the disposition of a division of one of our operations. Other income for 2002 includes a gain of \$0.6 million on the sale of the residential portion of one of our operations in the second quarter of 2002, and a gain of \$0.7 million related to the extinguishment of subordinated debt in the fourth quarter of 2002.

Write-off of Debt Costs and Discount, Net—In the fourth quarter of 2003 we recorded a non-cash write-off of \$4.7 million of deferred debt arrangement costs and discount when we terminated our previous credit facility. These amounts were partially offset by a \$1.3 million gain associated with the reduction in the value of a warrant and put obligation that arose when the facility terminated in the fourth quarter was originally established. This reduction in the value of the warrant and put obligation resulted from a significant restriction in the holder's ability to exercise the put provision. This restriction was agreed to by the holder in connection with terminating the related facility. We also reflected a non-cash charge of \$0.8 million in the first quarter of 2003 for deferred debt costs that were associated with previously higher levels of capacity under this credit facility. In the fourth quarter of 2002 we recorded a non-cash write-off of \$0.4 million of debt costs when we terminated a preceding credit facility. The first quarter of 2002 includes a non-cash writedown of \$0.6 million of debt costs in

connection with the reduction in our borrowing capacity following the Emcor transaction. The following table recaps these writeoffs (in thousands):

	2002	2003
Write-off of deferred financing fees and transaction costs	\$ 987	\$ 3,246
Write-off of discount originally arising from issue of warrant and put to credit facility lender	—	2,250
Reduction in valuation of warrant and put obligation	—	(1,324)
Total	\$ 987	\$ 4,172

Income Tax Expense (Benefit)—Our effective tax rates associated with results from continuing operations for 2002 and 2003 were 48.9% and 51.7%, respectively. Our effective rates in 2002 and in the first three quarters of 2003 were higher than statutory rates because of the effect of certain expenses that we incur that are not deductible for tax purposes, and due to reserves that we have established against certain deferred tax assets based on the possibility that we will not be able to ultimately realize the tax benefit for certain losses we have incurred, primarily at the state income tax level. In addition, since our recent pre-tax profit margins have been relatively low on a historical and an absolute basis, the impact of non-deductible expenses on our effective rate is magnified.

In the fourth quarter of 2003, our year-to-date pre-tax income from continuing operations turned negative as we recognized significant charges for the write-off of deferred debt arrangement costs and for goodwill impairment. The effective benefit rate on our full year 2003 pre-tax loss further increased over statutory rates to 51.7% as a result of additional tax adjustments in the fourth quarter. These adjustments included benefit for the reversal of tax contingency reserves no longer deemed necessary as a result of an updated review of our tax positions across the jurisdictions in which we do business, offset to a lesser degree by additional reserves against state-level deferred tax assets that may be not fully realized, and recognition of the effect of the nondeductible portion of the goodwill impairment we recorded in the fourth quarter.

We currently expect our 2004 effective rate to be in the mid-40% range.

Discontinued Operations—During the fourth quarter of 2003, we sold a small operating company. This unit's after-tax income of \$0.7 million and \$0.4 million for 2002 and 2003, respectively, has been reported in discontinued operations under "Operating results, net of tax." As a result of the sale of this unit, we recorded a loss of \$1.5 million, net of tax benefit, in discontinued operations under "Estimated loss on disposition, including tax." The loss resulted from the non-cash write-off of nondeductible goodwill.

During the third quarter of 2003, we committed to a plan to divest of a small operating company. This unit's after-tax income of \$0.1 million in 2002 and \$0.2 million for the first three quarters of 2003 has been reported in discontinued operations under "Operating results, net of tax." As a result of the decision in the third quarter of 2003 to sell this unit, we recorded an estimated loss of \$2.8 million, including taxes, related to this planned disposition in "Estimated loss on disposition, including tax" based upon an estimated sales price. The final loss as measured at the closing of this sale in the fourth quarter of 2003 was not materially different than the estimate recorded in the preceding quarter. The estimated loss resulted from the non-cash write-off of nondeductible goodwill.

During the second quarter of 2003, we sold a small operating company. This unit's after-tax income of \$0.1 million for each of 2002 and the first six months of 2003 has been reported in discontinued operations under "Operating results, net of tax." As a result of the decision in the first quarter of 2003 to sell this unit, we recorded an estimated loss in the first quarter of 2003 of \$0.9 million, including taxes, related to this transaction in "Estimated loss on disposition, including tax." The final loss as measured at the closing of this sale in the second quarter of 2003 was not materially

different than the estimate recorded in the preceding quarter. The loss resulted from the non-cash write-off of nondeductible goodwill.

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

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

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

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

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

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

In March 2002, we decided to divest of a small operating company. In the first quarter of 2002, we recorded an estimated loss of \$0.4 million, net of tax benefit, from this planned disposition in

discontinued operations under "Estimated loss on disposition, including tax." In the fourth quarter of 2002, we reversed this estimated loss because we decided not to sell this unit.

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

Cumulative Effect of Change in Accounting Principle—SFAS No. 142, "Goodwill and Other Intangible Assets," which required a transitional assessment of our goodwill assets went into effect in 2002. We adopted it as of January 1, 2002.

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

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

Outlook—As noted above, we have reported lower earnings in 2003 than in 2002. We have experienced reduced activity levels and increased price competition stemming from the general economic slowdown which began in 2001 and which worsened in late 2002 and early 2003 based on renewed uncertainty about the economy and international events. In addition, we had adverse cost developments in certain projects in two of our operations early in the current year. Further, we realized operating losses at a number of our units as a result of poor execution and challenging market conditions.

In the third quarter of 2003, our revenues at ongoing operations increased 1.3% as compared to 2002, and operating income and margin, excluding restructuring charges, were essentially unchanged. In the fourth quarter of 2003, revenues at ongoing operations increased 4.1% as compared to 2002. Operating income excluding restructuring charges and goodwill impairment increased 47.1% over a difficult fourth quarter of 2002, while operating margin determined on the same basis increased from 1.1% in 2002 to 1.6% in 2003. These are the first favorable year-over-year increases we have posted in some time, as we have continued to contend with difficult industry and economic conditions. While there can be no assurance of similar increases in 2004, they contribute to our expectation, as discussed further below, that we will produce improved operating results in 2004 as compared to 2003.

As noted earlier in this review, while we see signs that industry activity levels may increase in 2004, our primary emphasis for the upcoming year is on margin improvement rather than revenue growth. Margin indications in backlog as of yearend reflected slightly higher levels than at recent quarterends. In addition, our ongoing margin improvement efforts include a focus on reducing the number of our units with significantly decreased operating results or losses in 2004 as compared to 2003, and intensified project and service performance training at the unit level. Based on these efforts and on our expectation that industry and economic conditions will improve in 2004, we believe that our 2004

results will be significantly better than our 2003 results, although there can be no assurance that we will achieve this outcome.

2002 Compared to 2001

Revenues—Revenues decreased \$63.7 million, or 7.4%, to \$800.5 million in 2002 compared to 2001. The 7.4% decline in revenues was comprised of a 6.6% decline in revenues at ongoing operations and a 0.8% decline in revenues related to operations that were sold or shut down during 2001.

The decline in revenues at ongoing operations in 2002 resulted primarily from the effect of the general economic slowdown that began in 2001. This slowdown led to widespread delays in facility owners' decisions to proceed on both new and replacement projects, and also resulted in a more competitive pricing environment. The decline in revenue was also consistent with management's decreased emphasis on revenue growth in favor of improvement in profit margins, operating efficiency, and cash flow.

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

Backlog associated with continuing operations as of December 31, 2002 was \$432.9 million, an 7.1% increase from December 31, 2001 backlog of \$404.2 million. During the fourth quarter of 2002, we removed \$16.0 million from backlog that related to a project that we concluded was not going to proceed. This project was first reflected in backlog in the third quarter of 2001. If this project is excluded from all applicable periods, our backlog reflected an increase of 11.5% from an adjusted December 31, 2001 backlog of \$388.2 million.

Gross Profit—Gross profit decreased \$22.6 million, or 14.0%, to \$138.7 million in 2002 compared to 2001. As a percentage of revenues, gross profit decreased from 18.7% in 2001 to 17.3% in 2002, and posted a similar decline in ongoing operations.

The decline in gross profit for the year as a whole was primarily due to a more competitive pricing environment as a result of the general economic slowdown which began in 2001. This slowdown also resulted in project delays at a number of our operations as decisions to start new construction activities as well as retrofit projects were delayed in the fourth quarter of 2001. These delays significantly affected our revenue volume and profitability during the first part of 2002.

In the fourth quarter of 2002, we experienced cost overruns in certain operations as well as reduced activity levels in connection with renewed uncertainty about the economy and international events.

Selling, General and Administrative Expenses—SG&A decreased \$16.8 million, or 11.9%, to \$124.3 million in 2002 compared to 2001. As a percentage of revenues, SG&A decreased from 16.3% in 2001 to 15.5% in 2002. During the fourth quarter of 2001, we estimated and recorded bad debt expense of approximately \$3.5 million related to our receivables with Kmart, in light of that company's bankruptcy filing in January 2002. During the second quarter of 2002, we reversed \$0.8 million of the bad debt reserves that were established in the fourth quarter of 2001 related to the Kmart receivables as a result of a settlement with Kmart. Excluding the Kmart charge in 2001 and reversal in 2002, as well as the effects of operations we have sold that did not qualify for separate classification as discontinued operations, SG&A declined \$10.7 million, or 8.1%, to \$120.5 million, and as a percentage

of revenue, from 15.8% in 2001 to 15.6% in 2002. The decrease in SG&A was primarily due to a concerted effort to reduce SG&A throughout our Company. This effort included a reduction in corporate overhead at the end of the first quarter of 2002 in response to our smaller size following the sale of 19 units to Emcor as discussed further below under "Discontinued Operations." Costs associated with this particular reduction were reflected as restructuring charges in March 2002.

SG&A as a percentage of revenues for periods prior to the Emcor transaction is also higher because the financial statements do not allocate any corporate overhead to the discontinued operations. As a result, SG&A for continuing operations in those periods includes substantially the full amount of corporate office overhead that was in place to support our larger size prior to the sale of operations to Emcor.

Goodwill Amortization and Impairment—As discussed above, we no longer amortize goodwill via regular charges to our income statement due to our adoption of SFAS 142. See "Cumulative Effect of Change in Accounting Principle" for further discussion. We recorded an additional goodwill impairment charge of \$0.2 million during the fourth quarter of 2002.

Restructuring Charges—During the first quarter of 2002, we recorded restructuring charges of approximately \$1.9 million. These charges included approximately \$0.8 million for severance costs primarily associated with the reduction in corporate office overhead in light of our smaller size following the Emcor transaction. The severance costs related to the termination of 33 employees, all of whom had left the Company by March 31, 2002. The restructuring charges for the quarter also included approximately \$0.7 million for costs associated with decisions to merge or close three smaller divisions and realign regional operating management.

During the first quarter of 2001, we recorded restructuring charges of approximately \$0.2 million, primarily related to contractual severance obligations of two operating presidents in connection with our significant restructuring program in the second half of 2000. These restructuring charges were net of a gain of approximately \$0.1 million related to our decision to sell a small operation during the first quarter of 2001.

Interest Expense, Net—Interest expense, net, decreased \$3.7 million to \$4.3 million in 2002. A portion of our actual interest expense in both years has been allocated to the discontinued operations caption based upon our net investment in these operations. Therefore, interest expense relating to continuing operations does not reflect the pro forma reduction of interest expense from applying the proceeds from the sale of these operations to reduce debt in any earlier period. Interest expense allocated to the discontinued operations in 2001 and 2002 was \$13.8 million and \$1.5 million, respectively.

Other Income (Expense)—Other income was \$0.5 million for 2001 and \$1.7 million for 2002. Other income for the second quarter of 2002 includes a gain of \$0.6 million on the sale of the residential portion of one of our operations. In addition, a gain of \$0.7 million was recorded in the fourth quarter of 2002 related to the extinguishment of subordinated debt.

Write-off of Debt Costs and Discount, Net—The fourth quarter of 2002 includes a non-cash write-off of \$0.4 million of deferred financing costs resulting from the replacement of our previous credit facility. The first quarter of 2002 includes a non-cash writedown of \$0.6 million of loan arrangement costs in connection with the reduction in our borrowing capacity following the Emcor transaction.

Income Tax Expense (Benefit)—Our effective tax rates associated with results from continuing operations for 2001 and 2002 were 144.9% and 48.9%, respectively. As a result of the discontinuation of goodwill amortization in connection with the adoption of SFAS No. 142 effective January 1, 2002, our 2002 effective tax rate no longer reflects a permanent difference between book income and tax income for goodwill amortization that is not deductible for tax purposes.

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

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

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

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

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

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

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

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

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

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

Liquidity and Capital Resources

	Year ended December 31,		
	2001	2002	2003
(in thousands)			
Cash provided by (used in):			
Operating activities	\$ 66,829	\$ 14,090	\$ 13,504
Investing activities	\$ (4,003)	\$ 150,589	\$ (3,863)
Financing activities	\$ (68,222)	\$ (169,200)	\$ (5,609)
Free cash flow:			
Cash provided by operating activities	\$ 66,829	\$ 14,090	\$ 13,504
Taxes paid related to the sale of businesses	—	—	11,006
Purchases of property and equipment	(5,978)	(5,322)	(3,406)
Proceeds from sales of property and equipment	1,011	1,551	430
Free cash flow	\$ 61,862	\$ 10,319	\$ 21,534

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

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

allow us to complete the realization of revenue and earnings in cash within one year. Accordingly, we believe free cash flow, by encompassing both profit margins and the use of working capital over our approximately one year working capital cycle, is an effective measure of operating effectiveness and efficiency. We have included free cash flow information here for this reason, and because we are often asked about it by third parties evaluating the Company. However, free cash flow is not considered under generally accepted accounting principles to be a primary measure of an entity's financial results, and accordingly free cash flow should not be considered an alternative to operating income, net income, or amounts shown in our consolidated statements of cash flows as determined under generally accepted accounting principles.

For the year ended December 31, 2003, we had free cash flow of \$21.5 million as compared to \$10.3 million in 2002. This increase resulted primarily from using about \$3.4 million less in working capital to support our operations in 2003 as compared to 2002 when we increased our working capital investment by \$8.9 million.

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

Credit Facility—On December 31, 2003, we entered into a \$50 million senior credit facility (the "Facility") provided by a syndicate of four banks. The Facility is secured by substantially all of our assets, including the capital stock of all our current and future subsidiaries and substantially all of their assets. Amounts due under the Facility are also guaranteed by our current and future subsidiaries. The Facility consists of two parts: a term loan and a revolving credit facility.

The term loan under the Facility (the "Term Loan") is \$10 million, which the Company borrowed upon the closing of the Facility. The Term Loan must be repaid in quarterly installments over five years. The Facility requires prepayments of the Term Loan in certain circumstances. Proceeds in excess of \$1 million from the sale of an asset, or from a related series of asset sales, must be used to pay down the Term Loan. Asset sale proceeds of less than \$1 million must also be used to pay down the Term Loan unless they are reinvested in long-term assets within six months of being received. All principal payments under the Term Loan permanently reduce the original \$10 million capacity under this portion of the Facility.

The Facility also includes a three-year \$40 million revolving credit facility (the "Revolving Loan") available for borrowings or letters of credit. Letters of credit are discussed at greater length below under *Other Commitments*. The Facility requires that borrowings outstanding under the Revolving Loan must be less than \$2 million for ten consecutive business days at least once during each year. We have already satisfied this condition for 2004.

Our borrowings and letters of credit outstanding under the Facility at each monthend must be less than a borrowing base measured as of the same monthend. The borrowing base is defined under the Facility as 60% of the following: total trade receivables, less allowances for doubtful accounts, less receivables related to projects that are subject to payment or performance bonds. The borrowing base as of December 31, 2003 was \$78 million. We expect that our borrowing base will continue to exceed the \$50 million stated limit of the Facility by significant amounts.

Our borrowing and letter of credit capacity under the Revolving Loan portion of the Facility at any given time is \$40 million less borrowings and letters of credit outstanding, subject to the borrowing base described above. The Facility contains financial covenants defining various financial measures and the levels of these measures with which we must comply, as discussed further below. Covenant compliance is measured as of each quarterend. While the Facility's financial covenants do not specifically govern capacity under the Facility, if our debt level under the Facility at a quarterend covenant compliance measurement date caused us to violate the Facility's debt-to-EBITDA covenant (described in more detail below) our borrowing capacity under the Facility could be restricted by the lenders. Accordingly,

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available capacity amounts shown below are presented both on a financial covenant basis and on a Facility face value basis.

	As of Dec. 31, 2003	As of Feb. 24, 2004
	(in thousands)	
<i>Amounts Outstanding</i>		
Revolving loan	\$ —	\$ 3,900
Term loan	10,000	10,000
Other debt	403	386
Total debt	\$ 10,403	\$ 14,286
Letters of credit	\$ 20,031	\$ 21,054
<i>Available Capacity</i>		
Unused revolving loan and letter of credit capacity based on revolving loan face value of \$40 million	\$ 19,969	\$ 15,046
Unused revolving loan and letter of credit capacity based on quarterend debt-to-EBITDA covenant	\$ 19,969	n/a

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

Debt Service Coverage Ratio—The Facility requires that the ratio of EBITDA to the sum of interest expense and scheduled principal payments be at least 2.50. Interest expense is defined under the Facility for purposes of this covenant as interest expense for the four quarters ending as of any given quarterly covenant compliance measurement date, excluding corresponding twelve-month amounts for (a) amortization of deferred debt arrangement costs; and (b) mark-to-market interest expense. Scheduled principal payments for this ratio are also measured for the twelve months ending as of any given quarterly covenant compliance measurement date. The Facility provides, however, that during the first three quarters of 2004 interest expense and scheduled principal payments used in this ratio will be the annualized amounts of actual year-to-date interest expense and scheduled principal payments, instead of actual amounts for these items for the twelve months then ended. The Company's debt service coverage ratio as of December 31, 2003 as measured under this covenant was 4.26.

Tangible Net Worth—The Facility requires that our tangible net worth not be less than the sum of (a) \$75.4 million; (b) 75% of net income earned beginning October 1, 2003; and (c) the net proceeds of any equity transactions. For purposes of this ratio, the Facility defines tangible net worth as stockholders equity less the book value of the following intangible assets: goodwill, patents, copyrights, licenses, franchises, trade names, trade secrets, and operating leases. The Facility also provides that for purposes of this ratio, net income excludes any goodwill impairment charges. The Company's tangible net worth as of December 31, 2003 as measured under this covenant was \$96.6 million, as compared to a covenant requirement of \$75.4 million.

Debt to EBITDA—The Facility requires that our ratio of debt to EBITDA not exceed 2.0. Our debt-to-EBITDA ratio as of December 31, 2003 as measured under this covenant was 0.7.

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Capital Expenditures—The Facility limits capital expenditures to \$8.0 million per year. Our capital expenditures during 2003 were \$3.4 million.

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

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

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

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

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

Surety market conditions are currently difficult as a result of significant losses incurred by many sureties in recent periods, both in the construction industry as well as in certain larger corporate

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

The following recaps the future maturities of our debt along with other contractual obligations. Debt maturities in this recap are based on amounts outstanding as of February 24, 2004 while operating lease maturities are based on amounts outstanding as of December 31, 2003 (in thousands):

	Twelve Months Ended December 31,						Total
	2004	2005	2006	2007	2008	Thereafter	
Revolving loan	\$ —	\$ —	\$ 3,900	\$ —	\$ —	\$ —	\$ 3,900
Term loan	1,500	2,000	2,000	2,000	2,500	—	10,000
Other debt	77	67	61	58	63	60	386
Total debt	\$ 1,577	\$ 2,067	\$ 5,961	\$ 2,058	\$ 2,563	\$ 60	\$ 14,286
Operating lease obligations	\$ 8,719	\$ 7,008	\$ 5,756	\$ 4,545	\$ 3,344	\$ 12,901	\$ 42,273

As of December 31, 2003 we also have \$20.0 million of letter of credit commitments. While these commitments all expire in 2004, we expect the majority of them, primarily those supporting our property and casualty insurance programs, will be renewed annually.

Other than the operating lease obligations noted above, we have no significant purchase or operating commitments outside of commitments to deliver equipment and provide labor in the ordinary course of performing project work. In addition, the \$2.3 million value of the warrant and put obligation included in Other Long-Term liabilities on our balance sheet substantially reflects the value of the warrant portion of the obligation that can be converted into equity by the holder. Because this conversion would not require a cash disbursement, we have not included this obligation in the table of commitments above.

Outlook—We have generated positive net free cash flow for each of the last three years in challenging economic and industry conditions, and we currently have a relatively low level of debt. We anticipate that free cash flow from operations and credit capacity under the Facility will provide us with sufficient liquidity to fund our operations for the foreseeable future.

Seasonality and Cyclicity

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

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

New Accounting Pronouncements

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

In January 2003, the FASB issued interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN No. 46"). FIN No. 46 defines a variable interest entity as an entity in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN No. 46 requires an entity to consolidate a variable interest entity if that entity will absorb a majority of the variable interest entity's expected losses if they occur, receive a majority of the variable interest entity's expected residual returns if they occur, or both. FIN No. 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of the pronouncement were initially to be effective for the first interim or annual period beginning after June 15, 2003. However, in October 2003, the FASB delayed the effective date of FIN No. 46 on these entities to the first period beginning after December 15, 2003. We determined that we do not have any variable interest entities at December 31, 2003 as defined by the pronouncement.

Factors Which May Affect Future Results

Our future operating results are difficult to predict and may be affected by a number of factors, including the lack of a combined operating history and the difficulty of integrating formerly separate businesses, retention of key management, national or regional declines in non-residential construction activity, difficulty in obtaining or increased costs associated with debt financing or bonding, shortages of labor and specialty building materials, seasonal fluctuations in the demand for HVAC systems and the use of incorrect estimates for bidding fixed price contracts. As a result of these and other factors, there can be no assurance that we will not experience material fluctuations in future operating results or cash flows on a quarterly or annual basis.

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.

Our success depends in part on our ability to integrate and further consolidate the companies we acquired from 1997-1999 in building the Company. These businesses operated as separate, independent entities prior to their affiliation with us, and there can be no assurance that we will be able to integrate the operations of these businesses successfully or institute the necessary systems and procedures, including accounting and financial reporting systems, to effectively manage the combined enterprise on a profitable basis. Historical results of such businesses are not necessarily indicative of our future results because, among other reasons, our subsidiary operations were not under common control or management prior to their acquisition. There are also risks associated with unanticipated events or liabilities resulting from the acquired businesses' operations prior to the acquisition.

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

Surety markets conditions are currently difficult as a result of significant losses incurred by many sureties in recent periods, both in the construction industry as well as in certain larger corporate bankruptcies. As a result, less bonding capacity is available in the market and terms have become more restrictive. Further, under standard terms in the surety market, sureties issue bonds on a project by project basis, and can decline to issue bonds at any time. Historically, approximately 25% of our business has required bonds. While we have enjoyed a longstanding relationship with our surety, current market conditions as well as changes in our surety's assessment of our operating and financial risk could cause our surety to decline to issue bonds for our work. If that were to occur, our

alternatives would 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. There can be no assurance that we could easily achieve these alternatives. Accordingly, if we were to experience an interruption in the availability of bonding capacity, our revenues and profits could decline.

Key elements of our strategy are to both maintain and improve the profitability and cash flow of the individual businesses. Our level of success in this strategy, if any, will be affected by demand for new or replacement HVAC systems. In part, such demand will be contingent upon factors outside our control, such as the level of new construction or the potential for slower replacement based upon the overall level of activity in the economy. The HVAC industry is subject to both seasonal and cyclical variations, meaning that temperate weather and downturns in the domestic or regional economies will negatively affect overall demand for our services.

The timely provision of high-quality installation service and maintenance, repair and replacement of HVAC systems requires an adequate supply of skilled HVAC technicians. Accordingly, our ability to maintain and increase our productivity and profitability is affected by our ability to employ, train and retain the skilled technicians necessary to meet our service requirements.

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.

The existing senior management at certain subsidiary operations is comprised of former owners who committed to stay with their operations after acquisition. Certain of these individuals have suffered losses in the value of our common stock or have lower incomes than they averaged when they owned their former businesses. Further, former owners generally have noncompete obligations that expire on the fifth anniversary of their date of acquisition, and thus these obligations have largely expired. There is no assurance that we will be able to retain these individuals or find suitable replacements if such individuals leave the Company. The failure to retain or replace such management on a timely basis could negatively impact results from operations at such locations.

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. Our failure to comply, or the costs of compliance, with such laws and regulations could adversely affect our future results.

Because of these and other factors, past financial performance should not necessarily be considered an indicator of future performance. Investors should not rely solely on historical trends to anticipate future results and should be aware that the trading price of our Common Stock may be subject to wide fluctuations in response to quarter-to-quarter variations in operating results, general conditions in the HVAC industry, changes in analysts' earnings estimates, recommendations by analysts, or other events.

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

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

Our exposure to changes in interest rates primarily results from our short-term and long-term debt with both fixed and floating interest rates. Our debt with fixed interest rates consists of capital leases and various notes payable. Our debt with variable interest rates consists entirely of our Facility. The following table presents principal amounts (stated in thousands) and related weighted average interest rates by year of maturity for our debt obligations and their indicated fair market value at December 31, 2003:

	2004	2005	2006	2007	2008	Thereafter	Total	Fair Value
Liabilities—Long-Term Debt:								
Fixed Rate Debt	\$ 94	\$ 67	\$ 61	\$ 58	\$ 63	\$ 60	\$ 403	\$ 403
Average Interest Rate	7.2%	7.0%	7.5%	7.6%	7.7%	5.3%	7.1%	7.1%
Variable Rate Debt	\$ 1,500	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,500	\$ —	\$ 10,000	\$ 10,000
Average Interest Rate	4.4%	4.4%	4.4%	4.4%	4.4%	—	4.4%	4.4%

ITEM 8. Financial Statements and Supplemental Data

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REPORT OF INDEPENDENT AUDITORS

Board of Directors and Stockholders
Comfort Systems USA, Inc.

We have audited the accompanying consolidated balance sheets of Comfort Systems USA, Inc. (the "Company") as of December 31, 2002 and 2003, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2003. These consolidated 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 auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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. as of December 31, 2002 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 4 to the consolidated financial statements, on January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," which changed the method of accounting for goodwill and other intangible assets.

ERNST & YOUNG LLP

Houston, Texas
February 26, 2004

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

	December 31,	
	2002	2003
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 5,972	\$ 10,136
Accounts receivable, less allowance for doubtful accounts of \$5,959 and \$5,044	164,949	167,939
Other receivables	7,873	5,171
Inventories	11,967	9,838
Prepaid expenses and other	10,504	13,691
Costs and estimated earnings in excess of billings	17,768	16,162
Assets related to discontinued operations	10,934	—
	229,967	222,937
PROPERTY AND EQUIPMENT, net	15,933	13,231
GOODWILL, net	107,202	104,034
OTHER NONCURRENT ASSETS	13,433	10,908
	366,535	351,110
Total assets	\$ 366,535	\$ 351,110

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 1,780	\$ 1,594
Accounts payable	55,848	58,566
Accrued compensation and benefits	21,798	22,700
Billings in excess of costs and estimated earnings	26,498	29,657
Income taxes payable	9,797	—
Other current liabilities	29,412	26,782
Liabilities related to discontinued operations	2,520	—

Total current liabilities	147,653	139,299
LONG-TERM DEBT, NET OF CURRENT MATURITIES AND DISCOUNT OF \$2,850 in 2002	10,604	8,809
OTHER LONG-TERM LIABILITIES	3,192	2,342
Total liabilities	161,449	150,450
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$.01 par, 5,000,000 shares authorized, none issued and outstanding	—	—
Common stock, \$.01 par, 102,969,912 shares authorized, 39,258,913 shares issued	393	393
Treasury stock, at cost, 1,341,419 and 1,041,864 shares, respectively	(8,214)	(6,305)
Additional paid-in capital	338,606	337,605
Deferred compensation	(785)	(540)
Retained earnings (deficit)	(124,914)	(130,493)
Total stockholders' equity	205,086	200,660
Total liabilities and stockholders' equity	\$ 366,535	\$ 351,110

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

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COMFORT SYSTEMS USA, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Data)

	Year Ended December 31,		
	2001	2002	2003
REVENUES	\$ 864,222	\$ 800,485	\$ 784,976
COST OF SERVICES	702,880	661,781	658,427
Gross profit	161,342	138,704	126,549
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	141,077	124,280	114,542
GOODWILL AMORTIZATION AND IMPAIRMENT	8,096	218	2,726
RESTRUCTURING CHARGES	238	1,878	3,223
Operating income	11,931	12,328	6,058
OTHER INCOME (EXPENSE):			
Interest income	106	54	66
Interest expense	(8,112)	(4,317)	(3,893)
Write-off of debt costs and discount, net	—	(987)	(4,172)
Other	462	1,748	(178)
Other income (expense)	(7,544)	(3,502)	(8,177)
INCOME (LOSS) BEFORE INCOME TAXES	4,387	8,826	(2,119)
INCOME TAX EXPENSE (BENEFIT)	6,358	4,313	(1,095)
INCOME (LOSS) FROM CONTINUING OPERATIONS	(1,971)	4,513	(1,024)
DISCONTINUED OPERATIONS:			
Operating income (loss), net of applicable income tax benefit (expense) of \$(10,175), \$1,290, and \$(407)	15,095	930	655
Estimated loss on disposition, including income tax benefit (expense) of \$(23,324) and \$533	—	(12,002)	(5,210)
INCOME (LOSS) BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	13,124	(6,559)	(5,579)
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE, NET OF INCOME TAX BENEFIT OF \$26,317	—	(202,521)	—
NET INCOME (LOSS)	\$ 13,124	\$ (209,080)	\$ (5,579)
INCOME (LOSS) PER SHARE:			
Basic—			

Income (loss) from continuing operations	\$	(0.05)	\$	0.12	\$	(0.03)
Discontinued operations—						
Income (loss) from operations		0.40		0.02		0.02
Estimated loss on disposition		—		(0.32)		(0.14)
Cumulative effect of change in accounting principle		—		(5.38)		—
Net income (loss)	\$	0.35	\$	(5.56)	\$	(0.15)
Diluted—						
Income (loss) from continuing operations	\$	(0.05)	\$	0.12	\$	(0.05)
Discontinued operations—						
Income (loss) from operations		0.40		0.02		0.02
Estimated loss on disposition		—		(0.31)		(0.14)
Cumulative effect of change in accounting principle		—		(5.31)		—
Net income (loss)	\$	0.35	\$	(5.48)	\$	(0.17)
SHARES USED IN COMPUTING INCOME (LOSS) PER SHARE:						
Basic		37,436		37,605		37,702
Diluted		37,436		38,154		38,111

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In Thousands, Except Share Amounts)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Deferred Compensation	Retained Earnings (Deficit)	Total Stock- holders' Equity
	Shares	Amount	Shares	Amount				
BALANCE AT DECEMBER 31, 2000	39,258,913	\$ 393	(2,002,629)	\$ (13,119)	\$ 341,923	\$ —	\$ 71,042	\$ 400,239
Issuance of Treasury Stock:								
Issuance of Employee Stock Purchase Plan shares	—	—	398,287	2,570	(1,737)	—	—	833
Shares received from sale of businesses	—	—	(144,992)	(375)	—	—	—	(375)
Net income	—	—	—	—	—	—	13,124	13,124
BALANCE AT DECEMBER 31, 2001	39,258,913	393	(1,749,334)	(10,924)	340,186	—	84,166	413,821
Issuance of Treasury Stock:								
Issuance of shares for options exercised	—	—	242,146	1,499	(803)	—	—	696
Issuance of restricted stock	—	—	275,000	1,698	(618)	(1,080)	—	—
Shares exchanged in repayment of notes receivable	—	—	(49,051)	(204)	—	—	—	(204)
Shares received from sale of business	—	—	(55,882)	(263)	—	—	—	(263)
Shares received from settlement with former owner	—	—	(4,298)	(20)	—	—	—	(20)
Amortization of deferred compensation	—	—	—	—	(159)	295	—	136
Net loss	—	—	—	—	—	—	(209,080)	(209,080)
BALANCE AT DECEMBER 31, 2002	39,258,913	393	(1,341,419)	(8,214)	338,606	(785)	(124,914)	205,086

Issuance of Treasury
Stock:

Issuance of shares for options exercised including tax benefit	—	—	332,041	2,009	(907)	—	—	1,102
Shares received from sale of assets	—	—	(32,486)	(100)	—	—	—	(100)
Amortization of deferred compensation	—	—	—	—	(69)	245	—	176
Other	—	—	—	—	(25)	—	—	(25)
Net loss	—	—	—	—	—	—	(5,579)	(5,579)

BALANCE AT DECEMBER 31, 2003	39,258,913	\$	393	(1,041,864)	\$	(6,305)	\$	337,605	\$	(540)	\$	(130,493)	\$	200,660
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The accompanying notes are an integral part of these consolidated financial statements.

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

	Year Ended December 31,		
	2001	2002	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	\$ 13,124	\$ (209,080)	\$ (5,579)
Adjustments to reconcile net income (loss) to net cash provided by operating activities			
—			
Cumulative effect of change in accounting principle	—	202,521	—
Estimated loss on disposition of discontinued operations	—	12,002	5,210
Restructuring charges	238	1,878	3,223
Write-off of deferred financing costs and discount	—	987	4,172
Depreciation and amortization expense	24,466	7,008	5,343
Goodwill impairment	—	218	2,726
Bad debt expense	10,329	3,701	2,785
Deferred tax expense (benefit)	(1,408)	3,715	809
Extinguishment of subordinated notes	—	(658)	—
Amortization of debt financing costs	1,444	1,101	896
Loss (gain) on sale of assets	(199)	(893)	310
Deferred compensation expense	—	136	176
Mark-to-market warrant obligation	—	180	488
Amortization of debt discount	—	147	600
Changes in operating assets and liabilities, net of effects of acquisitions and divestitures—			
(Increase) decrease in—			
Receivables, net	12,095	13,292	(5,657)
Inventories	940	2,427	2,058
Prepaid expenses and other current assets	(3,516)	2,598	(1,487)
Costs and estimated earnings in excess of billings	11,007	(822)	1,494
Other noncurrent assets	(412)	565	120
Increase (decrease) in—			
Accounts payable and accrued liabilities	(3,178)	(27,744)	3,667
Billings in excess of costs and estimated earnings	2,513	1,052	3,178
Other, net	(614)	(241)	(22)
Taxes paid related to the sale of businesses	—	—	(11,006)
Net cash provided by operating activities	66,829	14,090	13,504
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(5,978)	(5,322)	(3,406)
Proceeds from sales of property and equipment	1,011	1,551	430
Proceeds from businesses sold, net of cash sold and transaction costs	964	154,360	(887)
Net cash provided by (used in) investing activities	(4,003)	150,589	(3,863)

CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from issuance of common stock	833	—	—
Net payments on revolving line of credit	(60,000)	(163,593)	(107)
Payments on other long-term debt	(9,113)	(18,338)	(14,736)
Borrowings of other long-term debt	58	15,202	10,018
Debt financing costs	—	(3,167)	(1,698)
Proceeds from exercise of options	—	696	914
Net cash used in financing activities	(68,222)	(169,200)	(5,609)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(5,396)	(4,521)	4,032
CASH AND CASH EQUIVALENTS, beginning of year—continuing operations and discontinued operations	16,021	10,625	6,104
CASH AND CASH EQUIVALENTS, end of year—continuing operations and discontinued operations	\$ 10,625	\$ 6,104	\$ 10,136

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

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COMFORT SYSTEMS USA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2003

1. Business and Organization

Comfort Systems USA, Inc., a Delaware corporation ("Comfort Systems" and collectively with its subsidiaries, the "Company"), is a national provider of comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services within the mechanical services industry. The Company operates primarily in the commercial, industrial and institutional HVAC markets, and performs most of its services within office buildings, retail centers, apartment complexes, manufacturing plants, and healthcare, education and government facilities. In addition to standard HVAC services, the Company provides specialized applications such as building automation control systems, fire protection, process cooling, electronic monitoring and process piping. Certain locations also perform related activities such as electrical service and plumbing. Approximately 52% of the Company's consolidated 2003 revenues are attributable to installation of systems in newly constructed facilities, with the remaining 48% attributable to maintenance, repair and replacement services. The Company's consolidated 2003 revenues relate to the following service activities: HVAC—74%, plumbing—11%, building automation control systems—6%, and other—9%. These service activities are within the mechanical services industry which is the single industry segment served by Comfort Systems.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Comfort Systems and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Cash Flow Information

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Cash paid for interest for continuing and discontinued operations in 2001, 2002 and 2003 was approximately \$20.7 million, \$5.3 million and \$1.9 million, respectively. Cash paid for income taxes for continuing operations in 2001, 2002 and 2003 was approximately \$5.3 million, \$5.0 million and \$1.9 million, respectively. Cash paid for income taxes for discontinued operations was approximately \$4.8 million, \$5.7 million and \$9.2 million, respectively. The cash tax payments in 2003 include approximately \$10.4 million associated with the sale in 2002 of 19 operations to Emcor Group, Inc. ("Emcor"). These taxes are included in the caption "Taxes paid related to the sale of businesses" in the accompanying Consolidated Statement of Cash Flows.

Inventories

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

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Property and Equipment

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

Expenditures for repairs and maintenance are charged to expense when incurred. Expenditures for major renewals and betterments, which extend the useful lives of existing equipment, are capitalized and depreciated over the remaining useful life of the equipment. Upon retirement or disposition of property and

equipment, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in "Other income (expense)" in the statement of operations.

Goodwill

Goodwill represents the excess of the aggregate purchase price paid by the Company in acquisitions accounted for as purchases over the fair value of the net tangible assets acquired. Prior to 2002, goodwill was amortized on a straight-line basis over 40 years. As further discussed in Note 4, "Goodwill," effective January 1, 2002, goodwill is no longer subject to scheduled amortization, but is subject to an annual impairment test.

Long-Lived Assets

Long-lived assets are comprised principally of goodwill, property and equipment, and deferred income tax assets. The Company periodically evaluates whether events and circumstances have occurred that indicate that the remaining balances of these assets may not be recoverable. The Company uses an estimate of future income from operations and cash flows, as well as other economic and business factors as a measure of recoverability of these assets.

Revenue Recognition

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

Changes in job performance, job conditions, estimated profitability and final contract settlements may result in revisions to estimated costs and, therefore, revenues. Such revisions are frequently based on further estimates and subjective assessments. The effects of these revisions are recognized in the period in which the revisions are determined. When such revisions lead to a conclusion that a loss will

be recognized on a contract, the full amount of the estimated ultimate loss is recognized in the period such a conclusion is reached, regardless of the percentage of completion of the contract. Revisions to project costs and conditions can give rise to change orders under which the customer agrees to pay additional contract price. Revisions can also result in claims the Company might make against the customer to recover project variances that have not been satisfactorily addressed through change orders with the customer. The Company does not recognize revenues or margin based on change orders or claims until they have been agreed upon with the customer, with immaterial exceptions. Variations from estimated project costs could have a significant impact on the Company's operating results, depending on project size, and the recoverability of the variation via additional customer payments.

Revenues associated with maintenance, repair and monitoring services and related contracts are recognized as services are performed.

Accounts Receivable

Accounts receivable include amounts billed to but not paid by customers pursuant to retention or retainage provisions in construction contracts. These amounts are due upon completion of the contracts and acceptance by the customer. Based on the Company's experience with similar contracts in recent years, billings for such retention balances at each balance sheet date are finalized and collected within the subsequent year. The retention balances at December 31, 2002 and 2003 are \$33.0 million and \$34.7 million, respectively, and are included in accounts receivable.

The carrying value of the Company's receivables, net of the allowance for doubtful accounts, represents their estimated net realizable value. The Company estimates its allowance for doubtful accounts based upon the creditworthiness of its customers, prior collection history, the ongoing relationship with its customers, the aging of past due balances, the Company's lien rights, if any, in the property where the Company performed the work, and the availability, if any, of payment bonds applicable to the contract.

Costs and Estimated Earnings in Excess of Billings

The current asset "Costs and estimated earnings in excess of billings" represents revenues recognized in excess of amounts billed under the terms of the contract. These amounts are billable upon completion of contract performance milestones or other specified conditions of the contract.

Self-Insurance Liabilities

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

Warranty Costs

The Company typically warrants labor for the first year after installation on new HVAC systems. The Company generally warrants labor for 30 days after servicing of existing HVAC systems. A reserve for warranty costs is estimated and recorded based upon the historical level of warranty claims and management's estimate of future costs.

Income Taxes

The Company files a consolidated return for federal income tax purposes. Income taxes are provided for under the liability method in accordance with SFAS No. 109, "Accounting for Income

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Taxes," which takes into account differences between financial statement treatment and tax treatment of certain transactions. Deferred tax assets represent the tax effect of activity that has been reflected in the financial statements but which will not be deductible for tax purposes until future periods. Deferred tax liabilities represent the tax effect of activity that has been reflected in the financial statements but which will not be taxable until future periods.

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

New Accounting Pronouncements

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

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN No. 46"). FIN No. 46 defines a variable interest entity as an entity in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN No. 46 requires an entity to consolidate a variable interest entity if that entity will absorb a majority of the variable interest entity's expected losses if they occur, receive a majority of the variable interest entity's expected residual returns if they occur, or both. FIN No. 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of the pronouncement were initially to be effective for the first interim or annual period beginning after June 15, 2003. However, in October 2003, the FASB delayed the effective date of FIN No. 46 for these entities to the first period beginning after December 15, 2003. The Company determined that it does not have any variable interest entities at December 31, 2003 as defined by the pronouncement.

Segment Disclosure

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

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions by management in determining the reported amounts of assets and liabilities, revenues and expenses and disclosures regarding contingent assets and liabilities.

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Actual results could differ from those estimates. The most significant estimates used in the Company's financial statements include revenue and cost recognition for construction contracts, allowance for doubtful accounts, self-insurance accruals and the quantification of fair value for reporting units in connection with the Company's goodwill impairment testing.

Concentrations of Credit Risk

The Company provides services in a broad range of geographic regions. The Company's credit risk primarily consists of receivables from a variety of customers including general contractors, property owners and developers, and commercial and industrial companies. The Company regularly reviews its accounts receivable and provides estimates of allowances for uncollectible amounts.

Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, receivables from related parties, other receivables, accounts payable, a line of credit, notes payable, and long-term debt. The Company believes that the carrying values of these instruments on the accompanying balance sheets approximate their fair values.

Stock-Based Compensation

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

	2001	2002	2003
Net Income (Loss) as reported	\$ 13,124	\$ (209,080)	\$ (5,579)
Add: Stock-based compensation included in reported net income, net of tax	—	88	114
Less: Compensation expense per SFAS No. 123, net of tax	(3,569)	(3,378)	(2,394)
Pro forma Net Income (Loss)	\$ 9,555	\$ (212,370)	\$ (7,859)
Net Income (Loss) Per Share—Basic			
Net Income (Loss) as reported	\$ 0.35	\$ (5.56)	\$ (0.15)
Pro forma Net Income (Loss) per share	\$ 0.25	\$ (5.65)	\$ (0.21)
Net Income (Loss) Per Share—Diluted			
Net Income (Loss) as reported	\$ 0.35	\$ (5.48)	\$ (0.17)
Pro forma Net Income (Loss) per share	\$ 0.25	\$ (5.57)	\$ (0.23)

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

	2001	2002	2003
Expected dividend yield	0.00%	0.00%	0.00%
Expected stock price volatility	75.46%	64.87%	62.24%
Risk-free interest rate	4.92%-5.61%	4.07%-5.51%	2.94%-3.85%
Expected life of options	10 years	10 years	7 years

Employee Stock Purchase Plan—Compensation cost associated with the stock purchase plan is recognized for the fair value of the employees' purchase rights, which is estimated using the Black-Scholes model with the following assumptions:

	2001
Expected dividend yield	0.00%
Expected volatility	105.90%
Risk-free interest rate	4.85%
Expected life of purchase rights	0.5 years

The weighted average fair values of the purchase rights granted in 2001 were \$0.88 per share. No purchase rights were granted in 2002 or 2003.

Reclassifications

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

3. Discontinued Operations

During the fourth quarter of 2003, the Company sold a small operating company. This unit's after-tax income of \$0.6 million, \$0.7 million, and \$0.4 million for the years ended December 31, 2001, 2002 and 2003, respectively, has been reported in discontinued operations under "Operating income (loss), net of applicable income taxes." As a result of the sale of this unit, the Company recorded a loss of \$1.5 million, net of tax benefit, in discontinued operations under "Estimated loss on disposition, including income taxes." The loss resulted from the non-cash write-off of nondeductible goodwill.

During the third quarter of 2003, the Company committed to a plan to divest of a small operating company. This unit's after-tax income of \$0.0 million and \$0.1 million for the years ended December 31, 2001 and 2002, respectively, and \$0.2 million for the first three quarters of 2003 has been reported under discontinued operations under "Operating income (loss), net of applicable income taxes." As a result of the decision in the third quarter of 2003 to sell this unit, the Company recorded an estimated loss of \$2.8 million, including taxes, related to this planned disposition in discontinued operations under "Estimated loss on disposition, including income taxes" based upon an estimated sales price. The final loss as measured at the closing of this sale in the fourth quarter of 2003 was not materially different than the estimate recorded in the preceding quarter. The estimated loss resulted from the non-cash write-off of nondeductible goodwill.

During the second quarter of 2003, the Company sold a small operating company. This unit's after-tax income of \$0.3 million and \$0.1 million for the years ended December 31, 2001 and 2002, respectively, and \$0.1 million for the first six months of 2003 has been reported in discontinued

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operations under "Operating income (loss), net of applicable income taxes". As a result of the decision in the first quarter of 2003 to sell this unit, the Company recorded an estimated loss in the first quarter of 2003 of \$0.9 million, including taxes, related to this transaction in discontinued operations under "Estimated loss on disposition, including income taxes." The final loss as measured at the closing of this sale in the second quarter of 2003 was not materially different than the estimate recorded in the preceding quarter. The loss resulted from the non-cash write-off of nondeductible goodwill.

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

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

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

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

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

Under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which took effect for the Company on January 1, 2002, the operating results of the companies sold to Emcor for all periods presented through the sale, as well as the loss on the sale of these operations, have been presented as discontinued operations. The Company realized an aggregate loss of \$11.8 million, including related tax expense, in connection with the sale of these operations. As a result of the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," the Company also recognized a

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goodwill impairment charge related to these operations of \$32.4 million, net of tax benefit, as of January 1, 2002. The reporting of the Company's aggregate initial goodwill impairment charge in connection with adopting SFAS No. 142 is discussed further in Note 4, "Goodwill."

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

During the second quarter of 2002, the Company sold a division of one of its operations. The after-tax loss for this division for the year ended December 31, 2001 of \$0.1 million and the first two quarters of 2002 of \$0.3 million has been reported in discontinued operations under "Operating income (loss), net of applicable income taxes." The Company realized a loss of \$0.2 million, net of tax benefit, on the sale of this division. This loss was included in discontinued operations under "Estimated loss on disposition, including income taxes" during the second quarter of 2002.

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

	December 31, 2002
Cash	\$ 132
Accounts receivable, net	3,443
Other current assets	785
Property and equipment, net	178
Goodwill, net	6,225
Other noncurrent assets	171
Total assets	\$ 10,934
Accounts payable	\$ 925
Other current liabilities	1,595
Total liabilities	\$ 2,520

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

	Year Ended December 31,		
	2001	2002	2003
Revenues	\$ 682,060	\$ 114,836	\$ 12,516
Pre-tax income (loss)	\$ 25,270	\$ (360)	\$ 1,062

Interest expense allocated to the discontinued operations in 2001 and 2002 was \$13.8 million and \$1.5 million, respectively. These amounts were allocated based upon the Company's net investment in these operations. No additional interest expense was allocated to discontinued operations subsequent to the first quarter of 2002.

4. Goodwill

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

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accounting principles, goodwill was required to be amortized, or regularly charged to the Company's operating results in its statement of operations.

SFAS No. 142, "Goodwill and Other Intangible Assets," went into effect in 2002. The Company adopted it as of January 1, 2002. SFAS No. 142 requires companies to assess goodwill asset amounts for impairment each year, and more frequently if circumstances suggest an impairment may have occurred. The Company currently performs its annual impairment testing as of October 1 and any impairment charges resulting from this process are reported in the fourth quarter. In the prior year, the Company performed its annual impairment test as of December 31. The Company changed its measurement date to earlier in the fourth quarter to have additional time to quantify the fair value of the Company's reporting units and to evaluate the results of the impairment testing. In addition to discontinuing the regular charge, or amortization, of goodwill against income, the new standard also introduces more rigorous criteria for determining how much goodwill should be reflected as an asset in a company's balance sheet.

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

As provided by SFAS No. 142, the transitional impairment loss identified by applying the standard's new, more rigorous valuation methodology upon initial adoption of the standard was reflected as a cumulative effect of a change in accounting principle in the Company's statement of operations. The resulting non-cash charge was \$202.5 million, net of tax benefit, and was recorded during the first quarter of 2002. Impairment charges recognized after the initial adoption, if any, generally are to be reported as a component of operating income. Additional impairment charges of \$0.2 million and \$2.7 million were recorded during the fourth quarter of 2002 and 2003, respectively. The impairment charge during 2003 primarily resulted from changes in operating plans that were identified in the fourth quarter for certain of the Company's reporting units as part of the Company's annual budgeting and business planning process.

The changes in the carrying amount of goodwill for the years ended December 31, 2002 and 2003 are as follows (in thousands):

Goodwill balance as of January 1, 2002 (a)	\$ 438,448
Impairment adjustment	(229,056)
Goodwill related to sale of operations	(95,965)
	<hr/>
Goodwill balance as of December 31, 2002 (a)	113,427
Goodwill related to sale of operations	(6,225)
Impairment adjustment	(2,726)
Reduction in goodwill related to deferred tax adjustment	(442)
	<hr/>
Goodwill balance as of December 31, 2003	\$ 104,034
	<hr/>

(a) A portion of this goodwill balance is included in "Assets Related to Discontinued Operations" in the Company's consolidated balance sheet.

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The unaudited results of operations presented below (in thousands) for the years ended December 31, 2001, 2002 and 2003 reflect the adoption of the non-amortization provisions of SFAS No. 142 effective January 1, 2001 and exclude the impact of the cumulative effect of change in accounting principle recorded in the first quarter of 2002. Therefore, the component of the cumulative effect of change in accounting principle related to the operations sold to Emcor is included in the estimated loss on disposition for purposes of this table.

	Year Ended December 31,		
	2001	2002	2003
Income (loss) from continuing operations	\$ (1,971)	\$ 4,513	\$ (1,024)
Add: Goodwill amortization, net of tax	7,414	—	—
	<hr/>	<hr/>	<hr/>
Adjusted income (loss) from continuing operations	5,443	4,513	(1,024)
Discontinued operations—			
Operating income (loss), net of tax	15,095	930	655
Add: Goodwill amortization, net of tax	3,195	—	—
	<hr/>	<hr/>	<hr/>

Adjusted operating income (loss), net of tax	18,290	930	655
Estimated loss on disposition, including tax	—	(45,776)	(5,210)
Adjusted net income (loss)	\$ 23,733	\$ (40,333)	\$ (5,579)
Adjusted income (loss) per share:			
Basic—			
Income (loss) from continuing operations	\$ 0.14	\$ 0.12	\$ (0.03)
Discontinued operations—			
Income (loss) from operations	0.49	0.02	0.02
Estimated loss on disposition	—	(1.21)	(0.14)
Net income (loss)	\$ 0.63	\$ (1.07)	\$ (0.15)
Diluted—			
Income (loss) from continuing operations	\$ 0.14	\$ 0.12	\$ (0.05)
Discontinued operations—			
Income (loss) from operations	0.49	0.02	0.02
Estimated loss on disposition	—	(1.20)	(0.14)
Net income (loss)	\$ 0.63	\$ (1.06)	\$ (0.17)

5. Restructuring Charges

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

During the first quarter of 2002, the Company recorded restructuring charges of approximately \$1.9 million. These charges included approximately \$0.8 million for severance costs primarily associated with the reduction in corporate office overhead in light of the Company's smaller size following the Emcor transaction described in Note 3, "Discontinued Operations." The severance costs related to the termination of 33 employees, all of whom had left the Company by March 31, 2002. The restructuring

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charges for the quarter also included approximately \$0.7 million for costs associated with decisions to merge or close three smaller divisions and realign regional operating management.

During the first quarter of 2001, the Company recorded restructuring charges of approximately \$0.2 million, primarily related to contractual severance obligations of two operating presidents in connection with the Company's significant restructuring program in the second half of 2000. These restructuring charges were net of a gain of approximately \$0.1 million related to management's decision to sell a small operation during the first quarter of 2001.

During the second half of 2000, the Company recorded restructuring charges primarily associated with configuration of certain underperforming operations and with its decision to cease e-commerce activities at Outbound Services, a subsidiary of the Company. As of December 31, 2002 and 2003, accrued lease termination costs of \$0.8 million and \$0.5 million, respectively, remain that were associated with these restructuring charges.

During the third quarter of 2001, the Company decided to retain one of its operations that had been previously held for sale and reversed approximately \$0.3 million of non-cash charges related to the anticipated loss on the sale of this operation. This amount was offset by an additional loss on the sale in late September 2001 of the final operation that was identified as part of this restructuring program. The losses associated with the other operations that were sold were consistent with the amounts recorded as restructuring charges in 2000.

Severance costs recorded in 2000 and 2001 relate to the termination of 147 employees (all of whom had left the Company by June 30, 2001) including certain corporate personnel and the management and employees of certain underperforming locations, and to the departure of the Company's former chief executive officer.

Aggregated financial information for 2001 related to the operations addressed by the 2001 restructuring charges is as follows (in thousands):

	Year Ended December 31, 2001
Revenues	\$ 6,337
Operating loss	\$ (2,666)

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The following table shows the remaining liabilities associated with the cash portion of the restructuring charges as of December 31, 2001, 2002 and 2003 (in thousands):

	Balance at Beginning of Period	Additions	Payments	Balance at End of Period
Year Ended December 31, 2001:				
Severance	\$ 1,218	\$ 350	\$ (1,358)	\$ 210
Lease termination costs and other	2,312	—	(1,164)	1,148
Total	\$ 3,530	\$ 350	\$ (2,522)	\$ 1,358
Year Ended December 31, 2002:				
Severance	\$ 210	\$ 846	\$ (1,056)	\$ —
Lease termination costs and other	1,148	704	(852)	1,000
Total	\$ 1,358	\$ 1,550	\$ (1,908)	\$ 1,000
Year Ended December 31, 2003:				
Severance	\$ —	\$ 1,506	\$ (1,506)	\$ —
Lease termination costs and other	1,000	1,716	(971)	1,745
Total	\$ 1,000	\$ 3,222	\$ (2,477)	\$ 1,745

6. Property and Equipment

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

	Estimated Useful Lives in Years	December 31,	
		2002	2003
Transportation equipment	3-7	\$ 14,752	\$ 12,623
Machinery and equipment	3-10	16,239	16,034
Computer and telephone equipment	3-7	14,895	15,662
Buildings and leasehold improvements	3-40	7,757	7,762
Furniture and fixtures	3-10	5,918	5,873
		59,561	57,954
Less—Accumulated depreciation		(43,628)	(44,723)
Property and equipment, net		\$ 15,933	\$ 13,231

Depreciation expense for the years ended December 31, 2001, 2002 and 2003 was \$7.9 million, \$6.4 million and \$5.3 million, respectively.

7. Detail of Certain Balance Sheet Accounts

Activity in the Company's allowance for doubtful accounts consists of the following (in thousands):

	December 31,		
	2001	2002	2003
Balance at beginning of year	\$ 4,212	\$ 9,542	\$ 5,959
Additions for bad debt expense	7,558	2,022	2,732
Deductions for uncollectible receivables written off, net of recoveries	(2,228)	(5,605)	(3,647)
Balance at end of year	\$ 9,542	\$ 5,959	\$ 5,044

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

	December 31,	
	2002	2003
Accrued warranty costs	\$ 2,152	\$ 2,415
Accrued insurance expense	11,788	14,702

Liabilities associated with discontinued operations	8,600	1,355
Other current liabilities	6,872	8,310
	<u>\$ 29,412</u>	<u>\$ 26,782</u>

Contracts in progress are as follows (in thousands):

	December 31,	
	2002	2003
Costs incurred on contracts in progress	\$ 461,017	\$ 467,234
Estimated earnings, net of losses	113,128	109,338
Less—Billings to date	(582,875)	(590,067)
	<u>\$ (8,730)</u>	<u>\$ (13,495)</u>
Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 17,768	\$ 16,162
Billings in excess of costs and estimated earnings on uncompleted contracts	(26,498)	(29,657)
	<u>\$ (8,730)</u>	<u>\$ (13,495)</u>

Other long-term liabilities consist of the following (in thousands):

	2002	2003
Warrant and put obligation	\$ 3,177	\$ 2,342
Other long-term liabilities	15	—
	<u>\$ 3,192</u>	<u>\$ 2,342</u>

8. Long-Term Debt Obligations

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

	December 31,	
	2002	2003
Revolving credit facility	\$ 107	\$ —
Term loan	14,625	10,000
Other	502	403
	<u>15,234</u>	<u>10,403</u>
Less—current maturities	(1,780)	(1,594)
	<u>13,454</u>	<u>8,809</u>
Less—discount on Facility	(2,850)	—
	<u>\$ 10,604</u>	<u>\$ 8,809</u>

The Company estimates the fair value of long-term debt as of December 31, 2002 and 2003 to be approximately the same as the recorded value. At December 31, 2003, future principal payments of long-term debt are as follows (in thousands):

Year Ending December 31—	
2004	\$ 1,594
2005	2,067
2006	2,061
2007	2,058
2008	2,563
Thereafter	60
	<u>\$ 10,403</u>

Credit Facility

On December 31, 2003, the Company entered into a \$50 million senior credit facility (the "Facility") provided by a syndicate of four banks. The Facility consists of two parts: a term loan and a revolving credit facility.

The term loan under the Facility (the "Term Loan") is \$10 million, which the Company borrowed upon the closing of the Facility. The Term Loan must be repaid in quarterly installments over five years. The Facility requires prepayments of the Term Loan in certain circumstances. Proceeds in excess of \$1 million from the sale of an asset, or from a related series of asset sales, must be used to pay down the Term Loan. Asset sale proceeds of less than \$1 million must also be used to pay down the Term Loan unless they are reinvested in long-term assets within six months of being received. All principal payments under the Term Loan permanently reduce the original \$10 million capacity under this portion of the Facility.

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

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

The Company's borrowings and letters of credit outstanding under the Facility at each monthend must be less than a borrowing base measured as of the same monthend. The borrowing base is defined

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under the Facility as 60% of the following: total trade receivables, less allowances for doubtful accounts, less receivables related to projects that are subject to payment or performance bonds. The borrowing base as of December 31, 2003 was \$78 million. The Company expects that its borrowing base will continue to exceed the \$50 million stated limit of the Facility by significant amounts.

The Company's borrowing and letter of credit capacity under the Revolving Loan portion of the Facility at any given time is \$40 million less borrowings and letters of credit outstanding, subject to the borrowing base described above. The Facility contains financial covenants defining various financial measures and the levels of these measures with which the Company must comply, as discussed below under *Covenants and Restrictions*. Covenant compliance is measured as of each quarterend. While the Facility's financial covenants do not specifically govern capacity under the Facility, if the Company's debt level under the Facility at a quarterend covenant compliance measurement date caused the Company to violate the Facility's debt-to-EBITDA covenant (described in more detail below) the Company's borrowing capacity under the Facility could be restricted by the lenders. Accordingly, available capacity amounts shown below are presented both on a financial covenant basis and on a Facility face value basis.

	As of Dec. 31, 2003	As of Feb. 24, 2004 (unaudited)
(in thousands)		
<i>Amounts Outstanding</i>		
Revolving loan	\$ —	\$ 3,900
Term loan	10,000	10,000
Other debt	403	386
Total debt	\$ 10,403	\$ 14,286
Letters of credit	\$ 20,031	\$ 21,054
<i>Available Capacity</i>		
Unused revolving loan and letter of credit capacity based on revolving loan face value of \$40 million	\$ 19,969	\$ 15,046
Unused revolving loan and letter of credit capacity based on quarterend debt-to-EBITDA covenant	\$ 19,969	n/a

If the Company voluntarily terminates the Facility in full before December 31, 2004, it would owe the Facility's lenders a termination fee of \$500,000. The Company may voluntarily terminate the Facility in full on or after December 31, 2004 without a termination fee. Short of a full termination, the Company may not reduce the Revolving Loan commitment within the Facility prior to December 31, 2004. During the second year of the Facility, the Company may voluntarily reduce the Revolving Loan commitment by as much as \$5 million. During the third year of the Facility, the Company may voluntarily reduce the Revolving Loan commitment by as much as \$10 million, less any reductions it made prior to the third year of the Facility.

Collateral

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

A common practice in the Company's industry is the posting of payment and performance bonds with customers. These bonds are offered by financial institutions known as sureties, and provide assurance to the customer that in the event the Company encounters significant financial or operational difficulties, the surety will arrange for the completion of the Company's contractual obligations and for the payment of the Company's vendors on the projects subject to the bonds. In cooperation with its lenders, the Company has granted its surety a first lien on assets such as receivables, costs incurred in excess of billings, and equipment specifically identifiable to projects for which bonds are outstanding, as collateral for potential obligations under bonds. As of December 31, 2003, the amount of these assets was approximately \$38.8 million.

Interest Rates and Fees

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

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

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

The interest rates underlying the Base Rate and Eurodollar Rate Options under the Facility are floating rates determined by the broad financial markets, meaning they can and do move up and down from time to time. For illustrative purposes, the following are the respective market rates as of December 31, 2003 relating to interest options under the Facility:

Base Rate Option—The higher of:		
Federal Funds Rate plus 0.50%		1.50%
Citibank, N.A. Prime Rate		4.00%
Eurodollar Rate Option		
One-month LIBOR		1.12%
Six-month LIBOR		1.22%

	Debt to EBITDA					
	Less than 0.75		0.75 to 1.50		1.50 or greater	
Additional Per Annum Interest Margin Added Under:						
Term Loan —						
Base Rate Option	1.75	%	2.25	%	2.75	%
Eurodollar Rate Option	2.75	%	3.25	%	3.75	%
Revolving Loan —						
Base Rate Option	1.50	%	2.00	%	2.50	%
Eurodollar Rate Option	2.50	%	3.00	%	3.50	%
Per Annum Letter of Credit Fees (not added to underlying Base Rate or Eurodollar Rate)	1.125	%	1.50	%	1.875	%

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

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

The Company incurred approximately \$1.2 million in financing and professional costs in connection with the arrangement and the closing of the Facility. These costs will be amortized to interest expense over the term of the Facility in the amount of approximately \$0.3 million per year, for the first three years of the Facility, and \$0.2 million per year during the fourth and fifth years of the Facility. To the extent prepayments of the Term Loan are made or the size of the Facility is reduced, the Company may have to accelerate amortization of these deferred financing and professional costs.

The weighted average interest rate that the Company currently pays on borrowings under the Facility is 5.4% per annum. This reflects a combination of borrowings under both interest rate options described above, as well as a transaction in which the interest rate relating to \$10 million in principal value of debt was fixed at 5.12% through early July, 2004. These rates do not include amortization of debt financing and arrangement costs or mark-to-market adjustments for derivatives.

Covenants and Restrictions

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

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

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instead of actual amounts for these items for the twelve months then ended. The Company's debt service coverage ratio as of December 31, 2003 as measured under this covenant was 4.26.

Tangible Net Worth—The Facility requires that the Company's tangible net worth not be less than the sum of (a) \$75.4 million; (b) 75% of net income earned beginning October 1, 2003; and (c) the net proceeds of any equity transactions. For purposes of this ratio, the Facility defines tangible net worth as stockholders equity less the book value of the following intangible assets: goodwill, patents, copyrights, licenses, franchises, trade names, trade secrets, and operating leases. The Facility also provides that for purposes of this ratio, net income excludes any goodwill impairment charges. The Company's tangible net worth as of December 31, 2003 as measured under this covenant was \$96.6 million, as compared to a covenant requirement of \$75.4 million.

Debt to EBITDA—The Facility requires that the Company's ratio of debt to EBITDA not exceed 2.0. The Company's debt-to-EBITDA ratio as of December 31, 2003 as measured under this covenant was 0.7.

Capital Expenditures—The Facility limits capital expenditures to \$8.0 million per year. The Company's capital expenditures during 2003 were \$3.4 million.

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

Interest Expense and Related Charges in Connection with Previous Credit Facilities

The credit facility that preceded the Company's current one was in place from October, 2002 to December, 2003. The Company's next previous credit facility had been in place for several years through October, 2002. Interest expense for 2001, 2002, and 2003 was incurred under these previous facilities and included the following primary elements (in thousands):

	2001	2002	2003
Interest expense on borrowings and unused commitment fees	\$ 6,668	\$ 2,889	\$ 1,397
Letter of credit fees	— (a)	— (a)	512
Amortization of deferred debt arrangement costs	1,444	1,248	1,496
Mark-to market adjustments on derivatives	—	180	488
Total	\$ 8,112	\$ 4,317	\$ 3,893

(a) In 2001 and 2002, letter of credit amounts outstanding and related fees were significantly lower. These fees were treated as an element of bank service charges in selling, general and administrative expenses during these periods.

When the Company's previous credit facilities were reduced in size or terminated, corresponding amounts of deferred debt arrangement costs were written off. The largest of these write-offs occurred in the fourth quarter of 2003 when the Company established its current facility and terminated the

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preceding facility which had been in place just over a year. This write-off was partially offset by a \$1.3 million gain associated with the reduction in the value of a warrant and put obligation that arose when the facility terminated in the fourth quarter was originally established. This reduction in the value of the warrant and put obligation resulted from a significant restriction in the holder's ability to exercise the put provision. This restriction was agreed to by the holder in connection with terminating the related Facility. These charges are reported as "Write-off of debt costs and discount, net" in the Company's consolidated statement of operations, and include the following primary elements (in thousands):

2002 2003

Write-off of deferred financing fees and transaction costs	\$ 987	\$ 3,246
Write-off of discount originally arising from issue of warrant and put to credit facility lender	—	2,250
Reduction in valuation of warrant and put obligation	—	(1,324)
Total	\$ 987	\$ 4,172

9. Income Taxes

The provision for income taxes consists of the following (in thousands):

	Year Ended December 31,		
	2001	2002	2003
Current—			
Federal	\$ 6,283	\$ (242)	\$ (2,375)
State and Puerto Rico	2,295	890	602
	8,578	648	(1,773)
Deferred—			
Federal	(2,000)	2,884	850
State and Puerto Rico	(220)	781	(172)
	(2,220)	3,665	678
	\$ 6,358	\$ 4,313	\$ (1,095)

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

	Year Ended December 31,		
	2001	2002	2003
Income tax expense (benefit) at the statutory rate	\$ 1,536	\$ 3,089	\$ (742)
Increase resulting from—			
State income taxes, net of federal tax effect	1,349	(413)	(603)
Increase in valuation allowance	253	1,498	1,427
Decrease in contingency reserves	—	—	(1,849)
Non-deductible goodwill amortization	2,225	—	—
Non-deductible goodwill impairment	—	—	688
Non-deductible expenses	974	147	(16)
Other	21	(8)	—
	\$ 6,358	\$ 4,313	\$ (1,095)

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

	December 31,	
	2002	2003
(In thousands)		
Deferred income tax assets—		
Accounts receivable and allowance for doubtful accounts	\$ 2,199	\$ 1,421
Goodwill	9,696	8,761
Accrued liabilities and expenses	7,180	8,141
Net operating loss	4,055	4,737
Other	434	110
Total deferred income tax assets	23,564	23,170
Deferred income tax liabilities—		
Property and equipment	(993)	(1,021)

Long-term contracts	(1,267)	(79)
Other	(43)	—
	<u> </u>	<u> </u>
Total deferred income tax liabilities	(2,303)	(1,100)
	<u> </u>	<u> </u>
Less—Valuation allowance	(2,545)	(3,972)
	<u> </u>	<u> </u>
Net deferred income tax assets	\$ 18,716	\$ 18,098
	<u> </u>	<u> </u>

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

	December 31,	
	2002	2003
Deferred income tax assets—		
Prepaid expenses and other	\$ 9,234	\$ 9,525
Other non-current assets	9,482	8,573
	<u> </u>	<u> </u>
Total deferred income tax assets	18,716	18,098
Deferred income tax liabilities—		
Other long-term liabilities	—	—
	<u> </u>	<u> </u>
Net deferred income tax assets	\$ 18,716	\$ 18,098
	<u> </u>	<u> </u>

At December 31, 2003 the Company has future tax benefits of \$4.7 million related to \$79.3 million of available state net operating loss carry forwards for income tax purposes which expire in 2004 through 2023. A valuation allowance of \$3.4 million and \$0.6 million, respectively, has been recorded against net operating loss carry forwards and related net deferred tax assets. This valuation allowance increased by \$1.4 million for the year ending December 31, 2003. A deferred tax asset for state net operating loss carry forwards, net of the related allowance, of \$1.3 million reflects the Company's conclusion that it is likely that this asset will be realized based upon forecasted future earnings in certain subsidiaries. The Company will update this assessment of the realizability of deferred tax assets relating to state net operating loss carry forwards on a quarterly basis.

It is the Company's policy to establish reserves for taxes that may become payable in future years as a result of tax examinations. The Company establishes reserves for taxes based upon management's assessment of total income tax exposures. Tax reserves are analyzed quarterly and adjustments are recorded, as events occur to warrant adjustment to the reserve. The Company is routinely audited by federal, state and local tax authorities. Income tax audits involve reviews of timing and amount of

deductions, state tax filing positions, and compliance with federal, state and local tax laws. As of December 31, 2003 the Company has recorded a reserve for exposures it has determined as probable. For the year ended December 31, 2003 the Company recorded a \$1.8 million decrease in the reserve resulting from changes in exposures.

10. Employee Benefit Plans

The Company and certain of the Company's subsidiaries sponsor various retirement plans for most full-time and some part-time employees. These plans consist of defined contribution plans and multi-employer pension plans and cover employees at substantially all of the Company's operating locations. The defined contribution plans generally provide for contributions up to 2.5% of covered employees' salaries or wages in 2002 and 2003 and up to 6% in 2001, and totaled \$4.4 million for 2001, \$3.3 million for 2002 and \$2.6 million for 2003. Of these amounts, approximately \$0.5 million and \$0.2 million were payable to the plans at December 31, 2002 and 2003, respectively.

Certain of the Company's subsidiaries also participate in various multi-employer pension plans for the benefit of their employees who are union members. Company contributions to these plans were approximately \$0.2 million for 2001, \$0.3 million for 2002 and \$0.6 million for 2003. The data available from administrators of the multi-employer pension plans is not sufficient to determine the accumulated benefit obligations, nor the net assets attributable to the multi-employer plans in which Company employees participate.

11. Commitments and Contingencies

Leases

The Company leases certain facilities and equipment under noncancelable operating leases. Rent expense for the years ended December 31, 2001, 2002 and 2003 was \$15.9 million, \$16.1 million, and \$16.0 million, respectively. Concurrent with the acquisitions of certain acquired companies, the Company entered into various agreements with previous owners to lease land and buildings used in the Company's operations. The terms of these leases range from three to ten years and provide for certain escalations in the rental expenses each year. Included in the 2001, 2002 and 2003 rent expense above is approximately \$5.6 million, \$4.6 million and \$3.8 million of rent paid to these related parties, respectively. The following represents future minimum rental payments under noncancelable operating leases (in thousands):

Year ending December 31—	
2004	\$ 8,719
2005	7,008

2006	5,756
2007	4,545
2008	3,344
Thereafter	12,901
	\$ 42,273

Claims and Lawsuits

The Company is party to litigation in the ordinary course of business. The Company has estimated and provided accruals for probable losses and related legal fees associated with certain of these actions in the accompanying consolidated financial statements. In some cases, the Company has project-related claims and liabilities that are individually significant, including one claim that will be subject to arbitration in the first half of 2004. With respect to this claim, and as with all such matters, the

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Company has accruals that reflect its judgment of the outcome. Because of this, in management's opinion, uninsured losses resulting from the ultimate resolution of these matters will not have a material adverse effect on the Company's operating results or financial condition.

Surety

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

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

Self-Insurance

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

12. Stockholders' Equity

Restricted Stock Grant

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

The Company awarded 75,000 shares of restricted stock to its President on November 1, 2002 under its 2000 Equity Incentive Plan. The shares were subject to forfeiture if the Company had not achieved certain performance levels for the twelve-month period ending December 31, 2003. These

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performance levels were met by the Company. The shares are subject to forfeiture if the executive leaves voluntarily or is terminated for cause. Such forfeiture provisions lapse pro rata over a four-year period that started on the date of grant.

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

Warrant

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

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

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

The value of this warrant and put will change over time, principally in response to changes in the market price of the Company's common stock. The warrant and the put qualify as a derivative for financial reporting purposes. Accordingly, such changes in the value of the warrant and put in any given period will be included in the Company's income statement for that period and in the Company's long-term liabilities, even though the warrant and put may not have been terminated and settled in cash during the period. Such adjustments are known as mark-to-market adjustments. In 2002 and 2003, these adjustments were losses of \$0.2 million and \$0.5 million, respectively, and were included in

interest expense as the warrant and put related to the Company's previous credit facility. Because the warrant and put do not relate to the Company's current credit facility, any future mark-to-market adjustments will be reflected as other income (expense) in the Company's income statement.

The table below provides an indication of the potential effect on the valuation of this derivative that might result from changes in the market price for the Company's stock. In this table, the value of the warrant has been calculated based upon the stock price being \$1 lower and \$1 higher than the Company's closing stock price at December 31, 2003 (value of warrant and put obligation in thousands).

Stock Price	Value of Warrant and Put Obligation
\$4.48	\$ 1,933
\$5.48 (a)	\$ 2,342
\$6.48	\$ 2,751

(a) This was the Company's closing stock price on December 31, 2003.

Restricted Common Stock

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

Each share of Restricted Voting Common Stock will automatically convert to Common Stock on a share-for-share basis (i) in the event of a disposition of such share of Restricted Voting Common Stock by the holder thereof (other than a distribution which is a distribution by a holder to its partners or beneficial owners, or a transfer to a related party of such holders (as defined in Sections 267, 707, 318 and/or 4946 of the Internal Revenue Code of 1986, as amended)), (ii) in the event any person acquires beneficial ownership of 15% or more of the total number of outstanding shares of Common Stock of the Company, or (iii) in the event any person offers to acquire 15% or more of the total number of outstanding shares of Common Stock of the Company. After July 1, 1998, the Board of Directors may elect to convert any remaining shares of Restricted Voting Common Stock into shares of Common Stock in the event 80% or more of the originally outstanding shares of Restricted Voting Common Stock have been previously converted into shares of Common Stock. As of December 31, 2003, there were 1,127,612 shares of Restricted Voting Common Stock remaining.

Earnings Per Share

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

Options to purchase 5.6 million shares of the Company's Common Stock ("Common Stock") at prices ranging from \$1.90 to \$21.44 per share were outstanding for the year ended December 31, 2003, but were not included in the computation of diluted EPS because the Company reported a loss from continuing operations for the year ended December 31, 2003. Under the calculations normally required by generally accepted accounting principles for

determining EPS, including the effect of these options when the Company reports a loss would increase diluted EPS, or have an "anti-dilutive" effect. When this situation occurs, generally accepted accounting principles require that such options or other

common stock equivalents be excluded from the determination of diluted EPS. Accordingly, they have been excluded. The Company would have included 339,479 shares related to the dilutive impact of stock options for the year ended December 31, 2003 if it were not for the loss from continuing operations during the period.

Options to purchase 3.2 million shares of Common Stock at prices ranging from \$3.81 to \$21.44 per share were outstanding for the year ended December 31, 2002, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the Common Stock.

Options had an anti-dilutive effect for the year ended December 31, 2001 because the Company reported a loss from continuing operations. Accordingly, options were excluded from the determination of diluted EPS. The Company would have included 62,688 shares related to the dilutive impact of stock options for the year ended December 31, 2001 if it were not for the loss from continuing operations during the period.

As noted above, the Company issued a warrant to purchase 409,051 shares of Company common stock along with related put rights for nominal consideration. The dilutive impact of this warrant is computed assuming the issuance of shares required to fulfill the warrant obligation at the end of the reporting period, and excluding the income effect for the period of (a) any mark-to-market adjustments made in connection with valuing the warrant, and (b) the gain associated with the reduction in the value of the put and warrant obligation that arose when the facility it was associated with was terminated in the fourth quarter of 2003. The put and warrant obligation had an anti-dilutive effect for the year ended December 31, 2002 but a dilutive effect for the year ended December 31, 2003.

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

	Year Ended December 31,		
	2001	2002	2003
Income (loss) from continuing operations used in computing earnings per share—basic	\$ (1,971)	\$ 4,513	\$ (1,024)
Mark-to-market adjustment related to warrant and put obligation (after tax)	—	—	488
Reduction in valuation of warrant and put obligation (after tax)	—	—	(1,324)
Income (loss) from continuing operations used in computing earnings per share—diluted	\$ (1,971)	\$ 4,513	\$ (1,860)
Net income (loss) used in computing earnings per share—basic	\$ 13,124	\$ (209,080)	\$ (5,579)
Mark-to-market adjustment related to warrant and put obligation (after tax)	—	—	488
Reduction in valuation of warrant and put obligation (after tax)	—	—	(1,324)
Net income (loss) used in computing earnings per share—diluted	\$ 13,124	\$ (209,080)	\$ (6,415)

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

	Year Ended December 31,		
	2001	2002	2003
Common shares outstanding, end of period (a)	37,510	37,642	37,992
Effect of using weighted average common shares Outstanding	(74)	(37)	(290)
Shares used in computing earnings per share—basic	37,436	37,605	37,702
Effect of shares issuable under stock option plans based on the treasury stock method	—	381	—
Effect of shares issuable related to warrants	—	—	409
Effect of contingently issuable restricted shares	—	168	—
Shares used in computing earnings per share—diluted	37,436	38,154	38,111

- (a) Excludes 275,000 and 225,000 shares of unvested contingently issuable restricted stock outstanding as of December 31, 2002 and 2003, respectively (see "Restricted Stock Grant" paragraphs above).

13. Stock Option Plans

Long-Term Incentive Plans

In March 1997, the Company's stockholders approved the Company's 1997 Long-Term Incentive Plan which provides for the granting or awarding of incentive or non-qualified stock options, stock appreciation rights, restricted or deferred stock, dividend equivalents or other incentive awards to directors, officers, key employees and consultants to the Company.

The Company's 1997 Long-Term Incentive Plan provides for the granting of options to key employees to purchase an aggregate of not more than 13% of the total number of shares of the Company's Common Stock outstanding at the time of grant. Such options have been issued by the Company at fair market value on the date of grant and become exercisable in five equal annual installments beginning on the first anniversary of the date of grant. The options expire after seven years from the date of grant if unexercised. Outstanding options may be canceled and reissued under terms specified in the plan.

In May 2000, the Company's stockholders approved the Company's 2000 Incentive Plan which provides for the granting or awarding of incentive or non-qualified stock options, restricted stock or performance awards to directors, officers, key employees and other persons or entities as approved by the Board of Directors. Options granted under this plan have been issued by the Company at fair market value on the date of grant and become exercisable in four equal annual installments beginning on the first anniversary of the date of grant. The options expire after ten years from the date of grant if unexercised.

Non-Employee Directors' Stock Plan

In March 1997, the Company's stockholders approved the 1997 Non-Employee Directors' Stock Plan (the "Directors' Plan"), which provides for the granting or awarding of stock options and stock appreciation rights to non-employees. The number of shares authorized and reserved for issuance under the Directors' Plan is 500,000 shares. The Directors' Plan provided for the automatic grant of options to purchase 10,000 shares to each non-employee director serving at the commencement of the initial public offering of the Company.

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Each non-employee director will be granted options to purchase 10,000 shares at the time of the initial election. In addition, each non-employee director is automatically granted options to purchase an additional 10,000 shares at each annual meeting of the stockholders that is more than two months after the date of the director's initial election. All options are granted with an exercise price equal to the fair market value at the date of grant and are immediately vested upon grant.

Either at the time of the initial public offering or upon election as a director, options were granted to six members of the board of directors to purchase in each case 10,000 shares of Common Stock at the initial public offering price or at the price in effect at the time of their election. Each of these directors received options for shares on the dates of the annual meetings which they have attended. In addition, directors who cease to be employees become eligible for the annual grant. One former employee received an annual grant in 2000. These options will expire at the earlier of 10 years from the date of grant or one year after termination of service as a director. As of December 31, 2003, 170,000 options were outstanding related to this plan.

The Directors' Plan allows non-employee directors to receive shares ("Deferred Shares") at future settlement dates in lieu of cash. The number of Deferred Shares will have an aggregate fair market value equal to the fees payable to the directors. No Deferred Shares have been issued as of December 31, 2003.

The Company has never altered the price of any option after its grant.

The following table summarizes activity under the Company's stock option plans:

Fixed Options	2001		2002		2003	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	7,356,159	\$ 9.35	7,158,722	\$ 8.59	5,518,301	\$ 8.26
Granted	585,000	\$ 2.34	229,000	\$ 3.79	1,119,500	\$ 2.13
Exercised	—	\$ —	(242,146)	\$ 2.88	(332,041)	\$ 2.75
Forfeited	(782,437)	\$ 10.94	(1,627,275)	\$ 9.90	(679,946)	\$ 7.72
Expired	—	\$ —	—	\$ —	—	\$ —
Outstanding at end of year	7,158,722	\$ 8.59	5,518,301	\$ 8.26	5,625,814	\$ 7.43
Options exercisable at year-end	3,044,485		3,579,155		3,537,269	
Weighted-average fair value of options granted during the year	\$ 1.93		\$ 2.90		\$ 1.36	

The following table summarizes information about fixed stock options outstanding at December 31, 2003:

Options Outstanding	Options Exercisable
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Range of Exercise Prices	Number Outstanding at 12/31/03	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable At 12/31/03	Weighted-Average Exercise Price
\$1.90 - 7.625	3,543,375	7.51 years	\$ 3.01	1,490,330	\$ 3.52
\$11.75 - 16.875	1,564,714	0.86 years	\$ 13.41	1,529,214	\$ 13.43
\$17.875 - 21.438	517,725	1.38 years	\$ 19.59	517,725	\$ 19.59
\$1.90 - 21.438	5,625,814	5.10 years	\$ 7.43	3,537,269	\$ 10.16

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Employee Stock Purchase Plan

In September 1997, the Company's stockholders approved the Company's 1998 Employee Stock Purchase Plan which allows employees to purchase shares from the Company's authorized but unissued shares of Common Stock or from shares of Common Stock reacquired by the Company, including shares repurchased on the open market.

The Company's 1998 Employee Stock Purchase Plan originally provided for the purchase of up to 300,000 shares, which was increased by an additional 600,000 shares in May 2000, at semi-annual intervals. In March 2001, after all of the shares were distributed, the Board of Directors of the Company voted to suspend the Employee Stock Purchase Plan indefinitely. Through the suspension date, full-time employees were eligible to purchase shares with payroll deductions ranging from 2% to 8% of compensation with a maximum deduction of \$2,000 for any purchase period for each participant. The purchase price per share was 85% of the lower of the market price on the first business day of the purchase period or the purchase date.

14. Quarterly Results of Operations (Unaudited)

Quarterly financial information for the years ended December 31, 2002 and 2003 is summarized as follows (in thousands, except per share data):

	2002			
	Q1	Q2	Q3	Q4
Revenues	\$ 186,767	\$ 207,651	\$ 210,243	\$ 195,824
Gross profit	\$ 29,613	\$ 37,509	\$ 38,896	\$ 32,686
Operating income (loss)	\$ (4,179)	\$ 7,476	\$ 7,364	\$ 1,667
Income (loss) from continuing operations	\$ (4,100)	\$ 4,756	\$ 3,385	\$ 472
Discontinued operations—				
Operating results, net of tax	\$ 354	\$ 181	\$ 355	\$ 40
Estimated loss on disposition, including tax	\$ (10,987)	\$ (169)	\$ —	\$ (846)
Income (loss) before cumulative effect of change in accounting principle	\$ (14,733)	\$ 4,768	\$ 3,740	\$ (334)
Cumulative effect of change in accounting principle	\$ (202,521)	\$ —	\$ —	\$ —
Net income (loss)	\$ (217,254)	\$ 4,768	\$ 3,740	\$ (334)
INCOME (LOSS) PER SHARE:				
Basic—				
Income (loss) from continuing operations	\$ (0.11)	\$ 0.13	\$ 0.09	\$ 0.01
Discontinued operations—				
Income (loss) from operations	0.01	—	0.01	—
Estimated loss on disposition	(0.29)	—	—	(0.02)
Cumulative effect of change in accounting principle	(5.40)	—	—	—
Net income (loss)	\$ (5.79)	\$ 0.13	\$ 0.10	\$ (0.01)
Diluted—				
Income (loss) from continuing operations	\$ (0.11)	\$ 0.12	\$ 0.09	\$ 0.01
Discontinued operations—				
Income (loss) from operations	0.01	—	0.01	—
Estimated loss on disposition	(0.29)	—	—	(0.02)
Cumulative effect of change in accounting principle	(5.40)	—	—	—
Net income (loss)	\$ (5.79)	\$ 0.12	\$ 0.10	\$ (0.01)
Cash flow from operations	\$ (9,262)	\$ 10,955	\$ 12,114	\$ 283

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	Q1	Q2	Q3	Q4
Revenues	\$ 179,664	\$ 199,339	\$ 208,269	\$ 197,704
Gross profit	\$ 27,079	\$ 34,136	\$ 35,078	\$ 30,256
Operating income (loss)	\$ (4,566)	\$ 4,076	\$ 6,203	\$ 345
Income (loss) from continuing operations (a)	\$ (4,131)	\$ 2,478	\$ 2,676	\$ (2,047)
Discontinued operations—				
Operating results, net of tax	\$ 227	\$ 95	\$ 272	\$ 61
Estimated loss on disposition, including tax	\$ (912)	\$ —	\$ (2,773)	\$ (1,525)
Net income (loss)	\$ (4,816)	\$ 2,573	\$ 175	\$ (3,511)
INCOME (LOSS) PER SHARE:				
Basic—				
Income (loss) from continuing operations	\$ (0.11)	\$ 0.07	\$ 0.07	\$ (0.05)
Discontinued operations—				
Income (loss) from operations	—	—	—	—
Estimated loss on disposition	(0.02)	—	(0.07)	(0.04)
Net income (loss)	\$ (0.13)	\$ 0.07	\$ —	\$ (0.09)
Diluted—				
Income (loss) from continuing operations	\$ (0.11)	\$ 0.07	\$ 0.07	\$ (0.08)
Discontinued operations—				
Income (loss) from operations	—	—	—	—
Estimated loss on disposition	(0.02)	—	(0.07)	(0.04)
Net income (loss)	\$ (0.13)	\$ 0.07	\$ —	\$ (0.12)
Cash flow from operations	\$ (2,343)	\$ 13,923	\$ (6,437)	\$ 8,361

(a) Fourth quarter 2003 includes a goodwill impairment charge of \$2.7 million, a non-cash write-off of \$4.7 million of deferred financing costs and discount related to the Company's previous credit facility and a gain of \$1.3 million on the reduction in the valuation of the warrant and put obligation.

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

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

None.

ITEM 9A. Controls and Procedures

The Company's executive management is responsible for insuring the effectiveness of our disclosure controls and procedures. We carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the fiscal year covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported in accordance with and within the time periods specified in Securities and Exchange Commission rules and forms. There has been no change in our internal control over financial reporting during the three months ended December 31, 2003 that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

PART III

ITEM 10. Directors and Executive Officers of the Registrant

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

The other information called for by this item has been omitted in accordance with the instructions to Form 10-K. The Company will file with the Commission a definitive proxy statement including the other information to be disclosed under this item in the 120 days following December 31, 2003 and such information is hereby incorporated by reference.

ITEM 11. Executive Compensation

The information called for by this item has been omitted in accordance with the instructions to Form 10-K. The Company will file with the Commission a definitive proxy statement including the information to be disclosed under this item in the 120 days following December 31, 2003 and such information is hereby incorporated by reference.

ITEM 12. Security Ownership of Certain Beneficial Owners and Managers and Related Stockholder Matters

Security Ownership of Certain Beneficial Owners and Managers has been omitted in accordance with the instructions to Form 10-K and such information is hereby incorporated by reference. The Company will file with the Commission a definitive proxy statement including the remaining information to be disclosed under Item 12 in the 120 days following December 31, 2003. The following table sets forth information about the Company's equity compensation plans as of December 31, 2003:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	5,954,362	\$ 7.43	1,606,354(1)
Equity compensation plans not approved by security holders	—	—	—
Total	5,954,362	\$ 7.43	1,606,354(1)

(1) Reflects availability of (i) 265,000 shares under our 1997 Non-Employee Director Plan, (ii) 1,000 shares under our 2000 Equity Incentive Plan, and (iii) 1,340,354 shares under our 1997 Long-Term Incentive Plan. Availability under our 1997 Long-Term Incentive Plan is limited to 13% of Company's issued and outstanding common stock as determined at the time of grant of the most recent award.

ITEMS 13 TO 15 INCLUSIVE

These items have been omitted in accordance with the instructions to Form 10-K. The Company will file with the Commission a definitive proxy statement including the information to be disclosed under the items in the 120 days following December 31, 2003 and such information is hereby incorporated by reference.

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PART IV

ITEM 16. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) The following documents are filed as part of this report:

(1) Consolidated Financial Statements (Included Under Item 8): The Index to the Consolidated Financial Statements is included on page 38 of this report and is incorporated herein by reference.

(2) Financial Statement Schedules:

None.

(b) Reports on Form 8-K

The Company filed a report on Form 8-K with the Securities and Exchange Commission on November 14, 2003. Under Item 7 of that report the Company announced that on November 12, 2003, the Company issued a press release, reporting Comfort's financial results for the third quarter of 2003.

(c) Exhibits

Reference is made to the Index of Exhibits beginning on page 78 which index is incorporated herein by reference.

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Exhibit Number	Description of Exhibits	Exhibit Number	Filing or File Number
3.1	— Second Amended and Restated Certificate of Incorporation of the Registrant.	3.1	333-24021
3.2	— Certificate of Amendment dated May 21, 1998.	3.2	1998 Form 10-K
3.3	— Certificate of Amendment dated July 19, 2003.		Filed Herewith
3.4	— Bylaws of Registrant, as amended	3.3	1988 Form 10-K
4.1	— Form of certificate evidencing ownership of Common Stock of the Registrant.	4.1	333-24021
*10.1	— Comfort Systems USA, Inc. 1997 Long-Term Incentive Plan.	10.1	333-24021
*10.2	— Comfort Systems USA, Inc. 1997 Non-Employee Directors' Stock Plan.	10.2	333-24021
*10.3	— Amendment to the 1997 Non-Employee Directors' Stock Plan dated May 23, 2002.	10.3	Second Quarter 2002 Form 10-Q/A
*10.4	— Comfort Systems USA, Inc. 2000 Incentive Plan.	10.7	Second Quarter 2000 Form 10-Q
*10.5	— Employment Agreement dated June 27, 2000 by and among Comfort Systems USA (Texas), L.P. and William F. Murdy.	10.2	Second Quarter
*10.6	— Employment Agreement dated November 4, 2002 by and among Comfort Systems USA (Texas), L.P. and Norman C. Chambers.	10.4	Third Quarter 2002 Form 10-Q
*10.7	— Employment Agreement dated December 1, 2003 by and among Comfort Systems USA (Texas), L.P. and J. Gordon Beittenmiller.		Filed Herewith
*10.8	— Employment Agreement dated December 1, 2003 by and among Comfort Systems USA (Texas), L.P. and William George III.		Filed Herewith
*10.9	— Employment Agreement between the Company, Eastern Heating & Cooling, Inc. and Alfred J. Giardinelli, Jr.	10.1	Second Quarter 2003 Form 10-Q
*10.10	— Employment Agreement dated January 1, 2004 by and among Comfort Systems USA (Texas), L.P. and Thomas N. Tanner.		Filed Herewith
*10.11	— Form of Restricted Stock Award Agreement between William F. Murdy and the Company dated March 22, 2002.	10.2	First Quarter 2002 Form 10-Q
*10.12	— Restricted Stock Award Agreement dated November 1, 2002 from the Company to Norman C. Chambers.	10.5	Third Quarter 2002 Form 10-Q
10.13	— Purchase Agreement between the Registrant and EMCOR-CSI Holding Co. dated February 11, 2002.	2.1	February 2002 Form 8-K

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10.14	— Stock Purchase Warrant and Repurchase Agreement dated October 11, 2002 granted by the Company to General Electric Capital Corporation.	10.2	Third Quarter 2002 Form 10-Q
10.15	— Amendment No. 1 to Stock Purchase Warrant and Repurchase Agreement dated December 31, 2003.		Filed Herewith
10.16	— Registration Rights Agreement dated October 11, 2002 by and among the Company and General Electric Capital Corporation.	10.3	Third Quarter 2002 Form 10-Q
10.17	— Amended and Restated Credit Agreement dated of December 31, 2003, by and among the Company Bank of Texas NA, individually and as Administrative Agent; Hibernia National Bank, as Documentation Agent; and the Lenders referred to in the agreement.		Filed Herewith
18.1	— Letter from Ernst & Young regarding the change in accounting principles.		Filed Herewith
21.1	— List of subsidiaries of Comfort Systems USA, Inc.		Filed Herewith
23.1	— Consent of Ernst & Young LLP.		Filed Herewith
24.1	— Power of Attorney (included in the signature page hereto).		Filed Herewith
31.1	— Rule 13a-14(a) Certification of William F. Murdy pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.		Filed Herewith
31.2	— Rule 13a-14(a) Certification of J. Gordon Beittenmiller pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.		Filed Herewith
32.1	— Section 1350 Certification of William F. Murdy pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.		Furnished Herewith
32.2	— Section 1350 Certification of J. Gordon Beittenmiller pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.		Furnished Herewith

*—Management contract or compensatory plan

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**CERTIFICATE OF AMENDMENT
OF
SECOND AMENDEND AND RESTATED
CERTIFICATE OF INCORPORATION
OF
COMFORT SYSTEMS USA, INC.**

Comfort Systems USA, Inc., a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware (the "Corporation"), DOES HEREBY CERTIFY:

FIRST: That the Board of Directors of the Corporation, by unanimous written consent, adopted a resolution proposing and declaring advisable the following amendment to the Second Amended and Restated Certificate of Incorporation of the Corporation:

Article Five of the Restated Certificate of Incorporation is to be amended by deleting the first paragraph of Article Five in its entirety and substituting the following:

"At each annual meeting of stockholders at which a quorum is present, the persons receiving a plurality of the votes cast shall be directors. No director may be removed from office by a vote of the stockholders at any time except for cause. Election of directors need not be by written ballot unless the Bylaws of the Corporation so provide".

SECOND: That the stockholders of the Corporation, at a meeting duly held, approved the amendment in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

THIRD: That this Certificate of Amendment has been duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, the Corporation has caused this Certificate of Amendment to be executed on July 9, 2003.

COMFORT SYSTEMS USA, INC.

By: /s/ WILLIAM GEORGE

William George, Senior Vice President

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[Exhibit 3.3](#)

[CERTIFICATE OF AMENDMENT OF SECOND AMENDEND AND RESTATED CERTIFICATE OF INCORPORATION OF COMFORT SYSTEMS USA, INC.](#)

EMPLOYMENT AGREEMENT

This Employment Agreement (this "AGREEMENT") by and among COMFORT SYSTEMS USA (TEXAS), L.P., a Texas limited partnership (the "COMPANY"), and J. GORDON BEITTENMILLER ("EMPLOYEE") is hereby entered into and effective as of the 1st day of December, 2003.

RECITALS

A. The Company is engaged primarily in the heating, ventilation, air conditioning, plumbing, mechanical contracting, specialty fabrication, electrical, fire protection and process piping industry.

B. Company desires to employ Employee hereunder in a confidential relationship wherein Employee, in the course of his employment, will become familiar with and aware of information as to the Company's customers, specific manner of doing business, processes, techniques and trade secrets and future plans with respect thereto, all of which have been and will be established and maintained at great expense to the Company, which information is a trade secret and constitutes the valuable good will of the Company; and

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

AGREEMENTS

1. EMPLOYMENT AND DUTIES.

(a) Company hereby employs Employee to serve as Chief Financial Officer and Executive Vice President of the Company. As such, Employee shall have responsibilities, duties and authority customarily accorded to and expected of an officer holding such position directly with the Company. Employee hereby accepts this employment upon the terms and conditions herein contained and agrees to devote his full time, attention and efforts to promote and further the business of Company.

(b) Employee shall faithfully adhere to, execute and fulfill all policies established by Company from time to time.

2. COMPENSATION. For all services rendered by Employee, Company shall compensate Employee as follows:

(a) **BASE SALARY.** Effective as of the Effective Date, the base salary payable to Employee shall be \$250,000 per year, payable on a regular basis in accordance with Company's standard payroll procedures but not less frequently than monthly. On at least an annual basis, Company will review Employee's performance and may, in its sole discretion, (i) make increases to such base salary; (ii) pay a performance bonus; or (iii) recommend Employee for the grant of Company stock options.

(b) **EMPLOYEE PERQUISITES, BENEFITS AND OTHER COMPENSATION.** Employee shall be entitled to receive additional benefits and compensation from Company in such form and to such extent as specified below:

(i) Coverage, subject to contributions required of executives of the Company generally, for Employee and his dependent family members under health, hospitalization, disability, dental, life and other insurance plans that Company may have in effect from time to time. Benefits provided to Employee under this clause (i) shall be equal to such benefits provided to other Company employees of the same level.

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

(iii) Company shall provide Employee with other employee perquisites as may be available to or deemed appropriate for Employee by Company and participation in all other Company-wide employee benefits as are available from time to time.

3. NONCOMPETITION AGREEMENT.

(a) Employee shall not, during the term of his employment hereunder, be engaged in any other business activity pursued for gain, profit or other pecuniary advantage if such activity interferes with Employee's duties and responsibilities hereunder. The foregoing limitations shall not be construed as prohibiting Employee from making personal investments in such form or manner as will neither require his services in the operation or affairs of the companies or enterprises in which such investments are made nor violate the terms of this paragraph 3. Employee will not, during the period of his employment by or with Company, and for a period of two (2) years immediately following the termination of his employment under this Agreement, except as provided below, directly or indirectly, for himself or on behalf of or in conjunction with any other person, persons, company, partnership, corporation or business of whatever nature:

(i) engage, as an officer, director, shareholder, owner, partner, joint venturer, or in a managerial capacity, whether as an employee, independent contractor, consultant or advisor, or as a sales representative, in any business in direct competition with Company or any of its subsidiaries and affiliates within 100 miles of where the Company or any of its subsidiaries and affiliates conduct business, including any territory serviced by the Company or any of such subsidiaries (the "TERRITORY");

(ii) call upon any person who is, at that time, an employee of Company or any of its subsidiaries or affiliates sales or managerial capacity for the purpose or with the intent of enticing such employee away from or out of the employ of Company or any of its subsidiaries or affiliates or any its subsidiaries or affiliates;

(iii) call upon any person or entity which is, at that time, or which has been, within one (1) year prior to that time, a customer of the Company or any of its subsidiaries or affiliates for the purpose of soliciting or selling products or services in direct competition with the Company or any of its subsidiaries or affiliates; or

(iv) call upon any prospective acquisition candidate, on Employee's own behalf or on behalf of any competitor, which candidate was, to Employee's actual knowledge after due inquiry, either called upon by Company or any of its subsidiaries or affiliates or for which Employee participated in an acquisition analysis for the purpose of acquiring such entity or all or substantially all of such entity's assets.

Notwithstanding the above, the foregoing covenant shall not be deemed to prohibit Employee from acquiring as a passive investment not more than two percent (2%) of the capital stock of a competing business the stock of which is traded on a national securities exchange or on an over-the-counter or similar market.

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(b) Because of the difficulty of measuring economic losses to Company or any of its subsidiaries or affiliates as a result of a breach of the foregoing covenant, and because of the immediate and irreparable damage that could be caused to Company or any of its subsidiaries or affiliates for which they would have no other adequate remedy, Employee agrees that the foregoing covenant may be enforced by Company or any of its subsidiaries or affiliates in the event of breach or threatened breach by Employee, by injunctions, restraining orders and other appropriate equitable relief.

(c) It is agreed by the parties that the foregoing covenants in this paragraph 3 impose a reasonable restraint on Employee in light of the activities and business of the Company on the date of the execution of this Agreement and the current plans of the Company or any of its subsidiaries or affiliates; but it is also the intent of the Company and Employee that such covenants be construed and enforced in accordance with the changing activities, business and locations of the Company or any of its subsidiaries or affiliates throughout the term of this covenant, whether before or after the date of termination of the employment of Employee. For example, if, during the term of this Agreement, the Company or any of its subsidiaries or affiliates engages in new and different activities, enters a new business or establishes new locations for its current activities or business in addition to or other than the activities or business enumerated under the Recitals above or the locations currently established therefor, then Employee will be precluded from soliciting the customers or Employees of such new activities or business or from such new location and from directly competing with such new business within 100 miles of its then-established operating location(s) through the term of this covenant.

It is further agreed by the parties hereto that, in the event that Employee shall cease to be employed hereunder, and shall enter into a business or pursue other activities not in competition with the Company or any of its subsidiaries or affiliates, or similar activities or business in locations the operation of which, under such circumstances, does not violate clause (i) of paragraph 3(a), Employee shall not be chargeable with a violation of this paragraph 3 if the Company or any of its subsidiaries or affiliates shall thereafter enter the same, similar or a competitive (i) business, (ii) course of activities or (iii) location, as applicable.

(d) The covenants in this paragraph 3 are severable and separate, and the unenforceability of any specific covenant shall not affect the provisions of any other covenant. Moreover, in the event any court of competent jurisdiction shall determine that the scope, time or territorial restrictions set forth herein are unreasonable, then it is the intention of the parties that such restrictions be enforced to the fullest extent which the court deems reasonable, and this Agreement shall thereby be reformed.

(e) All of the covenants in this paragraph 3 shall be construed as an agreement independent of any other provision in this Agreement, and the existence of any claim or cause of action of Employee against Company or any of its subsidiaries or affiliates, whether predicated on this Agreement or otherwise, shall not constitute a defense to the enforcement by Company or any of its subsidiaries or affiliates of such covenants. It is specifically agreed that the period of two (2) years following termination of employment stated at the beginning of this paragraph 3, during which the agreements and covenants of Employee made in this paragraph 3 shall be effective, shall be computed by excluding from such computation any time during which Employee is in violation of any provision of this paragraph 3.

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4. PLACE OF PERFORMANCE; RELOCATION RIGHTS.

(a) Employee understands that he may be requested by Company or any of its subsidiaries or affiliates to relocate from his present residence to another geographic location in order to more efficiently carry out his duties and responsibilities under this Agreement or as part of a promotion or other increase in duties and responsibilities. In such event, if Employee agrees to relocate, Company or any of its subsidiaries or affiliates will pay all relocation costs to move Employee, his immediate family and their personal property and effects. Such costs may include, by way of example, but are not limited to, pre-move visits to search for a new residence, investigate schools or for other purposes; temporary lodging and living costs prior to moving into a new permanent residence; duplicate home carrying costs; all closing costs on the sale of Employee's present residence and on the purchase of a comparable residence in the new location; and added income taxes that Employee may incur if any relocation costs are not deductible for tax purposes. The general intent of the foregoing is that Employee shall not personally bear any out-of-pocket cost as a result of the relocation, with an understanding that Employee will use his best efforts to incur only those costs which are reasonable and necessary to effect a smooth, efficient and orderly relocation with minimal disruption to the business affairs of Company or any of its subsidiaries or affiliates and the personal life of Employee and his family.

(b) Notwithstanding the above, if Employee is requested by Company to relocate his primary residence and Employee refuses, such refusal shall not constitute "CAUSE" for termination of this Agreement under the terms of paragraph 5(a)(iii).

5. TERM; TERMINATION; RIGHTS ON TERMINATION.

(a) **TERM.** The term of this Agreement shall begin on the date hereof and continue for two (2) years (the "INITIAL TERM") unless terminated sooner as herein provided, and shall automatically renew after the Initial Term on a year-to-year basis on the same terms and conditions contained herein in effect as of the time of renewal unless the Company notifies Employee at least 60 days prior to such expiration (the "TERM"). This Agreement and Employee's employment may be terminated in any one of the following ways:

(i) **TERMINATION AS A RESULT OF THE EMPLOYEE'S DEATH.** The death of Employee shall immediately terminate this Agreement and upon such termination Employee's Estate shall receive from the Company, in a lump-sum payment, the base salary at the rate then in effect for one (1) year, provided, however, that such lump-sum payment shall be reduced by the amount, if any, of benefit payable under any life insurance policies to the extent such policies are procured and paid for by the Company.

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(ii) **TERMINATION ON ACCOUNT OF DISABILITY.** If, as a result of incapacity due to physical or mental illness or injury, Employee shall have been absent from his full-time duties hereunder for four (4) consecutive months, then thirty (30) days after receiving written notice (which notice may occur before or after the end of such four (4) month period, but which shall not be effective earlier than the last day of such four (4) month period), Company may terminate Employee's employment hereunder provided Employee is unable to resume his full-time duties with or without reasonable accommodation at the conclusion of such notice period. Also, Employee may terminate his employment hereunder if his health should become impaired to an extent that makes the continued performance of his duties hereunder hazardous to his physical or mental health or his life, provided that Employee shall have furnished Company with a written statement from a qualified doctor to such effect and provided, further, that, at Company's request made within thirty (30) days of the date of such written statement, Employee shall submit to an examination by a doctor selected by Company who is reasonably acceptable to Employee or Employee's doctor and such doctor shall have concurred in the conclusion of Employee's doctor. In the event this Agreement is terminated as a result of Employee's disability, Employee shall receive from Company, in a lump-sum payment due within ten (10) days of the effective date of termination, the base salary at the rate then in effect for whatever time period is remaining under the Initial Term of this Agreement or for one (1) year, whichever amount is greater; provided, however, that any such payments shall be reduced by the amount of any disability insurance payments payable to the Employee as a result of such disability.

(iii) **TERMINATION BY THE COMPANY FOR CAUSE.** Company may terminate this Agreement immediately for "CAUSE," which shall be: (1) Employee's willful and material breach of this Agreement (which breach cannot be cured or, if capable of being cured, is not cured within ten (10) days after receipt of written notice to cure); (2) Employee's gross negligence in the performance or intentional nonperformance of any of Employee's material duties and responsibilities hereunder; (3) Employee's willful dishonesty, fraud or misconduct with respect to the business or affairs of Company or any of its subsidiaries or affiliates which materially and adversely affects the operations or reputation of Company or any of its subsidiaries or affiliates; (4) Employee's conviction of a felony crime; (5) Employee's confirmed positive illegal drug test result; (6) confirmed sexual harassment by Employee; or (7) Employee's material and willful violation of the Company's Compliance and Business Ethics Policies. In the event of a termination for Cause, as enumerated above, Employee shall have no right to any severance compensation.

(iv) **TERMINATION WITHOUT CAUSE.** At any time after the commencement of employment, either Employee or Company may, voluntarily or without cause, respectively, terminate this Agreement and Employee's employment, effective thirty (30) days after written notice is provided to the other. Should Employee be terminated by Company without Cause Employee shall receive from Company, in a lump-sum payment due on the effective date of termination, the base salary at the rate then in effect for one (1) year. Further, any termination without Cause by Company shall operate to shorten the period set forth in paragraph 3(a) and during which the terms of paragraph 3 apply to one (1) year from the date of termination of employment. Except as provided in paragraph 12 below, if Employee resigns or otherwise terminates this Agreement, the provisions of paragraph 3 hereof shall apply, except that Employee shall receive no severance compensation. If Employee is terminated by the Company without Cause, or if the Employee terminates his employment for Good Reason pursuant to paragraph 12(c) below, then the Company shall make the insurance premium payments contemplated by COBRA for a period of twelve (12) months immediately following such termination.

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(b) **CHANGE IN CONTROL OF THE COMPANY.** In the event of a Change in Control of the Company (as defined below) during the Term, paragraph 12 below shall apply.

(c) **EFFECT OF TERMINATION.** Upon termination of this Agreement for any reason provided above, Employee shall be entitled to receive all compensation earned and all benefits and reimbursements due through the effective date of termination. Additional compensation subsequent to termination, if any, will be due and payable to Employee only to the extent and in the manner expressly provided herein. All other rights and obligations of Company and Employee under this Agreement shall cease as of the effective date of termination, except that Company's obligations under paragraph 9 herein and Employee's obligations under paragraphs 3, 6, 7, 8 and 10 herein shall survive such termination in accordance with their terms.

(d) **BREACH BY COMPANY.** If termination of Employee's employment arises out of Company's material failure to pay Employee on a timely basis the amounts to which he is entitled under this Agreement or as a result of any other breach of this Agreement by Company, as determined by a court of competent jurisdiction or pursuant to the provisions of paragraph 16 below, Company shall pay all amounts and damages to which Employee may be entitled as a result of such breach, including interest thereon and all reasonable legal fees and expenses and other costs incurred by Employee to enforce his rights hereunder. Further, none of the provisions of paragraph 3 shall apply in the event this Agreement is terminated as a result of a breach by Company.

6. **RETURN OF COMPANY PROPERTY.** All records, designs, patents, business plans, financial statements, manuals, memoranda, lists and other property delivered to or compiled by Employee by or on behalf of the Company or its representatives, vendors or customers which pertain to the business of the Company shall be and remain the property of the Company and be subject at all times to its discretion and control. Likewise, all correspondence, reports, records, charts, advertising materials and other similar data pertaining to the business, activities or future plans of the Company which is collected by Employee shall be delivered promptly to the Company without request by it upon termination of Employee's employment.

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

8. **TRADE SECRETS.** Employee agrees that he will not, during or after the Term of this Agreement, disclose the specific terms of the Company's relationships or agreements with their respective significant vendors or customers or any other significant and material trade secret of the Company, whether in existence or proposed, to any person, firm, partnership, corporation or business for any reason or purpose whatsoever, except and only to the extent required by law or legal process following notice to the Company.

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9. **INDEMNIFICATION.** In the event Employee is made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by Company against Employee), by reason of the fact that he is or was performing services under this Agreement, then Company shall indemnify Employee against all expenses (including attorneys' fees), judgments, fines and amounts paid in settlement, as actually and reasonably incurred by Employee in connection therewith, to the maximum extent permitted by applicable law. The advancement of expenses shall be mandatory to the extent permitted by applicable law. In the event that both Employee and Company are made a party to the same third-party action, complaint, suit or proceeding, Company agrees to engage counsel, and Employee agrees to use the same counsel, provided that if counsel selected by Company shall have a conflict of interest that prevents such counsel from representing Employee, Employee may engage separate counsel and Company shall pay all reasonable attorneys' fees of such separate counsel. Company shall not be required to pay the fees of more than one law firm except as described in the preceding sentence, and shall not be required to pay the fees of more than two law firms under any circumstances. Further, while Employee is expected at all times to use his best efforts to faithfully discharge his duties under this Agreement, Employee cannot be held liable to Company for errors or omissions made in good faith where Employee has not exhibited gross, willful and wanton negligence or misconduct or performed criminal or fraudulent acts.

10. **NO PRIOR AGREEMENTS.** Employee hereby represents and warrants to Company and the Company that the execution of this Agreement by Employee and his employment by Company and the performance of his duties hereunder will not violate or be a breach of any agreement with a former Company, client or any other person or entity. Further, Employee agrees to indemnify Company and the Company for any claim, including, but not limited to, attorneys' fees and expenses of investigation, by any such third party that such third party may now have or may hereafter come to have against Company or any of its subsidiaries or affiliates based upon or arising out of any noncompetition agreement, invention or secrecy agreement between Employee and such third party which was in existence as of the date of this Agreement.

11. **ASSIGNMENT; BINDING EFFECT.** Employee understands that he has been selected for employment by Company and/or the Company on the basis of his personal qualifications, experience and skills. Employee agrees, therefore, he cannot assign all or any portion of his performance under this Agreement. Subject to the preceding two (2) sentences and the express provisions of paragraph 12 below, this Agreement shall be binding upon, inure to the benefit of and be enforceable by the parties hereto and their respective heirs, legal representatives, successors and assigns.

12. **CHANGE IN CONTROL.**

(a) Upon notice by Employee at any time during the 90 days following a Change in Control, the Employee may elect to terminate his employment and shall be entitled to receive in a lump-sum payment due upon the date of such termination the amount equal to two (2) times his annual base salary then in effect, and the noncompetition provisions of paragraph 3 shall apply for a period of one (1) year immediately following the effective date of termination.

(b) Upon a Change in Control, any options or restricted stock outstanding to Employee that have not previously vested shall be immediately vested.

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(c) In any Change in Control situation, if Employee is terminated by Company without Cause at any time during the twelve (12) months immediately following the closing of the transaction giving rise to the Change in Control, or Employee terminates this Agreement for Good Reason (as defined below) at any time during the twelve (12) months immediately following the closing of the transaction giving rise to the Change in Control, Employee shall be entitled to receive in a lump-sum payment, due on the effective date of termination, the amount equal to two (2) times the greater of (i) his annual base salary then in effect or (ii) his annual base salary in effect immediately prior to the closing of the transaction giving rise to the Change in Control, and the noncompetition provisions of paragraph 3 shall apply for a period of one (1) year immediately following the effective date of termination. For purposes of this Agreement, Employee shall have "GOOD REASON" to terminate this Agreement and his employment hereunder if, without Employee's consent, (x) Employee is demoted by means of a reduction in authority, responsibilities, duties or title to a position of materially less stature or importance within the Company than as described in paragraph 1 hereof or (y) the Company breaches this Agreement in any material respect and fails to cure such breach within ten (10) days after Employee delivers written notice and a written description of such breach to the Company, which notice shall specifically refer to this section of this Agreement.

(d) For purposes of applying paragraph 5 under the circumstances described in (b) above, the effective date of termination will be the closing date of the transaction giving rise to the Change in Control and all compensation, reimbursements and lump-sum payments due Employee must be paid in full by Company at or prior to such closing. Further, Company shall ensure that Employee will be given sufficient time and opportunity to elect whether to exercise all or any of his vested options to purchase the Company's Common Stock, including any options with accelerated vesting under the provisions of the Company's Long-Term Incentive Plans (or other applicable plan then in effect), such that he may convert the options to shares of the Company's Common Stock at or prior to the closing of the transaction giving rise to the Change in Control, if he so desires.

(e) A "CHANGE IN CONTROL" shall be deemed to have occurred if:

(i) any person, other than Comfort Systems USA, Inc., a Delaware corporation and the beneficial owner of the Company ("CSUSA"), or an employee benefit plan of CSUSA, or any entity controlled by either, acquires directly or indirectly the Beneficial Ownership (as defined in Section 13(d) of the Securities Exchange Act of 1934, as amended) of any voting security of the CSUSA and immediately after such acquisition such Person is, directly or indirectly, the Beneficial Owner of voting securities representing fifty percent (50%) or more of the total voting power of all of the then-outstanding voting securities of CSUSA;

(ii) the following individuals no longer constitute a majority of the members of the Board of Directors of CSUSA: (A) the individuals who, as of the date hereof, constitute the Board of Directors of CSUSA (the "ORIGINAL DIRECTORS"); (B) the individuals who thereafter are elected to the Board of Directors of the CSUSA and whose election, or nomination for election, to the Board of Directors of CSUSA was approved by a vote of at least two-thirds ($\frac{2}{3}$) of the Original Directors then still in office (such directors becoming "ADDITIONAL ORIGINAL DIRECTORS" immediately following their election); and (C) the individuals who are elected to the Board of Directors of CSUSA and whose election, or nomination for election, to the Board of Directors of CSUSA was approved by a vote of at least two-thirds ($\frac{2}{3}$) of the Original Directors and Additional Original Directors then still in office (such directors also becoming "ADDITIONAL ORIGINAL DIRECTORS" immediately following their election);

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(iii) the stockholders of CSUSA shall approve a merger, consolidation, recapitalization, or reorganization of CSUSA, a reverse stock split of outstanding voting securities, or consummation of any such transaction if stockholder approval is not obtained, other than any such transaction which would result in at least seventy-five percent (75%) of the total voting power represented by the voting securities of the surviving entity outstanding immediately after such transaction being Beneficially Owned by at least seventy-five percent (75%) of the holders of outstanding voting securities of CSUSA immediately prior to the transaction, with the voting power of each such continuing holder relative to other such continuing holders not substantially altered in the transaction; or

(iv) the stockholders of CSUSA shall approve a plan of complete liquidation of CSUSA or an agreement for the sale or disposition of all or a substantial portion of the CSUSA's assets (i.e., fifty percent (50%) or more of the total assets of CSUSA).

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

(f) If it shall be determined that any payment or distribution by Company, the Company or any other person to or for the benefit of the Employee (a "PAYMENT") would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "EXCISE TAX"), as a result of the termination of employment of the Employee in the event of a Change in Control, then Company, the Company or the successor to the Company shall pay an additional payment (a "GROSS-UP PAYMENT") in an amount such that after payment by the Employee of all taxes, including, without limitation, any income taxes and Excise Tax imposed on the Gross-Up Payment, the Employee retains an amount of the Gross-Up Payment equal to the Excise Tax imposed on the Payments. Such amount will be due and payable by Company, the Company or the successor to the Company within ten (10) days after the Employee delivers written request for reimbursement accompanied by a copy of the Employee's tax return(s) or other tax filings showing the excise tax actually incurred by the Employee.

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

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

To Company: Comfort Systems USA (Texas), L.P.
777 Post Oak Blvd, Suite 500
Houston, Texas 77056
Attention: Law Department

To Employee: J. Gordon Beittenmiller
537 South Third
Bellaire, TX 77004

Notice shall be deemed given and effective on the earlier of three (3) days after the deposit in the U.S. mail of a writing addressed as above and sent first class mail, certified, return receipt requested, or when actually received by means of hand delivery, delivery by Federal Express or other courier service, or by facsimile transmission. Either party may change the address for notice by notifying the other party of such change in accordance with this paragraph 14.1

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

16. **ARBITRATION.** With the exception of paragraphs 3 and 7, any unresolved dispute or controversy arising under or in connection with this Agreement shall be settled exclusively by arbitration, conducted before a panel of three (3) arbitrators in Houston, Texas, in accordance with the National Rules for the Resolution of Employment Disputes of the American Arbitration Association ("AAA") then in effect, provided that Employee shall comply with Company's grievance procedures in an effort to resolve such dispute or controversy before resorting to arbitration, and provided further that the parties may agree to use arbitrators other than those provided by the AAA. The arbitrators shall not have the authority to add to, detract from, or modify any provision hereof nor to award punitive damages to any injured party. The arbitrators shall have the authority to order back-pay, severance compensation, vesting of options or restricted stock (or cash compensation in lieu of vesting of options or restricted stock), reimbursement of costs, including those incurred to enforce this Agreement, and interest thereon in the event the arbitrators determine that Employee was terminated without disability or Cause, as defined in paragraphs 5(a)(ii) and 5(a)(iii), respectively, or that Company has breached this Agreement in any material respect. A decision by a majority of the arbitration panel shall be final and binding. Judgment may be entered on the arbitrators' award in any court having jurisdiction. The direct expense of any arbitration proceeding shall be borne by Company.

17. GOVERNING LAW. This Agreement shall in all respects be construed according to the laws of the State of Texas.

18. COUNTERPARTS. This Agreement may be executed simultaneously in two (2) or more counterparts, each of which shall be deemed an original and all of which together shall constitute but one and the same instrument.

19. THIRD-PARTY BENEFICIARY. The Company is intended to be a third-party beneficiary under this Agreement, and shall be entitled to enforce the provisions hereof benefiting the Company.

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

COMFORT SYSTEMS USA (TEXAS), L.P.

By: Comfort Systems USA G.P., Inc.

By: /s/ WILLIAM F. MURDY

William F. Murdy
Chief Executive Officer

COMFORT SYSTEMS USA, INC.

By: /s/ WILLIAM F. MURDY

William F. Murdy
Chief Executive Officer

EMPLOYEE:

/s/ J. GORDON BEITTENMILLER

J. Gordon Beittenmiller

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[Exhibit 10.7](#)

[EMPLOYMENT AGREEMENT](#)

EMPLOYMENT AGREEMENT

This Employment Agreement (this "AGREEMENT") by and among COMFORT SYSTEMS USA (TEXAS), L.P., a Texas limited partnership (the "COMPANY"), and WILLIAM GEORGE ("EMPLOYEE") is hereby entered into and effective as of the 1st day of December, 2003.

RECITALS

A. The Company is engaged primarily in the heating, ventilation, air conditioning, plumbing, mechanical contracting, specialty fabrication, electrical, fire protection and process piping industry.

B. Company desires to employ Employee hereunder in a confidential relationship wherein Employee, in the course of his employment, will become familiar with and aware of information as to the Company's customers, specific manner of doing business, processes, techniques and trade secrets and future plans with respect thereto, all of which have been and will be established and maintained at great expense to the Company, which information is a trade secret and constitutes the valuable good will of the Company; and

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

AGREEMENTS

1. EMPLOYMENT AND DUTIES.

(a) Company hereby employs Employee to serve as President of the Company. As such, Employee shall have responsibilities, duties and authority customarily accorded to and expected of an officer holding such position directly with the Company. Employee hereby accepts this employment upon the terms and conditions herein contained and agrees to devote his full time, attention and efforts to promote and further the business of Company.

(b) Employee shall faithfully adhere to, execute and fulfill all policies established by Company from time to time.

2. COMPENSATION. For all services rendered by Employee, Company shall compensate Employee as follows:

(a) **BASE SALARY.** Effective as of the Effective Date, the base salary payable to Employee shall be \$210,000 per year, payable on a regular basis in accordance with Company's standard payroll procedures but not less frequently than monthly. On at least an annual basis, Company will review Employee's performance and may, in its sole discretion, (i) make increases to such base salary; (ii) pay a performance bonus; or (iii) recommend Employee for the grant of Company stock options.

(b) **EMPLOYEE PERQUISITES, BENEFITS AND OTHER COMPENSATION.** Employee shall be entitled to receive additional benefits and compensation from Company in such form and to such extent as specified below:

(i) Coverage, subject to contributions required of executives of the Company generally, for Employee and his dependent family members under health, hospitalization, disability, dental, life and other insurance plans that Company may have in effect from time to time. Benefits provided to Employee under this clause (i) shall be equal to such benefits provided to other Company employees of the same level.

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

(iii) Company shall provide Employee with other employee perquisites as may be available to or deemed appropriate for Employee by Company and participation in all other Company-wide employee benefits as are available from time to time.

3. NONCOMPETITION AGREEMENT.

(a) Employee shall not, during the term of his employment hereunder, be engaged in any other business activity pursued for gain, profit or other pecuniary advantage if such activity interferes with Employee's duties and responsibilities hereunder. The foregoing limitations shall not be construed as prohibiting Employee from making personal investments in such form or manner as will neither require his services in the operation or affairs of the companies or enterprises in which such investments are made nor violate the terms of this paragraph 3. Employee will not, during the period of his employment by or with Company, and for a period of two (2) years immediately following the termination of his employment under this Agreement, except as provided below, directly or indirectly, for himself or on behalf of or in conjunction with any other person, persons, company, partnership, corporation or business of whatever nature:

(i) engage, as an officer, director, shareholder, owner, partner, joint venturer, or in a managerial capacity, whether as an employee, independent contractor, consultant or advisor, or as a sales representative, in any business in direct competition with Company or any of its subsidiaries and affiliates within 100 miles of where the Company or any of its subsidiaries and affiliates conduct business, including any territory serviced by the Company or any of such subsidiaries (the "TERRITORY");

(ii) call upon any person who is, at that time, an employee of Company or any of its subsidiaries or affiliates sales or managerial capacity for the purpose or with the intent of enticing such employee away from or out of the employ of Company or any of its subsidiaries or affiliates or any its subsidiaries or affiliates;

(iii) call upon any person or entity which is, at that time, or which has been, within one (1) year prior to that time, a customer of the Company or any of its subsidiaries or affiliates for the purpose of soliciting or selling products or services in direct competition with the Company or any of its subsidiaries or affiliates; or

(iv) call upon any prospective acquisition candidate, on Employee's own behalf or on behalf of any competitor, which candidate was, to Employee's actual knowledge after due inquiry, either called upon by Company or any of its subsidiaries or affiliates or for which Employee participated in an acquisition analysis for the purpose of acquiring such entity or all or substantially all of such entity's assets.

Notwithstanding the above, the foregoing covenant shall not be deemed to prohibit Employee from acquiring as a passive investment not more than two percent (2%) of the capital stock of a competing business the stock of which is traded on a national securities exchange or on an over-the-counter or similar market.

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(b) Because of the difficulty of measuring economic losses to Company or any of its subsidiaries or affiliates as a result of a breach of the foregoing covenant, and because of the immediate and irreparable damage that could be caused to Company or any of its subsidiaries or affiliates for which they would have no other adequate remedy, Employee agrees that the foregoing covenant may be enforced by Company or any of its subsidiaries or affiliates in the event of breach or threatened breach by Employee, by injunctions, restraining orders and other appropriate equitable relief.

(c) It is agreed by the parties that the foregoing covenants in this paragraph 3 impose a reasonable restraint on Employee in light of the activities and business of the Company on the date of the execution of this Agreement and the current plans of the Company or any of its subsidiaries or affiliates; but it is also the intent of the Company and Employee that such covenants be construed and enforced in accordance with the changing activities, business and locations of the Company or any of its subsidiaries or affiliates throughout the term of this covenant, whether before or after the date of termination of the employment of Employee. For example, if, during the term of this Agreement, the Company or any of its subsidiaries or affiliates engages in new and different activities, enters a new business or establishes new locations for its current activities or business in addition to or other than the activities or business enumerated under the Recitals above or the locations currently established therefor, then Employee will be precluded from soliciting the customers or Employees of such new activities or business or from such new location and from directly competing with such new business within 100 miles of its then-established operating location(s) through the term of this covenant.

It is further agreed by the parties hereto that, in the event that Employee shall cease to be employed hereunder, and shall enter into a business or pursue other activities not in competition with the Company or any of its subsidiaries or affiliates, or similar activities or business in locations the operation of which, under such circumstances, does not violate clause (i) of paragraph 3(a), Employee shall not be chargeable with a violation of this paragraph 3 if the Company or any of its subsidiaries or affiliates shall thereafter enter the same, similar or a competitive (i) business, (ii) course of activities or (iii) location, as applicable.

(d) The covenants in this paragraph 3 are severable and separate, and the unenforceability of any specific covenant shall not affect the provisions of any other covenant. Moreover, in the event any court of competent jurisdiction shall determine that the scope, time or territorial restrictions set forth herein are unreasonable, then it is the intention of the parties that such restrictions be enforced to the fullest extent which the court deems reasonable, and this Agreement shall thereby be reformed.

(e) All of the covenants in this paragraph 3 shall be construed as an agreement independent of any other provision in this Agreement, and the existence of any claim or cause of action of Employee against Company or any of its subsidiaries or affiliates, whether predicated on this Agreement or otherwise, shall not constitute a defense to the enforcement by Company or any of its subsidiaries or affiliates of such covenants. It is specifically agreed that the period of two (2) years following termination of employment stated at the beginning of this paragraph 3, during which the agreements and covenants of Employee made in this paragraph 3 shall be effective, shall be computed by excluding from such computation any time during which Employee is in violation of any provision of this paragraph 3.

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4. PLACE OF PERFORMANCE; RELOCATION RIGHTS.

(a) Employee understands that he may be requested by Company or any of its subsidiaries or affiliates to relocate from his present residence to another geographic location in order to more efficiently carry out his duties and responsibilities under this Agreement or as part of a promotion or other increase in duties and responsibilities. In such event, if Employee agrees to relocate, Company or any of its subsidiaries or affiliates will pay all relocation costs to move Employee, his immediate family and their personal property and effects. Such costs may include, by way of example, but are not limited to, pre-move visits to search for a new residence, investigate schools or for other purposes; temporary lodging and living costs prior to moving into a new permanent residence; duplicate home carrying costs; all closing costs on the sale of Employee's present residence and on the purchase of a comparable residence in the new location; and added income taxes that Employee may incur if any relocation costs are not deductible for tax purposes. The general intent of the foregoing is that Employee shall not personally bear any out-of-pocket cost as a result of the relocation, with an understanding that Employee will use his best efforts to incur only those costs which are reasonable and necessary to effect a smooth, efficient and orderly relocation with minimal disruption to the business affairs of Company or any of its subsidiaries or affiliates and the personal life of Employee and his family.

(b) Notwithstanding the above, if Employee is requested by Company to relocate his primary residence and Employee refuses, such refusal shall not constitute "CAUSE" for termination of this Agreement under the terms of paragraph 5(a)(iii).

5. TERM; TERMINATION; RIGHTS ON TERMINATION.

(a) **TERM.** The term of this Agreement shall begin on the date hereof and continue for two (2) years (the "INITIAL TERM") unless terminated sooner as herein provided, and shall automatically renew after the Initial Term on a year-to-year basis on the same terms and conditions contained herein in effect as of the time of renewal unless the Company notifies Employee at least 60 days prior to such expiration (the "TERM"). This Agreement and Employee's employment may be terminated in any one of the following ways:

(i) **TERMINATION AS A RESULT OF THE EMPLOYEE'S DEATH.** The death of Employee shall immediately terminate this Agreement and upon such termination Employee's Estate shall receive from the Company, in a lump-sum payment, the base salary at the rate then in effect for one (1) year, provided, however, that such lump-sum payment shall be reduced by the amount, if any, of benefit payable under any life insurance policies to the extent such policies are procured and paid for by the Company.

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(ii) **TERMINATION ON ACCOUNT OF DISABILITY.** If, as a result of incapacity due to physical or mental illness or injury, Employee shall have been absent from his full-time duties hereunder for four (4) consecutive months, then thirty (30) days after receiving written notice (which notice may occur before or after the end of such four (4) month period, but which shall not be effective earlier than the last day of such four (4) month period), Company may terminate Employee's employment hereunder provided Employee is unable to resume his full-time duties with or without reasonable accommodation at the conclusion of such notice period. Also, Employee may terminate his employment hereunder if his health should become impaired to an extent that makes the continued performance of his duties hereunder hazardous to his physical or mental health or his life, provided that Employee shall have furnished Company with a written statement from a qualified doctor to such effect and provided, further, that, at Company's request made within thirty (30) days of the date of such written statement, Employee shall submit to an examination by a doctor selected by Company who is reasonably acceptable to Employee or Employee's doctor and such doctor shall have concurred in the conclusion of Employee's doctor. In the event this Agreement is terminated as a result of Employee's disability, Employee shall receive from Company, in a lump-sum payment due within ten (10) days of the effective date of termination, the base salary at the rate then in effect for whatever time period is remaining under the Initial Term of this Agreement or for one (1) year, whichever amount is greater; provided, however, that any such payments shall be reduced by the amount of any disability insurance payments payable to the Employee as a result of such disability.

(iii) **TERMINATION BY THE COMPANY FOR CAUSE.** Company may terminate this Agreement immediately for "CAUSE," which shall be: (1) Employee's willful and material breach of this Agreement (which breach cannot be cured or, if capable of being cured, is not cured within ten (10) days after receipt of written notice to cure); (2) Employee's gross negligence in the performance or intentional nonperformance of any of Employee's material duties and responsibilities hereunder; (3) Employee's willful dishonesty, fraud or misconduct with respect to the business or affairs of Company or any of its subsidiaries or affiliates which materially and adversely affects the operations or reputation of Company or any of its subsidiaries or affiliates; (4) Employee's conviction of a felony crime; (5) Employee's confirmed positive illegal drug test result; (6) confirmed sexual harassment by Employee; or (7) Employee's material and willful violation of the Company's Compliance and Business Ethics Policies. In the event of a termination for Cause, as enumerated above, Employee shall have no right to any severance compensation.

(iv) **TERMINATION WITHOUT CAUSE.** At any time after the commencement of employment, either Employee or Company may, voluntarily or without cause, respectively, terminate this Agreement and Employee's employment, effective thirty (30) days after written notice is provided to the other. Should Employee be terminated by Company without Cause Employee shall receive from Company, in a lump-sum payment due on the effective date of termination, the base salary at the rate then in effect for one (1) year. Further, any termination without Cause by Company shall operate to shorten the period set forth in paragraph 3(a) and during which the terms of paragraph 3 apply to one (1) year from the date of termination of employment. Except as provided in paragraph 12 below, if Employee resigns or otherwise terminates this Agreement, the provisions of paragraph 3 hereof shall apply, except that Employee shall receive no severance compensation. If Employee is terminated by the Company without Cause, or if the Employee terminates his employment for Good Reason pursuant to paragraph 12(c) below, then the Company shall make the insurance premium payments contemplated by COBRA for a period of twelve (12) months immediately following such termination.

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(b) **CHANGE IN CONTROL OF THE COMPANY.** In the event of a Change in Control of the Company (as defined below) during the Term, paragraph 12 below shall apply.

(c) **EFFECT OF TERMINATION.** Upon termination of this Agreement for any reason provided above, Employee shall be entitled to receive all compensation earned and all benefits and reimbursements due through the effective date of termination. Additional compensation subsequent to termination, if any, will be due and payable to Employee only to the extent and in the manner expressly provided herein. All other rights and obligations of Company and Employee under this Agreement shall cease as of the effective date of termination, except that Company's obligations under paragraph 9 herein and Employee's obligations under paragraphs 3, 6, 7, 8 and 10 herein shall survive such termination in accordance with their terms.

(d) **BREACH BY COMPANY.** If termination of Employee's employment arises out of Company's material failure to pay Employee on a timely basis the amounts to which he is entitled under this Agreement or as a result of any other breach of this Agreement by Company, as determined by a court of competent jurisdiction or pursuant to the provisions of paragraph 16 below, Company shall pay all amounts and damages to which Employee may be entitled as a result of such breach, including interest thereon and all reasonable legal fees and expenses and other costs incurred by Employee to enforce his rights hereunder. Further, none of the provisions of paragraph 3 shall apply in the event this Agreement is terminated as a result of a breach by Company.

6. **RETURN OF COMPANY PROPERTY.** All records, designs, patents, business plans, financial statements, manuals, memoranda, lists and other property delivered to or compiled by Employee by or on behalf of the Company or its representatives, vendors or customers which pertain to the business of the Company shall be and remain the property of the Company and be subject at all times to its discretion and control. Likewise, all correspondence, reports, records, charts, advertising materials and other similar data pertaining to the business, activities or future plans of the Company which is collected by Employee shall be delivered promptly to the Company without request by it upon termination of Employee's employment.

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

8. **TRADE SECRETS.** Employee agrees that he will not, during or after the Term of this Agreement, disclose the specific terms of the Company's relationships or agreements with their respective significant vendors or customers or any other significant and material trade secret of the Company, whether in existence or proposed, to any person, firm, partnership, corporation or business for any reason or purpose whatsoever, except and only to the extent required by law or legal process following notice to the Company.

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9. **INDEMNIFICATION.** In the event Employee is made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by Company against Employee), by reason of the fact that he is or was performing services under this Agreement, then Company shall indemnify Employee against all expenses (including attorneys' fees), judgments, fines and amounts paid in settlement, as actually and reasonably incurred by Employee in connection therewith, to the maximum extent permitted by applicable law. The advancement of expenses shall be mandatory to the extent permitted by applicable law. In the event that both Employee and Company are made a party to the same third-party action, complaint, suit or proceeding, Company agrees to engage counsel, and Employee agrees to use the same counsel, provided that if counsel selected by Company shall have a conflict of interest that prevents such counsel from representing Employee, Employee may engage separate counsel and Company shall pay all reasonable attorneys' fees of such separate counsel. Company shall not be required to pay the fees of more than one law firm except as described in the preceding sentence, and shall not be required to pay the fees of more than two law firms under any circumstances. Further, while Employee is expected at all times to use his best efforts to faithfully discharge his duties under this Agreement, Employee cannot be held liable to Company for errors or omissions made in good faith where Employee has not exhibited gross, willful and wanton negligence or misconduct or performed criminal or fraudulent acts.

10. **NO PRIOR AGREEMENTS.** Employee hereby represents and warrants to Company and the Company that the execution of this Agreement by Employee and his employment by Company and the performance of his duties hereunder will not violate or be a breach of any agreement with a former Company, client or any other person or entity. Further, Employee agrees to indemnify Company and the Company for any claim, including, but not limited to, attorneys' fees and expenses of investigation, by any such third party that such third party may now have or may hereafter come to have against Company or any of its subsidiaries or affiliates based upon or arising out of any noncompetition agreement, invention or secrecy agreement between Employee and such third party which was in existence as of the date of this Agreement.

11. **ASSIGNMENT; BINDING EFFECT.** Employee understands that he has been selected for employment by Company and/or the Company on the basis of his personal qualifications, experience and skills. Employee agrees, therefore, he cannot assign all or any portion of his performance under this Agreement. Subject to the preceding two (2) sentences and the express provisions of paragraph 12 below, this Agreement shall be binding upon, inure to the benefit of and be enforceable by the parties hereto and their respective heirs, legal representatives, successors and assigns.

12. **CHANGE IN CONTROL.**

(a) Upon notice by Employee at any time during the 90 days following a Change in Control, the Employee may elect to terminate his employment and shall be entitled to receive in a lump-sum payment due upon the date of such termination the amount equal to two (2) times his annual base salary then in effect, and the noncompetition provisions of paragraph 3 shall apply for a period of one (1) year immediately following the effective date of termination.

(b) Upon a Change in Control, any options or restricted stock outstanding to Employee that have not previously vested shall be immediately vested.

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(c) In any Change in Control situation, if Employee is terminated by Company without Cause at any time during the twelve (12) months immediately following the closing of the transaction giving rise to the Change in Control, or Employee terminates this Agreement for Good Reason (as defined below) at any time during the twelve (12) months immediately following the closing of the transaction giving rise to the Change in Control, Employee shall be entitled to receive in a lump-sum payment, due on the effective date of termination, the amount equal to two (2) times the greater of (i) his annual base salary then in effect or (ii) his annual base salary in effect immediately prior to the closing of the transaction giving rise to the Change in Control, and the noncompetition provisions of paragraph 3 shall apply for a period of one (1) year immediately following the effective date of termination. For purposes of this Agreement, Employee shall have "GOOD REASON" to terminate this Agreement and his employment hereunder if, without Employee's consent, (x) Employee is demoted by means of a reduction in authority, responsibilities, duties or title to a position of materially less stature or importance within the Company than as described in paragraph 1 hereof or (y) the Company breaches this Agreement in any material respect and fails to cure such breach within ten (10) days after Employee delivers written notice and a written description of such breach to the Company, which notice shall specifically refer to this section of this Agreement.

(d) For purposes of applying paragraph 5 under the circumstances described in (b) above, the effective date of termination will be the closing date of the transaction giving rise to the Change in Control and all compensation, reimbursements and lump-sum payments due Employee must be paid in full by Company at or prior to such closing. Further, Company shall ensure that Employee will be given sufficient time and opportunity to elect whether to exercise all or any of his vested options to purchase the Company's Common Stock, including any options with accelerated vesting under the provisions of the Company's Long-Term Incentive Plans (or other applicable plan then in effect), such that he may convert the options to shares of the Company's Common Stock at or prior to the closing of the transaction giving rise to the Change in Control, if he so desires.

(e) A "CHANGE IN CONTROL" shall be deemed to have occurred if:

(i) any person, other than Comfort Systems USA, Inc., a Delaware corporation and the beneficial owner of the Company ("CSUSA"), or an employee benefit plan of CSUSA, or any entity controlled by either, acquires directly or indirectly the Beneficial Ownership (as defined in Section 13(d) of the Securities Exchange Act of 1934, as amended) of any voting security of the CSUSA and immediately after such acquisition such Person is, directly or indirectly, the Beneficial Owner of voting securities representing fifty percent (50%) or more of the total voting power of all of the then-outstanding voting securities of CSUSA;

(ii) the following individuals no longer constitute a majority of the members of the Board of Directors of CSUSA: (A) the individuals who, as of the date hereof, constitute the Board of Directors of CSUSA (the "ORIGINAL DIRECTORS"); (B) the individuals who thereafter are elected to the Board of Directors of the CSUSA and whose election, or nomination for election, to the Board of Directors of CSUSA was approved by a vote of at least two-thirds ($\frac{2}{3}$) of the Original Directors then still in office (such directors becoming "ADDITIONAL ORIGINAL DIRECTORS" immediately following their election); and (C) the individuals who are elected to the Board of Directors of CSUSA and whose election, or nomination for election, to the Board of Directors of CSUSA was approved by a vote of at least two-thirds ($\frac{2}{3}$) of the Original Directors and Additional Original Directors then still in office (such directors also becoming "ADDITIONAL ORIGINAL DIRECTORS" immediately following their election);

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(iii) the stockholders of CSUSA shall approve a merger, consolidation, recapitalization, or reorganization of CSUSA, a reverse stock split of outstanding voting securities, or consummation of any such transaction if stockholder approval is not obtained, other than any such transaction which would result in at least seventy-five percent (75%) of the total voting power represented by the voting securities of the surviving entity outstanding immediately after such transaction being Beneficially Owned by at least seventy-five percent (75%) of the holders of outstanding voting securities of CSUSA immediately prior to the transaction, with the voting power of each such continuing holder relative to other such continuing holders not substantially altered in the transaction; or

(iv) the stockholders of CSUSA shall approve a plan of complete liquidation of CSUSA or an agreement for the sale or disposition of all or a substantial portion of the CSUSA's assets (i.e., fifty percent (50%) or more of the total assets of CSUSA).

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

(f) If it shall be determined that any payment or distribution by Company, the Company or any other person to or for the benefit of the Employee (a "PAYMENT") would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "EXCISE TAX"), as a result of the termination of employment of the Employee in the event of a Change in Control, then Company, the Company or the successor to the Company shall pay an additional payment (a "GROSS-UP PAYMENT") in an amount such that after payment by the Employee of all taxes, including, without limitation, any income taxes and Excise Tax imposed on the Gross-Up Payment, the Employee retains an amount of the Gross-Up Payment equal to the Excise Tax imposed on the Payments. Such amount will be due and payable by Company, the Company or the successor to the Company within ten (10) days after the Employee delivers written request for reimbursement accompanied by a copy of the Employee's tax return(s) or other tax filings showing the excise tax actually incurred by the Employee.

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

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

To Company: Comfort Systems USA (Texas), L.P.
777 Post Oak Blvd, Suite 500
Houston, Texas 77056
Attention: Law Department

To Employee: William George
7938 Clarion Way
Houston, TX 77040

Notice shall be deemed given and effective on the earlier of three (3) days after the deposit in the U.S. mail of a writing addressed as above and sent first class mail, certified, return receipt requested, or when actually received by means of hand delivery, delivery by Federal Express or other courier service, or by facsimile transmission. Either party may change the address for notice by notifying the other party of such change in accordance with this paragraph 14.1

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

16. **ARBITRATION.** With the exception of paragraphs 3 and 7, any unresolved dispute or controversy arising under or in connection with this Agreement shall be settled exclusively by arbitration, conducted before a panel of three (3) arbitrators in Houston, Texas, in accordance with the National Rules for the Resolution of Employment Disputes of the American Arbitration Association ("AAA") then in effect, provided that Employee shall comply with Company's grievance procedures in an effort to resolve such dispute or controversy before resorting to arbitration, and provided further that the parties may agree to use arbitrators other than those provided by the AAA. The arbitrators shall not have the authority to add to, detract from, or modify any provision hereof nor to award punitive damages to any injured party. The arbitrators shall have the authority to order back-pay, severance compensation, vesting of options or restricted stock (or cash compensation in lieu of vesting of options or restricted stock), reimbursement of costs, including those incurred to enforce this Agreement, and interest thereon in the event the arbitrators determine that Employee was terminated without disability or Cause, as defined in paragraphs 5(a)(ii) and 5(a)(iii), respectively, or that Company has breached this Agreement in any material respect. A decision by a majority of the arbitration panel shall be final and binding. Judgment may be entered on the arbitrators' award in any court having jurisdiction. The direct expense of any arbitration proceeding shall be borne by Company.

17. GOVERNING LAW. This Agreement shall in all respects be construed according to the laws of the State of Texas.

18. COUNTERPARTS. This Agreement may be executed simultaneously in two (2) or more counterparts, each of which shall be deemed an original and all of which together shall constitute but one and the same instrument.

19. THIRD-PARTY BENEFICIARY. The Company is intended to be a third-party beneficiary under this Agreement, and shall be entitled to enforce the provisions hereof benefiting the Company.

10

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

COMFORT SYSTEMS USA (TEXAS), L.P.

By: Comfort Systems USA G.P., Inc.

By: /s/ WILLIAM F. MURDY

William F. Murdy
Chief Executive Officer

COMFORT SYSTEMS USA, INC.

By: /s/ WILLIAM F. MURDY

William F. Murdy
Chief Executive Officer

EMPLOYEE:

/s/ WILLIAM GEORGE

William George

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QuickLinks

[Exhibit 10.8](#)

[EMPLOYMENT AGREEMENT](#)

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (this "Agreement") between COMFORT SYSTEMS USA, INC., a Delaware corporation (referred to herein individually as "Comfort" and collectively with its subsidiaries and affiliates as the "Company"), and Thomas Tanner ("Executive") is entered into and effective as of the 1st day of January, 2004. This Agreement supersedes any other employment agreements or understandings, written or oral, between the Company and Executive.

RECITALS

The following statements are true and correct:

As of the date of this Agreement, the Company is engaged in the business of mechanical contracting services, including heating, ventilation and air conditioning, plumbing, piping, electrical and related services ("Services").

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

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

AGREEMENTS

1. *Employment and Duties.*

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

(b) Executive shall faithfully adhere to, execute and fulfill all lawful policies established by the Company, including the Company's Corporate Compliance Policy.

(c) Executive shall not, during the term of Executive's employment hereunder, be engaged in any other business activity pursued for gain, profit or other pecuniary advantage if such activity interferes in any material respect with Executive's duties and responsibilities hereunder. The foregoing limitations shall not be construed as prohibiting Executive from making personal investments in such form or manner as will neither require Executive's services in the operation or affairs of the companies or enterprises in which such investments are made nor violate the terms of Section 4 hereof.

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

(a) *Base Salary.* Effective the date hereof, the base salary payable to Executive shall be \$195,000 per year, payable on a regular basis in accordance with the Company's standard payroll procedures, but not less often than monthly.

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

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

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

3. *Confidentiality.*

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

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

4. *Non-Competition Agreement.*

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

(i) engage, as an officer, director, shareholder, owner, partner, joint venturer, or in a managerial capacity, whether as an employee, independent contractor, consultant or advisor, or as a sales representative, or make or guarantee loans or invest in or for any business engaged in Services in competition with the Company within 100 miles of where the Company conducts or has conducted business during the Term (the "Territory");

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

(iii) call upon any person or entity which is, at that time, or which has been, within two (2) years prior to that time, a customer of the Company for the purpose of soliciting or selling Services;

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

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

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

5. *Term; Termination; Rights on Termination.* The term of this Agreement shall begin on the date hereof and continue for two (2) (the "Term"), unless terminated sooner as herein provided. Beginning on the second anniversary and thereafter on each anniversary this Agreement shall renew for consecutive one-year terms unless either party shall give the other notice at least 30 days prior to such anniversary. This Agreement and Executive's employment may be terminated in any one of the following ways:

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

(b) *Disability.* If, as a result of incapacity due to physical or mental illness or injury, Executive shall have been absent from Executive's full-time duties hereunder for four (4) consecutive months, then thirty (30) days after receiving written notice (which notice may occur before or after the end of such four (4) month period, but which shall not be effective earlier than the last day of such four (4) month period), the Company may terminate Executive's employment hereunder, provided Executive is unable to resume Executive's full-time duties at the conclusion of such notice period. In the event this Agreement is terminated as a result of Executive's disability, Executive shall receive from the Company Executive's base salary at the rate then in effect for the lesser of the time period remaining under the Term of this Agreement or for one (1) year, and such amount shall be payable during such period in a manner consistent with Company's standard pay practices. The amount payable hereunder shall be decreased by the amount of benefits otherwise actually paid by the Company to Executive or on Executive's behalf or under any insurance procured by the Company.

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

(d) *Without Cause.* At any time after the commencement of Executive's employment, Executive or the Company may, without cause, terminate this Agreement and Executive's employment, effective thirty (30) days after receipt of written notice. Should Executive be terminated by the Company without cause, Executive shall receive from the Company Executive's base salary at the rate then in effect for one (1) year, and such amount shall be payable during such period in a manner consistent with the Company's standard pay practices.

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(e) *Change in Control.* In addition to the foregoing, Company has agreed that it will pay to Executive a bonus equal to one year of base salary within twenty business days of the definitive and final closing of any change of control of Comfort Systems USA, Inc. (a transaction that results in the sale of a majority of the Comfort's voting capital stock or substantially all of Comfort's assets).

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

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

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

9. *No Prior Agreements.* Executive hereby represents and warrants to the Company that the execution of this Agreement by Executive and Executive's employment by the Company and the performance of Executive's duties hereunder will not violate or be a breach of any agreement with a former employer, client or any other person or entity. Further, Executive agrees to indemnify the Company for any claim, including, but not limited to, attorneys' fees and expenses of investigation, by any such third party that such third party may now have or may hereafter come to have against the Company based upon or arising out of any non-competition agreement, invention or secrecy agreement between Executive and such third party which was in existence as of the date of this Agreement.

10. *Assignment; Binding Effect.* Executive understands that Executive has been selected for employment by the Company on the basis of Executive's personal qualifications, experience and skills. Executive agrees, therefore, that Executive cannot assign all or any portion of Executive's performance under this Agreement. Executive, Executive's spouse and the estates of each shall not have any right to encumber or dispose of any right to receive payments hereunder, it being understood that such payments and the right thereto are nonassignable and nontransferable; provided, however in the event of the death of Executive, any payments that Executive is entitled to receive may be assigned to the beneficiaries of Executive's estate. Subject to the preceding three (3) sentences and the express provisions of Section 11 below, this Agreement shall be binding upon, inure to the benefit of and be enforceable by the parties hereto and their respective heirs, legal representatives, successors and assigns.

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

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

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

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

To Executive: Thomas Tanner
6862 Claret Circle
Fayetteville, NY 13066

Notice shall be deemed given and effective on the earlier of five (5) days after the deposit in the U.S. mail of a writing addressed as above and sent first class mail, certified, return receipt requested, or when actually received. Either party may change the address for notice by notifying the other party of such change in accordance with this Section 13.

14. *Severability; Enforceability.* If any portion of this Agreement is held invalid or inoperative, the other portions of this Agreement shall be deemed valid and operative and, so far as is reasonable and possible, effect shall be given to the intent manifested by the portion held invalid or inoperative. Moreover, in the event any court of competent jurisdiction shall determine that the scope, time or territorial restrictions set forth in any covenant contained herein are unreasonable, then it is the intention of the parties that such restrictions be enforced to the fullest extent which the court deems reasonable, and this Agreement shall thereby be reformed. Each of the covenants contained in this Agreement shall be construed as an agreement independent of any other provision in this Agreement, and the existence of any claim or cause of action of Executive against the Company, whether predicated on this Agreement or otherwise, shall not constitute a defense to the enforcement by the Company of such covenants.

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

16. *Specific Performance.* Because of the difficulty of measuring economic losses to the Company as a result of a breach of the covenants contained in Sections 3, 4, 6, 7 and 8 and because of the immediate and irreparable damage that could be caused to the Company for which it would have no other adequate remedy, Executive agrees that the Company shall be entitled to specific performance and that such covenants may be enforced by the Company in the event of any breach or threatened breach by Executive, by injunctions, restraining orders and other appropriate equitable relief. Executive further agrees to waive any requirement for the securing or posting of any bond in excess of \$50,000 in connection with the obtaining of any such injunctive or any other equitable relief.

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17. *Arbitration.* With the exception of Sections 4 and 8, any unresolved dispute or controversy arising under or in connection with this Agreement shall be settled exclusively by arbitration, conducted by a single arbitrator in Houston, Texas, in accordance with the National Rules for the Resolution of Employment Disputes of the American Arbitration Association ("AAA") then in effect, provided that the parties may agree to use arbitrators other than those provided by the AAA. The arbitrators shall not have the authority to add to, detract from, or modify any provision hereof nor to award punitive damages to any injured party. The arbitrators shall have the authority to order back pay, severance compensation, reimbursement of costs, including those incurred to enforce this Agreement, and interest thereon. A decision by the arbitrator shall be final and binding. Judgment may be entered on the arbitrator's award in any court having jurisdiction. Responsibility for bearing the cost of the arbitration shall be determined by the arbitrator and shall be proportional to the arbitrator's decision on the merits.

18. *Attorney's Fees.* If any litigation is instituted to enforce or interpret the provisions of this Agreement or the transactions described herein, the prevailing party in such action shall be entitled to recover such party's reasonable attorneys' fees and other costs from the other party hereto.

19. *Governing Law.* This Agreement shall be governed by and construed in accordance with the internal laws of the State of Texas.

20. *Counterparts.* This Agreement may be executed in multiple counterparts, each of which shall be deemed to be an original and all of which together shall constitute one and the same instrument.

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

EXECUTIVE:

COMPANY:

/s/ THOMAS TANNER

/s/ WILLIAM MURDY

Thomas Tanner

William Murdy
Chief Executive Officer

QuickLinks

[Exhibit 10.10](#)

[EMPLOYMENT AGREEMENT](#)

**AMENDMENT NO. 1 TO STOCK PURCHASE
WARRANT AND REPURCHASE AGREEMENT**

This Amendment No. 1 to Stock Purchase Warrant and Repurchase Agreement, dated as of December 31, 2003 (this "*Amendment*"), is entered into by and among Comfort Systems USA, Inc., a Delaware corporation ("*Company*") and General Electric Capital Corporation ("*Holder*").

RECITALS

WHEREAS, Company and Holder are parties to that certain Stock Purchase Warrant and Repurchase Agreement, dated as of October 11, 2002 (the "*Warrant Agreement*");

WHEREAS, Company and Holder are desirous of amending the Warrant Agreement to the extent set forth herein and subject to the terms and conditions set forth herein; and

WHEREAS, these Recitals shall be construed as part of this Amendment;

NOW THEREFORE, in consideration of the premises and the mutual covenants hereinafter contained, and for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged by the parties, Agent and Holder hereby agree as follows:

1. *Definitions.* Except to the extent otherwise specified herein, capitalized terms used in this Amendment shall have the same meanings ascribed to them in the Warrant Agreement.

2. *Amendment.* The Warrant Agreement is amended as follows:

2.1. Clause (i) of Section 6 of the Warrant Agreement is hereby amended and restated in its entirety as follows:

"(i) At any time during the period commencing on the earliest to occur of (a) the consummation of a Qualifying Public Offering or (b) a Change of Control (each, a "*Trigger Event*") and ending on the fifth anniversary of the Date of Issuance, the Holder will have the right to cause the Company to repurchase (the "*Put*") all or any portion of the Holder's shares of Underlying Warrant Stock then in existence by delivering written notice (the "*Put Notice*") to the Company. The date on which the Company receives a Put Notice hereinafter is referred to as a "*Delivery Date*.""

3. *Reference to and Effect Upon the Warrant Agreement.*

3.1. Except for the specific amendment set forth in Section 2 above, the Warrant Agreement shall remain in full force and effect and is hereby ratified and confirmed in all respects.

3.2. Each reference in the Warrant Agreement to "this Agreement", "hereunder", "hereof", "herein" or any other word or words of similar import shall mean and be a reference to the Warrant Agreement as modified hereby.

4. *Counterparts.* This Amendment may be executed in any number of counterparts, each of which when so executed shall be deemed an original but all such counterparts shall constitute one and the same instrument. Delivery of an executed counterpart of a signature page to this Amendment by telecopier shall be as effective as delivery of a manually executed counterpart signature page to this Amendment.

5. *GOVERNING LAW.* THIS AMENDMENT SHALL BE GOVERNED BY AND CONSTRUED AND ENFORCED IN ACCORDANCE WITH THE INTERNAL LAWS (AS OPPOSED TO CONFLICTS OF LAW PROVISIONS) OF THE STATE OF NEW YORK.

6. *Headings.* Section headings in this Amendment are included herein for convenience of reference only and shall not constitute a part of this Amendment for any other purpose.

[Signature Pages Follow]

IN WITNESS WHEREOF, this Amendment has been duly executed as of the date first written above.

COMPANY:

COMFORT SYSTEMS USA, INC.

By: /s/ J. GORDON BEITTENMILLER

Name: J. Gordon Beittenmiller
Title: Executive Vice President and Chief Financial Officer

HOLDER:

GENERAL ELECTRIC CAPITAL CORPORATION

By: /s/ SUSAN K. STAUB

QuickLinks

[Exhibit 10.15](#)

[AMENDMENT NO. 1 TO STOCK PURCHASE WARRANT AND REPURCHASE AGREEMENT](#)

AMENDED AND RESTATED CREDIT AGREEMENT

by and among

COMFORT SYSTEMS USA, INC.,

as Borrower

and

BANK OF TEXAS NA,

as Administrative Agent

HIBERNIA NATIONAL BANK,

as Documentation Agent

HIBERNIA SOUTHCOAST CAPITAL, INC.,

as Arranger

and

CERTAIN FINANCIAL INSTITUTIONS

as Lenders

\$50,000,000

December 31, 2003

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AMENDED AND RESTATED CREDIT AGREEMENT

THIS AMENDED AND RESTATED CREDIT AGREEMENT is made as of December 31, 2003, by and among COMFORT SYSTEMS USA, INC., Delaware corporation ("Borrower"); BANK OF TEXAS NA, individually and as Administrative Agent ("Administrative Agent"); HIBERNIA NATIONAL BANK, as Documentation Agent; and the Lenders referred to below.

WITNESSETH:

In consideration of the mutual covenants and agreements contained herein in consideration of the loans which may hereafter be made by Lenders and the Letters of Credit which may be made available by LC Issuer to Borrower, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto do hereby agree as follows:

ARTICLE I—Definitions and References

Section 1.1. *Defined Terms.* As used in this Agreement, each of the following terms has the meaning given to such term in this Section 1.1 or in the sections and subsections referred to below:

"*Account Debtor*" means the Person which is obligated on any Receivable.

"*Adjusted Base Rate*" means, on any day, the Base Rate for such day plus the Base Rate Margin for such day, provided that the Adjusted Base Rate charged by any Person shall never exceed the Highest Lawful Rate.

"*Adjusted Borrowing Base*" means the Borrowing Base plus the face amount of all outstanding Letters of Credit.

"*Adjusted Eurodollar Rate*" means, for any Eurodollar Loan for any day during any Interest Period therefor, the rate per annum equal to the sum of (a) the Eurodollar Margin for such day plus (b) the rate per annum (rounded upwards, if necessary, to the nearest 1/100 of 1%) determined by Administrative Agent to be equal to the quotient obtained by dividing (i) the Eurodollar Rate for such Eurodollar Loan for such Interest Period by (ii) 1 minus the Reserve Requirement for such Eurodollar Loan for such Interest Period, provided that no Adjusted Eurodollar Rate charged by any Person shall ever exceed the Highest Lawful Rate. The Adjusted Eurodollar Rate for any Eurodollar Loan shall change whenever the Eurodollar Margin or the Reserve Requirement changes.

"*Administrative Agent*" means Bank of Texas NA, as Administrative Agent hereunder, and its successors in such capacity.

"*Affiliate*" means, as to any Person, each other Person that directly or indirectly (through one or more intermediaries or otherwise) controls, is controlled by, or is under common control with, such Person. A Person shall be deemed to be "controlled by" any other Person if such other Person possesses, directly or indirectly, power

(a) to vote 20% or more of the securities or other equity interests (on a fully diluted basis) having ordinary voting power for the election of directors, the managing general partner or partners or the managing member or members; or

(b) to direct or cause the direction of the management and policies of such Person whether by contract or otherwise.

"*Aggregate Commitment*" means the aggregate of all Lenders' Revolving Loan Commitments and Term Loan Commitments, as such Commitments may be reduced, amortized or adjusted from time to time in accordance with this Agreement.

"*Agreement*" means this Amended and Restated Credit Agreement.

"*Air Solutions*" means Air Solutions USA, Inc. a Delaware corporation.

"*Applicable Lending Office*" means, with respect to each Lender, such Lender's Domestic Lending Office in the case of Base Rate Loans and such Lender's Eurodollar Lending Office in the case of Eurodollar Loans.

"*Arranger*" means Hibernia Southcoast Capital, Inc., a Louisiana corporation.

"*Asset Disposition*" means the disposition whether by sale, lease, transfer, loss, damage, destruction, casualty, condemnation or otherwise of any of the following: (a) any of the Equity or ownership interest of any Subsidiary of Borrower; or (b) any or all of the assets of Borrower or any of its Subsidiaries other than sales of inventory in the ordinary course of business.

"Assignment and Acceptance" means the agreement contemplated by Section 10.5.

"Assignment of Prior Credit Documents" means (i) the Assignment Agreements each dated as of the Closing Date and executed by General Electric Capital Corporation and Regions Bank,; and (ii) the Assignment of Liens and Resignation and Appointment of Agent, L/C Issuer and Swing Line Lender, each dated as of the Closing Date and executed by General Electric Capital Corporation, as agent under the Prior Credit Agreement and each of the lenders thereto in favor of Administrative Agent and the other Lender Parties.

"Base Rate" means, for any day, the rate per annum equal to the higher of (a) the Federal Funds Rate for such day plus one-half of one percent (.5%) and (b) the Prime Rate for such day. Any change in the Base Rate due to a change in the Prime Rate or the Federal Funds Rate shall be effective on the effective date of such change in the Prime Rate or Federal Funds Rate. As used in this definition, "Prime Rate" means the per annum rate of interest established from time to time by Citibank, N.A. as its prime rate, which rate may not be the lowest rate of interest charged by Citibank, N.A. to its customers.

"Base Rate Loan" means a Loan that bears interest at the Adjusted Base Rate.

"Base Rate Margin" means on any date, with respect to each Base Rate Loan, the rate per annum set forth as such on the Pricing Schedule.

"Basis Point" or "bps" means one one-hundredth of one percent (0.01%).

"Bonded Receivables" means any Receivable resulting from goods or services provided to an Account Debtor under a job which is covered by a surety bond provided by Borrower or its agent, that is secured by assets of any Restricted Person.

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

"Borrowing" means a borrowing of new Loans of a single Type (and, in the case of Eurodollar Loans, with the same Interest Period) pursuant to Section 2.2 or a Continuation or Conversion of existing Loans into a single Type (and, in the case of Eurodollar Loans, with the same Interest Period) pursuant to Section 2.3.

"Borrowing Base" means, at any time of its determination, the lesser of (a) the aggregate Revolving Loan Commitments of the Lender Parties and (b) an amount equal to (i) sixty percent 60% of Eligible Receivables, less (ii) the face amount of all outstanding Letters of Credit; less (iii) the current outstanding principal amount of the Term Loan.

"Borrowing Base Certificate" means a report in the form attached hereto as Exhibit 2.8, appropriately completed, together with the following attachments: an aging schedule of all trade Receivables of Borrower on a Consolidated basis as of the date specified in such report, in summary form, which reflects aging, on an aggregate basis, of such trade Receivables.

"Borrowing Base Deficiency" has the meaning given to such term in Section 2.7(b).

"Borrowing Notice" means a written or telephonic request, or a written confirmation, made by Borrower which meets the requirements of Section 2.2.

"Business Day" means a day, other than a Saturday or Sunday, on which commercial banks are open for business with the public in Houston, Harris County, Texas. Any Business Day in any way relating to Eurodollar Loans (such as the day on which an Interest Period begins or ends) must also be a day on which, in the judgment of Administrative Agent, significant transactions in dollars are carried out in the interbank eurocurrency market.

"Capital Lease" means a lease with respect to which the lessee is required concurrently to recognize the acquisition of an asset and the incurrence of a liability in accordance with GAAP.

"Capital Lease Obligation" means, with respect to any Person and a Capital Lease, the amount of the obligation of such Person as the lessee under such Capital Lease which would, in accordance with GAAP, appear as a liability on a balance sheet of such Person.

"Cash Equivalents" means Investments in:

- (a) marketable obligations, maturing within twelve months after acquisition thereof, issued or unconditionally guaranteed by the United States of America or an instrumentality or agency thereof and entitled to the full faith and credit of the United States of America;
- (b) demand deposits, and time deposits (including certificates of deposit) maturing within twelve months from the date of deposit thereof, with any office of any Lender or with a domestic office of any national or state bank or trust company which is organized under the Laws of the United States of America or any state therein, which has capital, surplus and undivided profits of at least \$500,000,000, and whose long term certificates of deposit are rated at least Aa3 by Moody's or AA- by S & P;
- (c) repurchase obligations with a term of not more than seven days for underlying securities of the types described in subsection (a) above entered into with any commercial bank meeting the specifications of subsection (b) above;
- (d) open market commercial paper, maturing within 270 days after acquisition thereof, which are rated at least P-1 by Moody's or A-1 by S & P; and
- (e) money market or other mutual funds substantially all of whose assets comprise securities of the types described in subsections (a) through (d) above.

"Change of Control" means the occurrence of any of the following events: (a) any Person or two or more Persons acting as a group shall acquire beneficial ownership (within the meaning of Rule 13d-3 of the Securities and Exchange Commission under the Securities Act of 1934, as amended, and including holding proxies to vote for the election of directors other than proxies held by Borrower's management or their designees to be voted in favor of Persons nominated by Borrower's Board of Directors) of 35% or more of the outstanding voting securities of Borrower, measured by voting power (including both common stock and any preferred stock or other equity securities entitling the holders thereof to vote with the holders of common stock in elections for directors of Borrower) or (b) a

majority of the directors of Borrower shall consist of Persons not nominated by Borrower's Board of Directors (not including as Board nominees any directors which the Board is obligated to nominate pursuant to shareholders agreements, voting trust arrangements or similar arrangements).

"*Clean-up Period*" means the period of ten (10) consecutive Business Days during which Borrower is in compliance with Section 6.17.

"*Closing Date*" means the date on which all of the conditions precedent set forth in Section 4.1 and Section 4.2 shall have been satisfied or waived.

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"*Collateral*" means all property of any Restricted Person of any kind which, under the terms of any Security Document, is subject to or is purported to be subject to a Lien in favor of Lenders (or in favor of Administrative Agent for the benefit of Lenders).

"*Commitment*" means, for each Lender, its Term Loan Commitment and its Revolving Loan Commitment.

"*Commitment Fee*" shall have the meaning set forth in Section 2.5(c).

"*Commitment Fee Rate*" means, on any date, the rate per annum designated as such and set forth on the Pricing Schedule.

"*Commitment Period*" means the period from and including the Closing Date until the Maturity Date (or, if earlier, the day on which the obligations of Lenders to make Loans hereunder or the obligations of LC Issuer to issue Letters of Credit have been terminated or the Notes become due and payable in full).

"*Consolidated*" refers to the consolidation of any Person, in accordance with GAAP, with its properly consolidated subsidiaries. References herein to a Person's Consolidated financial statements, financial position, financial condition, liabilities, etc. refer to the consolidated financial statements, financial position, financial condition, liabilities, etc. of such Person and its properly consolidated subsidiaries.

"*Consolidated EBITDA*" means, for any Person for any period, the sum of (a) such Person's Consolidated Net Income during such period, plus (b) all interest expense which was deducted in determining such Person's Consolidated Net Income; plus (c) all income taxes which were deducted in determining such Person's Consolidated Net Income; plus (d) all depreciation and amortization which were deducted in determining such Person's Consolidated Net Income; plus (e) other non-cash charges, including non-cash amortization of debt incurrence costs and net mark-to-market losses. Notwithstanding the forgoing, Borrower and Lenders hereby stipulate that Consolidated EBITDA for (i) the Fiscal Quarter ended March 31, 2003 was <\$2,843,000>; (ii) the Fiscal Quarter ended June 30, 2003 was \$5,730,000; and (iii) the Fiscal Quarter ended September 30, 2003 was \$8,032,000. Beginning with the Fiscal Quarter ending December 31, 2003 and for each subsequent Fiscal Quarter thereafter, Consolidated EBITDA will be determined in accordance with the definition above.

"*Consolidated Interest Expense*" means, for any Person, for any period without duplication, all interest paid or accrued during such period on Indebtedness (including capital lease obligations) excluding amortization of debt incurrence expenses, original issue discount, and mark-to-market interest expense.

"*Consolidated Net Income*" means, for any Person, for any period, such Person's Consolidated net income for such period after eliminating earnings or losses attributable to outstanding minority interests and excluding the net income of any Person other than a Subsidiary in which such Person has an ownership interest plus any Goodwill Impairment Charges.

"*Consolidated Tangible Net Worth*" means, for any Person, at any time, (a) all Consolidated assets of such Person which would be shown on its Consolidated balance sheet prepared as of such time in accordance with GAAP, other than intangible assets (including patents, copyrights, licenses, franchises, goodwill, trade names, trade secrets and operating leases), minus (b) the sum of (i) all amounts which would be shown on such balance sheet as minority interests in any Subsidiaries of such Person, and (ii) all Consolidated Liabilities of such Person which would be shown on such balance sheet, adjusted by treating as Liabilities rather than equity all capital stock and other equity securities which such Person would be required to purchase, redeem or otherwise acquire at the election of any holder thereof, upon the passage of time, or upon the occurrence of any contingency (other than the voluntary election of such Person to make such purchase, redemption or acquisition).

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"*Consolidated Total Indebtedness*" means, for any Person, as of any date, the sum of the following (without duplication): (a) all Indebtedness which is classified as "long-term indebtedness" on a Consolidated balance sheet of such Person and its Consolidated Subsidiaries prepared as of such date in accordance with GAAP and any current maturities and other principal amount in respect of such Indebtedness due within one year but which was classified as "long-term indebtedness" at the creation thereof, (b) Indebtedness for borrowed money of such Person and its Consolidated Subsidiaries outstanding under a revolving credit or similar agreement providing for borrowings (and renewals and extensions thereof) over a period of more than one year, notwithstanding the fact that any such borrowing is made within one year of the expiration of such agreement, and (c) all Indebtedness in respect of Capital Leases of such Person and its Consolidated Subsidiaries.

"*Continuation*" shall refer to the continuation pursuant to Section 2.3 hereof of a Eurodollar Loan as a Eurodollar Loan from one Interest Period to the next Interest Period.

"*Continuation/Conversion Notice*" means a written or telephonic request, or a written confirmation, made by Borrower which meets the requirements of Section 2.3.

"*Conversion*" shall refer to a conversion pursuant to Section 2.3 or Article III of one Type of Loan into another Type of Loan.

"*Default*" means any Event of Default and any default, event or condition which would, with the giving of any requisite notices and the passage of any requisite periods of time, constitute an Event of Default.

"*Default Rate*" means, at the time in question (a) with respect to any Base Rate Loan any other Obligation except as described in the immediately following clause (b), the rate per annum equal to four percent (4%) above the Adjusted Base Rate then in effect for such Loan or other Obligation and (b) with respect to

any Eurodollar Loan, the rate per annum equal to four percent (4%) above the Adjusted Eurodollar Rate then in effect for such Loan or other Obligation, provided in each case that no Default Rate charged by any Person shall ever exceed the Highest Lawful Rate.

"*Disclosure Schedule*" means Schedule 5 hereto.

"*Distribution*" means (a) any dividend or other distribution made by a Restricted Person on or in respect of any stock, partnership interest, or other equity interest in such Restricted Person or any other Restricted Person (including any option or warrant to buy such an equity interest), or (b) any payment made by a Restricted Person to purchase, redeem, acquire or retire any stock, partnership interest, or other equity interest in such Restricted Person or any other Restricted Person (including any such option or warrant).

"*Domestic Lending Office*" means, with respect to any Lender, the office of such Lender specified as its "Domestic Lending Office" below its name on the signature pages hereto, or such other office as such Lender may from time to time specify to Borrower and Administrative Agent; with respect to LC Issuer, the office, branch, or agency through which it issues Letters of Credit; and, with respect to Administrative Agent, the office, branch, or agency through which it administers this Agreement.

"*Eligible Receivables*" means all trade Receivables less any Bonded Receivables and (ii) less reserves or allowances for doubtful accounts.

"*Eligible Transferee*" means a Person which either (a) is a Lender or an Affiliate of a Lender, or (b) is consented to as an Eligible Transferee by Administrative Agent and, so long as no Default or Event of Default is continuing, by Borrower, which consents in each case will not be unreasonably withheld (provided that no Person organized outside the United States may be an Eligible Transferee if Borrower would be required to pay withholding taxes on interest or principal owed to such Person).

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"*Environmental Laws*" means any and all Laws relating to the environment or to emissions, discharges, releases or threatened releases of pollutants, contaminants, chemicals, or industrial, toxic or hazardous substances or wastes into the environment including ambient air, surface water, ground water, or land, or otherwise relating to the manufacture, processing, distribution, use, treatment, storage, disposal, transport, or handling of pollutants, contaminants, chemicals, or industrial, toxic or hazardous substances or wastes.

"*Equity*" means shares of capital stock or a partnership, profits, capital, member or other equity interest, or options, warrants or any other rights to substitute for or otherwise acquire the capital stock or a partnership, profits, capital, member or other equity interest of any Person.

"*ERISA*" means the Employee Retirement Income Security Act of 1974, as amended from time to time, and any successor statutes or statute, together with all rules and regulations promulgated with respect thereto.

"*ERISA Affiliate*" means each Restricted Person and all members of a controlled group of corporations and all trades or businesses (whether or not incorporated) under common control that, together with such Restricted Person, are treated as a single employer under Section 414 of the Internal Revenue Code.

"*ERISA Plan*" means any employee pension benefit plan subject to Title IV of ERISA maintained by any ERISA Affiliate with respect to which any Restricted Person has a fixed or contingent liability.

"*Eurodollar Lending Office*" means, with respect to any Lender, the office of such Lender specified as its "Eurodollar Lending Office" below its name on the signature pages hereto (or, if no such office is specified, its Domestic Lending Office), or such other office of such Lender as such Lender may from time to time specify to Borrower and Administrative Agent.

"*Eurodollar Loan*" means a Loan that bears interest at the Adjusted Eurodollar Rate.

"*Eurodollar Margin*" means, on any date, with respect to each Eurodollar Loan, the rate per annum set forth on the Pricing Schedule.

"*Eurodollar Rate*" means, for any Eurodollar Loan within a Borrowing and with respect to the related Interest Period therefor, (a) the interest rate per annum (carried out to the fifth decimal place) equal to the rate determined by the Administrative Agent to be the offered rate that appears on the page of the Telerate Screen that displays an average British Bankers Association Interest Settlement Rate (such page currently being page number 3750) for deposits in U.S. dollars (for delivery on the first day of such Interest Period) with a term equivalent to such Interest Period, determined as of approximately 11:00 a.m. (London time) two Business Days prior to the first day of such Interest Period, or (b) in the event the rate referenced in the preceding subsection (a) does not appear on such page or service or such page or service shall cease to be available, the rate per annum (carried out to the fifth decimal place) equal to the rate determined by the Administrative Agent to be the offered rate on such other page or other service that displays an average British Bankers Association Interest Settlement Rate for deposits in U.S. dollars (for delivery on the first day of such Interest Period) with a term equivalent to such Interest Period, determined as of approximately 11:00 a.m. (London time) two Business Days prior to the first day of such Interest Period, or (c) in the event the rates referenced in the preceding subsections (a) and (b) are not available, the rate per annum determined by the Administrative Agent as the rate of interest at which deposits in U.S. dollars (for delivery on the first day of such Interest Period) in same day funds in the approximate amount of the applicable Eurodollar Loan and with a term equivalent to such Interest Period would be offered by its London branch to major banks in the offshore U.S. dollar market at their request at approximately 11:00 a.m. (London time) two Business Days prior to the first day of such Interest Period.

"*Event of Default*" has the meaning given to such term in Section 8.1.

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"*Federal Funds Rate*" means, for any day, the rate per annum (rounded upwards, if necessary, to the nearest 1/100th of one percent) equal to the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers on such day, as published by the Federal Reserve Bank of New York on the Business Day next succeeding such day, provided that (a) if the day for which such rate is to be determined is not a Business Day, the Federal Funds Rate for such day shall be such rate on such transactions on the next preceding Business Day as so published

on the next succeeding Business Day, and (b) if such rate is not so published for any day, the Federal Funds Rate for such day shall be the average rate quoted to Administrative Agent on such day on such transactions as determined by Administrative Agent.

"*Fiscal Quarter*" means a three-month period ending on March 31, June 30, September 30 or December 31 of any year.

"*Fiscal Year*" means a twelve-month period ending on December 31 of any year.

"*GAAP*" means those generally accepted accounting principles and practices which are recognized as such by the Financial Accounting Standards Board (or any generally recognized successor) and which, in the case of Restricted Persons and their Consolidated Subsidiaries, are applied for all periods after the date hereof in a manner consistent with the manner in which such principles and practices were applied to the Initial Financial Statements. If any change in any accounting principle or practice is required by the Financial Accounting Standards Board (or any such successor) in order for such principle or practice to continue as a generally accepted accounting principle or practice, all reports and financial statements required hereunder with respect to any Restricted Person or with respect to any Restricted Person and its Consolidated Subsidiaries may be prepared in accordance with such change, but all calculations and determinations to be made hereunder may be made in accordance with such change only after notice of such change is given to each Lender, and Required Lenders and Administrative Agent agree to such change insofar as it affects the accounting of such Restricted Person and its Consolidated Subsidiaries.

"*Goodwill Impairment Charges*" means accounting charges resulting from the write-up or write-down of acquired goodwill and other intangible assets in accordance with FAS 142.

"*Guarantor*" means any Person who has guaranteed some or all of the Obligations pursuant to a Guaranty listed on Schedule 4.1 or any other Person who has guaranteed some or all of the Obligations and who has been accepted by Administrative Agent as a Guarantor or any Subsidiary of Borrower which now or hereafter executes and delivers a Guaranty to Administrative Agent pursuant to Section 6.15.

"*Guaranty*" means that certain Amended and Restated Guaranty dated of even date herewith, executed by each Guarantor in favor of the Administrative Agent, for the ratable benefit of the Lenders, as it may be amended or modified and in effect from time to time.

"*Hazardous Materials*" means any substances regulated under any Environmental Law, whether as pollutants, contaminants, or chemicals, or as industrial, toxic or hazardous substances or wastes, or otherwise.

"*Hedging Contract*" means (a) any agreement providing for options, swaps, floors, caps, collars, forward sales or forward purchases involving interest rates, commodities or commodity prices, equities, currencies, bonds, or indexes based on any of the foregoing, (b) any option, futures or forward contract traded on an exchange, and (c) any other derivative agreement or other similar agreement or arrangement.

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"*Highest Lawful Rate*" means, with respect to each Lender Party to whom Obligations are owed, the maximum nonusurious rate of interest that such Lender Party is permitted under applicable Law to contract for, take, charge, or receive with respect to such Obligations. All determinations herein of the Highest Lawful Rate, or of any interest rate determined by reference to the Highest Lawful Rate, shall be made separately for each Lender Party as appropriate to assure that the Loan Documents are not construed to obligate any Person to pay interest to any Lender Party at a rate in excess of the Highest Lawful Rate applicable to such Lender Party.

"*Immaterial Subsidiary*" means one or more Subsidiaries with aggregate gross assets of less than \$250,000.

"*Indebtedness*" of any Person means obligations in any of the following categories:

- (a) debt for borrowed money;
- (b) an obligation to pay the deferred purchase price of property or services;
- (c) obligations evidenced by a bond, debenture, note or similar instrument;
- (d) Off-Balance Sheet Liabilities;
- (e) obligations arising under Hedging Contracts (on a net basis to the extent netting is provided for in the applicable Hedging Contract);
- (f) Capital Lease Obligations;
- (g) obligations arising under conditional sales or other title retention agreements;
- (h) obligations owing under direct or indirect guaranties of Indebtedness of any other Person or otherwise constituting obligations to purchase or acquire or to otherwise protect or insure a creditor against loss in respect of Indebtedness of any other Person (such as obligations under working capital maintenance agreements, agreements to keep-well, or agreements to purchase Indebtedness, assets, goods, securities or services), but excluding endorsements in the ordinary course of business of negotiable instruments in the course of collection;
- (i) obligations to purchase or redeem securities or other property, if such obligations arise out of or in connection with the sale or issuance of the same or similar securities or property (for example, repurchase agreements, mandatorily redeemable preferred stock and sale/leaseback agreements);
- (j) obligations with respect to letters of credit or applications or reimbursement agreements therefore; or
- (k) obligations with respect to banker's acceptances.

provided, however, that the "Indebtedness" of any Person shall not include obligations that were incurred by such Person to vendors, suppliers, or other Persons providing goods and services for use by such Person in the ordinary course of its business.

"*Indemnity Agreement*" means that certain Underwriting, Indemnity, and Security Agreement dated October 23, 2003 among Borrower, the other Restricted Persons and the Surety.

"*Initial Financial Statements*" means (a) the audited annual Consolidated financial statements of Borrower dated as of December 31, 2002, and (b) the unaudited quarterly Consolidated financial statements of Borrower dated as of September 30, 2003.

"*Intercreditor Agreement*" means that certain Intercreditor Agreement dated October 23, 2003 between the Surety and the Prior Agent.

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"*Interest Payment Date*" means (a) with respect to each Base Rate Loan, the first Business Day of each Fiscal Quarter; and (b) with respect to each Eurodollar Loan, the last day of the Interest Period that is applicable thereto and, if such Interest Period is greater than three months in length, than the first Business Day of each Fiscal Quarter shall also be an Interest Payment Date for each such Eurodollar Loan.

"*Interest Period*" means, with respect to each Eurodollar Loan, the period specified in the Borrowing Notice or Continuation/Conversion Notice applicable to such Eurodollar Loan, beginning on and including the date specified in such Borrowing Notice or Continuation/Conversion Notice (which must be a Business Day), and ending one, two, three, and six months thereafter, as Borrower may elect in such notice; provided that: (a) any Interest Period which would otherwise end on a day which is not a Business Day shall be extended to the next succeeding Business Day unless such Business Day falls in another calendar month, in which case such Interest Period shall end on the next preceding Business Day; (b) any Interest Period which begins on the last Business Day in a calendar month (or on a day for which there is no numerically corresponding day in the calendar month at the end of such Interest Period) shall end on the last Business Day in a calendar month; and (c) notwithstanding the foregoing, any Interest Period which would otherwise end after the last day of the Commitment Period shall end on the last day of the Commitment Period (or, if the last day of the Commitment Period is not a Business Day, on the next preceding Business Day).

"*Internal Revenue Code*" means the United States Internal Revenue Code of 1986, as amended from time to time and any successor statute or statutes, together with all rules and regulations promulgated with respect thereto.

"*Investment*" means any investment, made directly or indirectly, in any Person, whether by purchase, acquisition of equity interests, indebtedness or other obligations or securities or by extension of credit, loan, advance, capital contribution or otherwise and whether made in cash, by the transfer of property, or by any other means.

"*Law*" means any statute, law, regulation, ordinance, rule, treaty, judgment, order, decree, permit, concession, franchise, license, agreement or other governmental restriction of the United States or any state or political subdivision thereof or of any foreign country or any department, province or other political subdivision thereof. Any reference to a Law includes any amendment or modification to such Law, and all regulations, rulings, and other Laws promulgated under such Law.

"*LC Application*" means any application for a Letter of Credit hereafter made by Borrower to LC Issuer.

"*LC Collateral*" has the meaning given to such term in Section 2.14(a).

"*LC Conditions*" has the meaning given to such term in Section 2.10.

"*LC Issuer*" means Hibernia National Bank in its capacity as the issuer of Letters of Credit hereunder, and its successors in such capacity. Administrative Agent may, with the consent of Borrower and the Lender in question, appoint any Lender hereunder as an LC Issuer in place of or in addition to Hibernia National Bank.

"*LC Obligations*" means, at the time in question, the sum of all Matured LC Obligations plus the maximum amounts which LC Issuer might then or thereafter be called upon to advance under all Letters of Credit then outstanding.

"*Lender Hedging Obligations*" means Indebtedness to a Lender Party arising out of any Hedging Contract permitted under Section 7.3.

"*Lender Parties*" means Administrative Agent, Documentation Agent, LC Issuer, and all Lenders.

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"*Lenders*" means each signatory hereto (other than Borrower and any Restricted Person that is a party hereto), including the Term Lenders and the Revolving Lenders, and the successors of each such party as Lender hereunder pursuant to Section 10.5.

"*Lenders Schedule*" means Schedule 3.1 hereto.

"*Letter of Credit*" means any letter of credit issued by LC Issuer hereunder at the application of Borrower.

"*Liabilities*" means, as to any Person, all liabilities that would appear as such on a balance sheet of such Person under GAAP.

"*Lien*" means, with respect to any property or assets, any right or interest therein of a creditor to secure Liabilities owed to it or any other arrangement with such creditor which provides for the payment of such Liabilities out of such property or assets or which allows such creditor to have such Liabilities satisfied out of such property or assets prior to the general creditors of any owner thereof, including any lien, mortgage, security interest, pledge, rights of a vendor under any title retention or conditional sale agreement or lease substantially equivalent thereto, tax lien, mechanic's or materialman's lien, or any other charge or encumbrance for security purposes, whether arising by Law or agreement or otherwise, but excluding any right of offset which arises without agreement in the ordinary course of business.

"*Loan Documents*" means this Agreement, the Notes, the Security Documents, the Letters of Credit, the LC Applications, any Hedging Contract to which Borrower and any Lender are a party, the Intercreditor Agreement and all other agreements, certificates, documents, instruments and writings at any time

delivered in connection herewith or therewith (exclusive of term sheets and commitment letters).

"*Loans*" means the Term Loans and the Revolving Loans as otherwise described in Section 2.1.

"*Margin Stock*" means margin stock, as such term is defined in Regulation U promulgated by the Board of Governors of the Federal Reserve System.

"*Material Adverse Change*" means a material and adverse change, from the state of affairs presented in the Initial Financial Statements or as represented or warranted in any Loan Document, to (a) Borrower's Consolidated financial condition, (b) Borrower's Consolidated business, assets, operations or properties, considered as a whole, (c) Borrower's ability to timely pay the Obligations, or (d) the enforceability of the material terms of any Loan Documents.

"*Matured LC Obligations*" means all amounts paid by LC Issuer on drafts or demands for payment drawn or made under or purported to be made under any Letter of Credit and all other amounts due and owing to LC Issuer under any LC Application for any Letter of Credit, to the extent the same have not been repaid to LC Issuer (with the proceeds of Loans or otherwise).

"*Maturity Date*" means (a) three years from the date hereof in the case of the Revolving Loans; and (b) five years from the date hereof in the case of the Term Loans.

"*Maximum Drawing Amount*" means at the time in question the sum of the maximum amounts which LC Issuer might then or thereafter be called upon to advance under all Letters of Credit which are then outstanding.

"*Moody's*" means Moody's Investors Service, Inc., or its successor.

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"*Net Sales Proceeds*" means cash proceeds received by Borrower or any of its Subsidiaries from any Asset Disposition (including insurance proceeds, awards of condemnation, and payments under notes or other debt securities received in connection with any Asset Disposition), net of (a) the costs of such Asset Disposition (including taxes attributable to such sale, lease or transfer) and (b) amounts applied to repayment of Indebtedness (other than the Obligations) secured by a Lien on the asset or property disposed or required to be repaid in connection with such Asset Disposition.

"*Note(s)*" means the Revolving Notes and the Term Notes.

"*Obligations*" means all indebtedness, liabilities and obligations, whether matured or unmatured, liquidated or unliquidated, primary or secondary, direct or indirect, absolute, fixed or contingent, from time to time owing by any Restricted Person to any Lender Party under or pursuant to any of the Loan Documents, including all LC Obligations and any Lender Hedging Obligations. "Obligation" means any part of the Obligations.

"*Off-Balance Sheet Liability*" of a Person means (a) any repurchase obligation or liability of such Person with respect to accounts or notes receivable sold by such Person, (b) Synthetic Lease Obligations, or (c) any obligation arising with respect to any other transaction which is the functional equivalent of or takes the place of borrowing but which does not constitute a liability on the balance sheets of such Person (but, for the avoidance of doubt, excluding any operating leases other than a Synthetic Lease).

"*Percentage Share*" means, with respect to any Lender (a) when used in Section 2.1, 2.2 or 2.5, in any Borrowing Notice or when no Loans are outstanding hereunder, the percentage set forth opposite such Lender's name on the signature pages hereto, and (b) when used otherwise, the percentage obtained by dividing (i) the sum of the unpaid principal balance of such Lender's Loans at the time in question plus the Matured LC Obligations which such Lender has funded pursuant to Section 2.11(c) plus the portion of the Maximum Drawing Amount which such Lender might be obligated to fund under Section 2.11(c), by (ii) the sum of the aggregate unpaid principal balance of all Loans at such time plus the aggregate amount of LC Obligations outstanding at such time.

"*Permitted Acquisition*" means a transaction which has been approved by the Lenders by which Borrower, a newly formed Subsidiary that is a Restricted Person, or an existing Subsidiary that is a Restricted Person may acquire all or substantially all of the assets (by way of an asset acquisition or Equity acquisition) of any Person.

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"*Permitted Investments*" means:

- (a) Cash Equivalents;
- (b) existing Investments described in the Disclosure Schedule;
- (c) extensions of credit by Restricted Persons to their customers for buying goods and services in the ordinary course of business or to another Restricted Person in the ordinary course of business;
- (d) extensions of credit among Restricted Persons which are subordinated to the Obligations upon terms and conditions satisfactory to Required Lenders and Managing Agents in their sole and absolute discretion; and
- (e) Investments not described in subsections (a) through (d) above which do not (taking into account all Investments of all Restricted Persons) exceed an aggregate amount of \$2,500,000 during any Fiscal Year.

"*Permitted Liens*" means:

- (a) statutory Liens for taxes, assessments or other governmental charges or levies which are not yet delinquent or which are being contested in good faith by appropriate action and for which adequate reserves have been maintained in accordance with GAAP;

(b) landlords', operators', carriers', warehousemen's, repairmen's, mechanics', materialmen's, worker's, suppliers or other like Liens, in each case only to the extent arising in the ordinary course of business and only to the extent securing obligations (i) which are not delinquent or which are being contested in good faith by appropriate proceedings; and (ii) for which adequate reserves have been maintained in accordance with GAAP;

(c) zoning restrictions, easements, licenses, and minor defects and irregularities in title to any real property, so long as such defects and irregularities do not materially impair the value of such property or the use of such property for the purposes for which such property is held;

(d) pledges or deposits of cash or securities to secure (i) the performance of bids, trade contracts, leases, statutory obligations and other obligations of a like nature (excluding appeal bonds) incurred in the ordinary course of business; or (ii) obligations under worker's compensation, unemployment insurance, social security, or public Laws or similar legislation(excluding Liens arising under ERISA).

(e) Liens under the Security Documents;

(f) with respect only to property subject to any particular Security Document, Liens burdening such property which are expressly allowed by such Security Document;

(g) Liens expressly granted pursuant to the provisions of the Indemnity Agreement and subject to the provisions of the Intercreditor Agreement;

(h) deposits securing, or in lieu of, surety, appeal or customs bonds in proceedings to which Borrower or any of its Subsidiaries is a party;

(i) any attachment or judgment lien not constituting an Event of Default under *Section 8.1*;

(j) Liens existing on the date hereof and renewals and extensions thereof, which Liens are set forth on Schedule 1.1(a);

(k) Liens securing Indebtedness permitted by Section 7.1(c), provided that such Liens attach only to the assets financed by such Indebtedness and any proceeds thereof;

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(l) common law security interests of a surety in the actual proceeds of a project subject to the underlying surety bond provided by such surety; and

(m) inchoate Liens arising under ERISA to secure contingent Liabilities of Borrower or any of its Subsidiaries.

"*Person*" means an individual, corporation, general partnership, limited partnership, limited liability company, association, joint stock company, trust or trustee thereof, estate or executor thereof, Tribunal, or any other legally recognizable entity.

"*Pricing Schedule*" means the Schedule attached hereto identified as such.

"*Prior Agent*" means General Electric Credit Corporation, in its capacity as agent under the Prior Credit Documents.

"*Prior Credit Documents*" means that certain Credit Agreement dated October 11, 2002, as amended from time to time heretofore, among Borrower, certain of its Subsidiaries, General Electric Credit Corporation, as agent and a lender thereunder and the other financial institutions party thereto, as lenders, together with the promissory notes made by Borrower thereunder and any and all other documents and instruments executed in connection therewith.

"*Prior Indebtedness*" means all Indebtedness outstanding under the Prior Credit Documents on the date hereof.

"*Rating Agency*" means either S & P or Moody's.

"*Receivables*" means all present and future rights of Borrower or any Subsidiary of Borrower to payment for goods sold or leased or for services rendered (except those evidenced by instruments or chattel paper), whether now existing or hereafter arising and wherever arising and whether or not earned by performance.

"*Regulation D*" means Regulation D of the Board of Governors of the Federal Reserve System as from time to time in effect.

"*Required Lenders*" means Lenders having aggregate Percentage Shares equal or exceed sixty-six and two-thirds percent (66²/3%).

"*Reserve Requirement*" means, at any time, the maximum rate at which reserves (including any marginal, special, supplemental, or emergency reserves) are required to be maintained under regulations issued from time to time by the Board of Governors of the Federal Reserve System (or any successor) by member banks of the Federal Reserve System against "Eurocurrency liabilities" (as such term is used in Regulation D). Without limiting the effect of the foregoing, the Reserve Requirement shall reflect any other reserves required to be maintained by such member banks with respect to (a) any category of liabilities which includes deposits by reference to which the Adjusted Eurodollar Rate is to be determined, or (b) any category of extensions of credit or other assets which include Eurodollar Loans.

"*Restricted Person*" means any of Borrower, each Subsidiary of Borrower, and each Guarantor.

"*Revolving Credit Advance*" has the meaning ascribed to it in Section 2.1(b).

"*Revolving Facility Usage*" means, at the time in question, without duplication, the aggregate principal amount of outstanding Revolving Loans and LC Obligations at such time.

"*Revolving Lenders*" means those Lenders having a Revolving Loan Commitment.

"*Revolving Loan(s)*" means, at any time, the aggregate amount of Revolving Credit Advances outstanding to Borrower.

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

"*Revolving Notes*" has the meaning ascribed to it in Section 2.1(b).

"*S & P*" means Standard & Poor's Ratings Services (a division of The McGraw Hill Companies), or its successor.

"*Scheduled Principal Amortization of Long Term Debt*" means the amount of principal payments on the Term Loan during the preceding twelve-month period.

"*Security Documents*" means the instruments listed on Schedule 4.1 and all other security agreements, deeds of trust, mortgages, chattel mortgages, pledges, guaranties, financing statements, continuation statements, extension agreements and other agreements or instruments now, heretofore, or hereafter delivered by any Restricted Person to Administrative Agent in connection with this Agreement or any transaction contemplated hereby to secure or guarantee the payment of any part of the Obligations or the performance of any Restricted Person's other duties and obligations under the Loan Documents.

"*Secured Obligations*" means all Obligations.

"*Solvent*" means, with respect to any Person on a particular date, that on such date (a) the fair value of the property of such Person is greater than the total amount of liabilities, including subordinated and contingent liabilities, of such Person; (b) the present fair saleable value of the assets of such Person is not less than the amount that will be required to pay the probable liability of such Person on its debts and liabilities, including subordinated and contingent liabilities as they become absolute and matured; (c) such Person does not intend to, and does not believe that it will, incur debts or liabilities beyond such Person's ability to pay as such debts and liabilities mature; and (d) such Person is not engaged in a business or transaction, and is not about to engage in a business or transaction, for which such Person's property would constitute an unreasonably small capital. The amount of contingent liabilities (such as litigation, guaranties and pension plan liabilities) at any time shall be computed as the amount that, in light of all the facts and circumstances existing at the time, represents the amount that can be reasonably be expected to become an actual or matured liability.

"*Subordinated Debt*" means unsecured Indebtedness incurred as so-called "seller paper" in connection with Permitted Acquisitions and subordinated to the Obligations in a manner and form reasonably satisfactory to Administrative Agent, as to the right and time of payment and as to any and all other rights and remedies thereunder.

"*Subsidiary*" means, with respect to any Person, any corporation, association, partnership, limited liability company, joint venture, or other business or corporate entity, enterprise or organization which is directly or indirectly (through one or more intermediaries) controlled by or owned fifty percent or more by such Person.

"*Surety*" means Federal Insurance Company, an Indiana corporation, its Affiliates and Subsidiaries and their respective co-sureties and reinsurers, and their respective successors and permitted assigns.

"*Synthetic Lease Obligations*" means an arrangement treated as an operating lease for financial accounting purposes and a financing lease for tax purposes.

"*Termination Event*" means (a) the occurrence with respect to any ERISA Plan of (i) a reportable event described in Section 4043(c)(5) or (6) of ERISA or (ii) any other reportable event described in Section 4043(c) of ERISA other than a reportable event not subject to the provision for 30-day notice to the Pension Benefit Guaranty Corporation pursuant to a waiver by such corporation under Section 4043(a) or 4043(b)(4) of ERISA, or (b) the withdrawal of any ERISA Affiliate from an ERISA Plan during a plan year in which it was a "substantial employer" as defined in Section 4001(a)(2) of ERISA, or (c) the filing of a notice of intent to terminate any ERISA Plan or the treatment of any ERISA Plan amendment as a termination under Section 4041(c) of ERISA, or (d) the institution of proceedings to terminate any ERISA Plan by the Pension Benefit Guaranty Corporation under Section 4042 of ERISA, or (e) any other event or condition which might constitute grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any ERISA Plan.

"*Term Lenders*" means those Lenders having Term Loan Commitments.

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

"*Term Loans*" has the meaning ascribed to it in Section 2.1(a).

"*Term Notes*" has the meaning ascribed to it in Section 2.1(a).

"*Tribunal*" means any government, any arbitration panel, any court or any governmental department, commission, board, bureau, agency or instrumentality of the United States of America or any state, province, commonwealth, nation, territory, possession, county, parish, town, township, village or municipality, whether now or hereafter constituted or existing.

"*Type*" means, with respect to any Loans, the characterization of such Loans as either Base Rate Loans or Eurodollar Loans.

Section 1.2. *Exhibits and Schedules; Additional Definitions.* All Exhibits and Schedules attached to this Agreement are a part hereof for all purposes. Reference is hereby made to Schedule 4.1 for the meaning of certain terms defined therein and used but not defined herein, which definitions are incorporated herein by reference.

Section 1.3. *Amendment of Defined Instruments.* Unless the context otherwise requires or unless otherwise provided herein the terms defined in this Agreement which refer to a particular agreement, instrument or document also refer to and include all renewals, extensions, modifications, amendments and restatements of such agreement, instrument or document, provided that nothing contained in this section shall be construed to authorize any such renewal, extension, modification, amendment or restatement.

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Section 1.4. *References and Titles.* All references in this Agreement to Exhibits, Schedules, articles, sections, subsections and other subdivisions refer to the Exhibits, Schedules, articles, sections, subsections and other subdivisions of this Agreement unless expressly provided otherwise. Exhibits and Schedules to any Loan Document shall be deemed incorporated by reference in such Loan Document. References to any document, instrument, or agreement (a) shall include all exhibits, schedules, and other attachments thereto, and (b) shall include all documents, instruments, or agreements issued or executed in replacement thereof. Titles appearing at the beginning of any subdivisions are for convenience only and do not constitute any part of such subdivisions and shall be disregarded in construing the language contained in such subdivisions. The words "this Agreement", "this instrument", "herein", "hereof", "hereby", "hereunder" and words of similar import refer to this Agreement as a whole and not to any particular subdivision unless expressly so limited. The phrases "this section" and "this subsection" and similar phrases refer only to the sections or subsections hereof in which such phrases occur. The word "or" is not exclusive, and the word "including" (in its various forms) means "including without limitation". Pronouns in masculine, feminine and neuter genders shall be construed to include any other gender, and words in the singular form shall be construed to include the plural and vice versa, unless the context otherwise requires. Accounting terms have the meanings assigned to them by GAAP, as applied the accounting entity to which they refer. References to "days" shall mean calendar days, unless the term "Business Day" is used. Unless otherwise specified, references herein to any particular Person also refer to its successors and permitted assigns.

Section 1.5. *Calculations and Determinations.* All calculations under the Loan Documents of interest chargeable with respect to Eurodollar Loans and of fees shall be made on the basis of actual days elapsed (including the first day but excluding the last) and a year of 360 days. All other calculations of interest made under the Loan Documents shall be made on the basis of actual days elapsed (including the first day but excluding the last) and a year of 365 or 366 days, as appropriate. Each determination by a Lender Party of amounts to be paid under Article III or any other matters which are to be determined hereunder by a Lender Party (such as any Eurodollar Rate, Adjusted Eurodollar Rate, Business Day, Interest Period, or Reserve Requirement) shall, in the absence of manifest error, be conclusive and binding. Unless otherwise expressly provided herein or unless Required Lenders otherwise consent all financial statements and reports furnished to any Lender Party hereunder shall be prepared and all financial computations and determinations pursuant hereto shall be made in accordance with GAAP.

Section 1.6. *Joint Preparation; Construction of Indemnities and Releases.* This Agreement and the other Loan Documents have been reviewed and negotiated by sophisticated parties with access to legal counsel and no rule of construction shall apply hereto or thereto which would require or allow any Loan Document to be construed against any party because of its role in drafting such Loan Document. All indemnification and release provisions of this Agreement shall be construed broadly (and not narrowly) in favor of the Persons receiving indemnification or being released.

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ARTICLE II

THE LOANS AND LETTERS OF CREDIT

Section 2.1. *Commitments to Lend; Notes.*

(a) *Term Loans.* Each Term Lender agrees, severally and not jointly, to lend to Borrower in one draw, on the Closing Date, its Percentage Share of the aggregate amount of \$10,000,000 (the "*Term Loan*"). The Term Loan shall be evidenced by promissory notes substantially in the form of Exhibit 2.1(a) made by the Borrower payable to the order of each Term Lender (each a "*Term Note*" and, collectively, the "*Term Notes*"). Each Term Note shall represent the obligation of Borrower to pay the amount of the applicable Term Loan Commitment of each Term Lender, together with interest thereon. Accrued interest on the Term Loan shall be due and payable as provided below. The principal amount of the Term Loan shall be payable in nineteen consecutive quarterly installments commencing on April 1, 2004 and continuing on the first day of each Fiscal Quarter thereafter until the Maturity Date when the remaining unpaid principal balance shall be paid. Each quarterly principal installment shall be in the amount of \$500,000. All payments received on the Term Loan shall be applied first to accrued interest and then to principal.

(b) *Revolving Loans.* Subject to the terms and conditions hereof, each Revolving Lender agrees, severally and not jointly, to make Revolving Loans to Borrower upon the request of Borrower from time to time during the Commitment Period, provided that (a) subject to Sections 3.3, 3.4 and 3.6, Revolving Loans of the same Type made on the same day shall be made by Revolving Lenders in accordance with their respective Percentage Shares and as part of the same Borrowing; (b) after giving effect to such Revolving Loans, the Revolving Facility Usage does not exceed the Aggregate Commitment then in effect; and (c) after giving effect to such Revolving Loans, the aggregate amount of all outstanding Revolving Loans and outstanding Matured LC Obligations shall not exceed the Borrowing Base. The amount of all Revolving Loans in any Borrowing must be greater than or equal to \$100,000 or must equal the remaining availability under the Borrowing Base. The obligation of Borrower to repay to each Revolving Lender the aggregate amount of all Revolving Loans made by such Revolving Lender, together with interest accruing in connection therewith, shall be evidenced by one or more promissory notes made by Borrower payable to the order of such Revolving Lender in the principal amount of the Revolving Loan Commitment of the applicable Revolving Lender, substantially in the form of Exhibit 2.1(b) (each a "*Revolving Note*" and, collectively, the "*Revolving Notes*"). The amount of principal owing on any Revolving Note at any given time shall be the aggregate amount of all Revolving Loans theretofore made by such Revolving Lender minus all payments of principal theretofore received by such Revolving Lender on such Revolving Note. Interest on each Revolving Note shall accrue and be due and payable as provided herein. Each Revolving Note shall be due and payable as provided herein, and shall be due and payable in full on the Maturity Date. Subject to the terms and conditions hereof, Borrower may borrow, repay, and reborrow hereunder.

Section 2.2. *Requests for Revolving Loans.* Borrower must give to Administrative Agent written or electronic notice (or telephonic notice promptly confirmed in writing) of any requested Borrowing of new Revolving Loans to be advanced by Revolving Lenders. Each such notice constitutes a "Borrowing Notice" hereunder and must:

(a) specify (i) the aggregate amount of any such Borrowing of new Base Rate Loans and the date on which such Base Rate Loans are to be advanced, or (ii) the aggregate amount of any such Borrowing of new Eurodollar Loans, the date on which such Eurodollar Loans are to be advanced (which shall be the first day of the Interest Period which is to apply thereto), and the length of the applicable Interest Period; and

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(b) be received by Administrative Agent not later than 11:00 a.m., Houston, Texas, time, on (i) the day on which any such Base Rate Loans are to be made, or (ii) the third Business Day preceding the day on which any such Eurodollar Loans are to be made.

Each such written request or confirmation must be made in the form and substance of the "Borrowing Notice" attached hereto as Exhibit 2.2(b), duly completed. Each such telephonic request shall be deemed a representation, warranty, acknowledgment and agreement by Borrower as to the matters which are required to be set out in such written confirmation. Upon receipt of any such Borrowing Notice, Administrative Agent shall give each Lender prompt notice of the terms thereof. If all conditions precedent to such new Revolving Loans have been met, each Revolving Lender will on the date requested promptly remit to Administrative Agent at Administrative Agent's office in Houston, Texas the amount of such Revolving Lender's new Revolving Loan in immediately available funds, and upon receipt of such funds, unless to its actual knowledge any conditions precedent to such Revolving Loans have been neither met nor waived as provided herein, Administrative Agent shall promptly make such Revolving Loans available to Borrower. Unless Administrative Agent shall have received prompt notice from a Revolving Lender that such Revolving Lender will not make available to Administrative Agent such Revolving Lender's new Revolving Loan, Administrative Agent may in its discretion assume that such Revolving Lender has made such Revolving Loan available to Administrative Agent in accordance with this section and Administrative Agent may if it chooses, in reliance upon such assumption, make such Revolving Loan available to Borrower. If and to the extent such Revolving Lender shall not so make its new Revolving Loan available to Administrative Agent, such Revolving Lender and Borrower severally agree to pay or repay to Administrative Agent within three days after demand the amount of such Revolving Loan together with interest thereon, for each day from the date such amount was made available to Borrower until the date such amount is paid or repaid to Administrative Agent, with interest at (i) the Federal Funds Rate, if such Revolving Lender is making such payment and (ii) the interest rate applicable at the time to the other new Revolving Loans made on such date, if Borrower is making such repayment. If neither such Revolving Lender nor Borrower pays or repays to Administrative Agent such amount within such three-day period, Administrative Agent shall in addition to such amount be entitled to recover from such Revolving Lender and from Borrower, on demand, interest thereon at the Default Rate, calculated from the date such amount was made available to Borrower. The failure of any Revolving Lender to make any new Revolving Loan to be made by it hereunder shall not relieve any other Revolving Lender of its obligation hereunder, if any, to make its new Revolving Loan, but no Revolving Lender shall be responsible for the failure of any other Revolving Lender to make any new Revolving Loan to be made by such other Revolving Lender.

Section 2.3. *Continuations and Conversions of Existing Loans.* Borrower may make the following elections with respect to Loans already outstanding: to convert Base Rate Loans to Eurodollar Loans, to convert Eurodollar Loans to Base Rate Loans on the last day of the Interest Period applicable thereto, and to continue Eurodollar Loans beyond the expiration of such Interest Period by designating a new Interest Period to take effect at the time of such expiration. In making such elections, Borrower may combine existing Loans made pursuant to separate Borrowings into one new Borrowing or divide existing Loans made pursuant to one Borrowing into separate new Borrowings, provided that Borrower may have no more than five Borrowings of Eurodollar Loans outstanding at any time. To make any such election, Borrower must give to Administrative Agent written notice (or telephonic notice promptly confirmed in writing) of any such Conversion or Continuation of existing Loans, with a separate notice given for each new Borrowing. Each such notice constitutes a "Continuation/Conversion Notice" hereunder and must:

(a) specify the existing Loans which are to be Continued or Converted;

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(b) specify (i) the aggregate amount of any Borrowing of Base Rate Loans into which such existing Loans are to be converted and the date on which such Continuation or Conversion is to occur, or (ii) the aggregate amount of any Borrowing of Eurodollar Loans into which such existing Loans are to be continued or converted, the date on which such Continuation or Conversion is to occur (which shall be the first day of the Interest Period which is to apply to such Eurodollar Loans), and the length of the applicable Interest Period; and

(c) be received by Administrative Agent not later than 11:00 a.m., Houston, Texas time, on (i) the day on which any such conversion to Base Rate Loans is to occur, or (ii) the third Business Day preceding the day on which any such Continuation or Conversion to Eurodollar Loans is to occur.

Each such written request or confirmation must be made in the form and substance of the "Continuation/Conversion Notice" attached hereto as Exhibit 2.3(c), duly completed. Each such telephonic request shall be deemed a representation, warranty, acknowledgment and agreement by Borrower as to the matters which are required to be set out in such written confirmation. Upon receipt of any such Continuation/Conversion Notice, Administrative Agent shall give each Lender prompt notice of the terms thereof. Each Continuation/Conversion Notice shall be irrevocable and binding on Borrower. During the continuance of any Default, Borrower may not make any election to convert existing Loans into Eurodollar Loans or continue existing Loans as Eurodollar Loans. If (due to the existence of a Default or for any other reason) Borrower fails to timely and properly give any Continuation/Conversion Notice with respect to a Borrowing of existing Eurodollar Loans at least three days prior to the end of the Interest Period applicable thereto, such Eurodollar Loans shall automatically be converted into Base Rate Loans at the end of such Interest Period. No new funds shall be repaid by Borrower or advanced by any Lender in connection with any Continuation or Conversion of existing Loans pursuant to this section, and no such Continuation or Conversion shall be deemed to be a new advance of funds for any purpose; such Continuations and Conversions merely constitute a change in the interest rate applicable to already outstanding Loans.

Section 2.4. *Use of Proceeds.* Borrower shall use the Term Loans to refinance Prior Indebtedness under the Prior Credit Documents; and Revolving Loans to (i) refinance Prior Indebtedness under the Prior Credit Documents; (ii) refinance Matured LC Obligations; and (iii) provide working capital for its operations and for other general business purposes. Borrower shall use all Letters of Credit for its general corporate purposes. In no event shall the funds from any Loan or any Letter of Credit be used directly or indirectly by any Person for personal, family, household or agricultural purposes or for the purpose, whether immediate, incidental or ultimate, of purchasing, acquiring or carrying any Margin Stock or to extend credit to others directly or indirectly for the purpose of purchasing or carrying any such Margin Stock. Borrower represents and warrants that Borrower is not engaged principally, or as one of Borrower's important activities, in the business of extending credit to others for the purpose of purchasing or carrying such Margin Stock.

Section 2.5. *Interest Rates and Fees; Payment Dates.* (a) *Interest.* Subject to subsection (b) below, (i) each Base Rate Loan shall bear interest on each day it is outstanding at the Adjusted Base Rate in effect on such day, and (ii) each Eurodollar Loan shall bear interest on each day during the related Interest Period at the related Adjusted Eurodollar Rate in effect on such day, and (iii) if an Event of Default has occurred and is continuing, all Loans shall bear interest on each day outstanding at the applicable Default Rate. Past due payments of principal and interest shall bear interest at the rates and in the manner set forth in the Notes. Notwithstanding the forgoing, Borrower may request from time to time that Borrower and the Lender enter into a Hedging Contract providing for interest

(b) *Default Rate.* If an Event of Default shall have occurred and be continuing under Section 8.1(a), (b), (j)(i), (j)(ii), or (j)(iii), all outstanding Loans shall bear interest at the applicable Default Rate. In addition, if an Event of Default shall have occurred and be continuing (other than under Section 8.1(a), (b), (j)(i), (j)(ii), or (j)(iii)), Required Lenders may, by notice to Borrower, elect to have the outstanding Loans bear interest at the applicable Default Rate, whereupon such Loans shall bear interest at the applicable Default Rate until the earlier of (i) the first date thereafter upon which there shall be no Event of Default continuing and (ii) the date upon which Required Lenders shall have rescinded such notice.

(c) *Commitment Fees.* In consideration of each Revolving Loan Commitment of each Revolving Lender to make Revolving Loans, Borrower will pay to Administrative Agent for the account of each Revolving Lender a fee (the "Commitment Fee") determined on a daily basis by multiplying the applicable Commitment Fee Rate by the Percentage Share of such Revolving Lender of the unused portion of the Revolving Loan Commitment on each day during the Commitment Period, determined for each such day by deducting from the amount of the Revolving Loan Commitment at the end of such day the Revolving Facility Usage. This Commitment Fee shall be due and payable in arrears on the first day of each Fiscal Quarter and at the end of the Commitment Period.

(d) *Upfront Fees.* In consideration of the Lenders' commitment to make Loans, Borrower will pay to Administrative Agent for the ratable account of the Lenders an upfront fee in the aggregate amount of \$250,000, due and payable on the date hereof.

(e) *Additional Fees.* In addition to all other amounts due to Administrative Agent under the Loan Documents, Borrower will pay fees to Administrative Agent and the Arranger as described in a letter agreement of even date herewith between Administrative Agent, Arranger and Borrower.

(f) *Payment Dates.* On each Interest Payment Date relating to Base Rate Loans, Borrower shall pay to the Lenders all unpaid interest which has accrued on the Base Rate Loans to but not including such Interest Payment Date. On each Interest Payment Date relating to a Eurodollar Loan, Borrower shall pay to Lenders all unpaid interest which has accrued on such Eurodollar Loan to but not including such Interest Payment Date.

Section 2.6. *Optional Prepayments and Voluntary Reduction of Commitment.* Borrower may, without penalty, (a) upon notice to Administrative Agent to be received no later than 11:00 a.m., Houston, Texas time, with respect to any Base Rate Loan and (b) upon three Business Days' notice to each Lender with respect to any Eurodollar Loan, from time to time and without premium or penalty prepay the Loans, in whole or in part, provided (i) that the aggregate amounts of all partial prepayments of principal on the Notes equals \$100,000 or any higher integral multiple of \$100,000; and (ii) that if Borrower prepays any Eurodollar Loan on any day other than the last day of the Interest Period applicable thereto, it shall pay to Lenders any amounts due under Section 3.5. Each prepayment of principal of any Eurodollar Loan under this section shall be accompanied by all interest then accrued and unpaid on the principal so prepaid. Any principal or interest prepaid pursuant to this section shall be in addition to, and not in lieu of, all payments otherwise required to be paid under the Loan Documents at the time of such prepayment. During the period from the Closing Date through the first anniversary of this Agreement, Borrower may, upon at least three (3) Business Days' prior written notice to the Administrative Agent, prepay the Obligations in full and upon receipt of such prepayment and a payment to the Lenders of a termination fee in the amount of \$500,000, the Aggregate Commitments of the Lenders will terminate. During the period from the first anniversary of this Agreement until the Maturity Date, Borrower may, upon at least three (3) Business Days' prior written notice to the Administrative Agent, prepay the Obligations in full, without premium or penalty,

and upon receipt of such prepayment, the Aggregate Commitments of the Lenders will terminate. Notwithstanding the forgoing, during the period from the Closing Date until the first anniversary of this Agreement, Borrower may not partially reduce the Revolving Loan Commitments hereunder. From the date of the first anniversary of the Agreement until the second anniversary of this Agreement, Borrower may, upon at least three (3) Business Days' prior written notice to the Administrative Agent, without premium or penalty, reduce the Revolving Loan Commitments by an amount not to exceed \$5,000,000. From the date of the second anniversary of this Agreement through the third anniversary of this Agreement, Borrower may, upon at least three (3) Business Days' prior written notice to the Administrative Agent, without premium or penalty, further reduce the Revolving Loan Commitments; provided, however, the amount by which the Revolving Loan Commitments were reduced after the first anniversary of this Agreement and the amount by which the Revolving Loan Commitments are to be reduced after the second anniversary of this Agreement may not exceed \$10,000,000 in the aggregate.

Section 2.7. *Mandatory Prepayments.* (a) If at any time the Revolving Facility Usage exceeds the Revolving Loan Commitment (whether due to a reduction in the Revolving Loan Commitment in accordance with this Agreement, or otherwise), Borrower shall immediately upon demand prepay the principal of the Loans (and after the Loans are repaid in full, provide LC Collateral in accordance with Section 2.14(a)) in an amount at least equal to such excess.

(b) If at any time the Revolving Facility Usage is less than the Revolving Loan Commitment but in excess of the Adjusted Borrowing Base (such excess being herein called a "Borrowing Base Deficiency"), Borrower shall, within five Business Days after Administrative Agent gives notice of such fact to Borrower, either:

(i) give notice to Administrative Agent electing to prepay the principal of the Revolving Loans (and after all Revolving Loans are repaid in full, provide LC Collateral in accordance with Section 2.14(a)) in an aggregate amount at least equal to such Borrowing Base Deficiency (or, if the Revolving Loans have been paid in full, pay to LC Issuer LC Collateral as required under Section 2.14(a)), such prepayment to be made in full on or before the second Business Day after such notice by Borrower, or

(ii) provide the Administrative Agent with a revised Borrowing Base Certificate which indicates therein that the Borrowing Base Deficiency no longer exists.

(c) Within three (3) Business Days after the receipt of any Net Sales Proceeds aggregating in excess of \$1,000,000 for any single transaction or related series of transactions, Borrower shall apply such Net Sales Proceeds to repay (i) the Term Loans then outstanding; and (ii) after the Term Loans have been paid in full, the Revolving Loans and in the case of a prepayment under this clause (ii), the Revolving Loan Commitment shall be permanently reduced in an aggregate amount equal to such Net Sales Proceeds. No later than the 180th day after the receipt of any Net Sales Proceeds aggregating \$1,000,000 or less for any single

transaction or related series of transactions, Borrower shall apply such Net Sales Proceeds to repay (x) the Term Loans then outstanding; and (y) after the Term Loans have been paid in full, the Revolving Loans and in the case of prepayments under this clause (y) the Revolving Loan Commitment shall be permanently reduced in an aggregate amount equal to such Net Sales Proceeds unless within 180 days of receipt thereof, such Net Sales Proceeds are reinvested in productive replacement assets of a kind then used or useable in the business of Borrower or a Subsidiary which is a Restricted Person.

(d) Each prepayment of principal under this section shall be accompanied by all interest then accrued and unpaid on the principal so prepaid. Any principal or interest prepaid pursuant to this section shall be in addition to, and not in lieu of, all payments otherwise required to be paid under the Loan Documents at the time of such prepayment.

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Section 2.8. *Borrowing Base.* Borrower shall determine from time to time the Borrowing Base by submitting to the Administrative Agent the Borrowing Base Certificate substantially in the form of Exhibit 2.8 hereto.

Section 2.9. *Letters of Credit.* Subject to the terms and conditions hereof, Borrower may during the Commitment Period request LC Issuer to, and LC Issuer shall (provided, however, LC Issuer shall not be obligated to issue a Letter of Credit in favor of the Surety if the issuance of such Letter of Credit would cause the aggregate outstanding Letters of Credit issued in favor of the Surety to exceed \$5,000,000), issue one or more Letters of Credit, provided that, after taking such Letter of Credit into account:

- (a) the Revolving Facility Usage does not exceed the Adjusted Borrowing Base at such time; and
- (b) the expiration date of such Letter of Credit is prior to the end of the Commitment Period.

Section 2.10. *Requesting Letters of Credit.* Borrower must make written application for any Letter of Credit at least two (2) Business Days (or such shorter period as LC Issuer may in its discretion from time to time agree) before the date on which Borrower desires for LC Issuer to issue such Letter of Credit. By making any such written application Borrower shall be deemed to have represented and warranted that the LC Conditions described in Section 2.11 will be met as of the date of issuance of such Letter of Credit. Each such written application for a Letter of Credit must be made in writing in the form and substance of Exhibit 2.10, the terms and provisions of which are hereby incorporated herein by reference (or in such other form as may mutually be agreed upon by LC Issuer and Borrower). Two Business Days after the LC Conditions for a Letter of Credit have been met as described in Section 2.11 (or if LC Issuer otherwise desires to issue such Letter of Credit), LC Issuer will issue such Letter of Credit at LC Issuer's office in Houston, Texas. If any provisions of any LC Application conflict with any provisions of this Agreement, the provisions of this Agreement shall govern and control. Borrower shall promptly examine a copy of each Letter of Credit and each amendment thereto that is delivered to it and, in the event of any claim of noncompliance with Borrower's instructions or other irregularity, Borrower will promptly notify LC Issuer.

Section 2.11. *Reimbursement and Participations.* (a) *Reimbursement by Borrower.* Each Maturity LC Obligation shall constitute a Revolving Loan by LC Issuer to Borrower. Borrower promises to pay to LC Issuer, or to LC Issuer's order, on the Business Day immediately following the day on which a demand is made, the full amount of each Maturity LC Obligation, together with interest thereon at the Default Rate applicable to Base Rate Loans. The obligation of Borrower to reimburse LC Issuer for each Maturity LC Obligation shall be absolute, unconditional and irrevocable, and shall be paid strictly in accordance with the terms of this Agreement (including any LC Application) under all circumstances, including the following: (i) any lack of validity or enforceability of such Letter of Credit or any other agreement or instrument relating thereto; (ii) the existence of any claim, counterclaim, set-off, defense or other right that Borrower may have at any time against any beneficiary or any transferee of such Letter of Credit (or any Person for whom any such beneficiary or any such transferee may be acting), LC Issuer or any other Person, whether in connection with this Agreement, the transactions contemplated hereby or by such Letter of Credit or any agreement or instrument relating thereto, or any unrelated transaction; (iii) any draft, demand, certificate or other document presented under such Letter of Credit proving to be forged, fraudulent, invalid or insufficient in any respect or any statement therein being untrue or inaccurate in any respect; or any loss or delay in the

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transmission or otherwise of any document required in order to make a drawing under such Letter of Credit; (iv) any payment by LC Issuer under such Letter of Credit against presentation of a draft or certificate that does not strictly comply with the terms of such Letter of Credit; or (v) any other circumstance or happening whatsoever, whether or not similar to any of the foregoing. Without limiting the generality of the foregoing, it is expressly agreed that the absolute and unconditional nature of Borrower's obligations under this section to reimburse LC Issuer for each drawing under a Letter of Credit will not be excused by the gross negligence or willful misconduct of LC Issuer. However, the foregoing shall not be construed to excuse LC Issuer from liability to Borrower to the extent of any direct damages (as opposed to consequential damages, claims in respect of which are hereby waived by Borrower to the extent permitted by applicable Law) suffered by Borrower that are caused by LC Issuer's gross negligence or willful misconduct in determining whether drafts and other documents presented under a Letter of Credit comply with the terms thereof.

(b) *Letter of Credit Advances.* If the beneficiary of any Letter of Credit makes a draft or other demand for payment thereunder then Borrower may, during the interval between the making thereof and the honoring thereof by LC Issuer, request Lenders to make Loans to Borrower in the amount of such draft or demand, which Loans shall be made concurrently with LC Issuer's payment of such draft or demand and shall be immediately used by LC Issuer to repay the amount of the resulting Maturity LC Obligation. Such a request by Borrower shall be made in compliance with all of the provisions hereof, provided that for the purposes of the first sentence of Section 2.1(b), the amount of such Loans shall be considered, but the amount of the Maturity LC Obligation to be concurrently paid by such Loans shall not be considered.

(c) *Participation by Lenders.* LC Issuer irrevocably agrees to grant and hereby grants to each Lender, and to induce LC Issuer to issue Letters of Credit hereunder each Lender irrevocably agrees to accept and purchase and hereby accepts and purchases from LC Issuer, on the terms and conditions hereinafter stated and for such Lender's own account and risk, an undivided interest equal to such Lender's Percentage Share of LC Issuer's obligations and rights under each Letter of Credit issued hereunder and the amount of each Maturity LC Obligation paid by LC Issuer thereunder. Each Lender unconditionally and irrevocably agrees with LC Issuer that, if a Maturity LC Obligation is paid under any Letter of Credit for which LC Issuer is not reimbursed in full by Borrower in accordance with the terms of this Agreement and the related LC Application (including any reimbursement by means of concurrent Loans or by the application of LC Collateral), such Lender shall (in all circumstances and without set-off or counterclaim) pay to LC Issuer on demand, in immediately available funds at LC Issuer's address for notices hereunder, such Lender's Percentage Share of such Maturity LC Obligation (or any portion thereof which has not been reimbursed by Borrower). Each

Lender's obligation to pay LC Issuer pursuant to the terms of this subsection is irrevocable and unconditional. If any amount required to be paid by any Lender to LC Issuer pursuant to this subsection is paid by such Lender to LC Issuer within three Business Days after the date such payment is due, LC Issuer shall in addition to such amount be entitled to recover from such Lender, on demand, interest thereon calculated from such due date at the Federal Funds Rate. If any amount required to be paid by any Lender to LC Issuer pursuant to this subsection is not paid by such Lender to LC Issuer within three Business Days after the date such payment is due, LC Issuer shall in addition to such amount be entitled to recover from such Lender, on demand, interest thereon calculated from such due date at the Default Rate.

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(d) *Distributions to Participants.* Whenever LC Issuer has in accordance with this section received from any Lender payment of such Lender's Percentage Share of any Matured LC Obligation, if LC Issuer thereafter receives any payment of such Matured LC Obligation or any payment of interest thereon (whether directly from Borrower or by application of LC Collateral or otherwise, and excluding only interest for any period prior to LC Issuer's demand that such Lender make such payment of its Percentage Share), LC Issuer will distribute to such Lender its Percentage Share of the amounts so received by LC Issuer; provided, however, that if any such payment received by LC Issuer must thereafter be returned by LC Issuer, such Lender shall return to LC Issuer the portion thereof which LC Issuer has previously distributed to it.

(e) *Calculations.* A written advice setting forth in reasonable detail the amounts owing under this section, submitted by LC Issuer to Borrower or any Lender from time to time, shall be conclusive, absent manifest error, as to the amounts thereof.

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

Section 2.13. *No Duty to Inquire.* (a) *Drafts and Demands.* LC Issuer is authorized and instructed to accept and pay drafts and demands for payment under any Letter of Credit without requiring, and without responsibility for, any determination as to the existence of any event giving rise to said draft, either at the time of acceptance or payment or thereafter. LC Issuer is under no duty to determine the proper identity of anyone presenting such a draft or making such a demand (whether by tested telex or otherwise) as the officer, representative or Administrative Agent of any beneficiary under any Letter of Credit, and payment by LC Issuer to any such beneficiary when requested by any such purported officer, representative or Administrative Agent is hereby authorized and approved. Borrower releases each Lender Party from, and agrees to hold each Lender Party harmless and indemnified against, any liability or claim in connection with or arising out of the subject matter of this section, which indemnity shall apply whether or not any such liability or claim is in any way or to any extent caused, in whole or in part, by any negligent act or omission of any kind by any Lender Party, provided only that no Lender Party shall be entitled to indemnification for that portion, if any, of any liability or claim which is proximately caused by its own individual gross negligence or willful misconduct, as determined in a final judgment.

(b) *Extension of Maturity.* If the maturity of any Letter of Credit is extended by its terms or by Law or governmental action, if any extension of the maturity or time for presentation of drafts or any other modification of the terms of any Letter of Credit is made at the request of any Restricted Person, or if the amount of any Letter of Credit is increased at the request of any Restricted Person, this Agreement shall be binding upon all Restricted Persons with respect to such Letter of Credit as so extended, increased or otherwise modified, with respect to drafts and property covered thereby, and with respect to any action taken by LC Issuer, LC Issuer's correspondents, or any Lender Party in accordance with such extension, increase or other modification.

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(c) *Transferees of Letters of Credit.* If any Letter of Credit provides that it is transferable, LC Issuer shall have no duty to determine the proper identity of anyone appearing as transferee of such Letter of Credit, nor shall LC Issuer be charged with responsibility of any nature or character for the validity or correctness of any transfer or successive transfers, and payment by LC Issuer to any purported transferee or transferees as determined by LC Issuer is hereby authorized and approved, and Borrower releases each Lender Party from, and agrees to hold each Lender Party harmless and indemnified against, any liability or claim in connection with or arising out of the foregoing, which indemnity shall apply whether or not any such liability or claim is in any way or to any extent caused, in whole or in part, by any negligent act or omission of any kind by any Lender Party, provided only that no Lender Party shall be entitled to indemnification for that portion, if any, of any liability or claim which is proximately caused by its own individual gross negligence or willful misconduct, as determined in a final judgment.

Section 2.14. *LC Collateral.* (a) If, after the making of all mandatory prepayments of principal of the Loans required under Section 2.7(a), the outstanding LC Obligations will exceed the Adjusted Borrowing Base, then in addition to prepayment of the entire principal balance of the Loans, Borrower will immediately pay to the Administrative Agent an amount equal to such excess. The Administrative Agent will hold such amount as security for the remaining LC Obligations (all such amounts held as security for LC Obligations being herein collectively called "LC Collateral") and the other Obligations, and such collateral may be applied from time to time to any Matured LC Obligations or other Obligations which are due and payable. At the Borrower's request and when no Default exists, the Administrative Agent shall return to the Borrower the amount held as LC Collateral, to the extent such amount is in excess of the amount required under the first sentence of this Section 2.14(a). Neither this subsection nor the following subsection shall, however, limit or impair any rights which LC Issuer may have under any other document or agreement relating to any Letter of Credit, LC Collateral or LC Obligation, including any LC Application, or any rights which any Lender Party may have to otherwise apply any payments by Borrower and any LC Collateral under Section 3.1.

(b) *Acceleration of LC Obligations.* If the Obligations or any part thereof become immediately due and payable pursuant to Section 8.1 then, unless Required Lenders otherwise specifically elect to the contrary (which election may thereafter be retracted by Required Lenders at any time), all LC Obligations shall be deemed to become immediately due and payable without regard to whether or not actual drawings or payments on the Letters of Credit have occurred, and Borrower shall be obligated to pay to LC Issuer immediately an amount equal to the aggregate LC Obligations which are then outstanding, which amount shall be held by LC Issuer as LC Collateral securing the remaining LC Obligations and the other Obligations, and such LC Collateral may be applied from time to time to any Matured LC Obligations or any other Obligations which are due and payable.

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(c) *Investment of LC Collateral.* Pending application thereof, all LC Collateral shall be invested by the Administrative Agent in such Investments as the Administrative Agent may choose in its sole discretion. All interest on (and other proceeds of) such Investments shall be reinvested or applied to Matured LC Obligations or other Obligations which are due and payable. When all Obligations have been satisfied in full, including all LC Obligations, all Letters of Credit have expired or been terminated, and all of Borrower's reimbursement obligations in connection therewith have been satisfied in full or when the condition pursuant to which the LC Collateral was required no longer exists, the Administrative Agent shall release any remaining LC Collateral. Borrower hereby assigns and grants to the Administrative Agent a continuing security interest in all LC Collateral paid by it to the Administrative Agent, all Investments purchased with such LC Collateral, and all proceeds thereof to secure its Matured LC Obligations and its Obligations under this Agreement, each Note, and the other Loan Documents, and Borrower agrees that such LC Collateral, Investments and proceeds shall be subject to all of the terms and conditions of the Security Documents. Borrower further agrees that the Administrative Agent shall have all of the rights and remedies of a secured party under the Uniform Commercial Code as adopted in the State of Texas with respect to such security interest and that an Event of Default under this Agreement shall constitute a default for purposes of such security interest.

(d) *Payment of LC Collateral.* When Borrower is required to provide LC Collateral for any reason and fails to do so on the day when required, the Administrative Agent or LC Issuer may without notice to Borrower or any other Restricted Person provide such LC Collateral (whether by application of proceeds of other Collateral, by transfers from other accounts maintained with the Administrative Agent or LC Issuer, or otherwise) using any available funds of Borrower or any other Person also liable to make such payments. Any such amounts which are required to be provided as LC Collateral and which are not provided on the date required shall, for purposes of each Security Document, be considered past due Obligations owing hereunder, and LC Issuer is hereby authorized to exercise its respective rights under each Security Document to obtain such amounts.

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ARTICLE III

PAYMENTS TO LENDERS

Section 3.1. *General Procedures.* Borrower will make each payment which it owes under the Loan Documents to Administrative Agent for the account of the Lender Party to whom such payment is owed, in lawful money of the United States of America, without set-off, deduction or counterclaim, and in immediately available funds. Each such payment must be received by Administrative Agent not later than 11:00 a.m., Houston, Texas time, on the date such payment becomes due and payable. Any payment received by Administrative Agent after such time will be deemed to have been made on the next following Business Day. Should any such payment become due and payable on a day other than a Business Day, the maturity of such payment shall be extended to the next succeeding Business Day, and, in the case of a payment of principal or past due interest, interest shall accrue and be payable thereon for the period of such extension as provided in the Loan Document under which such payment is due. Each payment under a Loan Document shall be due and payable at the place set forth for Administrative Agent on the signature pages hereto. When Administrative Agent collects or receives money on account of the Obligations, Administrative Agent shall distribute all money so collected or received, and each Lender Party shall apply all such money so distributed, as follows (except as otherwise provided in Section 8.3):

- (a) first, for the payment of all Obligations which are then due (and if such money is insufficient to pay all such Obligations, first to any reimbursements due Administrative Agent under Section 6.9 or 10.4 and then to the partial payment of all other Obligations then due in proportion to the amounts thereof, or as Lender Parties shall otherwise agree);
- (b) then for the prepayment of amounts owing under the Loan Documents (other than principal of the Loans) if so specified by Borrower;
- (c) then for the prepayment of principal of the Loans, together with accrued and unpaid interest on the principal so prepaid; and
- (d) last, for the payment or prepayment of any other Obligations.

All payments applied to principal or interest on any Note shall be applied first to any interest then due and payable, then to principal then due and payable, and last to any prepayment of principal and interest in compliance with Sections 2.6 and 2.7. All distributions of amounts described in any of subsections (b), (c) or (d) above shall be made by Administrative Agent pro rata to each Lender Party then owed Obligations described in such subsection in proportion to all amounts owed to all Lender Parties which are described in such subsection; provided that if any Lender then owes payments to LC Issuer for the purchase of a participation under Section 2.13(c) or to Administrative Agent under Section 9.9, any amounts otherwise distributable under this section to such Lender shall be deemed to belong to LC Issuer, or Administrative Agent, respectively, to the extent of such unpaid payments, and Administrative Agent shall apply such amounts to make such unpaid payments rather than distribute such amounts to such Lender.

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Section 3.2. *Capital Reimbursement.* If either (a) the introduction or implementation after the date hereof of or the compliance with or any change after the date hereof in or in the interpretation of any Law regarding capital adequacy, or (b) the introduction or implementation after the date hereof of or the compliance with any request, directive or guideline issued after the date hereof from any central bank or other governmental authority (whether or not having the force of Law) regarding capital requirements has or would have the effect of reducing the rate of return on any Lender Party's capital, or on the capital of any corporation controlling such Lender Party, as a consequence of the Loans made, or Letters of Credit issued, by such Lender Party, to a level below that which such Lender Party or such corporation could have achieved but for such change (taking into consideration such Lender Party's policies and the policies of any such corporation with respect to capital adequacy), then from time to time Borrower will pay to Administrative Agent for the benefit of such Lender Party, within five (5) Business Days of demand therefore by such Lender Party, such additional amount or amounts which such Lender Party shall determine to be appropriate to compensate such Lender Party for such reduction.

Section 3.3. *Increased Cost of Eurodollar Loans or Letters of Credit.* (a) If any change after the date hereof in any applicable Law (whether now in effect or hereinafter enacted or promulgated, including Regulation D) or any interpretation or administration thereof by any governmental authority charged with the

interpretation or administration thereof (whether or not having the force of Law):

(i) shall change the basis of taxation of payments to any Lender Party of any principal, interest, or other amounts attributable to any Eurodollar Loan or Letter of Credit or otherwise due under this Agreement in respect of any Eurodollar Loan or Letter of Credit (other than Reimbursable Taxes governed by Section 3.6 and taxes imposed on or measured by its overall net income, and franchise taxes imposed on it (in lieu of net income taxes), by the jurisdiction (or any political subdivision thereof) under the Laws of which it is organized or otherwise resides for tax purposes or maintains any Applicable Lending Office); or

(ii) shall change, impose, modify, apply or deem applicable any reserve, special deposit or similar requirements in respect of any Eurodollar Loan made by any Lender Party or any Letter of Credit (excluding any reserve requirement included in the computation of the Adjusted Eurodollar Rate) or against assets of, deposits with or for the account of, or credit extended by, such Lender Party; or

(iii) shall impose on any Lender Party or the interbank eurocurrency deposit market any condition affecting any Eurodollar Loan or Letter of Credit,

the result of which is to increase the cost to any Lender Party of agreeing to make or making, funding or maintaining Eurodollar Loans or (as the case may be) issuing or participating in Letters of Credit, or a reduction in the amount received or receivable by such Lender in connection with any of the foregoing, then such Lender Party shall promptly notify Administrative Agent and Borrower in writing of the happening of such event and of the amount required to compensate such Lender Party for such additional costs or reduced return (on an after-tax basis, taking into account any taxes on and deductions, credits or other tax benefits in respect of such compensation), whereupon (i) Borrower shall pay such amount to Administrative Agent for the account of such Lender Party and (ii) Borrower may elect, by giving to Administrative Agent and such Lender Party not less than three Business Days' notice, to convert all (but not less than all) of any such Eurodollar Loans of such Lender Party into Base Rate Loans.

(b) A certificate of a Lender Party setting forth the amount or amounts necessary to compensate such Lender Party or the corporation controlling such Lender Party, as the case may be, as specified in Section 3.2 or this Section 3.3 shall be delivered to Borrower and shall be conclusive absent manifest error. Borrower shall pay the applicable Lender Party the amount shown as due on any such certificate within 3 Business Days after receipt thereof.

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(c) Failure or delay on the part of any Lender Party to demand compensation pursuant to Section 3.2 or this Section 3.3 shall not constitute a waiver of such Lender Party's right to demand such compensation.

Section 3.4. *Illegality.* If any change after the date hereof in applicable Laws, or in the interpretation or administration thereof or in any jurisdiction whatsoever, domestic or foreign, shall make it unlawful for any Lender Party to fund or maintain Eurodollar Loans, then, upon notice by such Lender Party to Borrower and Administrative Agent, (a) Borrower's right to elect Eurodollar Loans from such Lender Party shall be suspended to the extent and for the duration of such illegality, (b) all Eurodollar Loans of such Lender Party which are then the subject of any Borrowing Notice and which cannot be lawfully funded shall be funded as Base Rate Loans of such Lender Party, and (c) all Eurodollar Loans of such Lender Party shall be converted automatically to Base Rate Loans on the respective last days of the then current Interest Periods with respect to such Loans or within such earlier period as required by Law. If any such conversion of a Eurodollar Loan occurs on a day which is not the last day of the then current Interest Period with respect thereto, Borrower shall pay to such Lender Party such amounts, if any, as may be required pursuant to Section 3.5.

Section 3.5. *Funding Losses.* In addition to its other obligations hereunder, Borrower will indemnify each Lender Party against, and reimburse each Lender Party on demand for, any loss or expense incurred or sustained by such Lender Party (including any loss or expense incurred by reason of the liquidation or reemployment of deposits or other funds acquired by a Lender Party to fund or maintain Eurodollar Loans but excluding any loss of Base Rate Margin or Eurodollar Margin), as a result of (a) any payment or prepayment (whether authorized or required hereunder or otherwise) of all or a portion of a Eurodollar Loan on a day other than the day on which the applicable Interest Period ends, (b) any payment or prepayment, whether required hereunder or otherwise, of a Loan made after the delivery, but before the effective date, of a Continuation/Conversion Notice requesting the continuation of outstanding Eurodollar Loans as, or the conversion of outstanding Base Rate Loans to, Eurodollar Loans, if such payment or prepayment prevents such Continuation/Conversion Notice from becoming fully effective, (c) the failure of any Loan to be made or of any Continuation/Conversion Notice requesting the continuation of outstanding Eurodollar Loans as, or the conversion of outstanding Base Rate Loans to, Eurodollar Loans to become effective due to any condition precedent not being satisfied or due to any other action or inaction of any Restricted Person, (d) any Conversion (whether authorized or required hereunder or otherwise) of all or any portion of any Eurodollar Loan into a Base Rate Loan or into a different Eurodollar Loan on a day other than the day on which the applicable Interest Period ends, or (e) any assignment of a Eurodollar Loan on a day other than the last day of the Interest Period therefor as a result of a request by Borrower pursuant to Section 3.8(b).

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Section 3.6. *Reimbursable Taxes.* Borrower covenants and agrees that:

(a) Borrower will indemnify each Lender Party against and reimburse each Lender Party for all present and future income, stamp and other taxes, levies, costs and charges whatsoever imposed, assessed, levied or collected on or in respect of this Agreement or any Eurodollar Loans or Letters of Credit (whether or not legally or correctly imposed, assessed, levied or collected), excluding, however, (i) taxes imposed on or measured by its overall net income, and franchise taxes imposed on it (in lieu of net income taxes), by the jurisdiction (or any political subdivision thereof) under the Laws of which it is organized or otherwise resides for tax purposes or maintains any Applicable Lending Office, (ii) with respect to each Lender Party, taxes imposed by reason of any present or former connection between such Lender Party and the jurisdiction imposing such taxes, other than solely as a result of this Agreement or any Note or any transaction contemplated hereby, and (iii) any United States withholding tax imposed on any payment by Borrower pursuant to this Agreement or under any Eurodollar Loans or Letters of Credit, but not excluding any portion of such tax that exceeds the United States withholding tax which would have been imposed on such a payment to such Lender Party under the laws and treaties in effect when such Lender Party first becomes a party to this Agreement (all such non-excluded taxes, levies, costs and charges being collectively called "Reimbursable Taxes"). Such indemnification shall be on an after-tax basis and, except as otherwise provided in Section 3.6(b), paid within 3 Business Days after a Lender Party makes demand therefor.

(b) All payments on account of the principal of, and interest on, each Lender Party's Loans and Note, and all other amounts payable by Borrower to any Lender Party hereunder, shall be made in full without set-off or counterclaim and shall be made free and clear of and without deductions or withholdings of any nature by reason of any Reimbursable Taxes, all of which will be for the account of Borrower. In the event of Borrower being compelled by Law to make any such deduction or withholding from any payment to any Lender Party, Borrower shall pay on the due date of such payment, by way of additional interest, such additional amounts as are needed to cause the amount receivable by such Lender Party after such deduction or withholding to equal the amount which would have been receivable in the absence of such deduction or withholding. If Borrower should make any deduction or withholding as aforesaid, Borrower shall within 60 days thereafter forward to such Lender Party an official receipt or other official document evidencing payment of such deduction or withholding.

(c) If Borrower is ever required to pay any Reimbursable Tax with respect to any Eurodollar Loan, Borrower may elect, by giving to Administrative Agent and such Lender Party not less than three Business Days' notice, to convert all (but not less than all) of any such Eurodollar Loan into a Base Rate Loan, but such election shall not diminish Borrower's obligation to pay all Reimbursable Taxes.

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(d) Notwithstanding the foregoing provisions of this section, Borrower shall be entitled, to the extent it is required to do so by Law, to deduct or withhold (and not to make any indemnification or reimbursement for) income or other similar taxes imposed by the United States of America from interest, fees or other amounts payable hereunder for the account of any Lender Party, other than a Lender Party (i) who is a U.S. person for Federal income tax purposes or (ii) who has the Prescribed Forms on file with Administrative Agent (with copies provided to Borrower) for the applicable year to the extent deduction or withholding of such taxes is not required as a result of the filing of such Prescribed Forms, provided that if Borrower shall so deduct or withhold any such taxes, it shall provide a statement to Administrative Agent and such Lender Party, setting forth the amount of such taxes so deducted or withheld, the applicable rate and any other information or documentation which such Lender Party may reasonably request for assisting such Lender Party to obtain any allowable credits or deductions for the taxes so deducted or withheld in the jurisdiction or jurisdictions in which such Lender Party is subject to tax. As used in this section, "Prescribed Forms" means such duly executed forms or statements, and in such number of copies, which may, from time to time, be prescribed by Law and which, pursuant to applicable provisions of (x) an income tax treaty between the United States and the country of residence of the Lender Party providing the forms or statements, (y) the Internal Revenue Code, or (z) any applicable rules or regulations thereunder, permit Borrower to make payments hereunder for the account of such Lender Party free of such deduction or withholding of income or similar taxes.

Section 3.7. *Alternative Rate of Interest.* If prior to the commencement of any Interest Period for a Borrowing of Eurodollar Loans:

(a) Administrative Agent determines that adequate and reasonable means do not exist for ascertaining the Eurodollar Rate for such Interest Period (any such determination shall be conclusive absent manifest error); or

(b) Administrative Agent is advised by Required Lenders that the Eurodollar Rate for such Interest Period will not adequately and fairly reflect the cost to such Lenders of making or maintaining their Loans included in such Borrowing for such Interest Period;

then Administrative Agent shall give notice thereof to Borrower and Lenders by telephone or telecopy as promptly as practicable thereafter and, until Administrative Agent notifies Borrower and Lenders that the circumstances giving rise to such notice no longer exist, (i) any Continuation/Conversion Notice that requests the conversion of any Borrowing to, or continuation of any Borrowing as, a Borrowing of Eurodollar Loans shall be ineffective and shall be deemed a request to continue such Borrowing as a Borrowing of Base Rate Loans and (ii) if any Borrowing Notice requests a Borrowing of Eurodollar Loans, such Borrowing shall be made as a Borrowing of Base Rate Loans. Upon receipt of such notice, Borrower may revoke any pending request for a Borrowing of, conversion to or continuation of Eurodollar Loans.

Section 3.8. *Change of Applicable Lending Office; Replacement of Lenders.*

(a) Each Lender Party agrees that, upon the occurrence of any event giving rise to the operation of Sections 3.2, 3.3, 3.4 or 3.6 with respect to such Lender Party, it will, if requested by Borrower, use reasonable efforts (subject to overall policy considerations of such Lender Party) to designate another Applicable Lending Office, provided that such designation is made on such terms that such Lender Party and its Applicable Lending Office suffer no economic, legal or regulatory disadvantage, with the object of avoiding the consequence of the event giving rise to the operation of any such section. Nothing in this section shall affect or postpone any of the obligations of Borrower or the rights of any Lender Party provided in Sections 3.2, 3.3, 3.4, or 3.6.

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(b) If any Lender requests compensation under Section 3.2 or 3.3, or if Borrower is required to pay any additional amount to any Lender Party or any governmental authority for the account of any Lender Party pursuant to Section 3.6, or if the obligation of any Lender Party to make or maintain Loans as, or convert Loans to, Eurodollar Loans is suspended pursuant to Section 3.4, or if any Lender Party defaults in its obligation to fund Loans hereunder, then Borrower may, at its sole expense and effort (such expense to include any transfer fee payable to Administrative Agent under Section 10.5(c) and any expense pursuant to Article III), upon notice to such Lender Party and Administrative Agent, require such Lender Party to assign and delegate in whole (but not in part), without recourse (in accordance with and subject to the restrictions contained in Section 10.5), all its interests, rights and obligations under this Agreement to an Eligible Transferee that shall assume such obligations (which Eligible Transferee may be another Lender Party, if a Lender Party accepts such assignment); provided that (i) Borrower shall have received the prior written consent of Administrative Agent, which consent shall not unreasonably be withheld, (ii) such Lender Party shall have received payment of an amount equal to the outstanding principal of its Loans, accrued interest thereon, accrued fees and all other amounts payable to it hereunder from Borrower or such Eligible Transferee (including any amounts payable pursuant to Section 3.5), (iii) in the case of any such assignment resulting from a claim for compensation under Section 3.2 or 3.3 or payments required to be made pursuant to Section 3.6, such assignment will result in a reduction in such compensation or payments, and (iv) if the Borrower elects to exercise such right with respect to any Lender Party, it shall be obligated to replace all Lender Parties that have made similar requests. A Lender Party shall not be required to make any such assignment and delegation if, prior thereto, as a result of a waiver by such Lender Party or otherwise, the circumstances entitling Borrower to require such assignment and delegation cease to apply. Any Lender Party being replaced shall execute and deliver an Assignment and Acceptance with respect to such Lender Party's outstanding Loans and participations in LC Obligations.

ARTICLE IV

CONDITIONS PRECEDENT TO LENDING

Section 4.1. *Documents to be Delivered.* No Lender has any obligation to make its first Loan, and LC Issuer has no obligation to issue the first Letter of Credit, unless Administrative Agent shall have received all of the following, at Administrative Agent's office in Houston, Texas, duly executed and delivered and in form, substance and date reasonably satisfactory to the Administrative Agent, the Lenders and their counsel:

- (a) This Agreement.
- (b) Each Term Note and Revolving Note.
- (c) Each Security Document listed on the Schedule 4.1.
- (d) Certain certificates of Borrower and each Subsidiary including:
 - (i) An "Omnibus Certificate" of the Secretary or Assistant Secretary and of the Chairman of the Board or President of Borrower, which shall contain the names and signatures of the officers of Borrower authorized to execute Loan Documents and which shall certify to the truth, correctness and completeness of the following exhibits attached thereto: (1) a copy of resolutions duly adopted by the Board of Directors of Borrower and each Subsidiary and in full force and effect at the time this Agreement is entered into, authorizing the execution of this Agreement and the other Loan Documents delivered or to be delivered in connection herewith and the consummation of the transactions contemplated herein and therein, (2) a copy of the charter documents of Borrower and each Subsidiary and all amendments thereto, certified by the appropriate official of such party's state of organization, and (3) a copy of the bylaws of Borrower and each Subsidiary; and
 - (ii) A "Compliance Certificate" of the Chairman of the Board, President or of the chief financial officer of Borrower, as of the Closing Date, in which such officers certify to the satisfaction of the conditions set out in subsections (a), (b), and (c) of Section 4.2.
- (e) Certificate (or certificates) of good standing and due qualification to do business for Borrower and each Subsidiary, issued by appropriate officials in any states in which Borrower and each Subsidiary owns property subject to Security Documents.
- (f) The Guaranty executed by each Guarantor.
- (g) A favorable opinion of (i) Bracewell & Patterson, L.L.P., counsel for Restricted Persons, substantially in the form set forth in Exhibit 4.1(g)(i); and (ii) William George, in-house counsel for Restricted Persons, substantially in the form set forth in Exhibit 4.1(g)(ii).
- (h) The Initial Financial Statements.
- (i) A certificate executed by the chief financial officer of Borrower, certifying that the Initial Financial Statements of Borrower delivered pursuant to clause (h) above fairly present the Consolidated financial position for the periods covered thereby, as of the date of such Initial Financial Statements.
- (j) A Borrowing Base Certificate dated as of the Closing Date.
- (k) Certificates or binders evidencing Restricted Persons' insurance in effect on the date hereof.
- (l) The certificate of insurance required by Section 6.8.

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- (m) Payment of all fees including all Commitment Fees, upfront, Administrative Agent, and Arranger fees required to be paid to any Lender or any other Party pursuant to any Loan Documents.
 - (n) Documents (i) confirming the payment in full of all Indebtedness under the Prior Credit Documents, (ii) releasing and terminating all Liens on any Restricted Person's property securing such Indebtedness (or assigning such Liens to Administrative Agent for the benefit of Lenders, and (iii) terminating the credit facility under the Prior Credit Documents.
 - (o) The review and approval of the field audit conducted by the Prior Agent dated June 2003, which shall be acceptable to the Administrative Agent, in its sole and absolute discretion.
 - (p) The Assignment of Prior Credit Documents in form an substance satisfactory to the Agent in its sole discretion, executed by the Prior Agent, as agent, and each of the lenders party to the Prior Credit Agreement on the Closing Date and the delivery of all Collateral in possession of the Prior Agent.
 - (q) Such other documents and instruments as the Administrative Agent and its counsel may require.

Section 4.2. *Additional Conditions Precedent.* No Lender has any obligation to make any Loan (including its first), and LC Issuer has no obligation to issue any Letter of Credit (including its first), unless the following conditions precedent have been satisfied:

(a) All representations and warranties made by any Restricted Person in any Loan Document shall be true in all material respects (*without duplication of materiality qualifiers contained therein*) on and as of the date of such Loan or the date of issuance of such Letter of Credit as if such representations and warranties had been made as of the date of such Loan or the date of issuance of such Letter of Credit, except to the extent that such representation or warranty was made as of a specific date or updated, modified or supplemented as of a subsequent date with the consent of Required Lenders.

(b) No Default shall exist at the date of such Loan or the date of issuance of such Letter of Credit.

(c) The making of such Loan or the issuance of such Letter of Credit shall not be prohibited by any Law and shall not subject any Lender or any LC Issuer to any penalty or other

Remainder of this page intentionally left blank.

ARTICLE V

REPRESENTATIONS AND WARRANTIES

To confirm each Lender's understanding concerning Restricted Persons and Restricted Persons' businesses, properties and obligations and to induce each Lender to enter into this Agreement and to extend credit hereunder, Borrower represents and warrants to each Lender that:

Section 5.1. *No Default.* No event has occurred and is continuing which constitutes a Default or an Event of Default.

Section 5.2. *Organization and Good Standing.* Each Restricted Person is duly organized, validly existing and in good standing under the Laws of its jurisdiction of organization, having all powers required to carry on its business and enter into and carry out the transactions contemplated hereby. Each Restricted Person is duly qualified, in good standing, and authorized to do business in all other jurisdictions within the United States wherein the character of the properties owned or held by it or the nature of the business transacted by it makes such qualification necessary, except where the failure to so qualify or be authorized could not reasonably be expected to result in a Material Adverse Change. Each Restricted Person has taken all actions and procedures customarily taken in order to enter, for the purpose of conducting business or owning property, each jurisdiction outside the United States wherein the character of the properties owned or held by it or the nature of the business transacted by it makes such actions and procedures desirable could not reasonably be expected to result in a Material Adverse Change.

Section 5.3. *Authorization.* Each Restricted Person has the power and authority to execute, deliver, and perform its respective obligations under this Agreement and the other Loan Documents. Each Restricted Person has taken all action necessary to authorize the execution and delivery by it of the Loan Documents to which it is a party and to authorize the consummation of the transactions contemplated thereby and the performance of its obligations thereunder. This Agreement and the other Loan Documents have been duly executed and delivered by Borrower and each other Restricted Person a Party thereto. Borrower is duly authorized to borrow funds hereunder.

Section 5.4. *No Conflicts or Consents.* The execution and delivery by the various Restricted Persons of the Loan Documents to which each is a party, the performance by each of its obligations under such Loan Documents, and the consummation of the transactions contemplated by the various Loan Documents, do not and will not (a) conflict with any provision of (i) any Law, (ii) the organizational documents of any Restricted Person, or (iii) any material agreement, judgment, license, order or permit applicable to or binding upon any Restricted Person; (b) result in the acceleration of any Indebtedness owed by any Restricted Person; or (c) result in or require the creation of any Lien upon any assets or properties of any Restricted Person except as expressly contemplated or permitted in the Loan Documents. Except as expressly contemplated in the Loan Documents, no permit, consent, approval, authorization or order of, and no notice to or filing with, any Tribunal or third party is required in connection with the execution, delivery or performance by any Restricted Person of any Loan Document or to consummate any transactions contemplated by the Loan Documents.

Section 5.5. *Enforceable Obligations.* This Agreement is, and the other Loan Documents when duly executed and delivered will be, legal, valid and binding obligations of each Restricted Person which is a party hereto or thereto, enforceable in accordance with their respective terms except as such enforcement may be limited by bankruptcy, insolvency or similar Laws of general application relating to the enforcement of creditors' rights.

Section 5.6. *Initial Financial Statements.* Restricted Persons have heretofore delivered to each Lender true, correct and complete copies of the Initial Financial Statements. The Initial Financial Statements fairly present Borrower's Consolidated financial position at the respective dates thereof and the Consolidated results of Borrower's operations and Borrower's Consolidated cash flows for the respective periods thereof. Since the date of the annual Initial Financial Statements, no Material Adverse Change has occurred, except as reflected in the quarterly Initial Financial Statements or in Section 5.6 of the Disclosure Schedule.

Section 5.7. *Other Obligations and Restrictions.* As of the Closing Date, no Restricted Person has any outstanding Liabilities of any kind which are, in the aggregate, material to Borrower or material with respect to Borrower's Consolidated financial condition and not shown in the Initial Financial Statements or disclosed in Section 5.7 of the Disclosure Schedule or otherwise permitted under Section 7.1. Except as shown in the Initial Financial Statements or disclosed in Section 5.7 of the Disclosure Schedule, no Restricted Person is subject to or restricted by any franchise, contract, deed, charter restriction, or other instrument or restriction which could reasonably be expected to cause a Material Adverse Change.

Section 5.8. *Full Disclosure.* No certificate, written statement or other written information delivered herewith or heretofore by any Restricted Person to any Lender in connection with the negotiation of this Agreement or in connection with any transaction contemplated hereby contains any untrue statement of a material fact or omits to state any material fact known to any Restricted Person (other than industry-wide risks normally associated with the types of businesses conducted by Restricted Persons) necessary to make the statements contained herein or therein, taken as a whole, not misleading as of the date made or deemed made. There is no fact known to any Restricted Person that has not been disclosed to each Lender in writing which could reasonably be expected to cause a

Material Adverse Change. There are no statements or conclusions in any report delivered by any Restricted Person to the Lenders which are based upon or include misleading information or fail to take into account material information regarding the matters reported therein.

Section 5.9. *Litigation.* Except as disclosed in the Initial Financial Statements or in Section 5.9 of the Disclosure Schedule: (a) there are no actions, suits or legal, equitable, arbitral or administrative proceedings pending, or to the knowledge of any Restricted Person threatened, against any Restricted Person or affecting any Collateral (including any which challenge or otherwise pertain to any Restricted Person's title to any Collateral) before any Tribunal which could reasonably be expected to cause a Material Adverse Change, and (b) there are no outstanding judgments, injunctions, writs, rulings or orders by any such Tribunal against any Restricted Person or, to the knowledge of Borrower, any Restricted Person's stockholders, partners, directors or officers, or affecting any Collateral or any of its material assets or property which could reasonably be expected to cause a Material Adverse Change.

Section 5.10. *Labor Disputes and Acts of God.* Except as disclosed in Section 5.10 of the Disclosure Schedule, neither the business nor the properties of any Restricted Person has been affected by any fire, explosion, accident, strike, lockout or other labor dispute, drought, storm, hail, earthquake, embargo, act of God or of the public enemy or other casualty (whether or not covered by insurance), which could reasonably be expected to cause a Material Adverse Change.

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Section 5.11. *ERISA Plans and Liabilities.* All ERISA Plans in effect on the Closing Date are listed in Section 5.11 of the Disclosure Schedule. Except as disclosed in the Initial Financial Statements or in Section 5.11 of the Disclosure Schedule, no Termination Event has occurred with respect to any ERISA Plan and all ERISA Affiliates are in compliance with ERISA which could reasonably be expected to cause a Material Adverse Change. Except as permitted under Section 7.10 hereof, no ERISA Affiliate is required to contribute to, or has any other absolute or contingent liability in respect of, any "multiemployer plan" as defined in Section 4001 of ERISA. Except as set forth in Section 5.11 of the Disclosure Schedule as of the Closing Date: (a) no "accumulated funding deficiency" (as defined in Section 412(a) of the Internal Revenue Code) exists with respect to any ERISA Plan, whether or not waived by the Secretary of the Treasury or his delegate, and (b) the current value of each ERISA Plan's benefits does not exceed the current value of such ERISA Plan's assets available for the payment of such benefits which could reasonably be expected to cause a Material Adverse Change.

Section 5.12. *Environmental and Other Laws.* Except as disclosed in Section 5.12 of the Disclosure Schedule: (a) Restricted Persons are conducting their businesses in compliance with all applicable Laws, including Environmental Laws, which the failure to so comply could reasonably be expected to cause a Material Adverse Change, and have and are in compliance with all licenses and permits required under any such Laws which the failure to so comply could reasonably be expected to cause a Material Adverse Change; (b) none of the operations or properties of any Restricted Person is the subject of federal, state or local investigation evaluating whether any material remedial action is needed to respond to a release of any Hazardous Materials into the environment or to the improper storage or disposal (including storage or disposal at offsite locations) of any Hazardous Materials which could reasonably be expected to cause a Material Adverse Change; (c) no Restricted Person (and to the best knowledge of Borrower, no other Person) has filed any notice under any Law indicating that any Restricted Person is responsible for the improper release into the environment, or the improper storage or disposal, of any material amount of any Hazardous Materials or that any Hazardous Materials have been improperly released, or are improperly stored or disposed of, upon any property of any Restricted Person which could reasonably be expected to cause a Material Adverse Change; (d) to the knowledge of Borrower, no Restricted Person has transported or arranged for the transportation of any Hazardous Material to any location which is (i) listed on the National Priorities List under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, listed for possible inclusion on such National Priorities List by the Environmental Protection Agency in its Comprehensive Environmental Response, Compensation and Liability Information System List, or listed on any similar state list or (ii) the subject of federal, state or local enforcement actions or other investigations, in the case of either of the forgoing clauses (i) and (ii), which may lead to claims against any Restricted Person for clean-up costs, remedial work, damages to natural resources or for personal injury claims (whether under Environmental Laws or otherwise) which could reasonably be expected to cause a Material Adverse Change; and (e) no Restricted Person otherwise has any known material contingent liability under any Environmental Laws or in connection with the release into the environment, or the storage or disposal, of any Hazardous Materials which could reasonably be expected to cause a Material Adverse Change. Each Restricted Person undertook, at the time of its acquisition of each of its material properties, all appropriate inquiry into the previous ownership and uses of the Property and any potential environmental liabilities associated therewith.

Section 5.13. *Names and Places of Business.* As of the Closing Date, no Restricted Person has, during the preceding two (2) years, been known by, or used any other trade or fictitious name, except as disclosed in Section 5.13 of the Disclosure Schedule. Except as otherwise indicated in Section 5.13 of the Disclosure Schedule, as of the Closing Date, the chief executive office and principal place of business of each Restricted Person are (and for the preceding two (2) years have been) located at the address of Borrower set out on the signature pages hereto. Except as indicated in Section 5.13 of the Disclosure Schedule otherwise disclosed in writing to the Administrative Agent, no Restricted Person has any other office or place of business.

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Section 5.14. *Subsidiaries.* Borrower does not presently have any Subsidiary except those listed in Section 5.14 of the Disclosure Schedule or disclosed to Administrative Agent in writing. No Restricted Person has any equity investments in any other Person except those listed in Section 5.14 of the Disclosure Schedule or otherwise permitted under this Agreement. Borrower owns, directly or indirectly, the equity interests in each of its Subsidiaries indicated in Section 5.14 of the Disclosure Schedule or as disclosed to Administrative Agent in writing.

Section 5.15. *Government Regulation.* Neither Borrower nor any other Restricted Person owing Obligations is (a) a "registered holding company", or a "subsidiary company" of a "registered holding company", or an "affiliate" of a "registered holding company" within the meaning of the Public Utility Holding Company Act of 1935, as amended; or (b) an "investment company" or a company "controlled" by an "investment company" within the meaning of the Investment Company Act of 1940, as amended. The pledge of the Equity of each Subsidiary of Borrower does not violate Regulation T, U, or X of the Board of Governors of the Federal Reserve System.

Section 5.16. *Insider.* No Restricted Person, nor, to the knowledge of Borrower as of the Closing Date, any Person having "control" (as that term is defined in 12 U.S.C. § 375b(9) or in regulations promulgated pursuant thereto) of any Restricted Person, is a "director" or an "executive officer" or "principal shareholder" (as those terms are defined in 12 U.S.C. § 375b(8) or (9) or in regulations promulgated pursuant thereto) of any Lender, of a bank holding company of which any Lender is a Subsidiary or of any Subsidiary of a bank holding company of which any Lender is a Subsidiary.

Section 5.17. *Solvency.* Upon giving effect to the issuance of the Notes, the execution of the Loan Documents by Borrower and each Guarantor and the consummation of the transactions contemplated hereby, Borrower and the Guarantors, on a Consolidated basis, will be Solvent. Neither Borrower nor any

Restricted Person has incurred (whether under the Loan Documents or otherwise), nor does any Restricted Person intend to incur or believe that it will incur Liabilities which will be beyond its ability to pay as such debts mature.

Section 5.18. *Tax Shelter Regulations.* Borrower does not intend to treat the Loans and/or Letters of Credit and related transactions as being a "reportable transaction" (within the meaning of Treasury Regulation Section 1.6011-4). In the event Borrower determines to take any action inconsistent with such intention, it will promptly notify Administrative Agent thereof. If Borrower so notifies Administrative Agent, Borrower acknowledges that one or more of the Lenders may treat its Loans and/or Letters of Credit as part of a transaction that is subject to Treasury Regulation Section 301.6112-1, and such Lender or Lenders, as applicable, will maintain the lists and other records required by such Treasury Regulation.

Section 5.19. *Title to Properties; Licenses.* Each Restricted Person has good and defensible title to all of the Collateral and to all of its material properties and assets, free and clear of all Liens, encumbrances, or adverse claims other than Permitted Liens and free and clear of all impediments to the use of such properties and assets in such Restricted Person's business. Each Restricted Person possesses all licenses, permits, franchises, patents, copyrights, trademarks and trade names, and other intellectual property (or otherwise possesses the right to use such intellectual property without violation of the rights of any other Person) which are necessary to carry out its business as presently conducted and as presently proposed to be conducted hereafter, which could reasonably be expected to cause a Material Adverse Change and no Restricted Person is in violation of the terms under which it possesses such intellectual property or the right to use such intellectual property, the violation of which could reasonably be expected to cause a Material Adverse Change.

Section 5.20. *Regulation U.* None of the Borrower and its Subsidiaries are engaged in the business of extending credit for the purpose of purchasing or carrying Margin Stock, and no proceeds of any Loans will be used for a purpose which violates Regulation U.

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ARTICLE VI

AFFIRMATIVE COVENANTS OF BORROWER.

Borrower covenants and agrees that until the full and final payment of the Obligations and the termination of this Agreement, unless Required Lenders have previously agreed otherwise:

Section 6.1. *Payment and Performance.* Borrower will cause each other Restricted Person to observe, perform and comply with every term, covenant and condition in any Loan Document.

Section 6.2. *Books, Financial Statements and Reports.* Each Restricted Person will at all times maintain full and accurate books of account and records. Borrower will maintain and will cause its Subsidiaries to maintain a standard system of accounting, will maintain its Fiscal Year, and will furnish the following statements and reports to each Lender Party at Borrower's expense:

(a) As soon as available, and in any event within one hundred twenty (120) days after the end of each Fiscal Year, complete Consolidated and consolidating financial statements of Borrower together with all notes thereto, prepared in reasonable detail in accordance with GAAP, together with an unqualified opinion on the Consolidated Statements, based on an audit using GAAP, by independent certified public accountants selected by Borrower of nationally recognized standing, stating that such Consolidated financial statements have been so prepared. These financial statements shall contain a Consolidated and consolidating balance sheet as of the end of such Fiscal Year and Consolidated and consolidating statements of income for such Fiscal Year and Consolidated statements of cash flows and stockholders' equity for such Fiscal Year, each setting forth in comparative form the corresponding figures for the preceding Fiscal Year.

(b) As soon as available, and in any event within forty-five (45) days after the end of the first three Fiscal Quarters in each Fiscal Year, Borrower's unaudited Consolidated and consolidating balance sheet and income statements as of the end of such Fiscal Quarter and Consolidated statements of Borrower's cash flows and stockholders' equity for the period from the beginning of the then current Fiscal Year to the end of such Fiscal Quarter, all in reasonable detail and prepared in accordance with GAAP, subject to changes resulting from normal year-end adjustments. In addition Borrower will, together with each such set of financial statements and each set of financial statements furnished under subsection (a) of this section, furnish a certificate in the form of Exhibit 6.2(b) signed by the chief financial officer of Borrower stating that such financial statements are fair and complete in all material respects and fairly present the Consolidated financial position of Borrower for the periods covered thereby (subject to normal year-end adjustments), stating that he has reviewed the Loan Documents, containing calculations showing compliance (or non-compliance) at the end of such Fiscal Quarter with the requirements of Section 7.11 and stating that no Default exists at the end of such Fiscal Quarter or at the time of such certificate or specifying the nature and period of existence of any such Default.

(c) Promptly upon their becoming available, copies of all financial statements, reports, notices and proxy statements sent by any Restricted Person to its stockholders and all registration statements, periodic reports and other statements and schedules filed by any Restricted Person with any securities exchange, the Securities and Exchange Commission or any similar governmental authority.

(d) As soon as available, and in any event within twenty (20) days after the end of each calendar month, (i) a Borrowing Base Certificate substantially in the form of Exhibit 2.8, duly completed by an authorized officer of Borrower, with information required therein completed to reflect the Borrowing Base as of the end of the preceding calendar month; and (ii) an aging schedule of all Receivables of Borrower on a Consolidated basis in summary form, certified by an authorized officer of Borrower, which reflects aging, on an aggregate basis, of Receivables which are current or 30, 60, or 90 days past due from the date of invoice with respect thereto.

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Section 6.3. *Other Information and Inspections.* Each Restricted Person will furnish to each Lender any information which Administrative Agent may from time to time reasonably request concerning any provision of the Loan Documents, any Collateral, or any matter in connection with Restricted Persons'

businesses, properties, prospects, financial condition and operations, including all evidence which Administrative Agent from time to time reasonably requests in writing as to the accuracy and validity of or compliance with all representations, warranties and covenants made by any Restricted Person in the Loan Documents, the satisfaction of all conditions contained therein, and all other matters pertaining thereto. Each Restricted Person will permit representatives appointed by Administrative Agent (including independent accountants, auditors, Administrative Agents, attorneys, appraisers and any other Persons) to visit and inspect during normal business hours any of such Restricted Person's property, including its books of account, other books and records, and any facilities or other business assets, and to make extra copies therefrom and photocopies and photographs thereof, and to write down and record any information such representatives obtain, and each Restricted Person shall permit Administrative Agent or its representatives to investigate and verify the accuracy of the information furnished to Administrative Agent or any Lender in connection with the Loan Documents and to discuss all such matters with its officers, employees and representatives.

Section 6.4. *Notice of Material Events and Change of Address.* Borrower will, after it has knowledge thereof, promptly notify each Lender in writing, stating that such notice is being given pursuant to this Agreement, of:

- (a) the occurrence of any Material Adverse Change,
- (b) the occurrence of any Default or Event of Default,
- (c) the acceleration of the maturity of any Indebtedness owed by any Restricted Person or of any default by any Restricted Person under any indenture, mortgage, agreement, contract or other instrument to which any of them is a party or by which any of them or any of their properties is bound, if such acceleration or default could reasonably be expected to cause a Material Adverse Change,
- (d) the occurrence of any Termination Event,
- (e) any claim of \$1,000,000 or more, any notice of potential liability under any Environmental Laws which might exceed such amount, or any other material adverse claim asserted against any Restricted Person or with respect to any Restricted Person's properties,
- (f) the filing of any suit or proceeding against any Restricted Person in which an adverse decision could reasonably be expected to cause a Material Adverse Change, and
- (g) the filing of any material financing statement, registration of a pledge (such as with an issuer of uncertificated securities), or other arrangement or action which would serve to perfect a Lien, regardless of whether such financing statement is filed, such registration is made, or such arrangement or action is undertaken before or after such Lien exists.

Upon the occurrence of any of the foregoing Restricted Persons will take all necessary or appropriate steps to promptly remedy any such Material Adverse Change, Default, Event of Default, acceleration, default or Termination Event, to protect against any such adverse claim, to defend any such suit or proceeding, and to resolve all controversies on account of any of the foregoing. Borrower will also notify Administrative Agent and Administrative Agent's counsel in writing at least ten (10) Business Days prior to the date that any Restricted Person changes its name or the location of its chief executive office or its location under the Uniform Commercial Code.

Section 6.5. *Maintenance of Properties.* Each Restricted Person will maintain, preserve, protect, and keep all Collateral and all other material property used or useful in the conduct of its business in good condition (ordinary wear and tear excepted) in accordance with reasonably prudent industry standards, and in compliance with all applicable Laws which could reasonably be expected to cause a Material Adverse Change, in conformity with all applicable contracts, servitudes, leases and agreements which could reasonably be expected to cause a Material Adverse Change, and will from time to time make all commercially reasonable repairs, renewals and replacements needed to enable the business and operations carried on in connection therewith to be promptly and advantageously conducted at all times.

Section 6.6. *Maintenance of Existence and Qualifications.* Except as permitted under Section 7.4, each Restricted Person will maintain and preserve its existence and its rights and franchises in full force and effect and will qualify to do business in all states or jurisdictions where required by applicable Law, except where the failure to maintain, preserve and qualify could reasonably be expected to cause a Material Adverse Change.

Section 6.7. *Payment of Taxes.* Each Restricted Person will (a) timely file all required tax returns including any extensions; (b) timely pay all taxes, assessments, and other governmental charges or levies imposed upon it or upon its income, profits or property before the same become delinquent; and (c) maintain appropriate accruals and reserves for all of the foregoing in accordance with GAAP. Each Restricted Person may, however, delay paying or discharging any of the foregoing so long as it is in good faith contesting the validity thereof by appropriate proceedings, if necessary, and has set aside on its books adequate reserves therefore which are required by GAAP.

Section 6.8. *Insurance.*

(a) Each Restricted Person shall at all times maintain (at its own expense) insurance for its property and insurance with respect to all Collateral and liability insurance, with financially sound and reputable insurance companies, in such amounts and against such risks as is customary in the industry for similarly situated businesses and properties. All insurance policies covering Collateral shall be endorsed (i) to provide for payment of losses to Administrative Agent as its interests may appear and Borrower shall deliver a certificate to that effect, (ii) to provide that such policies may not be canceled or reduced or affected in any material manner for any reason without ten (10) days prior notice to Administrative Agent from the insurer, (iii) to provide for any other matters specified in any applicable Security Document or which Administrative Agent may reasonably require; and (iv) to provide for insurance against fire, casualty and any other hazards normally insured against, (less a reasonable deductible not to exceed amounts customary in the industry for similarly situated businesses and properties) of the property insured.

(b) Each such policy shall (A) if such policy is for liability insurance, name the appropriate Restricted Person and Administrative Agent, as agent for the Lenders, as insured parties thereunder (without any representation or warranty by or obligation upon Administrative Agent or Lenders) as their interests may appear, (B) if such policy is for property insurance, contain the agreement by the insurer that any loss thereunder shall be payable to Administrative Agent notwithstanding any action, inaction or breach of representation or warranty by any Restricted Person, and (C) provide that there shall be no recourse against Administrative Agent or Lenders for payment of premiums or other amounts with respect thereto. Each Restricted Person will, if so requested by Administrative Agent, deliver to Administrative Agent original or duplicate policies of such insurance. Administrative Agent is

hereby authorized to enforce payment under all such insurance policies and to compromise and settle any claims thereunder, in its own name or in the name of the Restricted Persons.

(c) Reimbursement under any liability insurance maintained by Restricted Persons pursuant to this Section 6.8 may be paid directly to the Person who has incurred the liability covered by such insurance. With respect to any loss involving damage to Collateral as to which subsection (d) of this Section 6.8 is not applicable, each Restricted Person will make or cause to be made the necessary repairs to or replacements of such Collateral, and any proceeds of insurance maintained by each Restricted Person pursuant to this Section 6.8 shall be paid to such Restricted Person by Administrative Agent as reimbursement for the costs of such repairs or replacements as such repairs or replacements are made or acquired.

(d) Upon the occurrence and during the continuance of an Event of Default or upon the occurrence of a loss of any Collateral, all property and casualty insurance payments in respect of such Collateral shall be paid to Administrative Agent and applied as specified in the Security Agreements.

Section 6.9. *Performance on Borrower's Behalf.* If any Restricted Person fails to pay any taxes, insurance premiums, expenses, attorneys' fees or other amounts it is required to pay under any Loan Document, Administrative Agent may pay the same. Borrower shall immediately reimburse Administrative Agent for any such payments and each amount paid by Administrative Agent shall constitute an Obligation owed hereunder which is due and payable on the date such amount is paid by Administrative Agent.

Section 6.10. *Interest.* Borrower hereby promises to each Lender Party to pay interest at the Default Rate on all Obligations (including Obligations to pay fees or to reimburse or indemnify any Lender) which Borrower has in this Agreement promised to pay to such Lender Party and which are not paid when due. Such interest shall accrue from the date such Obligations become due until they are paid.

Section 6.11. *Compliance with Law.* Each Restricted Person will conduct its business and affairs in compliance with all Laws applicable thereto. Each Restricted Person will cause all licenses and permits necessary or appropriate for the conduct of its business and the ownership and operation of its property used and useful in the conduct of its business to be at all times maintained in good standing and in full force and effect, except as could reasonably be expected to cause a Material Adverse Change.

Section 6.12. *Environmental Matters; Environmental Reviews.*

(a) Each Restricted Person will comply with all Environmental Laws now or hereafter applicable to such Restricted Person, as well as all contractual obligations and agreements with respect to environmental remediation or other environmental matters (except as could not reasonably be expected to result in a Material Adverse Change), and shall obtain, at or prior to the time required by applicable Environmental Laws, all environmental, health and safety permits, licenses and other authorizations necessary for its operations (except as could not reasonably be expected to result in a Material Adverse Change) and will maintain such authorizations in full force and effect (except as could not reasonably be expected to result in a Material Adverse Change). No Restricted Person will do anything or permit anything to be done which will subject any of its properties to any remedial obligations under, or result in noncompliance with applicable permits and licenses issued under, any applicable Environmental Laws, assuming disclosure to the applicable governmental authorities of all relevant facts, conditions and circumstances (except as could not reasonably be expected to result in a Material Adverse Change).

(b) Borrower will promptly furnish to Administrative Agent copies of all written notices of violation, orders, claims, citations, complaints, penalty assessments, suits or other proceedings received by any Restricted Person, or of which Borrower otherwise has notice, pending or threatened against any Restricted Person by any governmental authority with respect to any alleged violation of or non-compliance with any Environmental Laws or with respect to any permits, licenses or authorizations in connection with any Restricted Person's ownership or use of its properties or the operation of its business, in each case, that could reasonably be expected to result in a Material Adverse Change.

(c) Borrower will promptly furnish to Administrative Agent all written requests for information, notices of claim, demand letters, and other written notifications, received by Borrower in connection with any Restricted Person's ownership or use of its properties or the conduct of its business, relating to potential responsibility with respect to any investigation or clean-up of Hazardous Material at any location that could reasonably be expected to have a Material Adverse Change.

Section 6.13. *Intentionally Left Blank.*

Section 6.14. *Bank Accounts; Offset.* To secure the repayment of the Obligations Borrower hereby grants to each Lender a security interest, a lien, and a right of offset, each of which shall be in addition to all other interests, liens, and rights of any Lender at common Law, under the Loan Documents, or otherwise, and each of which shall be upon and against (a) any and all moneys, securities or other property (and the proceeds therefrom) of Borrower now or hereafter held or received by or in transit to any Lender from or for the account of Borrower, whether for safekeeping, custody, pledge, transmission, collection or otherwise, (b) any and all deposits (general or special, time or demand, provisional or final) of Borrower with any Lender, and (c) any other credits and claims of Borrower at any time existing against any Lender, including claims under certificates of deposit. At any time and from time to time after the occurrence of any Event of Default, each Lender is hereby authorized to foreclose upon, or to offset against the Obligations then due and payable (in either case without notice to Borrower), any and all items hereinabove referred to. The remedies of foreclosure and offset are separate and cumulative, and either may be exercised independently of the other without regard to procedures or restrictions applicable to the other.

Section 6.15. *Guaranties of Borrower's Subsidiaries.* Each Subsidiary of Borrower now existing and each Subsidiary, other than an Immaterial Subsidiary, hereafter created, acquired or coming into existence after the date hereof shall, promptly upon request by Administrative Agent, execute and deliver to Administrative Agent an absolute and unconditional guaranty of the timely repayment of the Obligations and the due and punctual performance of the obligations of Borrower hereunder, which guaranty shall be satisfactory to Administrative Agent in form and substance. Each Subsidiary of Borrower existing on the date hereof shall duly execute and deliver such a guaranty prior to the making of any Loan hereunder. Borrower will cause each of its now existing Subsidiaries, other than an Immaterial Subsidiary, hereafter formed or acquired to deliver to Administrative Agent, simultaneously with its delivery of such a guaranty, written

evidence satisfactory to Administrative Agent and its counsel that such Subsidiary has taken all corporate or partnership action necessary to duly approve and authorize its execution, delivery and performance of such guaranty and any other documents which it is required to execute.

Section 6.16. *Agreement to Deliver Security Documents.* Borrower agrees to deliver and to cause each other Restricted Person to deliver, to further secure the Obligations whenever requested by Administrative Agent in its sole and absolute discretion, deeds of trust, mortgages, chattel mortgages, security agreements, financing statements continuation statements, extension agreements, acknowledgments, and other Security Documents in form and substance satisfactory to Administrative Agent for the purpose of granting, confirming, protecting and perfecting Liens or security interests in any personal property now owned or hereafter acquired by any Restricted Person.

Section 6.17. *Clean-up Period.* Borrower will select a Clean-Up Period at least once during each Fiscal Year and will not during such Clean-Up Period permit the outstanding cash portion of the Revolving Loans to be greater than \$2,000,000; provided, that, if at any time during the Clean-Up Period the LC Issuer shall make payment under a Letter of Credit, Borrower shall have two Business Days following such payment in which to pay the Revolving Loans resulting from such payment.

Section 6.18 *Disposition of Air Solutions.* Notwithstanding anything contained herein to the contrary, Borrower has advised the Lenders that it anticipates that a transaction involving the sale of the Equity or assets of Air Solutions will take place after Closing. Borrower has requested and Lenders have agreed to temporarily waive the requirement that Air Solutions (i) execute the guaranty required by Section 6.15 above; (ii) execute the Security Documents required by Section 6.16 above; and (iii) become a Restricted Person under this Agreement and the related Loan Documents. Further, notwithstanding anything contained herein to the contrary, if such sale occurs on or before January 31, 2004, then such sale will be deemed permitted under this Agreement and the Net Sales Proceeds from such sale will not be required to be applied as set forth in Section 2.7(c) hereof. From the Closing Date through and including the date of such sale, Borrower will not include any Eligible Receivables from the operations of Air Solutions in the calculation of the Borrowing Base. If such sale is not consummated before February 1, 2004, Borrower will promptly (i) cause Air Solutions to execute the Loan Documents contemplated by Sections 6.15 and 6.16; (ii) deliver with respect to Air Solutions all appropriate documents, certificates and resolutions required to be delivered on the Closing Date by each Restricted Person; and (iii) cause counsel for Borrower and Air Solutions to deliver such similar legal opinions applicable to Air Solutions as were rendered for each other Restricted Person on the Closing Date.

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ARTICLE VII

NEGATIVE COVENANTS OF BORROWER

To conform with the terms and conditions under which each Lender is willing to have credit outstanding to Borrower, and to induce each Lender to enter into this Agreement and make the Loans, Borrower warrants, covenants and agrees that until the full and final payment of the Obligations and the termination of this Agreement, unless Required Lenders have previously agreed otherwise:

Section 7.1. *Indebtedness.* No Restricted Person will in any manner owe or be liable for Indebtedness except:

- (a) the Obligations;
- (b) unsecured Indebtedness among Borrower and the Guarantors arising in the ordinary course of business;
- (c) purchase money Indebtedness and Capital Lease Obligations in an aggregate principal amount not to exceed \$2,500,000 at any time, provided that the original principal amount of any such Indebtedness shall not be in excess of the purchase price of the asset acquired thereby and such Indebtedness shall be secured only by the acquired asset;
- (e) Indebtedness existing on the date hereof and listed on Schedule 7.1, and renewals and extensions thereof;
- (f) Subordinated Debt incurred in connection with Permitted Acquisitions;
- (g) Indebtedness in respect of deferred software licensing fees in connection with Borrower or any of its Subsidiaries licensing software in the ordinary course of business consistent with past practices in a total amount not to exceed \$1,000,000 in the aggregate at any time outstanding;
- (h) unsecured Indebtedness consisting of industrial revenue bonds in a total amount not to exceed \$300,000 in the aggregate at any time outstanding; and
- (i) any other unsecured Indebtedness not to exceed \$1,000,000 in the aggregate at any time outstanding.

Section 7.2. *Limitation on Liens.* Except for Permitted Liens, no Restricted Person will create, assume or permit to exist any Lien upon any of the properties or assets which it now owns or hereafter acquires.

Section 7.3. *Hedging Contracts.* (a) No Restricted Person will be a party to or in any manner be liable on any Hedging Contract except Hedging Contracts entered into by a Restricted Person and the Document Agent or any other Lender with the purpose and effect of fixing interest rates on a principal amount of indebtedness of such Restricted Person that is accruing interest at a variable rate, provided that (i) the aggregate notional amount of such contracts never exceeds seventy-five percent (75%) of the anticipated outstanding principal balance of the indebtedness to be hedged by such contracts or an average of such principal balances calculated using a generally accepted method of matching interest swap contracts to declining principal balances, and (ii) the floating rate

Section 7.4. *Limitation on Mergers, Issuances of Securities.* No Restricted Person will merge or consolidate with or into any other Person except that any Subsidiary of Borrower may be merged into or consolidated with (a) another Subsidiary of Borrower and, if a Guarantor is one of the merged entities, so long as a Guarantor is the surviving business entity, or (b) Borrower, so long as Borrower is the surviving business entity. Borrower will not issue any securities other than shares of its common or preferred stock and any options or warrants giving the holders thereof only the right to acquire such shares. No Subsidiary of Borrower will issue any additional shares of its capital stock or other securities or any options, warrants or other rights to acquire such additional shares or other securities except to Borrower or another Subsidiary of Borrower and only to the extent not otherwise forbidden under the terms hereof. No Subsidiary of Borrower which is a partnership will allow any diminution of Borrower's interest (direct or indirect) therein.

Section 7.5. *Limitation on Sales of Property.* No Restricted Person will sell, transfer, lease, exchange, alienate or dispose of any of its material assets or properties or any material interest therein, or discount, sell, pledge or assign any notes payable to it, accounts receivable or future income, except:

- (a) equipment which is worthless, obsolete, no longer used by or useful to a Restricted Person or which is replaced by equipment of equal suitability and value;
- (b) inventory which is sold in the ordinary course of business; and
- (c) other property which is sold for fair consideration not in the aggregate in excess of \$5,000,000 in any Fiscal Year, the sale of which will not materially impair or diminish the value of the Collateral or the Consolidated financial condition, business or operations of Borrower.

Section 7.6. *Limitation on Dividends and Redemptions.* No Restricted Person will declare or make any Distribution, other than Distributions payable to Borrower or to Guarantors which are Subsidiaries of Borrower. Borrower may make regularly scheduled cash interest payments pursuant to the terms of the Subordinated Debt; provided that no Default or Event of Default exists at the time of any such payment or would occur as a result thereof, and may repurchase the Subordinated Debt to the extent not prohibited by this Agreement.

Section 7.7. *Limitation on Investments and New Businesses.* No Restricted Person will (a) make any expenditure or commitment or incur any obligation or enter into or engage in any transaction except (i) in the ordinary course of business or as otherwise permitted or not prohibited under this Agreement; and (ii) in the case of any capital expenditure, not to exceed \$8,000,000 in any Fiscal Year; (b) engage directly or indirectly in any business or conduct any operations except in connection with or incidental to its present businesses and operations, or (c) make any acquisitions of or capital contributions to or other Investments in any Person or property, other than Permitted Investments.

Section 7.8. *Intentionally Omitted.*

Section 7.9. *Transactions with Affiliates.* Neither Borrower nor any of its Subsidiaries will engage in any material transaction with any of its Affiliates on terms which are less favorable to it than those which would have been obtainable at the time in arm's-length dealing with Persons other than such Affiliates, provided that such restriction shall not apply to transactions among Borrower and its Subsidiaries.

Section 7.10. *Prohibited Contracts.* Except as expressly provided for in the Loan Documents, no Restricted Person will, directly or indirectly, enter into, create, or otherwise allow to exist any contract that restricts or other consensual restriction on, the ability of any Subsidiary of Borrower to: (a) pay dividends or make other Distributions to Borrower, (b) to redeem Equity held in it by Borrower, (c) to repay loans and other Indebtedness owing by it to Borrower, (d) to transfer any of its assets to Borrower, or (e) make loans or advances to Borrower or any of its Subsidiaries. No Restricted Person will enter, or permit the entry by any Restricted Person into, any contract, lease, or amendment that releases, qualifies, limits, makes contingent or otherwise materially detrimentally affects the rights and benefits of Administrative Agent or any Lender under or acquired pursuant to any Security Documents. No ERISA Affiliate will incur any obligation to contribute to any "multiemployer plan" as defined in Section 4001 of ERISA, except in the ordinary course of business for employees subject to collective bargaining agreements.

Section 7.11. *Financial Covenants.*

(a) *Debt Service Coverage Ratio.* The Borrower will not permit the ratio of (i) the Consolidated EBITDA of Borrower for the four Fiscal Quarter period most recently ended, to (ii) the sum of (A) the Consolidated Interest Expense of Borrower for the four Fiscal Quarter period most recently ended, plus (B) Scheduled Principal Amortization of Long Term Debt of Borrower for the four Fiscal Quarter period most recently ended, to be less than 2.50 to 1.0. For purposes of the foregoing sentence, Consolidated Interest Expense and Scheduled Principal Amortization of Long Term Debt shall be determined (i) as of March 31, 2004 by calculating such amounts for the Fiscal Quarter then ended and multiplying by four; (ii) as of June 30, 2004 by calculating such amounts for the two Fiscal Quarters then ended and multiplying by two; (iii) as of September 30, 2004 by calculating such amounts for the three Fiscal Quarters then ended and multiplying by 1.3333; and (iv) on the last day of each Fiscal Quarter thereafter by calculating such amounts for the four Fiscal Quarters then ended.

(b) *Minimum Tangible Net Worth.* The Borrower will not permit its Consolidated Tangible Net Worth to be less than the sum of (i) \$75,362,000, plus (ii) seventy-five percent (75%) of its Consolidated Net Income earned from October 1, 2003 through the last day of the most recently ended Fiscal Quarter, plus (iii) 100% of the net proceeds of any offering, sale, or other transfer of any Equity of any kind of the Borrower or any Subsidiary (other than to the Borrower or another Subsidiary).

(c) *Consolidated Total Indebtedness Ratio.* The Borrower will not permit the ratio of its Consolidated Total Indebtedness to its Consolidated EBITDA, to be greater than 2.0 to 1.0.

Section 7.12. *Indemnity Agreement.* Borrower will not and will not permit any Restricted Person to, directly or indirectly, change, amend, or otherwise modify the terms of the Indemnity Agreement if such change, amendment or modification could reasonably be expected to adversely affect a Lender Party, except that a Restricted Person which has executed a Guaranty and such other documentation as may be required by the Administrative Agent, may become an additional "Principal" and "Indemnitor" (as those terms are defined in the Indemnity Agreement) under the Indemnity Agreement.

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ARTICLE VIII

EVENTS OF DEFAULT AND REMEDIES

Section 8.1. *Events of Default.* Each of the following events constitutes an Event of Default under this Agreement:

- (a) Any Restricted Person fails to pay any principal component of any Obligation when due and payable
- (b) Any Restricted Person fails to pay any payment of interest or fees on the date which such payment is due and such failure continues for a period of three (3) days;
- (c) Any Restricted Person fails to pay any Obligation (other than the Obligations in subsection (a) above) within three Business Days after the same becomes due and payable, whether at a date for the payment of a fixed installment or as a contingent or other payment becomes due and payable or as a result of acceleration or otherwise;
- (d) Any "default" or "event of default" occurs under any Loan Document which defines either such term, and the same is not remedied within the applicable period of grace (if any) provided in such Loan Document;
- (e) Any Restricted Person fails to duly observe, perform or comply with any covenant, agreement or provision of Article VI and such failure continues for a period for a period of thirty (30) days;
- (f) Any Restricted Person fails to duly observe, perform or comply with any covenant, agreement or provision of Article VII;
- (g) Any Restricted Person fails (other than as referred to in subsections (a), (b), (c) or (d) above) to duly observe, perform or comply with any covenant, agreement, condition or provision of any Loan Document, and such failure remains unremedied for a period of thirty (30) days after notice of such failure is given by Administrative Agent to Borrower;
- (h) Any representation or warranty previously, presently or hereafter made in writing by or on behalf of any Restricted Person in connection with any Loan Document shall prove to have been false or incorrect in any material respect on any date on or as of which made, or any Loan Document at any time ceases to be valid, binding and enforceable as warranted in Section 5.5 for any reason other than its release or subordination by Administrative Agent;
- (i) Any Restricted Person (i) fails to pay any portion, when such portion is due, of any of its Indebtedness in excess of \$2,500,000, or (ii) breaches or defaults in the performance of any agreement or instrument by which any such Indebtedness is issued, evidenced, governed, or secured, and any such failure, breach or default continues beyond any applicable period of grace provided therefor;
- (j) Either (i) any "accumulated funding deficiency" (as defined in Section 412(a) of the Internal Revenue Code) in excess of \$2,500,000 exists with respect to any ERISA Plan, whether or not waived by the Secretary of the Treasury or his delegate, or (ii) any Termination Event occurs with respect to any ERISA Plan and the then current value of such ERISA Plan's benefit liabilities exceeds the then current value of such ERISA Plan's assets available for the payment of such benefit liabilities by more than \$2,500,000 (or in the case of a Termination Event involving the withdrawal of a substantial employer, the withdrawing employer's proportionate share of such excess exceeds such amount);

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(k) Any Restricted Person:

- (i) suffers the entry against it of a judgment, decree or order for relief by a Tribunal of competent jurisdiction in an involuntary proceeding commenced under any applicable bankruptcy, insolvency or other similar Law of any jurisdiction now or hereafter in effect, including the federal Bankruptcy Code, as from time to time amended, or has any such proceeding commenced against it which remains undismissed for a period of sixty days; or
- (ii) commences a voluntary case under any applicable bankruptcy, insolvency or similar Law now or hereafter in effect, including the federal Bankruptcy Code, as from time to time amended; or applies for or consents to the entry of an order for relief in an involuntary case under any such Law; or makes a general assignment for the benefit of creditors; or fails generally to pay (or admits in writing its inability to pay) its debts as such debts become due; or takes corporate or other action to authorize any of the foregoing; or
- (iii) suffers the appointment of or taking possession by a receiver, liquidator, assignee, custodian, trustee, sequestrator or similar official of all or a substantial part of its assets or of any part of the Collateral in a proceeding brought against or initiated by it, and such appointment or taking possession is neither made ineffective nor discharged within sixty days after the making thereof, or such appointment or taking possession is at any time consented to, requested by, or acquiesced to by it; or

(iv) suffers the entry against it of a final judgment for the payment of money in excess of \$2,500,000 (not covered by insurance satisfactory to Administrative Agent in its reasonable discretion), unless the same is discharged within forty-five days after the date of entry thereof or an appeal or appropriate proceeding for review thereof is taken within such period and a stay of execution pending such appeal is obtained; or

(v) suffers a writ or warrant of attachment or any similar process to be issued by any Tribunal against all or any substantial part of its assets or any part of the Collateral, and such writ or warrant of attachment or any similar process is not stayed or released within forty-five days after the entry or levy thereof or after any stay is vacated or set aside;

(l) Any Change of Control occurs;

(m) Any Material Adverse Change occurs;

(n) The occurrence of an Event of Default under the Indemnity Agreement or any other document to which any Restricted Person and the Surety are both parties.

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Upon the occurrence of an Event of Default described in subsection (j)(i), (j)(ii) or (j)(iii) of this section with respect to Borrower, all of the Obligations shall thereupon be immediately due and payable, without demand, presentment, notice of demand or of dishonor and nonpayment, protest, notice of protest, notice of intention to accelerate, declaration or notice of acceleration, or any other notice or declaration of any kind, all of which are hereby expressly waived by Borrower and each Restricted Person who at any time ratifies or approves this Agreement. Upon any such acceleration, any obligation of any Lender and any obligation of LC Issuer to issue Letters of Credit hereunder to make any further Loans shall be permanently terminated. During the continuance of any other Event of Default, Administrative Agent at any time and from time to time may (and upon written instructions from Required Lenders, Administrative Agent shall), without notice to Borrower or any other Restricted Person, do either or both of the following: (1) terminate any obligation of Lenders to make Loans hereunder, and any obligation of LC Issuer to issue Letters of Credit hereunder, and (2) declare any or all of the Obligations immediately due and payable, and all such Obligations shall thereupon be immediately due and payable, without demand, presentment, notice of demand or of dishonor and nonpayment, protest, notice of protest, notice of intention to accelerate, declaration or notice of acceleration, or any other notice or declaration of any kind, all of which are hereby expressly waived by Borrower and each Restricted Person who at any time ratifies or approves this Agreement.

Section 8.2. *Remedies.* If any Event of Default shall occur and be continuing, each Lender Party may terminate its Revolving Loan Commitment and protect and enforce its rights under the Loan Documents by any appropriate proceedings, including proceedings for specific performance of any covenant or agreement contained in any Loan Document, and each Lender Party may enforce the payment of any Obligations due it or enforce any other legal or equitable right which it may have. All rights, remedies and powers conferred upon Lender Parties under the Loan Documents shall be deemed cumulative and not exclusive of any other rights, remedies or powers available under the Loan Documents or at Law or in equity.

Section 8.3. *Application of Proceeds after Acceleration.* Except as otherwise provided in the Security Documents with respect to application of proceeds to any reimbursements due Administrative Agent thereunder and to the Hedging Obligations, if Administrative Agent collects or receives money on account of the Obligations after the acceleration of the Obligations as provided in Section 8.1, Administrative Agent shall distribute all money so collected or received:

(a) first to any reimbursements due Administrative Agent hereunder; and

(b) then ratably to the payment or cash-collateralization of the Obligations (and among the outstanding Obligations in the manner provided in Section 3.1).

Administrative Agent shall have no responsibility to determine the existence or amount of Lender Hedging Obligations and may reserve from the application of amounts under this Section amounts distributable in respect of Lender Hedging Obligations until it has received evidence satisfactory to it of the existence and amount of such Lender Hedging Obligations.

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ARTICLE IX

ADMINISTRATIVE AGENT

Section 9.1. *Appointment and Authority.* Each Lender Party hereby irrevocably authorizes Administrative Agent, and Administrative Agent hereby undertakes, to receive payments of principal, interest and other amounts due hereunder as specified herein and to take all other actions and to exercise such powers under the Loan Documents as are specifically delegated to Administrative Agent by the terms hereof or thereof, together with all other powers reasonably incidental thereto. The relationship of Administrative Agent to the other Lender Parties is only that of one commercial lender acting as Administrative Agent for others, and nothing in the Loan Documents shall be construed to constitute Administrative Agent a trustee or other fiduciary for any Lender Party or any holder of any participation in a Note nor to impose on Administrative Agent duties and obligations other than those expressly provided for in the Loan Documents. With respect to any matters not expressly provided for in the Loan Documents and any matters which the Loan Documents place within the discretion of Administrative Agent, Administrative Agent shall not be required to exercise any discretion or take any action, and it may request instructions from Lenders with respect to any such matter, in which case it shall be required to act or to refrain from acting (and shall be fully protected and free from liability to all Lender Parties in so acting or refraining from acting) upon the instructions of Required Lenders (including itself), provided, however, that Administrative Agent shall not be required to take any action which exposes it to a risk of personal liability that it considers unreasonable or which is contrary to the Loan Documents or to applicable Law.

Section 9.2. *Exculpation, Administrative Agent's Reliance, Etc.* Neither Administrative Agent nor any of its directors, officers, Administrative Agents, attorneys, or employees shall be liable for any action taken or omitted to be taken by any of them under or in connection with the Loan Documents, including

their negligence of any kind, except that each shall be liable for its own gross negligence or willful misconduct. Without limiting the generality of the foregoing, Administrative Agent (a) may treat the Person whose name is set forth on the Register as the holder of any Obligation as the holder thereof until Administrative Agent receives written notice of the assignment or transfer thereof in accordance with this Agreement, signed by such Person and in the form required under Section 10.5(c) payee and in form satisfactory to Administrative Agent; (b) may consult with legal counsel (including counsel for Borrower), independent public accountants and other experts selected by it and shall not be liable for any action taken or omitted to be taken in good faith by it in accordance with the advice of such counsel, accountants or experts; (c) makes no warranty or representation to any other Lender and shall not be responsible to any other Lender Party for any statements, warranties or representations made in or in connection with the Loan Documents; (d) shall not have any duty to ascertain or to inquire as to the performance or observance of any of the terms, covenants or conditions of the Loan Documents on the part of any Restricted Person or to inspect the property (including the books and records) of any Restricted Person; (e) shall not be responsible to any other Lender for the due execution, legality, validity, enforceability, genuineness, sufficiency or value of any Loan Document or any instrument or document furnished in connection therewith; (f) may rely upon the representations and warranties of each Restricted Person or Lender Party in exercising its powers hereunder; and (g) shall incur no liability under or in respect of the Loan Documents by acting upon any notice, consent, certificate or other instrument or writing (including any facsimile, telegram, cable or telex) believed by it to be genuine and signed or sent by the proper Person or Persons.

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Section 9.3. *Credit Decisions.* Each Lender Party acknowledges that it has, independently and without reliance upon any other Lender Party, made its own analysis of Borrower and the transactions contemplated hereby and its own independent decision to enter into this Agreement and the other Loan Documents. Each Lender Party also acknowledges that it will, independently and without reliance upon any other Lender Party and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under the Loan Documents.

Section 9.4. *Indemnification.* Each Lender agrees to indemnify Administrative Agent (to the extent not reimbursed by Borrower within ten (10) days after demand) from and against such Lender's Percentage Share of any and all liabilities, obligations, claims, losses, damages, penalties, fines, actions, judgments, suits, settlements, costs, expenses or disbursements (including reasonable fees of attorneys, accountants, experts and advisors) of any kind or nature whatsoever (in this section collectively called "liabilities and costs") which to any extent (in whole or in part) may be imposed on, incurred by, or asserted against Administrative Agent growing out of, resulting from or in any other way associated with any of the Collateral, the Loan Documents and the transactions and events (including the enforcement thereof) at any time associated therewith or contemplated therein (whether arising in contract or in tort and otherwise and including any violation or noncompliance with any Environmental Laws by any Person or any liabilities or duties of any Person with respect to Hazardous Materials found in or released into the environment).

THE FOREGOING INDEMNIFICATION SHALL APPLY WHETHER OR NOT SUCH LIABILITIES AND COSTS ARE IN ANY WAY OR TO ANY EXTENT OWED, IN WHOLE OR IN PART, UNDER ANY CLAIM OR THEORY OF STRICT LIABILITY, OR ARE CAUSED, IN WHOLE OR IN PART, BY ANY NEGLIGENT ACT OR OMISSION OF ANY KIND BY ADMINISTRATIVE AGENT,

provided only that no Lender shall be obligated under this section to indemnify Administrative Agent for that portion, if any, of any liabilities and costs which is proximately caused by Administrative Agent's own individual gross negligence or willful misconduct, as determined in a final judgment. Cumulative of the foregoing, each Lender agrees to reimburse Administrative Agent promptly upon demand for such Lender's Percentage Share of any costs and expenses to be paid to Administrative Agent by Borrower under Section 10.4(a) to the extent that Administrative Agent is not timely reimbursed for such expenses by Borrower as provided in such section. As used in this section the term "Administrative Agent" shall refer not only to the Person designated as such in Section 1.1 but also to each director, officer, Administrative Agent, attorney, employee, representative and Affiliate of such Person.

Section 9.5. *Rights as Lender.* In its capacity as a Lender, Administrative Agent shall have the same rights and obligations as any Lender and may exercise such rights as though it were not Administrative Agent. Administrative Agent may accept deposits from, lend money to, act as trustee under indentures of, and generally engage in any kind of business with any Restricted Person or their Affiliates, all as if it were not Administrative Agent hereunder and without any duty to account therefor to any other Lender.

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Section 9.6. *Sharing of Set-Offs and Other Payments.* Each Lender Party agrees that if it shall, whether through the exercise of rights under Security Documents or rights of banker's lien, set off, or counterclaim against Borrower or otherwise, obtain payment of a portion of the aggregate Obligations owed to it which, taking into account all distributions made by Administrative Agent under Section 3.1, causes such Lender Party to have received more than it would have received had such payment been received by Administrative Agent and distributed pursuant to Section 3.1, then (a) it shall be deemed to have simultaneously purchased and shall be obligated to purchase interests in the Obligations as necessary to cause all Lender Parties to share all payments as provided for in Section 3.1, and (b) such other adjustments shall be made from time to time as shall be equitable to ensure that Administrative Agent and all Lender Parties share all payments of Obligations as provided in Section 3.1; provided, however, that nothing herein contained shall in any way affect the right of any Lender Party to obtain payment (whether by exercise of rights of banker's lien, set-off or counterclaim or otherwise) of indebtedness other than the Obligations. Borrower expressly consents to the foregoing arrangements and agrees that any holder of any such interest or other participation in the Obligations, whether or not acquired pursuant to the foregoing arrangements, may to the fullest extent permitted by Law exercise any and all rights of banker's lien, set-off, or counterclaim as fully as if such holder were a holder of the Obligations in the amount of such interest or other participation. If all or any part of any funds transferred pursuant to this section is thereafter recovered from the seller under this section which received the same, the purchase provided for in this section shall be deemed to have been rescinded to the extent of such recovery, together with interest, if any, if interest is required pursuant to the order of a Tribunal order to be paid on account of the possession of such funds prior to such recovery.

Section 9.7. *Investments.* Whenever Administrative Agent in good faith determines that it is uncertain about how to distribute to Lender Parties any funds which it has received, or whenever Administrative Agent in good faith determines that there is any dispute among Lender Parties about how such funds should be distributed, Administrative Agent may choose to defer distribution of the funds which are the subject of such uncertainty or dispute. If Administrative Agent in good faith believes that the uncertainty or dispute will not be promptly resolved, or if Administrative Agent is otherwise required to invest funds pending distribution to Lender Parties, Administrative Agent shall invest such funds pending distribution; all interest on any such Investment shall be distributed upon the distribution of such Investment and in the same proportion and to the same Persons as such Investment. All monies received by Administrative Agent for distribution to Lender Parties (other than to the Person who is Administrative Agent in its separate capacity as a Lender Party) shall be held by Administrative

Agent pending such distribution solely as Administrative Agent for such Lender Parties, and Administrative Agent shall have no equitable title to any portion thereof.

Section 9.8. *Benefit of Article IX.* The provisions of this Article (other than the following Section 9.9) are intended solely for the benefit of Lender Parties, and no Restricted Person shall be entitled to rely on any such provision or assert any such provision in a claim or defense against any Lender. Lender Parties may waive or amend such provisions as they desire without any notice to or consent of Borrower or any Restricted Person.

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Section 9.9. *Resignation.* Administrative Agent may resign at any time by giving written notice thereof to Lenders and Borrower. Each such notice shall set forth the date of such resignation. Upon any such resignation, Required Lenders shall have the right to appoint (with, unless an Event of Default shall have occurred and be continuing, the consent of Borrower, such consent not to be unreasonably withheld or delayed) a successor Administrative Agent. A successor must be appointed for any retiring Administrative Agent, and such Administrative Agent's resignation shall become effective when such successor accepts such appointment. If, within thirty days after the date of the retiring Administrative Agent's resignation, no successor Administrative Agent has been appointed and has accepted such appointment, then the retiring Administrative Agent may appoint (with, unless an Event of Default shall have occurred and be continuing, the consent of Borrower, such consent not to be unreasonably withheld or delayed) a successor Administrative Agent, which shall be a commercial bank organized or licensed to conduct a banking or trust business under the Laws of the United States of America or of any state thereof. Upon the acceptance of any appointment as Administrative Agent hereunder by a successor Administrative Agent, the retiring Administrative Agent shall be discharged from its duties and obligations under this Agreement and the other Loan Documents. After any retiring Administrative Agent's resignation hereunder the provisions of this Article IX shall continue to inure to its benefit as to any actions taken or omitted to be taken by it while it was Administrative Agent under the Loan Documents.

Section 9.10. *Notice of Default.* Administrative Agent shall not be deemed to have knowledge or notice of the occurrence of any Default, except with respect to defaults in the payment of principal, interest and fees required to be paid to Administrative Agent for the account of Lenders, unless Administrative Agent shall have received written notice from a Lender or Borrower referring to this Agreement, describing such Default and stating that such notice is a "notice of default." Administrative Agent will notify Lenders of its receipt of any such notice. Administrative Agent shall take such action with respect to such Default as may be directed by Required Lenders in accordance with Article VIII; provided, however, that unless and until Administrative Agent has received any such direction, Administrative Agent may (but shall not be obligated to) take such action, or refrain from taking such action, with respect to such Default as it shall deem advisable or in the best interest of Lenders.

Section 9.11. *Co-Administrative Agents.* The Parties identified on the facing page of this Agreement as "Arranger", and "Documentation Agent", respectively, have no right, power, obligation, liability, responsibility, or duty under the Loan Documents in such capacities. Without limiting the foregoing, the Parties so identified as "Arranger", and "Documentation Agent", respectively, shall not have and shall not be deemed to have any fiduciary relationship with any other Lender. Each Lender acknowledges that it has not relied, and will not rely, on taking or not taking action hereunder.

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ARTICLE X

MISCELLANEOUS

Section 10.1. *Waivers and Amendments; Acknowledgments.*

(a) *Waivers and Amendments.* No failure or delay (whether by course of conduct or otherwise) by any Lender in exercising any right, power or remedy which such Lender Party may have under any of the Loan Documents shall operate as a waiver thereof or of any other right, power or remedy, nor shall any single or partial exercise by any Lender Party of any such right, power or remedy preclude any other or further exercise thereof or of any other right, power or remedy. No waiver of any provision of any Loan Document and no consent to any departure therefrom shall ever be effective unless it is in writing and signed as provided below in this section, and then such waiver or consent shall be effective only in the specific instances and for the purposes for which given and to the extent specified in such writing. No notice to or demand on any Restricted Person shall in any case of itself entitle any Restricted Person to any other or further notice or demand in similar or other circumstances. This Agreement and the other Loan Documents set forth the entire understanding between the parties hereto with respect to the transactions contemplated herein and therein and supersede all prior discussions and understandings with respect to the subject matter hereof and thereof, and no waiver, consent, release, modification or amendment of or supplement to this Agreement or the other Loan Documents shall be valid or effective against any party hereto unless the same is in writing and signed by (i) if such party is Borrower, by Borrower, (ii) if such party is Administrative Agent or LC Issuer, by such party, and (iii) if such party is a Lender, by such Lender or by Administrative Agent on behalf of Lenders with the written consent of Required Lenders (which consent has already been given as to the termination of the Loan Documents as provided in Section 10.9). Notwithstanding the foregoing or anything to the contrary herein, Administrative Agent shall not, without the prior consent of each individual Lender, execute and deliver on behalf of such Lender any waiver or amendment which would: (1) waive any of the conditions specified in Article IV (provided that Administrative Agent may in its discretion withdraw any request it has made under Section 4.2), (2) increase the maximum amount which such Lender is committed hereunder to lend, (3) reduce any fees payable to such Lender hereunder, or the principal of, or interest on, either of such Lender's Notes, (4) extend the Maturity Date, or postpone any date fixed for any payment of any such fees, principal or interest, (5) amend the definition herein of "Required Lenders" or otherwise change the aggregate amount of Percentage Shares which is required for Administrative Agent, Lenders or any of them to take any particular action under the Loan Documents, (6) release Borrower from its obligation to pay such Lender's Obligations or any Guarantor (other than a Guarantor which ceases to be a Subsidiary pursuant to a sale or other disposition permitted by the Loan Documents) from its guaranty of such payment or (7) release all or substantially all of the any Collateral, except for such releases relating to sales or dispositions of property permitted by the Loan Documents, or (8) amend this Section 10.1(a). Notwithstanding the foregoing or anything to the contrary herein, Administrative Agent shall not, without the prior consent of each individual Lender affected thereby (or, as applicable, an Affiliate of such Lender), execute and deliver any waiver or amendment to any Loan Document which would (i) cause an obligation under any outstanding Hedging Contract owing to such Lender (or its Affiliate) that, prior to such waiver or amendment, constituted a "Lender Hedging Obligation" to cease to be a "Lender Hedging Obligation" or (ii) cause the priority of the Lien securing such obligation or the priority of payment with respect to such obligation in connection with the exercise of remedies under such Loan Document to be subordinate in any manner to the Obligations (other than expense reimbursements, expenses of enforcement, and other similar obligations owing under the Loan Documents).

(b) *Acknowledgments and Admissions.* Borrower hereby represents, warrants, acknowledges and admits that (i) it has been advised by counsel in the negotiation, execution and delivery of the Loan Documents to which it is a party, (ii) it has made an independent decision to enter into this Agreement and the other Loan Documents to which it is a party, without reliance on any representation, warranty, covenant or undertaking by Administrative Agent or any Lender, whether written, oral or implicit, other than as expressly set out in this Agreement or in another Loan Document delivered on or after the date hereof, (iii) there are no representations, warranties, covenants, undertakings or agreements by any Lender as to the Loan Documents except as expressly set out in this Agreement or in another Loan Document delivered on or after the date hereof, (iv) no Lender has any fiduciary obligation toward Borrower with respect to any Loan Document or the transactions contemplated thereby, (v) the relationship pursuant to the Loan Documents between Borrower and the other Restricted Persons, on one hand, and each Lender, on the other hand, is and shall be solely that of debtor and creditor, respectively, provided that, solely for purposes of Section 10.5(f), Administrative Agent shall act as Administrative Agent of Borrower in maintaining the Register as set forth therein, (vi) no partnership or joint venture exists with respect to the Loan Documents between any Restricted Person and any Lender, (vii) Administrative Agent is not Borrower's Administrative Agent, but Administrative Agent for Lenders, provided that, solely for purposes of Section 10.5(f), Administrative Agent shall act as Administrative Agent of Borrower in maintaining the Register as set forth therein, (viii) should an Event of Default or Default occur or exist, each Lender will determine in its sole discretion and for its own reasons what remedies and actions it will or will not exercise or take at that time subject to the terms of this Agreement, (ix) without limiting any of the foregoing, Borrower is not relying upon any representation or covenant by any Lender, or any representative thereof, and no such representation or covenant has been made, that any Lender will, at the time of an Event of Default or Default, or at any other time, waive, negotiate, discuss, or take or refrain from taking any action permitted under the Loan Documents with respect to any such Event of Default or Default or any other provision of the Loan Documents, and (x) all Lender Parties have relied upon the truthfulness of the acknowledgments in this section in deciding to execute and deliver this Agreement and to become obligated hereunder.

(c) *Joint Acknowledgment.* **THIS WRITTEN AGREEMENT AND THE OTHER LOAN DOCUMENTS REPRESENT THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES.**

THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

Section 10.2. *Survival of Agreements; Cumulative Nature.* Except for representations and warranties given as of a specified date, all of Restricted Persons' various representations, warranties, covenants and agreements in the Loan Documents shall survive the execution and delivery of this Agreement and the other Loan Documents and the performance hereof and thereof, including the making or granting of the Loans and the delivery of the Notes and the other Loan Documents, and shall further survive until all of the Obligations are paid in full to each Lender Party and all of Lender Parties' obligations to Borrower are terminated. All statements and agreements contained in any certificate or other instrument delivered by any Restricted Person to any Lender Party under any Loan Document shall be deemed representations and warranties by Borrower or agreements and covenants of Borrower under this Agreement. The representations, warranties, indemnities, and covenants made by Restricted Persons in the Loan Documents, and the rights, powers, and privileges granted to Lender Parties in the Loan Documents, are cumulative, and, except for expressly specified waivers and consents, no Loan Document shall be construed in the context of another to diminish, nullify, or otherwise reduce the benefit to any Lender Party of any such representation, warranty, indemnity, covenant, right, power or privilege. In particular and without limitation, no exception set out in this Agreement to any representation, warranty, indemnity, or covenant herein contained shall apply to any similar representation, warranty, indemnity, or covenant contained in any other Loan Document, unless the Loan Documents shall expressly provide that such exception shall apply to such similar representation, warranty, indemnity, or covenant.

Section 10.3. *Notices.* All notices, requests, consents, demands and other communications required or permitted under any Loan Document shall be in writing, unless otherwise specifically provided in such Loan Document (provided that Administrative Agent may give telephonic notices to the other Lender Parties), and shall be deemed sufficiently given or furnished if delivered by personal delivery, by facsimile or other electronic transmission, by delivery service with proof of delivery, or by registered or certified United States mail, postage prepaid, to Borrower and Restricted Persons at the address of Borrower specified on the signature pages hereto and to each Lender Party at its address specified on the signature pages hereto (unless changed by similar notice in writing given by the particular Person whose address is to be changed). Any such notice or communication shall be deemed to have been given (a) in the case of personal delivery or delivery service, as of the date of first attempted delivery during normal business hours at the address provided herein, (b) in the case of facsimile or other electronic transmission, upon receipt, or (c) in the case of registered or certified United States mail, three days after deposit in the mail; provided, however, that no Borrowing Notice shall become effective until actually received by Administrative Agent.

Section 10.4. *Payment of Expenses; Indemnity.*

(a) *Payment of Expenses.* Whether or not the transactions contemplated by this Agreement are consummated, Borrower will promptly (and in any event, within thirty (30) days after any invoice or other statement or notice) pay: (i) all transfer, stamp, mortgage, documentary or other similar taxes, assessments or charges levied by any governmental or revenue authority in respect of this Agreement or any of the other Loan Documents or any other document or transaction referred to herein or therein, (ii) all reasonable costs and expenses incurred by or on behalf of Administrative Agent (including without limitation reasonable attorneys' fees, travel costs and miscellaneous expenses), but excluding consultants fees other than in connection with an annual field audit permitted below, in connection with (1) the negotiation, preparation, execution and delivery of the Loan Documents, and any and all consents, waivers or other documents or instruments relating thereto, (2) the filing, recording, refiling and re-recording of any Loan Documents and any other documents or instruments or further assurances required to be filed or recorded or refilled or re-recorded by the terms of any Loan Document, (3) the borrowings hereunder and other action reasonably required in the course of administration hereof, (4) monitoring or confirming (or preparation or negotiation of any document related to) any Restricted Person's compliance with any covenants or conditions contained in this

Agreement or in any Loan Document, and (iii) all reasonable costs and expenses incurred by the Administrative Agent on behalf of any Lender Party (including without limitation reasonable attorneys' fees, reasonable consultants' fees and reasonable accounting fees) in connection with the conduct of an annual field audit, the preservation of any rights under the Loan Documents or the defense or enforcement of any of the Loan Documents (including this section), any attempt to cure any breach thereunder by any Restricted Person, or the defense of any Lender Party's exercise of its rights thereunder. In addition to the foregoing, until all Obligations have been paid in full, Borrower will also pay or reimburse Administrative Agent for all reasonable out-of-pocket costs and expenses of Administrative Agent or its agents or employees in connection with the continuing administration of the Loans and the related due diligence of Administrative Agent, including travel and miscellaneous expenses and reasonable fees and expenses of Administrative Agent's outside counsel and consultants engaged in connection with the Loan Documents.

(b) *Indemnity.* Borrower agrees to indemnify each Lender Party, upon demand, from and against any and all liabilities, obligations, broker's fees, claims, losses, damages, penalties, fines, actions, judgments, suits, settlements, costs, expenses or disbursements (including reasonable fees of attorneys, accountants, experts and advisors) of any kind or nature whatsoever (in this section collectively called "liabilities and costs") which to any extent (in whole or in part) may be imposed on, incurred by, or asserted against such Lender Party growing out of, resulting from or in any other way associated with any of the Collateral, the Loan Documents and the transactions and events (including the enforcement or defense thereof) at any time associated therewith or contemplated therein (whether arising in contract or in tort or otherwise). Among other things, the foregoing indemnification covers all liabilities and costs incurred by any Lender Party related to any breach of a Loan Document by a Restricted Person, any bodily injury to any Person or damage to any Person's property, or any violation or noncompliance with any Environmental Laws by any Lender Party or any other Person or any liabilities or duties of any Lender Party or any other Person with respect to Hazardous Materials found in or released into the environment.

THE FOREGOING INDEMNIFICATION SHALL APPLY WHETHER OR NOT SUCH LIABILITIES AND COSTS ARE IN ANY WAY OR TO ANY EXTENT OWED, IN WHOLE OR IN PART, UNDER ANY CLAIM OR THEORY OF STRICT LIABILITY OR CAUSED, IN WHOLE OR IN PART BY ANY NEGLIGENT ACT OR OMISSION OF ANY KIND BY ANY LENDER PARTY,

provided only that no Lender Party shall be entitled under this section to receive indemnification for that portion, if any, of any liabilities and costs which is proximately caused by its own individual gross negligence or willful misconduct, as determined in a final judgment. If any Person (including Borrower or any of its Affiliates) ever alleges such gross negligence or willful misconduct by any Lender Party, the indemnification provided for in this section shall nonetheless be paid upon demand, subject to later adjustment or reimbursement, until such time as a court of competent jurisdiction enters a final judgment as to the extent and effect of the alleged gross negligence or willful misconduct. As used in this section the term "Lender Party" shall refer not only to each Person designated as such in Section 1.1 but also to each director, officer, Administrative Agent, trustee, attorney, employee, representative and Affiliate of or for such Person.

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Section 10.5. *Joint and Several Liability; Parties in Interest; Assignments.*

(a) All Obligations which are incurred by two or more Restricted Persons shall be their joint and several obligations and liabilities. All grants, covenants and agreements contained in the Loan Documents shall bind and inure to the benefit of the parties thereto and their respective successors and assigns; provided, however, that no Restricted Person may assign or transfer any of its rights or delegate any of its duties or obligations under any Loan Document without the prior consent of the Required Lenders. Neither Borrower nor any Affiliates of Borrower shall directly or indirectly purchase or otherwise retire any Obligations owed to any Lender nor will any Lender accept any offer to do so, unless each Lender shall have received substantially the same offer with respect to the same Percentage Share of the Obligations owed to it. If Borrower or any Affiliate of Borrower at any time purchases some but less than all of the Obligations owed to all Lender Parties, such purchaser shall not be entitled to any rights of any Lender under the Loan Documents unless and until Borrower or its Affiliates have purchased all of the Obligations.

(b) No Lender shall sell any participation interest in its commitment hereunder or any of its rights under its Loans or under the Loan Documents to any Person unless the agreement between such Lender and such participant at all times provides: (i) that such participation exists only as a result of the agreement between such participant and such Lender and that such transfer does not give such participant any right to vote as a Lender or any other direct claims or rights against any Person other than such Lender, (ii) that such participant is not entitled to payment from any Restricted Person under Sections 3.2 through 3.8 of amounts in excess of those payable to such Lender under such sections (determined without regard to the sale of such participation), and (iii) unless such participant is an Affiliate of such Lender, that such participant shall not be entitled to require such Lender to take any action under any Loan Document or to obtain the consent of such participant prior to taking any action under any Loan Document, except for actions which would require the consent of all Lenders under subsection (a) of Section 10.1. No Lender selling such a participation shall, as between the other parties hereto and such Lender, be relieved of any of its obligations hereunder as a result of the sale of such participation. Each Lender which sells any such participation to any Person (other than an Affiliate of such Lender) shall give prompt notice thereof to Administrative Agent and Borrower.

(c) Except for sales of participations under the immediately preceding subsection, no Lender shall make any assignment or transfer of any kind of its commitments or any of its rights under its Loans or under the Loan Documents, except for assignments to an Eligible Transferee, and then only if such assignment is made in accordance with the following requirements:

(i) Each such assignment shall apply to all Obligations owing to the assignor Lender hereunder and to the unused portion of the assignor Lender's commitments, so that after such assignment is made the assignor Lender shall have a fixed (and not a varying) Percentage Share in its Loans and Notes and be committed to make that Percentage Share of all future Loans, the assignee shall have a fixed Percentage Share in such Loans and Notes and be committed to make that Percentage Share of all future Loans, and, except in the case of an assignment of the entire remaining amount of the assignor's Percentage Share of the Revolving Loan Commitment, the Percentage Share of the Revolving Loan Commitment of both the assignor and assignee shall equal or exceed \$2,500,000.

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(ii) The parties to each such assignment shall execute and deliver to Administrative Agent, for its acceptance and recording in the "Register" (as defined below in this section), an Assignment and Acceptance in the form of Exhibit 10.5, appropriately completed, together with the Note subject to such assignment and a processing fee payable to Administrative Agent of \$3,500. Upon such execution, delivery, and payment and upon the satisfaction of the conditions set out in such Assignment and Acceptance, then (1) Borrower shall issue new Notes to such assignor and assignee upon return of the old Notes to Borrower, and (2) as of the "Settlement Date" specified in such Assignment and Acceptance the assignee thereunder shall be a party hereto and a

Lender hereunder and Administrative Agent shall thereupon deliver to Borrower and each Lender a schedule showing the revised Percentage Shares of such assignor Lender and such assignee Lender and the Percentage Shares of all other Lenders.

(iii) Each assignee Lender which is not a United States person (as such term is defined in Section 7701(a)(30) of the Internal Revenue Code) for Federal income tax purposes, shall (to the extent it has not already done so) provide Administrative Agent and Borrower with the "Prescribed Forms" referred to in Section 3.6(d).

(iv) Unless the assignee is an Affiliate of the assignor, such assignment shall not be effective unless consented to in writing by Administrative Agent and, unless an Event of Default shall have occurred and be continuing, Borrower (such consent not to be unreasonably withheld or delayed).

(d) Nothing contained in this section shall prevent or prohibit any Lender from assigning or pledging all or any portion of its Loans and Notes to any Federal Reserve Bank as collateral security pursuant to Regulation A of the Board of Governors of the Federal Reserve System and any Operating Circular issued by such Federal Reserve Bank; provided that no such assignment or pledge shall relieve such Lender from its obligations hereunder.

(e) By executing and delivering an Assignment and Acceptance, each assignee Lender thereunder will be confirming to and agreeing with Borrower, Administrative Agent and each other Lender Party that such assignee understands and agrees to the terms hereof, including Article IX hereof.

(f) Administrative Agent shall maintain a copy of each Assignment and Acceptance and a register for the recordation of the names and addresses of Lenders and the Percentage Shares of, and principal amount of the Loans owing to, each Lender from time to time (in this section called the "Register"). The entries in the Register shall be conclusive, in the absence of manifest error, and Borrower and each Lender Party may treat each Person whose name is recorded in the Register as a Lender hereunder for all purposes. The Register shall be available for inspection by Borrower or any Lender Party at any reasonable time and from time to time upon reasonable prior notice. Administrative Agent shall act as Administrative Agent of Borrower solely for purposes of maintaining the Register as set forth in this Section 10.5(f).

Section 10.6. *Confidentiality.* Each Lending Party agrees to keep confidential any information furnished or made available to it by any Restricted Person pursuant to this Agreement that is financial information, information in connection with a proposed transaction, or information marked confidential; provided that nothing herein shall prevent any Lending Party from disclosing such information (a) to any other Lending Party or any Affiliate of any Lending Party, or any officer, director, employee, Administrative Agent, attorney, auditor, or advisor of any Lending Party or Affiliate of any Lending Party, (b) to any other Person if reasonably incidental to the administration of the credit facility provided herein, (c) as required by any Law, (d) upon the order of any court or administrative agency, (e) upon the request or demand of any Tribunal, (f) that is or becomes available to the public or that is or becomes available to any Lending Party other than as a result of a disclosure by any Lending Party prohibited by this Agreement, (g) to the extent necessary in connection with the exercise of any right or remedy under this Agreement or any other Loan Document, (h) subject to provisions substantially similar to those contained in this section, to any actual or proposed participant

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or assignee or any actual or proposed contractual counterparty (or its advisors) to any securitization, hedge, or other derivative transaction relating to the parties' obligations hereunder, and (i) if it is otherwise available in the public domain. Notwithstanding anything set forth herein to the contrary, each party to this Agreement and each of its employees, representatives, and other Administrative Agents is hereby expressly authorized to disclose the "tax treatment" and "tax structure" (as those terms are defined in Treas. Reg. §§ 1.6011-4(c)(8) and (9), respectively) of the transactions contemplated hereby and all materials of any kind, including opinions or other tax analyses, that have been provided to it by any other party relating to such tax treatment or tax structure. Any Person required to maintain the confidentiality of information described in this section shall be considered to have complied with its obligation to do so if such Person has exercised the same degree of care to maintain the confidentiality of such information as such Person would accord to its own confidential information.

Section 10.7. *Governing Law; Submission to Process.* Except to the extent that the Law of another jurisdiction is expressly elected in a Loan Document, the Loan Documents shall be deemed contracts and instruments made under the Laws of the State of Texas and shall be construed and enforced in accordance with and governed by the Laws of the State of Texas and the Laws of the United States of America, without regard to principles of conflicts of law. Chapter 346 of the Texas Finance Code (which regulates certain revolving credit loan accounts and revolving tri-party accounts) does not apply to this Agreement or to the Notes. Borrower hereby irrevocably submits itself and each other Restricted Person to the exclusive jurisdiction of the state and federal courts sitting in the State of Texas and agrees and consents that service of process may be made upon it or any Restricted Person in any legal proceeding relating to the Loan Documents or the Obligations by any means allowed under Texas or federal law. Any legal proceeding arising out of or in any way related to any of the Loan Documents shall be brought and litigated exclusively in the United States District Court for the Southern District of Texas, Houston Division, to the extent it has subject matter jurisdiction, and otherwise in the Texas District Courts sitting in Harris County, Texas. The parties hereto hereby waive and agree not to assert, by way of motion, as a defense or otherwise, that any such proceeding is brought in an inconvenient forum or that the venue thereof is improper, and further agree to a transfer of any such proceeding to a federal court sitting in the State of Texas to the extent that it has subject matter jurisdiction, and otherwise to a state court in Houston, Texas. In furtherance thereof, Borrower and Lender Parties each hereby acknowledge and agree that it was not inconvenient for them to negotiate and receive funding of the transactions contemplated by this Agreement in such county and that it will be neither inconvenient nor unfair to litigate or otherwise resolve any disputes or claims in a court sitting in such county.

Section 10.8. *Limitation on Interest.* Lender Parties, Restricted Persons and any other parties to the Loan Documents intend to contract in strict compliance with applicable usury Law from time to time in effect. In furtherance thereof such Persons stipulate and agree that none of the terms and provisions contained in the Loan Documents shall ever be construed to create a contract to pay, for the use, forbearance or detention of money, interest in excess of the maximum amount of interest permitted to be charged by applicable Law from time to time in effect. Neither any Restricted Person nor any present or future guarantors, endorsers, or other Persons hereafter becoming liable for payment of any Obligation shall ever be liable for unearned interest thereon or shall ever be required to pay interest thereon in excess of the maximum amount that may be lawfully contracted for, charged, or received under applicable Law from time to time in effect, and the provisions of this section shall control over all other provisions of the Loan Documents which may be in conflict or apparent conflict herewith. Lender Parties expressly disavow any intention to contract for, charge, or collect excessive unearned interest or finance charges in the event the maturity of any Obligation is accelerated. If (a) the maturity of any Obligation is accelerated for any reason, (b) any Obligation is prepaid and as a result any amounts held to constitute interest are determined to be in excess of the legal maximum, or (c) any Lender or any other holder of any or all of the Obligations shall otherwise collect moneys

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which are determined to constitute interest which would otherwise increase the interest on any or all of the Obligations to an amount in excess of that permitted to be charged by applicable Law then in effect, then all sums determined to constitute interest in excess of such legal limit shall, without penalty, be promptly applied to reduce the then outstanding principal of the related Obligations or, at such Lender's or holder's option, promptly returned to Borrower or the other payor thereof upon such determination. In determining whether or not the interest paid or payable, under any specific circumstance, exceeds the maximum amount permitted under applicable Law, Lender Parties and Restricted Persons (and any other payors thereof) shall to the greatest extent permitted under applicable Law, (i) characterize any non-principal payment as an expense, fee or premium rather than as interest, (ii) exclude voluntary prepayments and the effects thereof, and (iii) amortize, prorate, allocate, and spread the total amount of interest throughout the entire contemplated term of the instruments evidencing the Obligations in accordance with the amounts outstanding from time to time thereunder and the maximum legal rate of interest from time to time in effect under applicable Law in order to lawfully contract for, charge, or receive the maximum amount of interest permitted under applicable Law. In the event applicable Law provides for an interest ceiling under Chapter 303 of the Texas Finance Code (the "Texas Finance Code") as amended, for that day, the ceiling shall be the "weekly ceiling" as defined in the Texas Finance Code, provided that if any applicable Law permits greater interest, the Law permitting the greatest interest shall apply. As used in this section the term "applicable Law" means the Laws of the State of Texas or the Laws of the United States of America, whichever Laws allow the greater interest, as such Laws now exist or may be changed or amended or come into effect in the future.

Section 10.9. *Termination; Limited Survival.* In its sole and absolute discretion Borrower may at any time that no Obligations are owing (other than indemnity obligations and similar obligations that survive the termination of this Agreement for which no notice of a claim has been received by Borrower) elect in a written notice delivered to Administrative Agent to terminate this Agreement. Upon receipt by Administrative Agent of such a notice, if no Obligations are then owing, this Agreement and all other Loan Documents shall thereupon be terminated and the parties thereto released from all prospective obligations thereunder. Notwithstanding the foregoing or anything herein to the contrary, any waivers or admissions made by any Restricted Person in any Loan Document, any Obligations under Sections 3.2 through Section 3.6, and any obligations which any Person may have to indemnify or reimburse any Lender Party shall survive any termination of this Agreement or any other Loan Document. At the request and expense of Borrower, Administrative Agent shall prepare and execute all necessary instruments to reflect and effect such termination of the Loan Documents. Administrative Agent is hereby authorized to execute all such instruments on behalf of all Lenders, without the joinder of or further action by any Lender.

Section 10.10. *Severability.* If any term or provision of any Loan Document shall be determined to be illegal or unenforceable all other terms and provisions of the Loan Documents shall nevertheless remain effective and shall be enforced to the fullest extent permitted by applicable Law.

Section 10.11. *Counterparts; Fax.* This Agreement may be separately executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed shall be deemed to constitute one and the same Agreement. This Agreement and the Loan Documents may be validly executed and delivered by facsimile or other electronic transmission.

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Section 10.12. *Intentionally Omitted.*

Section 10.13. *Waiver of Jury Trial, Punitive Damages, etc.* Each of the Borrower and each Lender Party hereby knowingly, voluntarily, intentionally, and irrevocably (a) waives, to the maximum extent not prohibited by Law, any right it may have to a trial by jury in respect of any litigation based hereon, or directly or indirectly at any time arising out of, under or in connection with the Loan Documents or any transaction contemplated thereby or associated therewith, before or after maturity; (b) waives, to the maximum extent not prohibited by Law, any right they may have to claim or recover in any such litigation any "Special Damages", as defined below, (c) certifies that no party hereto nor any representative or Administrative Agent or counsel for any party hereto has represented, expressly or otherwise, or implied that such party would not, in the event of litigation, seek to enforce the foregoing waivers, and (d) acknowledges that it has been induced to enter into this Agreement, the other Loan Documents and the transactions contemplated hereby and thereby by, among other things, the mutual waivers and certifications contained in this section. As used in this section, "Special Damages" includes all special, consequential, exemplary, or punitive damages (regardless of how named), but does not include any payments or funds which any party hereto has expressly promised to pay or deliver to any other party hereto.

Section 10.14. *Procedure for Increases and Addition of New Lenders.* This Agreement permits certain increases in a Lender's Commitment and the admission of new Lenders providing new commitments, none of which require any consents or approvals from the other Lenders. Any amendment hereto for such an increase or addition shall be in the form attached hereto as Exhibit 10.14 and shall only require the written signatures of the Administrative Agent, Borrower and the Lender(s) being added or increasing their Commitment. In addition, within a reasonable time after the effective date of any increase, the Administrative Agent shall, and is hereby authorized and directed to, revise the Schedule 3.1 reflecting such increase and shall distribute such revised Schedule to each of the Lenders and Borrower, whereupon such revised Schedule 3.1 shall replace the old Schedule 3.1 and become part of this Agreement. On the Business Day following any such increase, all outstanding Base Rate Loans shall be reallocated among the Lenders (including any newly added Lenders) in accordance with the Lenders' respective revised Percentage Shares. Eurodollar Loans shall not be reallocated among the Lenders prior to the expiration of the applicable Interest Period in effect at the time of any such increase.

Section 10.15. *Amendment and Restatement.* This Agreement amends and restates in its entirety the Prior Credit Documents, and from and after the date hereof, the terms and provisions of the Prior Credit Documents shall be superseded by the terms and provisions of this Agreement. Borrower hereby agrees that (i) the Prior Indebtedness, all accrued and unpaid interest thereon, and all accrued and unpaid fees under the Prior Credit Documents shall be deemed to be Indebtedness of Borrower outstanding under and governed by this Agreement and (ii) all Liens securing the Prior Indebtedness shall continue in full force and effect to secure the Secured Obligations.

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IN WITNESS WHEREOF, this Agreement is executed as of the date first written above.

COMFORT SYSTEMS USA, INC.,
Borrower

By: /s/ J. GORDON BEITTENMILLER

J. Gordon Beittenmiller
Executive Vice President and Chief Financial Officer

Address:
777 Post Oak Boulevard, Suite 500
Houston, Texas 77056
Attention: J. Gordon Beittenmiller

Telephone: (713) 830-9620
Fax: (713) 830-9646

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Term Loan Commitment:	\$3,500,000	BANK OF TEXAS NA,
Revolving Loan Commitment:	\$14,000,000	Administrative Agent and Lender
Percentage Share:	35%	

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

H. Gale Smith, Jr.
Senior Vice President

Address:

Bank of Texas NA
5 Houston Center
1401 McKinney, Suite 1650
Houston, Texas 77010
Attention: H. Gale Smith, Jr.

Telephone: (713) 289-5823
Fax: (713) 289-5825

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Term Loan Commitment:	\$3,000,000	HIBERNIA NATIONAL BANK,
Revolving Loan Commitment:	\$12,000,000	Documentation Agent, LC Issuer and Lender
Percentage Share:	30%	

By: /s/ MICHAEL MEISS

Michael Meiss
Senior Vice President

Address:

Hibernia National Bank
1800 Bering Drive, Suite 510
Houston, Texas 77057
Attention: Michael Meiss

Telephone: (713) 706-5420
Fax: (713) 706-5499

With a copy to:
Hibernia Southcoast Capital
909 Poydras Street, Suite 1000
New Orleans, Louisiana 70112
Attention: Troy Villafarra, CFA

Telephone: (504) 593-6126
Fax: (504) 593-6175

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Term Loan Commitment:	\$2,000,000	BANK OF SCOTLAND,
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Revolving Loan Commitment: \$8,000,000
Percentage Share: 20%

Lender

By: /s/ JOSEPH FRATUS

Joseph Fratus
First Vice President

Address:

Bank of Scotland
565 Fifth Avenue
New York, New York 10017
Attention: Shirley Vargas

Telephone: (212) 450-0875
Fax: (212) 479-2807

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Term Loan Commitment: \$1,500,000
Revolving Loan Commitment: \$6,000,000
Percentage Share: 15%

FirstCapital Bank, ssb
Lender

By: /s/ WILLIAM H. FOWLER

William H. Fowler
Senior Vice President

Address:

FirstCapital Bank, ssb
5433 Westheimer, Suite 100
Houston, Texas 77056
Attention: William H. Fowler

Telephone: (713) 386-2460
Fax: (713) 840-1332

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Exhibit 18.1

February 26, 2004

Board of Directors
Comfort Systems USA, Inc.
777 Post Oak Blvd, Suite 500
Houston, Texas 77056

Members of the Board of Directors:

Note 4 of the Notes to the Consolidated Financial Statements of Comfort Systems USA, Inc. (the "Company") included in its annual report on Form 10-K for the year ended December 31, 2003, describes an accounting change regarding the date of the annual goodwill impairment assessment from December 31 to October 1. There is no authoritative literature concerning which measurement date is preferable. However, we conclude that such change is acceptable and based on your business judgment to make these changes for the stated reasons, are preferable in your circumstances.

Ernst & Young LLP

Houston, Texas

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ENTITY NUMBER	NAME OF ENTITY	STATE OF ORGANIZATION
1.	ACI Mechanical, Inc.	Delaware
2.	ACI Mechanical USA, Inc. <i>(formerly Comfort Systems USA (Oregon), Inc.)</i>	Delaware
3.	ARC Comfort Systems USA, Inc. <i>(formerly American Refrigeration Contractors, Inc.)</i>	Delaware
4.	Accurate Air Systems, L.P.	Texas
5.	Accu-Temp GP, Inc.	Delaware
6.	Accu-Temp LP, Inc.	Delaware
7.	Air Temp, Inc.	Delaware
8.	Atlas-Accurate Holdings, L.L.C.	Delaware
9.	Atlas Air Conditioning Company, L.P.	Texas
10.	Batchelor's Mechanical Contractors, Inc.	Alabama
11.	BCM Controls Corporation	Massachusetts
12.	California Comfort Systems USA, Inc. <i>(formerly Helm Sand Diego)</i>	California
13.	CEL, Inc. (Casey Electric)	Delaware
14.	Central Mechanical, Inc.	Delaware
15.	Climate Control, Inc. <i>(formerly Comfort Systems USA (South Boston), Inc.)</i>	Delaware
16.	Comfort Systems USA (Arkansas), Inc. <i>(formerly River City Mechanical, Incorporated)</i>	Delaware
17.	Comfort Systems USA (Baltimore), Inc.	Delaware
18.	Comfort Systems USA (Bowling Green), Inc. <i>(formerly Southern Bluegrass Mechanical, Inc.)</i>	Delaware
19.	Comfort Systems USA (Bristol), Inc. <i>(formerly Fred Hayes Mechanical Contractors, Inc.-Delaware)</i>	Delaware
20.	Comfort Systems USA (Cleveland), Inc. <i>(formerly Tech Heating and Air Conditioning, Inc.)</i>	Ohio
21.	Comfort Systems USA (Florida), Inc. <i>(formerly The Drake Corporation — All Temp Services, Inc)</i>	Florida
22.	Comfort Systems USA G.P., Inc.	Delaware
23.	Comfort Systems USA (Hartford), Inc. <i>(formerly The Harvey Robbin Company)</i>	
24.	Comfort Systems USA (Intermountain), Inc. <i>(formerly Contract Service, Inc merged with Freeway Heating & Air Conditioning, Inc.)</i>	Utah
25.	Comfort Systems USA National Accounts Services, LLC <i>(formerly Accu-Temp, LLC)</i>	Indiana
26.	Comfort Systems USA (Syracuse), Inc. <i>(formerly Armani Plumbing & Mechanical, Inc.)</i>	New York
27.	Comfort Systems USA (Texas), L.P.	Texas
28.	Comfort Systems USA (Twin Cities), Inc. <i>(formerly EDS, Inc./Energy Development Services)</i>	Minnesota
29.	Comfort Systems USA (Western Michigan), Inc. <i>(reorganization of River City Mechanical, Inc. and H&H Plumbing & Heating, Inc. and Troost Service Co.)</i>	Michigan
30.	CS44 Acquisition Corp. [Edmonds/Service Refrigeration]	Delaware
31.	CS53 Acquisition Corp. <i>(Mgm Member Atlas-Accurate)</i>	Delaware
32.	Design Mechanical Incorporated	Delaware
33.	Eastern Heating & Cooling, Inc.	New York
34.	ESS Engineering, Inc.	Delaware
35.	Gulfside Mechanical, Inc.	Delaware
36.	H & M Mechanical, Inc.	Delaware
37.	Helm Corporation	Colorado
38.	Hess Mechanical Corporation	Delaware
39.	Industrial Cooling Inc.	Delaware
40.	J & J Mechanical, Inc.	Kentucky
41.	James Air Conditioning Enterprise Inc.	Puerto Rico
42.	Martin Heating, Inc.	Wyoming
43.	Mechanical Service Group, Inc. [Page]	Delaware
44.	Mechanical Technical Services, L.P.	Texas
45.	MJ Mechanical Services, Inc.	Delaware
46.	Neel Mechanical Contractors, Inc.	Delaware
47.	North American Mechanical, Inc.	Delaware
48.	Quality Air Heating & Cooling, Inc.	Michigan
49.	S&K Air Conditioning Co., Inc.	Georgia
50.	S. I. Goldman Company, Inc.	Delaware
51.	S.M. Lawrence Company, Inc.	Tennessee
52.	SA Associates, Inc. (fka Salmon & Alder, Inc.)	Utah
53.	Salmon & Alder, LLC	Utah
54.	Seasonair, Inc.	Maryland
55.	Sheren Plumbing & Heating, Inc.	Delaware
56.	Target Construction, Inc.	Delaware
57.	Temp-Right Service, Inc.	Delaware
58.	The Capital Refrigeration Company	Delaware
59.	Tri-City Mechanical, Inc.	Arizona
60.	United Environmental Services, L.P.	Texas
61.	Western Building Services, Inc.	Colorado

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Exhibit 23.1

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statements (Form S-8 No. 333-38011, No. 333-44354, and No. 333-44356), and the Registration Statement (Form S-4 No. 333-75595) of Comfort Systems USA, Inc. and in the related Prospectus of our report dated February 26, 2004 with respect to the consolidated financial statements of Comfort Systems USA, Inc. included in this Annual Report (Form 10-K) for the year ended December 31, 2003.

ERNST & YOUNG LLP

Houston, Texas
February 26, 2004

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[CONSENT OF INDEPENDENT AUDITORS](#)

