UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2022

OR

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

For the transition period from to

Commission file number: 1-13011

COMFORT SYSTEMS USA, INC.

(Exact name of registrant as specified in its charter)

Delaware	**76-0526487**
(State or other jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

675 Bering Drive
Suite 400
Houston, Texas 77057
(Address of Principal Executive Offices) (Zip Code)

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

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $0.01 par value	FIX	New York Stock Exchange

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

Large accelerated filer ☒	Accelerated filer ☐	Non-accelerated filer ☐	Smaller reporting company ☐	Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

The number of shares outstanding of the issuer's common stock as of October 21, 2022 was 35,760,816 (excluding treasury shares of 5,362,549).

COMFORT SYSTEMS USA, INC.
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FOR THE QUARTER ENDED SEPTEMBER 30, 2022

PART I—FINANCIAL INFORMATION

Item 1. *Financial Statements*

COMFORT SYSTEMS USA, INC.

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Amounts)

	September 30, 2022 (Unaudited)	December 31, 2021
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 71,139	$ 58,776
Billed accounts receivable, less allowance for credit losses of $9,903 and $8,808, respectively	1,026,523	773,716
Unbilled accounts receivable, less allowance for credit losses of $986 and $715, respectively	89,941	61,881
Other receivables, less allowance for credit losses of $498 and $503, respectively	83,267	57,491
Inventories	38,149	21,853
Prepaid expenses and other	27,372	23,704
Costs and estimated earnings in excess of billings, less allowance for credit losses of $67 and $84, respectively	21,700	29,900
Total current assets	1,358,091	1,027,321
PROPERTY AND EQUIPMENT, NET	138,229	128,554
LEASE RIGHT-OF-USE ASSET	133,443	124,756
GOODWILL	611,039	592,114
IDENTIFIABLE INTANGIBLE ASSETS, NET	285,094	304,781
DEFERRED TAX ASSETS	11,327	22,905
OTHER NONCURRENT ASSETS	12,250	8,683
Total assets	$ 2,549,473	$ 2,209,114
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 2,514	$ 2,788
Accounts payable	330,288	254,788
Accrued compensation and benefits	149,926	129,971
Billings in excess of costs and estimated earnings	411,942	307,380
Accrued self-insurance	25,320	22,227
Other current liabilities	124,015	119,400
Total current liabilities	1,044,005	836,554
LONG-TERM DEBT, NET	378,192	385,242
LEASE LIABILITIES	114,443	107,701
DEFERRED TAX LIABILITIES	1,745	1,745
OTHER LONG-TERM LIABILITIES	59,956	72,206
Total liabilities	1,598,341	1,403,448
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, $.01 par, 5,000,000 shares authorized, none issued and outstanding	—	—
Common stock, $.01 par, 102,969,912 shares authorized, 41,123,365 and 41,123,365 shares issued, respectively	411	411
Treasury stock, at cost, 5,349,349 and 5,032,311 shares, respectively	(185,574)	(150,580)
Additional paid-in capital	331,710	327,061
Retained earnings	804,585	628,774
Total stockholders' equity	951,132	805,666
Total liabilities and stockholders' equity	$ 2,549,473	$ 2,209,114

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

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands, Except Per Share Data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
REVENUE	$ 1,120,012	$ 833,896	$ 3,023,176	$ 2,217,552
COST OF SERVICES	917,788	674,684	2,492,816	1,808,416
Gross profit	202,224	159,212	530,360	409,136
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	121,194	95,287	357,694	271,050
GAIN ON SALE OF ASSETS	(406)	(180)	(1,112)	(1,021)
Operating income	81,436	64,105	173,778	139,107
OTHER INCOME (EXPENSE):				
Interest income	5	1	14	7
Interest expense	(3,609)	(1,586)	(8,764)	(4,443)
Changes in the fair value of contingent earn-out obligations	(3,443)	(1,244)	530	4,523
Other	46	20	101	112
Other income (expense)	(7,001)	(2,809)	(8,119)	199
INCOME BEFORE INCOME TAXES	74,435	61,296	165,659	139,306
PROVISION (BENEFIT) FOR INCOME TAXES	12,920	14,999	(24,864)	33,553
NET INCOME	$ 61,515	$ 46,297	$ 190,523	$ 105,753
INCOME PER SHARE:				
Basic	$ 1.72	$ 1.28	$ 5.30	$ 2.91
Diluted	$ 1.71	$ 1.27	$ 5.28	$ 2.90
SHARES USED IN COMPUTING INCOME PER SHARE:				
Basic	35,853	36,296	35,966	36,328
Diluted	35,972	36,434	36,078	36,500

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

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In Thousands, Except Share Amounts)

(Unaudited)

	Nine Months Ended September 30, 2021						
	Common Stock		Treasury Stock		Additional Paid-In	Retained	Total Stockholders'
	Shares	Amount	Shares	Amount	Capital	Earnings	Equity
BALANCE AT DECEMBER 31, 2020	41,123,365	$ 411	(4,935,186)	$ (129,243)	$ 322,451	$ 502,810	$ 696,429
Net income	—	—	—	—	—	26,491	26,491
Issuance of Stock:							
Issuance of shares for options exercised	—	—	61,454	1,616	(211)	—	1,405
Issuance of restricted stock & performance stock	—	—	29,544	777	1,431	—	2,208
Shares received in lieu of tax withholding payment on vested restricted stock	—	—	(11,424)	(854)	—	—	(854)
Stock-based compensation	—	—	—	—	2,472	—	2,472
Dividends ($0.115 per share)	—	—	—	—	—	(4,163)	(4,163)
Share repurchase	—	—	(13,250)	(885)	—	—	(885)
BALANCE AT MARCH 31, 2021	41,123,365	411	(4,868,862)	(128,589)	326,143	525,138	723,103
Net income	—	—	—	—	—	32,965	32,965
Issuance of Stock:							
Issuance of shares for options exercised	—	—	69,342	1,853	191	—	2,044
Issuance of restricted stock & performance stock	—	—	71,816	1,904	(1,904)	—	—
Shares received in lieu of tax withholding payment on vested restricted stock	—	—	(19,989)	(1,509)	—	—	(1,509)
Stock-based compensation	—	—	—	—	1,749	—	1,749
Dividends ($0.115 per share)	—	—	—	—	—	(4,178)	(4,178)
Share repurchase	—	—	(27,092)	(2,162)	—	—	(2,162)
BALANCE AT JUNE 30, 2021	41,123,365	411	(4,774,785)	(128,503)	326,179	553,925	752,012
Net income	—	—	—	—	—	46,297	46,297
Issuance of Stock:							
Issuance of shares for options exercised	—	—	—	—	—	—	—
Issuance of restricted stock & performance stock	—	—	—	—	—	—	—
Shares received in lieu of tax withholding payment on vested restricted stock	—	—	—	—	—	—	—
Stock-based compensation	—	—	—	—	314	—	314
Dividends ($0.12 per share)	—	—	—	—	—	(4,350)	(4,350)
Share repurchase	—	—	(306,122)	(22,484)	—	—	(22,484)
BALANCE AT SEPTEMBER 30, 2021	41,123,365	$ 411	(5,080,907)	$ (150,987)	$ 326,493	$ 595,872	$ 771,789

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In Thousands, Except Share Amounts)

(Unaudited)

	Nine Months Ended September 30, 2022						
	Common Stock		Treasury Stock		Additional Paid-In	Retained	Total Stockholders'
	Shares	Amount	Shares	Amount	Capital	Earnings	Equity
BALANCE AT DECEMBER 31, 2021	41,123,365	$ 411	(5,032,311)	$ (150,580)	$ 327,061	$ 628,774	$ 805,666
Net income	—	—	—	—	—	86,762	86,762
Issuance of Stock:							
Issuance of shares for options exercised	—	—	—	—	—	—	—
Issuance of restricted stock & performance stock	—	—	38,863	1,232	2,312	—	3,544
Shares received in lieu of tax withholding payment on vested restricted stock	—	—	(15,348)	(1,399)	—	—	(1,399)
Stock-based compensation	—	—	—	—	2,605	—	2,605
Dividends ($0.13 per share)	—	—	—	—	—	(4,673)	(4,673)
Share repurchase	—	—	(161,614)	(14,097)	—	—	(14,097)
BALANCE AT MARCH 31, 2022	41,123,365	411	(5,170,410)	(164,844)	331,978	710,863	878,408
Net income	—	—	—	—	—	42,246	42,246
Issuance of Stock:							
Issuance of shares for options exercised	—	—	—	—	—	—	—
Issuance of restricted stock & performance stock	—	—	75,092	2,425	(2,425)	—	—
Shares received in lieu of tax withholding payment on vested restricted stock	—	—	(20,658)	(1,848)	—	—	(1,848)
Stock-based compensation	—	—	—	—	1,822	—	1,822
Dividends ($0.14 per share)	—	—	—	—	—	(5,026)	(5,026)
Share repurchase	—	—	(226,689)	(18,757)	—	—	(18,757)
BALANCE AT JUNE 30, 2022	41,123,365	411	(5,342,665)	(183,024)	331,375	748,083	896,845
Net income	—	—	—	—	—	61,515	61,515
Issuance of Stock:							
Issuance of shares for options exercised	—	—	29,862	1,023	(79)	—	944
Issuance of restricted stock & performance stock	—	—	—	—	—	—	—
Shares received in lieu of tax withholding payment on vested restricted stock	—	—	—	—	—	—	—
Stock-based compensation	—	—	—	—	414	—	414
Dividends ($0.14 per share)	—	—	—	—	—	(5,013)	(5,013)
Share repurchase	—	—	(36,546)	(3,573)	—	—	(3,573)
BALANCE AT SEPTEMBER 30, 2022	41,123,365	$ 411	(5,349,349)	$ (185,574)	$ 331,710	$ 804,585	$ 951,132

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

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

(Unaudited)

	Nine Months Ended September 30, 2022	Nine Months Ended September 30, 2021
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 190,523	$ 105,753
Adjustments to reconcile net income to net cash provided by operating activities—		
Amortization of identifiable intangible assets	36,602	28,934
Depreciation expense	24,643	21,066
Change in right-of-use assets	15,873	12,904
Bad debt expense (benefit)	1,471	(1,698)
Deferred tax provision	11,578	6,589
Amortization of debt financing costs	613	403
Gain on sale of assets	(1,112)	(1,021)
Changes in the fair value of contingent earn-out obligations	(530)	(4,523)
Stock-based compensation	7,479	7,378
Changes in operating assets and liabilities, net of effects of acquisitions and divestitures—		
(Increase) decrease in—		
Receivables, net	(275,848)	(25,809)
Inventories	(16,335)	(6,248)
Prepaid expenses and other current assets	1,513	15,592
Costs and estimated earnings in excess of billings and unbilled accounts receivable	(17,180)	(8,698)
Other noncurrent assets	(86)	(1,248)
Increase (decrease) in—		
Accounts payable and accrued liabilities	98,781	15,112
Billings in excess of costs and estimated earnings	103,402	257
Other long-term liabilities	(11,863)	(12,089)
Net cash provided by operating activities	169,524	152,654
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(34,793)	(15,864)
Proceeds from sales of property and equipment	2,151	1,802
Cash paid for acquisitions, net of cash acquired	(48,507)	(105,543)
Payments for investments	(1,610)	—
Net cash used in investing activities	(82,759)	(119,605)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from revolving credit facility	495,000	160,000
Payments on revolving credit facility	(380,000)	(115,000)
Payments on term loan	(120,000)	(15,000)
Payments on other debt	(7,834)	(9,000)
Payments on finance lease liabilities	(820)	(207)
Debt financing costs	(2,297)	—
Payments of dividends to stockholders	(14,712)	(12,691)
Share repurchase	(36,427)	(25,531)
Shares received in lieu of tax withholding	(3,247)	(2,363)
Proceeds from exercise of options	944	3,449
Deferred acquisition payments	(50)	(400)
Payments for contingent consideration arrangements	(4,959)	(3,481)
Net cash used in financing activities	(74,402)	(20,224)
NET INCREASE IN CASH AND CASH EQUIVALENTS	12,363	12,825
CASH AND CASH EQUIVALENTS, beginning of period	58,776	54,896
CASH AND CASH EQUIVALENTS, end of period	$ 71,139	$ 67,721

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

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2022

(Unaudited)

1. Business and Organization

Comfort Systems USA, Inc., a Delaware corporation, provides comprehensive mechanical and electrical contracting services, which principally includes heating, ventilation and air conditioning ("HVAC"), plumbing, electrical, piping and controls, as well as off-site construction, monitoring and fire protection. We build, install, maintain, repair and replace mechanical, electrical and plumbing ("MEP") systems throughout the United States. The terms "Comfort Systems," "we," "us," or the "Company," refer to Comfort Systems USA, Inc. or Comfort Systems USA, Inc. and its consolidated subsidiaries, as appropriate in the context.

2. Summary of Significant Accounting Policies and Estimates

Basis of Presentation

These interim statements should be read in conjunction with the historical Consolidated Financial Statements and related notes of Comfort Systems included in the Annual Report on Form 10-K as filed with the Securities and Exchange Commission ("SEC") for the year ended December 31, 2021 (the "Form 10-K").

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

Use of Estimates

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

Recent Accounting Pronouncements

Recent Accounting Pronouncements Not Yet Adopted

In October 2021, the FASB issued ASU 2021-08, "Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers." This standard requires an acquirer to apply Accounting Standards Codification Topic 606 to recognize and measure contract assets and contract liabilities in a business combination. ASU 2021-08 is effective for fiscal years beginning after December 15, 2022 and interim periods within that year. Early adoption is permitted. We do not expect our adoption of this standard on January 1, 2023 to have a material impact on our consolidated financial statements.

Revenue Recognition

We recognize revenue over time for all of our services as we perform them because (i) control continuously transfers to that customer as work progresses, and (ii) we have the right to bill the customer as costs are incurred. The customer typically controls the work in process, as evidenced either by contractual termination clauses or by our rights to payment for work performed to date, plus a reasonable profit, for delivery of products or services that do not have an alternative use to the Company.

For the reasons listed above, revenue is recognized based on the extent of progress towards completion of the performance obligation. The selection of the method to measure progress towards completion requires judgment and is based on the nature of the products or services to be provided. We generally use a cost-to-cost input method to measure our progress towards satisfaction of the performance obligation for our contracts, as it best depicts the transfer of assets to the customer that occurs as we incur costs on our contracts. Under the cost-to-cost input method, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs at completion of the performance obligation. Revenue, including estimated fees or profits, is recorded proportionally as costs are incurred. Costs to fulfill include labor, materials, subcontractors' costs, other direct costs and an allocation of indirect costs.

For a small portion of our business in which our services are delivered in the form of service maintenance agreements for existing systems to be repaired and maintained, as opposed to constructed, our performance obligation is to maintain the customer's mechanical system for a specific period of time. Similar to construction jobs, we recognize revenue over time; however, for service maintenance agreements in which the full cost to provide services may not be known, we generally use an input method to recognize revenue, which is based on the amount of time we have provided our services out of the total time we have been contracted to perform those services. Our revenue recognition policy is further discussed in Note 3 "Revenue from Contracts with Customers."

Accounts Receivable and Allowance for Credit Losses

We are required to estimate and record the expected credit losses over the contractual life of our financial assets measured at amortized cost, including billed and unbilled accounts receivable, other receivables and contract assets. Accounts receivable include amounts from work completed in which we have billed or have an unconditional right to bill our customers. Our trade receivables are contractually due in less than a year.

We estimate our credit losses using a loss-rate method for each of our identified portfolio segments. Our portfolio segments are construction, service and other. While our construction and service financial assets are often with the same subset of customers and industries, our construction financial assets will generally have a lower loss-rate than service financial assets due to lien rights, which we are more likely to have on construction jobs. These lien rights result in lower credit loss expenses on average compared to receivables that do not have lien rights. Financial assets classified as Other include receivables that are not related to our core revenue producing activities, such as receivables related to our acquisition activity from former owners, our vendor rebate program or receivables for estimated losses in excess of our insurance deductible, which are accrued with a corresponding accrued insurance liability.

Loss rates for our portfolios are based on numerous factors, including our history of credit loss expense by portfolio, the financial strength of our customers and counterparties in each portfolio, the aging of our receivables, our expectation of likelihood of payment, macroeconomic trends in the U.S. and the current and forecasted non-residential construction market trends in the U.S.

In addition to the loss-rate calculations discussed above, we also record allowance for credit losses for specific receivables that are deemed to have a higher risk profile than the rest of the respective pool of receivables (e.g., when we hold concerns about a specific customer going bankrupt and no longer being able to pay the receivables due to us).

Income Taxes

We conduct business throughout the United States in virtually all fifty states. Our effective tax rate changes based upon our relative profitability, or lack thereof, in states with varying tax rates and rules. In addition, discrete items such as tax law changes, judgments and legal structures, can impact our effective tax rate. These items can also include the tax treatment for impairment of goodwill and other intangible assets, changes in fair value of acquisition-related assets and liabilities, uncertain tax positions, and accounting for losses associated with underperforming operations.

In early October 2020, we filed amended federal returns for 2016, 2017 and 2018, primarily to claim the credit for increasing research activities (the “R&D tax credit”) requesting refunds of $9.8 million, $9.5 million and $11.9 million, respectively. The $31.2 million of refunds requested was offset by unrecognized tax benefits of $28.8 million due to the uncertainty of the outcome of an Internal Revenue Service (“IRS”) examination. The R&D tax credit had no material impact on our effective tax rates for the 2020 and 2021 calendar years.

Following an IRS survey of previously filed refund claims for the 2016, 2017 and 2018 tax years, the Joint Committee on Taxation approved such refunds in late January 2022. As a result, our benefit for income taxes in the first quarter of 2022 included a $28.8 million reduction in unrecognized tax benefits plus approximately $1.6 million of net interest income on the refunds.

Our benefit for income taxes in the first quarter of 2022 was further increased by $26.8 million for the expected refunds due to our intention to claim the R&D tax credit for the 2019, 2020 and 2021 tax years. In the third quarter of 2022, we claimed the R&D tax credit on our originally filed 2021 federal return and recognized an additional $1.7 million benefit for the 2019, 2020 and 2021 tax years. Furthermore, we have included an estimate for the R&D tax credit in the computation of our annual effective tax rate for the current year and will continue to do so for the foreseeable future.

The Inflation Reduction Act was enacted on August 16, 2022. This law, among other provisions, provides a corporate alternative minimum tax on adjusted financial statement income over $1 billion, which is effective for tax years beginning after December 31, 2022, and a 1% excise tax on net corporate stock repurchases after December 31, 2022. We currently believe these provisions will be immaterial to our overall financial results, financial position and cash flows.

Financial Instruments

Our financial instruments consist of cash and cash equivalents, accounts receivable, other receivables, accounts payable and life insurance policies, for which we deem the carrying values approximate their fair value due to the short-term nature of these instruments, as well as notes to former owners and a revolving credit facility. We believe the carrying value of our debt associated with our revolving credit facility approximates its fair value due to the variable rate on such debt.

Investments

We have a $1.6 million investment with a fair value that is not readily determinable and is recorded at cost. This investment is included in “Other Noncurrent Assets” in our Consolidated Balance Sheet and is reviewed quarterly for impairment. We did not recognize any impairments in the current year related to this investment.

3. Revenue from Contracts with Customers

Revenue is recognized when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration to which we expect to be entitled in exchange for those goods or services. Sales-based taxes are excluded from revenue.

We provide mechanical and electrical contracting services. Our mechanical segment principally includes HVAC, plumbing, piping and controls, as well as off-site construction, monitoring and fire protection. Our electrical segment includes installation and servicing of electrical systems. We build, install, maintain, repair and replace products and systems throughout the United States. All of our revenue is recognized over time as we deliver goods and services to our customers. Revenue can be earned based on an agreed-upon fixed price or based on actual costs incurred, marked up at an agreed-upon percentage.

We account for a contract when: (i) it has approval and commitment from both parties, (ii) the rights of the parties are identified, (iii) payment terms are identified, (iv) the contract has commercial substance, and (v) collectability of consideration is probable. We consider the start of a project to be when the above criteria have been met and we either have written authorization from the customer to proceed or an executed contract.

We generally do not incur significant incremental costs related to obtaining or fulfilling a contract prior to the start of a project. On rare occasions, when significant pre-contract costs are incurred, they are capitalized and amortized over the life of the contract using a cost-to-cost input method to measure progress towards contract completion. We do not currently have any capitalized obtainment or fulfillment costs in our Consolidated Balance Sheet and have not incurred any impairment loss on such costs in the current year.

Due to the nature of the work required to be performed on many of our performance obligations, the estimation of total revenue and cost at completion (the process described below in more detail) is complex, subject to many variables and requires significant judgment. The consideration to which we are entitled on our long-term contracts may include both fixed and variable amounts. Variable amounts can either increase or decrease the transaction price. A common example of variable amounts that can either increase or decrease contract value are pending change orders that represent contract modifications for which a change in scope has been authorized or acknowledged by our customer, but the final adjustment to contract price is yet to be negotiated. Other examples of positive variable revenue include amounts awarded upon achievement of certain performance metrics, program milestones or cost of completion date targets and can be based upon customer discretion. Variable amounts can result in a deduction from contract revenue if we fail to meet stated performance requirements, such as complying with the construction schedule.

We include estimated amounts of variable consideration in the contract price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Our estimates of variable consideration and determination of whether to include estimated amounts in the contract price are based largely on an assessment of our anticipated performance and all information (historical, current and forecasted) that is reasonably available to us. We reassess the amount of variable consideration each accounting period until the uncertainty associated with the variable consideration is resolved. Changes in the assessed amount of variable consideration are accounted for prospectively as a cumulative adjustment to revenue recognized in the current period.

Contracts are often modified to account for changes in contract specifications and requirements. We consider contract modifications to exist when the modification either creates new, or changes the existing, enforceable rights and obligations. Most of our contract modifications are for goods or services that are not distinct from the existing performance obligation(s). The effect of a contract modification on the transaction price, and our measure of progress for the performance obligation to which it relates, is recognized as an adjustment to revenue (either as an increase or decrease) on a cumulative catch-up basis.

We have a Company-wide policy requiring periodic review of the Estimate at Completion in which management reviews the progress and execution of our performance obligations and estimated remaining obligations. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress towards completion and the related program schedule, identified risks and opportunities and the related changes in estimates of revenue and costs. The risks and opportunities include management's judgment about the ability and cost to achieve the schedule (e.g., the number and type of milestone events), technical requirements (e.g., a newly developed product versus a mature product) and other contract requirements. Management must make assumptions and estimates regarding labor productivity and availability, the complexity of the work to be performed, the availability of materials, the length of time to complete the performance obligation (e.g., to estimate increases in wages and prices for materials and related support cost allocations), execution by our subcontractors, the availability and timing of funding from our customer, and overhead cost rates, among other variables.

Based on this analysis, any adjustments to revenue, cost of services, and the related impact to operating income are recognized as necessary in the quarter when they become known. These adjustments may result from positive program performance if we determine we will be successful in mitigating risks surrounding the technical, schedule and cost aspects of those performance obligations or realizing related opportunities and may result in an increase in operating income during the performance of individual performance obligations. Likewise, if we determine we will not be successful in mitigating these risks or realizing related opportunities, these adjustments may result in a decrease in operating income. Changes in estimates of revenue, cost of services and the related impact to operating income are recognized quarterly on a cumulative catch-up basis, meaning we recognize in the current period the cumulative effect of the changes on current and prior periods based on our progress towards complete satisfaction of a performance obligation. A significant change in one or more of these estimates could affect the profitability of one or more of our performance obligations. For projects in which estimates of total costs to be incurred on a performance obligation exceed total estimates of revenue to be earned, a provision for the entire loss on the performance obligation is recognized in the period the loss is determined.

In the first nine months of 2022 and 2021, net revenue recognized from our performance obligations satisfied in previous periods was not material.

Disaggregation of Revenue

Our consolidated 2022 revenue was derived from contracts to provide service activities in the mechanical and electrical services segments we serve. Refer to Note 11 “Segment Information” for additional information on our reportable segments. We disaggregate our revenue from contracts with customers by activity, customer type and service provided, as we believe it best depicts how the nature, amount, timing and uncertainty of our revenue and cash flows are affected by economic factors. See details in the following tables (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
Revenue by Service Provided	**2022**		**2021**		**2022**		**2021**	
Mechanical Services	$ 858,768	76.7 %	$ 690,680	82.8 %	$ 2,318,036	76.7 %	$ 1,868,096	84.2 %
Electrical Services	261,244	23.3 %	143,216	17.2 %	705,140	23.3 %	349,456	15.8 %
Total	$ 1,120,012	100.0 %	$ 833,896	100.0 %	$ 3,023,176	100.0 %	$ 2,217,552	100.0 %

	Three Months Ended September 30,				Nine Months Ended September 30,			
Revenue by Type of Customer	**2022**		**2021**		**2022**		**2021**	
Industrial	$ 542,222	48.4 %	$ 379,605	45.5 %	$ 1,422,897	47.1 %	$ 960,263	43.3 %
Education	133,422	11.9 %	115,536	13.9 %	342,116	11.3 %	300,374	13.5 %
Office Buildings	94,931	8.5 %	77,806	9.3 %	255,963	8.5 %	229,816	10.4 %
Healthcare	147,234	13.2 %	101,446	12.2 %	423,142	14.0 %	292,541	13.2 %
Government	63,070	5.6 %	40,268	4.8 %	186,747	6.2 %	125,939	5.7 %
Retail, Restaurants and Entertainment	84,354	7.5 %	62,365	7.5 %	230,370	7.6 %	155,874	7.0 %
Multi-Family and Residential	34,310	3.1 %	29,741	3.6 %	88,924	2.9 %	82,742	3.7 %
Other	20,469	1.8 %	27,129	3.2 %	73,017	2.4 %	70,003	3.2 %
Total	$ 1,120,012	100.0 %	$ 833,896	100.0 %	$ 3,023,176	100.0 %	$ 2,217,552	100.0 %

	Three Months Ended September 30,				Nine Months Ended September 30,			
Revenue by Activity Type	**2022**		**2021**		**2022**		**2021**	
New Construction	$ 524,122	46.8 %	$ 397,446	47.6 %	$ 1,438,453	47.6 %	$ 1,029,397	46.4 %
Existing Building Construction	346,683	31.0 %	250,893	30.1 %	910,284	30.1 %	682,811	30.8 %
Service Projects	103,439	9.2 %	75,525	9.1 %	273,663	9.0 %	201,848	9.1 %
Service Calls, Maintenance and Monitoring	145,768	13.0 %	110,032	13.2 %	400,776	13.3 %	303,496	13.7 %
Total	$ 1,120,012	100.0 %	$ 833,896	100.0 %	$ 3,023,176	100.0 %	$ 2,217,552	100.0 %

Contract Assets and Liabilities

Project contracts typically provide for a schedule of billings or invoices to the customer based on our job-to-date completion percentage of specific tasks inherent in the fulfillment of our performance obligation(s). The schedules for such billings usually do not precisely match the schedule on which costs are incurred. Contract assets include unbilled amounts typically resulting from sales under long term contracts when the cost-to-cost method of revenue recognition is used, revenue recognized exceeds the amount billed to the customer and right to payment is conditional or subject to completing a milestone, such as a phase of the project. Contract assets are not considered a significant financing component, as they are intended to protect the customer in the event that we do not perform our obligations under the contract. Contract assets are generally classified as current, as it is very unusual for us to have contract assets with a term of greater than one year.

Contract liabilities consist of advance payments and billings in excess of revenue recognized. It is very unusual for us to have advanced payments with a term of greater than one year; therefore, our contract liabilities are usually all current. If we have advanced payments with a term greater than one year, the noncurrent portion of advanced payments would be included in “Other Long-term Liabilities” in our Consolidated Balance Sheets. Contract liabilities are not considered to have a significant financing component, as they are used to meet working capital requirements that are generally higher in the early stages of a contract and are intended to protect us from the other party failing to meet its obligations under the contract. Our contract assets and liabilities are reported in a net position on a contract by contract basis at the end of each reporting period.

The following table presents the changes in contract assets and contract liabilities (in thousands):

	Nine Months Ended September 30, 2022		Year Ended December 31, 2021	
	Contract Assets	Contract Liabilities	Contract Assets	Contract Liabilities
Balance at beginning of period	$ 29,900	$ 307,380	$ 18,622	$ 226,237
Change due to acquisitions / disposals	2,426	1,160	10,356	36,523
Change related to credit allowance	17	—	(5)	—
Other changes in the period	(10,643)	126,216	927	44,620
Balance at end of period	$ 21,700	$ 434,756	$ 29,900	$ 307,380

In the first nine months of 2022 and 2021, we recognized revenue of $277.5 million and $204.6 million related to our contract liabilities at January 1, 2022 and January 1, 2021, respectively.

We did not have any impairment losses recognized on our receivables or contract assets in the first nine months of 2022 and 2021.

Remaining Performance Obligations

Remaining construction performance obligations represent the remaining transaction price of firm orders for which work has not been performed and exclude unexercised contract options. As of September 30, 2022, the aggregate amount of the transaction price allocated to remaining performance obligations was $3.25 billion. The Company expects to recognize revenue on approximately 80-85% of the remaining performance obligations over the next 12 months, with the remaining recognized thereafter. Our service maintenance agreements are generally one-year renewable agreements. We have adopted the practical expedient that allows us to not include service maintenance contracts with a total term of one year or less; therefore, we do not report unfulfilled performance obligations for service maintenance agreements.

4. Fair Value Measurements

Interest Rate Risk Management and Derivative Instruments

In April 2020, we entered into interest rate swap agreements to reduce our exposure to variable interest rates on our revolving credit facility. The interest rate swap agreements terminated on September 30, 2022.

At times, we use derivative instruments to manage exposure to market risk, including interest rate risk. Unsettled amounts under our interest rate swaps are recorded in the Consolidated Balance Sheet at fair value in “Other Receivables” or “Other Current Liabilities.” Gains and losses on our interest rate swaps are recorded in the Consolidated Income Statement in “Interest Expense.” For the three months ended September 30, 2022 and September 30, 2021, we recognized a net gain of $0.3 million and a net loss of $0.1 million, respectively, related to our interest rate swaps. For the nine months ended September 30, 2022 and September 30, 2021, we recognized a net gain of $0.3 million and a net loss of $0.4 million, respectively, related to our interest rate swaps.

Fair Value Measurements

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

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

The following table summarizes the fair values, and levels within the fair value hierarchy in which the fair value measurements are included, for assets and liabilities measured on a recurring basis as of September 30, 2022 and December 31, 2021 (in thousands):

	Fair Value Measurements at September 30, 2022			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 71,139	$ —	$ —	$ 71,139
Life insurance—cash surrender value	$ —	$ 6,678	$ —	$ 6,678
Contingent earn-out obligations	$ —	$ —	$ 26,968	$ 26,968

	Fair Value Measurements at December 31, 2021			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 58,776	$ —	$ —	$ 58,776
Life insurance—cash surrender value	$ —	$ 6,643	$ —	$ 6,643
Contingent earn-out obligations	$ —	$ —	$ 34,114	$ 34,114

Cash and cash equivalents consist primarily of highly rated money market funds at a variety of well-known institutions with original maturities of three months or less. The original cost of these assets approximates fair value due to their short-term maturity. The carrying value of our borrowings associated with the revolving credit facility approximate its fair value due to the variable rate on such debt.

We have life insurance policies covering 116 employees with a combined face value of $80.6 million. The policies are invested in several investment vehicles, and the fair value measurement of the cash surrender balance associated with these policies is determined using Level 2 inputs within the fair value hierarchy and will vary with investment performance. The cash surrender value of these policies was $6.7 million as of September 30, 2022 and $6.6 million as of December 31, 2021. These assets are included in “Other Noncurrent Assets” in our Consolidated Balance Sheets.

We value contingent earn-out obligations using a probability weighted discounted cash flow method. This fair value measurement is based on significant unobservable inputs in the market and thus represents a Level 3 measurement within the fair value hierarchy. This analysis reflects the contractual terms of the purchase agreements (e.g., minimum and maximum payments, length of earn-out periods, manner of calculating any amounts due, etc.) and utilizes assumptions with regard to future cash flows and operating income, probabilities of achieving such future cash flows and operating income and a weighted average cost of capital. Significant changes in any of these assumptions could result in a significantly higher or lower potential liability. The contingent earn-out obligations are measured at fair value each reporting period, and changes in estimates of fair value are recognized in earnings. As of September 30, 2022, cash flows were discounted using a weighted average cost of capital ranging from 12.0% - 18.0%.

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

	Nine Months Ended September 30, 2022	Year Ended December 31, 2021
Balance at beginning of period	$ 34,114	$ 25,979
Issuances	—	19,949
Settlements	(6,616)	(3,994)
Adjustments to fair value	(530)	(7,820)
Balance at end of period	$ 26,968	$ 34,114

5. Acquisitions

On April 1, 2022, we acquired Atlantic Electric, LLC and its related subsidiary (“Atlantic”), headquartered in Charleston, South Carolina, and with operations in South Carolina and Western North Carolina, for a total preliminary purchase price of $48.1 million, which included $34.1 million of cash paid on the closing date, $5.3 million in notes payable to former owners and a working capital adjustment. Atlantic performs electrical contracting for customers in various South Carolina markets, as well as installation of airport runway lighting in the Southeast. As a result of the acquisition, Atlantic is a wholly owned subsidiary of the Company reported in our electrical services segment.

On December 31, 2021, we acquired MEP Holding Co., Inc., and its related subsidiaries (collectively, “MEP Holdings”) for a total preliminary purchase price of $57.3 million, which included $45.2 million funded on the closing date, $7.6 million in notes payable to former owners, an earn-out that will be paid if certain financial targets are met after the acquisition date and a working capital adjustment. As a result of the acquisition, MEP Holdings is a wholly owned subsidiary of the Company and reports as a separate operating location in our electrical services segment. Additionally, on December 31, 2021, we completed an acquisition of a service and controls business in Kentucky with a total preliminary purchase price of $20.5 million and a temporary staffing company based in Indiana with a total preliminary purchase price of $4.7 million, which are both reported in our mechanical services segment.

On December 1, 2021, we acquired Ivey Mechanical Company, LLC (“Ivey”) headquartered in Kosciusko, Mississippi for a total preliminary purchase price of $79.1 million, which included $64.1 million of cash paid on the closing date, a $0.4 million short-term payable which was settled in the third quarter of 2022, $8.0 million in notes payable to former owners, plus an earn-out that will be paid if certain financial targets are met after the acquisition date and a working capital adjustment. As a result of the acquisition, Ivey is a wholly owned subsidiary of the Company and reports as a separate operating location in our mechanical services segment.

On August 1, 2021, we acquired all of the issued and outstanding equity interests of Amteck Holdco LLC and each of its wholly owned subsidiaries (collectively “Amteck”). The total purchase price was $138.9 million of which $113.1 million was allocated to goodwill and identifiable intangible assets. The total purchase price included $107.4 million in cash, $8.6 million in working capital adjustment, $10.0 million in notes payable to former owners and a $12.9 million contingent earn-out obligation. Amteck provides electrical contracting solutions and services, including design and build, pre-fabrication and installation for core electric and low-voltage systems, as well as services for planned maintenance, retrofit and emergency work. Amteck is headquartered in Kentucky and primarily serves the greater Southeastern United States, including Kentucky, Tennessee and the Carolinas. As a result of the acquisition, Amteck is a wholly owned subsidiary of the Company reported in our electrical services segment.

In the first quarter of 2021, we completed an acquisition of a mechanical contractor in Utah with a total purchase price of $18.1 million, which is reported in our mechanical services segment.

The results of operations of acquisitions are included in our consolidated financial statements from their respective acquisition dates. Our Consolidated Balance Sheet includes preliminary allocations of the purchase price to the assets acquired and liabilities assumed for the applicable acquisitions pending the completion of the final valuation of intangible assets and accrued liabilities. The acquisitions completed in the current and prior year were not material, individually or in the aggregate. Additional contingent purchase price (“earn-out”) has been or will be paid if certain acquisitions achieve predetermined profitability targets. Such earn-outs, when they are not subject to the continued employment of the sellers, are estimated as of the purchase date and included as part of the consideration paid for the acquisition. If we have an earn-out under which continued employment is a condition to receipt of payment, then the earn-out is recorded as compensation expense over the period earned.

6. Goodwill and Identifiable Intangible Assets, Net

Goodwill

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

	Mechanical Services Segment	Electrical Services Segment	Total
Balance at December 31, 2020	$ 307,448	$ 156,944	$ 464,392
Acquisitions and purchase price adjustments (See Note 5)	52,771	74,951	127,722
Impact of segment reorganization	1,101	(1,101)	—
Balance at December 31, 2021	361,320	230,794	592,114
Acquisitions and purchase price adjustments (See Note 5)	1,859	17,066	18,925
Balance at September 30, 2022	$ 363,179	$ 247,860	$ 611,039

During the fourth quarter of 2021, the Company performed a qualitative assessment for all of our reporting units except one for which we performed a quantitative assessment, which considered various factors, including changes in the carrying value of the reporting unit, forecasted operating results, long-term growth rates and discount rates. Additionally, we considered qualitative key events and circumstances (i.e. macroeconomic environment, industry and market specific conditions, cost factors and events specific to the reporting unit, etc.). Based on this assessment, we concluded that it was more likely than not that the fair value of each of the reporting units was substantially greater than its carrying value. Accordingly, no further testing was required. For our Texas electrical operation, we performed a step 1 quantitative assessment, and the calculated fair value exceeded the carrying value by 32%. As a result of the reporting unit's smaller excess of fair value percentage, this reporting unit is more susceptible to impairment risk from additional adverse changes in its operating environment, including micro- and macroeconomic environment conditions that could negatively impact them. Such adverse changes could include worsening economic conditions in the locations or markets they primarily serve, whether due to COVID-19 or other events and conditions. As of September 30, 2022, the Texas electrical operation had a goodwill balance of $96.8 million.

Identifiable Intangible Assets, Net

At September 30, 2022, future amortization expense of identifiable intangible assets is as follows (in thousands):

Year ending December 31—	
2022 (remainder of the year)	$ 11,193
2023	36,252
2024	34,063
2025	31,876
2026	31,032
Thereafter	140,678
Total	$ 285,094

7. Debt Obligations

Debt obligations consist of the following (in thousands):

	September 30, 2022	December 31, 2021
Revolving credit facility	$ 335,000	$ 220,000
Term loan	—	120,000
Notes to former owners	45,400	47,954
Finance lease liabilities (See Note 8)	79	266
Other debt	227	—
Total principal amount	380,706	388,220
Less—unamortized debt issuance costs	—	(190)
Total debt, net of unamortized debt issuance costs	380,706	388,030
Less—current portion	(2,514)	(2,788)
Total long-term portion of debt, net	$ 378,192	$ 385,242

At September 30, 2022, future principal payments of debt are as follows (in thousands):

Year ending December 31—	
2022 (remainder of the year)	$ 499
2023	9,467
2024	10,867
2025	22,229
2026	2,644
2027	335,000
	$ 380,706

Revolving Credit Facility

On May 25, 2022, we amended our senior credit facility (as amended, the “Facility”) arranged by Wells Fargo Bank, National Association, as administrative agent, and provided by a syndicate of banks, increasing our borrowing capacity from $562.5 million (of which $450 million was a revolving credit facility) to $850 million. As amended, the Facility is composed of a revolving credit line guaranteed by certain of our subsidiaries, in the amount of $850.0 million, and the previous term loan has been eliminated. The amended Facility also provides for an accordion or increase option not to exceed the greater of (a) $250 million and (b) 1.0x Credit Facility Adjusted EBITDA (as defined below), as well as a sublimit of up to $175.0 million issuable in the form of letters of credit. The Facility expires in July 2027 and is secured by a first lien on substantially all of our personal property except for assets related to projects subject to surety bonds and the equity of, and assets held by, certain unrestricted subsidiaries and our wholly owned captive insurance company, and a second lien on our assets related to projects subject to surety bonds. In 2022, we incurred approximately $2.3 million in financing and professional costs in connection with the amendment to the Facility, which, combined with previously unamortized costs of $1.2 million, are being amortized on a straight-line basis as a non-cash charge to interest expense over the remaining term of the Facility. As of September 30, 2022, we had $335.0 million of outstanding borrowings on the revolving credit facility, $55.6 million in letters of credit outstanding and $459.4 million of credit available.

Covenants and Restrictions

The Facility contains financial covenants defining various financial measures and the levels of these measures with which we must comply. Covenant compliance is assessed as of each quarter end. Credit Facility Adjusted EBITDA is defined under the Facility for financial covenant purposes as consolidated net income for the four fiscal quarters ending as of any given quarterly covenant compliance measurement date, plus the corresponding amounts for (a) interest expense; (b) provision for income taxes; (c) depreciation and amortization; (d) stock or equity compensation; (e) other non-cash charges; and (f) pre-acquisition results of acquired companies. The Facility's principal financial covenants include:

Net Leverage Ratio—The Facility requires that the ratio of (a) our Consolidated Total Indebtedness (as defined in the Facility) minus unrestricted cash and cash equivalents up to $100,000,000, to (b) our Credit Facility Adjusted EBITDA not exceed 3.50 to 1.00 as of the end of each fiscal quarter.

Interest Coverage Ratio—The Facility requires that the ratio of (a) Credit Facility Adjusted EBITDA to (b) consolidated interest expense, defined as all interest paid or accrued on indebtedness during the period excluding amortization of debt incurrence expenses, original issue discount, and mark-to-market interest expense, be at least 3.00 to 1.00. Credit Facility Adjusted EBITDA and consolidated interest expense are calculated for purposes of this covenant for the four fiscal quarters ending as of any given quarterly covenant compliance measurement date.

Other Restrictions—The Facility (a) permits unlimited acquisitions when the Company's Net Leverage Ratio is less than or equal to 3.25 to 1.00, (b) expands certain baskets for permitted indebtedness and liens, and (c) permits unlimited distributions, stock repurchases, and investments when the Net Leverage Ratio is less than or equal to 2.75 to 1.00.

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

We were in compliance with all of our financial covenants as of September 30, 2022.

Interest Rates and Fees

There are two interest rate options for borrowings under the Facility, the Base Rate Loan (as defined in the Facility) option and the Secured Overnight Financing Rate ("SOFR") Loan option. Under the Base Rate Loan option, the interest rate is determined based on the highest of (a) the Federal Funds Rate (as defined in the Facility) plus 0.5%, (b) the prime lending rate established by Wells Fargo Bank, N.A., and (c) the one-month Adjusted Term SOFR (as defined in the Facility) plus 1.00%. Under the SOFR Loan option, the interest rate is determined based on Adjusted Term SOFR for a one, three, or six-month tenor at our election. Additional margins are then added to these two rates. The additional margins are determined based on our Net Leverage Ratio.

The interest rates under the Facility are floating rates determined by the broad financial markets, meaning they can and do move up and down from time to time. For illustrative purposes, the following are the respective market rates as of September 30, 2022 relating to interest options under the Facility:

Base Rate Loan Option:	
Federal Funds Rate plus 0.50%	3.58%
Wells Fargo Bank, N.A. Prime Rate	6.25%
One-month SOFR plus 1.00%	3.47%
SOFR Loan Option:	
One-month SOFR	2.47%
Six-month SOFR	1.43%

Certain of our vendors require letters of credit to ensure reimbursement for accounts they are disbursing on our behalf, such as to beneficiaries under our self-funded insurance programs. We have also occasionally used letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. Our lenders issue such letters of credit through the Facility. A letter of credit commits the lenders to pay specified amounts to the holder of the letter of credit if the holder demonstrates that we have failed to perform specified actions. If this were to occur, we would be required to reimburse the lenders for amounts they fund to honor the letter of credit holder's claim. Absent a claim, there is no payment or reserving of funds by us in connection with a letter of credit. However, because a claim on a letter of credit would require immediate reimbursement by us to our lenders, letters of credit are treated as a use of Facility capacity.

Commitment fees are payable on the portion of the revolving loan capacity not in use for borrowings or letters of credit at any given time. Letter of credit fees and commitment fees are based on the Net Leverage Ratio.

	Net Leverage Ratio				
	Less than 1.00	**1.00 to less than 1.75**	**1.75 to less than 2.50**	**2.50 to less than 3.00**	**3.00 or greater**
Additional Per Annum Interest Margin Added Under:					
Base Rate Loan Option	0.00 %	0.25 %	0.50 %	0.75 %	1.00 %
SOFR Loan Option	1.00 %	1.25 %	1.50 %	1.75 %	2.00 %
Letter of credit fees	1.00 %	1.25 %	1.50 %	1.75 %	2.00 %
Commitment fees on any portion of the Revolving Loan capacity not in use for borrowings or letters of credit at any given time	0.15 %	0.175 %	0.20 %	0.225 %	0.25 %

The weighted average interest rate applicable to the borrowings under the revolving credit facility was approximately 4.4% as of September 30, 2022.

Notes to Former Owners

As part of the consideration used to acquire nine companies, we have outstanding notes to the former owners. Together, these notes had an outstanding balance of $45.4 million as of September 30, 2022. At September 30, 2022, future principal payments of notes to former owners by maturity year are as follows (dollars in thousands):

	Balance at September 30, 2022	**Range of Stated Interest Rates**
2022	$ 400	2.5 %
2023	9,400	2.5 %
2024	10,800	2.5 - 3.0 %
2025	22,175	2.3 - 2.5 %
2026	2,625	2.5 %
Total	$ 45,400	

8. Leases

We lease certain facilities, vehicles and equipment primarily under noncancelable operating leases. The most significant portion of these noncancelable operating leases is for the facilities occupied by our corporate office and our operating locations. We have finance leases on vehicles that are not material to our consolidated financial position. Leases with an initial term of 12 months or less are not recorded in the Balance Sheet. We do not separate lease components from their associated non-lease components pursuant to lease accounting guidance. We have certain leases with variable payments based on an index as well as some short-term leases on equipment and facilities. Variable lease expense and short-term lease expense were not material to our financial statements and aggregated to $14.4 million and $6.1 million in the first nine months of 2022 and 2021, respectively. Lease right-of-use assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we generally use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The weighted average discount rate for our operating leases as of September 30, 2022 and December 31, 2021 was 4.2% and 4.0%, respectively. We recognize operating lease expense, including escalating lease payments and lease incentives, on a straight-line basis over the lease term. Operating lease expense for the three months ended September 30, 2022 and 2021 was $13.1 million and $7.7 million, respectively. Operating lease expense for the nine months ended September 30, 2022 and 2021 was $34.3 million and $22.1 million, respectively.

The lease terms generally range from three to ten years. Some leases include one or more options to renew, which may be exercised to extend the lease term. We include the exercise of lease renewal options in the lease term when it is reasonably certain that we will exercise the option and such exercise is at our sole discretion. The weighted average remaining lease term for our operating leases was 8.2 years at September 30, 2022 and 8.7 years at December 31, 2021.

A majority of the Company's real property leases are with individuals or entities with whom we have no other business relationship. However, in certain instances the Company enters into real property leases with current or former employees. Rent paid to related parties for the three months ended September 30, 2022 and 2021 was approximately $1.7 million and $1.1 million, respectively. Rent paid to related parties for the nine months ended September 30, 2022 and 2021 was approximately $5.2 million and $3.6 million, respectively.

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. Our lease agreements do not contain any material residual value guarantees or material restrictive covenants. On rare occasions, we rent or sublease certain real estate assets that we no longer use to third parties.

Finance lease right-of-use assets are included in "Property and equipment, net," and current and long-term finance lease liabilities are included within "Current maturities of long-term debt" and "Long-term debt, net," respectively, in the Consolidated Balance Sheet. The following table summarizes the operating lease assets and liabilities included in the Consolidated Balance Sheet as follows (in thousands):

	September 30, 2022	December 31, 2021
Operating lease right-of-use assets	$ 133,443	$ 124,756
Operating lease liabilities:		
Other current liabilities	$ 21,056	$ 19,050
Long-term operating lease liabilities	114,443	107,701
Total operating lease liabilities	$ 135,499	$ 126,751

The maturities of operating lease liabilities are as follows (in thousands):

Year ending December 31—	
2022 (excluding the nine months ended September 30, 2022)	$ 6,753
2023	25,578
2024	22,934
2025	21,760
2026	18,740
Thereafter	65,470
Total Lease Payments	161,235
Less—Present Value Discount	(25,736)
Present Value of Operating Lease Liabilities	$ 135,499

Supplemental information related to operating leases was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Cash paid for amounts included in the measurement of operating lease liabilities	$ 6,777	$ 5,597	$ 19,793	$ 16,297
Operating lease right-of-use assets obtained in exchange for lease liabilities	$ 6,191	$ 13,154	$ 24,560	$ 22,513

9. Commitments and Contingencies

Claims and Lawsuits

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

During the third quarter of 2022, we recorded a net gain of $4.5 million related to legal matters that merited changes to our assessments of the related accruals in the ordinary course of our business based on information received in the third quarter of 2022. The largest change in the third quarter resulted from favorable developments related to a dispute with a customer regarding the outcome of a completed project as well as the obligation to perform subcontract work under two executed letters of intent for subsequent projects that we believed were not enforceable. The net gain of $4.5 million has been recorded primarily as an increase in gross profit in our Consolidated Statements of Operations.

As of September 30, 2022, we recorded an accrual for unresolved matters, which is not material to our financial statements, based on our analysis of likely outcomes related to the respective matters; however, it is possible that the ultimate outcome and associated costs will deviate from our estimates and that, in the event of an unexpectedly adverse outcome, we may experience additional costs and expenses in future periods.

Surety

Many customers, particularly in connection with new construction, require us to post performance and payment bonds issued by a financial institution known as a surety. If we fail to perform under the terms of a contract or to pay subcontractors and vendors who provided goods or services under a contract, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the surety for any expenses or outlays it incurs.

Current market conditions for surety markets and bonding capacity are adequate, with acceptable terms and conditions. Historically, approximately 15% to 25% of our business has required bonds. While we currently have strong surety relationships to support our bonding needs, future market conditions or changes in the sureties' assessment of our operating and financial risk could cause the sureties to decline to issue bonds for our work. If that were to occur, the alternatives include doing more business that does not require bonds, posting other forms of collateral for project performance, such as letters of credit or cash, and seeking bonding capacity from other sureties. We would likely also encounter concerns from customers, suppliers and other market participants as to our creditworthiness. While we believe our general operating and financial characteristics would enable us to ultimately respond effectively to an interruption in the availability of bonding capacity, such an interruption would likely cause our revenue and profits to decline in the near term.

Self-Insurance

We are substantially self-insured for workers' compensation, employer's liability, auto liability, general liability and employee group health claims, in view of the relatively high per-incident deductibles we absorb under our insurance arrangements for these risks. Losses are estimated and accrued based upon known facts, historical trends and industry averages. Estimated losses in excess of our deductible, which have not already been paid, are included in our accrual with a corresponding receivable from our insurance carrier. Loss estimates associated with the larger and longer-developing risks, such as workers' compensation, auto liability and general liability, are reviewed by a third-party actuary quarterly.

10. Stockholders' Equity

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

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

There were zero anti-dilutive stock options excluded from the calculation of diluted EPS for the three and nine months ended September 30, 2022. There were less than 0.1 million anti-dilutive stock options excluded from the calculation of diluted EPS for the three and nine months ended September 30, 2021.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Common shares outstanding, end of period	35,774	36,042	35,774	36,042
Effect of using weighted average common shares outstanding	79	254	192	286
Shares used in computing earnings per share—basic	35,853	36,296	35,966	36,328
Effect of shares issuable under stock option plans based on the treasury stock method	32	73	39	100
Effect of restricted and contingently issuable shares	87	65	73	72
Shares used in computing earnings per share—diluted	35,972	36,434	36,078	36,500

Share Repurchase Program

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from time to time increased the number of shares that may be acquired under the program and approved extensions of the program. On May 17, 2022, the Board approved an extension to the program by increasing the shares authorized for repurchase by 0.7 million shares. Since the inception of the repurchase program, the Board has approved 10.9 million shares to be repurchased. As of September 30, 2022, we have repurchased a cumulative total of 10.1 million shares at an average price of $24.39 per share under the repurchase program.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. During the nine months ended September 30, 2022, we repurchased 0.4 million shares for approximately $36.4 million at an average price of $85.74 per share.

11. Segment Information

Our activities are within the mechanical services industry and the electrical services industry, which represent our two reportable segments. We aggregate our operating segments into two reportable segments, as the operating segments meet all of the aggregation criteria. The following tables present information about our reportable segments (in thousands):

	Three Months Ended September 30, 2022			
	Mechanical Services	Electrical Services	Corporate	Consolidated
Revenue	$ 858,768	$ 261,244	$ —	$ 1,120,012
Gross Profit	$ 150,872	$ 51,352	$ —	$ 202,224

	Three Months Ended September 30, 2021			
	Mechanical Services	Electrical Services	Corporate	Consolidated
Revenue	$ 690,680	$ 143,216	$ —	$ 833,896
Gross Profit	$ 138,618	$ 20,594	$ —	$ 159,212

	Nine Months Ended September 30, 2022			
	Mechanical Services	Electrical Services	Corporate	Consolidated
Revenue	$ 2,318,036	$ 705,140	$ —	$ 3,023,176
Gross Profit	$ 416,205	$ 114,155	$ —	$ 530,360

	Nine Months Ended September 30, 2021			
	Mechanical Services	Electrical Services	Corporate	Consolidated
Revenue	$ 1,868,096	$ 349,456	$ —	$ 2,217,552
Gross Profit	$ 359,151	$ 49,985	$ —	$ 409,136

The electrical services segment included a benefit in the third quarter of 2022 related to favorable developments from a dispute with a customer. See Note 9 “Commitments and Contingencies” for further information.

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

The following discussion and analysis should be read in conjunction with our historical Consolidated Financial Statements and related notes included elsewhere in this Form 10-Q and the Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2021 (the "Form 10-K"). This discussion contains "forward-looking statements" regarding our business and industry within the meaning of applicable securities laws and regulations. These statements are based on our current plans and expectations and involve risks and uncertainties that could cause our actual future activities and results of operations to be materially different from those set forth in the forward-looking statements. Important factors that could cause actual results to differ include risks set forth in "Item 1A. Risk Factors" included in our Form 10-K. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. The terms "Comfort Systems," "we," "us," or the "Company," refer to Comfort Systems USA, Inc. or Comfort Systems USA, Inc. and its consolidated subsidiaries, as appropriate in the context.

Introduction and Overview

We are a national provider of comprehensive mechanical and electrical installation, renovation, maintenance, repair and replacement services within the mechanical and electrical services industries. We operate primarily in the commercial, industrial and institutional markets and perform most of our work in industrial, healthcare, education, office, technology, retail and government facilities. We operate our business in two business segments: mechanical and electrical.

Nature and Economics of Our Business

In our mechanical business segment, customers hire us to ensure HVAC 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.

In our electrical business segment, our principal business activity is electrical construction and engineering in the commercial and industrial field. We also perform electrical logistics services, electrical service work, and electrical construction and engineering services.

In both our mechanical and electrical business segments, 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.

Approximately 86.7% of our revenue is earned on a project basis for installation services in newly constructed facilities or for replacement of systems in existing facilities. When competing for project business, we usually estimate the costs we will incur on a project, and then propose a bid to the customer that includes a contract price and other performance and payment terms. Our bid price and terms are intended to cover our estimated costs on the project and provide a profit margin to us commensurate with the value of the installed system to the customer, the risk that project costs or duration will vary from estimate, the schedule on which we will be paid, the opportunities for other work that we might forego by committing capacity to this project, and other costs that we incur to support our operations but which are not specific to the project. Typically, customers will seek pricing from competitors for a given project. While the criteria on which customers select a provider 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 for value is the most influential factor for most customers in choosing a mechanical or electrical installation and service provider.

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

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

As of September 30, 2022, we had 10,414 projects in process. Our average project takes six to nine months to complete, with an average contract price of approximately $791,000. Our projects generally require working capital funding of equipment and labor costs. Customer payments on periodic billings generally do not recover these costs until late in the job. Our average project duration, together with typical retention terms as discussed above, generally allow us to complete the realization of revenue and earnings in cash within one year. We have what we consider to be a well-diversified distribution of revenue across end-use sectors that we believe reduces our exposure to negative developments in any given sector. Because of the integral nature of our services to most buildings, we have the legal right in almost all cases to attach liens to buildings or related funding sources when we have not been fully paid for installing systems, except with respect to some government buildings. The service work that we do, which is discussed further below, usually does not give rise to lien rights.

We also perform larger projects. Taken together, projects with contract prices of $1 million or more totaled $7.2 billion of aggregate contract value as of September 30, 2022, or approximately 87% of a total contract value for all projects in progress, totaling $8.2 billion. Generally, projects closer in size to $1 million will be completed in one year or less. It is unusual for us to work on a project that exceeds two years in length.

A stratification of projects in progress as of September 30, 2022, by contract price, is as follows:

Contract Price of Project	No. of Projects	Aggregate Contract Price Value (millions)
Under $1 million	9,256	$ 1,032.8
$1 million - $5 million	788	1,827.1
$5 million - $10 million	193	1,317.5
$10 million - $15 million	63	785.4
Greater than $15 million	114	3,271.6
Total	10,414	$ 8,234.4

In addition to project work, approximately 13.3% of our revenue represents maintenance and repair service on already installed HVAC, electrical, and controls systems. This kind of work usually takes from a few hours to a few days to perform. Prices to the customer are 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 are for one or more years and frequently contain thirty- to sixty-day cancellation notice periods.

A relatively small portion of our revenue comes from national and regional account customers. These customers typically have multiple sites and contract with us to perform maintenance and repair service. These contracts may also provide for us to perform new or replacement systems installation. We operate a national call center to dispatch technicians to sites requiring service. We perform the majority of this work with our own employees, with the balance being subcontracted to third parties that meet our performance qualifications.

Profile and Management of Our Operations

We manage our 42 operating units based on a variety of factors. Financial measures we emphasize include profitability and use of capital as indicated by cash flow and by other measures of working capital principally involving project cost, billings and receivables. We also monitor selling, general, administrative and indirect project support expense, backlog, workforce size and mix, growth in revenue and profits, variation of actual project cost from original estimate, and overall financial performance in comparison to budget and updated forecasts. Operational factors we emphasize include project selection, estimating, pricing, management and execution practices, labor utilization, safety, training, and the make-up of both existing backlog as well as new business being pursued, in terms of project size, technical application, facility type, end-use customers and industries and location of the work.

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

Economic and Industry Factors

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

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

Operating Environment and Management Emphasis

During the five-year period from 2015 to 2019, there was an increase in nonresidential building construction and renovation activity levels. In 2020, the advent of a global pandemic led to some delays in service and construction, including delayed project starts and air pockets during 2020 and 2021. We believe that delays and air pockets have now substantially abated; however, we expect to continue to experience supply chain constraints and reduced labor availability during 2022.

We have a credit facility in place with terms we believe are favorable that does not expire until July 2027. As of September 30, 2022, we had $459.4 million of credit available to borrow under our credit facility. We have strong surety relationships to support our bonding needs, and we believe our relationships with the surety markets are strong and benefit from our operating history and financial position. We have generated positive free cash flow in each of the last twenty-three calendar years and will continue our emphasis in this area. We believe that the relative size and strength of our Balance Sheet and surety relationships, as compared to most companies in our industry, represent competitive advantages for us.

As discussed at greater length in “Results of Operations” below, we expect price competition to continue as local and regional industry participants compete for customers. We will continue to invest in our service business, to pursue the more active sectors in our markets, and to emphasize our regional and national account business.

Cyclicality and Seasonality

The construction industry is subject to business cycle fluctuation. As a result, our volume of business, particularly in new construction projects and renovation, may be adversely affected by declines in new installation and replacement projects in various geographic regions of the United States during periods of economic weakness.

The mechanical and electrical contracting industries are also subject to seasonal variations. 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 our services is generally higher in the second and third calendar quarters due to increased construction activity and increased use of air conditioning during the warmer months. Accordingly, we expect our revenue and operating results generally will be lower in the first calendar quarter.

Critical Accounting Policies and Estimates

Management believes that there have been no significant changes during the three months ended September 30, 2022, to the items that we disclosed as our "Critical Accounting Policies and Estimates" in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 31, 2021. A summary of significant accounting policies and a summary of recent accounting pronouncements applicable to our Consolidated Financial Statements are included in Note 2 “Summary of Significant Accounting Policies and Estimates”.

Results of Operations (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2022		2021		2022		2021	
Revenue	$ 1,120,012	100.0 %	$ 833,896	100.0 %	$ 3,023,176	100.0 %	$ 2,217,552	100.0 %
Cost of services	917,788	81.9 %	674,684	80.9 %	2,492,816	82.5 %	1,808,416	81.6 %
Gross profit	202,224	18.1 %	159,212	19.1 %	530,360	17.5 %	409,136	18.4 %
Selling, general and administrative expenses	121,194	10.8 %	95,287	11.4 %	357,694	11.8 %	271,050	12.2 %
Gain on sale of assets	(406)	—	(180)	—	(1,112)	—	(1,021)	—
Operating income	81,436	7.3 %	64,105	7.7 %	173,778	5.7 %	139,107	6.3 %
Interest income	5	—	1	—	14	—	7	—
Interest expense	(3,609)	(0.3)%	(1,586)	(0.2)%	(8,764)	(0.3)%	(4,443)	(0.2)%
Changes in the fair value of contingent earn-out obligations	(3,443)	(0.3)%	(1,244)	(0.1)%	530	—	4,523	0.2 %
Other income (expense)	46	—	20	—	101	—	112	—
Income before income taxes	74,435	6.6 %	61,296	7.4 %	165,659	5.5 %	139,306	6.3 %
Provision (benefit) for income taxes	12,920		14,999		(24,864)		33,553	
Net income	$ 61,515	5.5 %	$ 46,297	5.6 %	$ 190,523	6.3 %	$ 105,753	4.8 %

We had 41 operating locations as of December 31, 2021. In the second quarter of 2022, we completed the acquisition of Atlantic Electric, LLC (“Atlantic”), which reports as a separate operating location. We had 42 operating locations as of September 30, 2022. Acquisitions are included in our results of operations from the respective acquisition date. The same-store comparison from 2022 to 2021, as described below, excludes Atlantic, which was acquired on April 1, 2022, Ivey Mechanical Company, LLC ("Ivey"), which was acquired on December 1, 2021 and MEP Holding Co., Inc. ("MEP Holdings"), which was acquired on December 31, 2021, as well as one month of results for Amteck Holdco LLC ("Amteck"), which was acquired on August 1, 2021. An operating location is included in the same-store comparison on the first day it has comparable prior year operating data, except for immaterial acquisitions that are often absorbed and integrated with existing operations.

Revenue—Revenue for the third quarter of 2022 increased $286.1 million, or 34.3%, to $1.12 billion compared to the same period in 2021. The increase included a 22.7% increase in revenue related to same-store activity and an 11.6% increase related to the Atlantic, Ivey, MEP Holdings and Amteck acquisitions. The same-store revenue growth was largely driven by strong market conditions, including the increase in our backlog, as well as the impact of inflation on our cost of goods sold that was passed on to our customers.

The following table presents our operating segment revenue (in thousands, except percentages):

	Three Months Ended September 30,			
	2022		2021	
Revenue:				
Mechanical Services	$ 858,768	76.7 %	$ 690,680	82.8 %
Electrical Services	261,244	23.3 %	143,216	17.2 %
Total	$ 1,120,012	100.0 %	$ 833,896	100.0 %

Revenue for our mechanical services segment increased $168.1 million, or 24.3%, to $858.8 million for the third quarter of 2022 compared to the same period in 2021. The increase was broad-based and included the acquisition of Ivey ($48.6 million), as well as an increase in activity in the industrial sector at our North Carolina operation ($36.2 million), in the healthcare sector at one of our Florida operations ($13.7 million), and in the multi-family and residential sector at our Colorado operation ($9.9 million).

Revenue for our electrical services segment increased $118.0 million, or 82.4%, to $261.2 million for the third quarter of 2022 compared to the same period in 2021. The increase primarily resulted from the acquisitions of MEP Holdings ($23.6 million), Amteck ($15.8 million) and Atlantic ($9.0 million), as well as an increase in activity in the industrial sector at our Texas electrical operation ($56.9 million).

Revenue for the first nine months of 2022 increased $805.6 million, or 36.3%, to $3.02 billion compared to the same period in 2021. The increase included a 21.2% increase in revenue related to same-store activity and a 15.1% increase related to the Atlantic, Ivey, MEP Holdings and Amteck acquisitions. The same-store revenue growth was largely driven by strong market conditions, including the increase in our backlog, as well as the impact of inflation on our cost of goods sold that was passed on to our customers.

The following table presents our operating segment revenue (in thousands, except percentages):

	Nine Months Ended September 30,			
	2022		2021	
Revenue:				
Mechanical Services	$ 2,318,036	76.7 %	$ 1,868,096	84.2 %
Electrical Services	705,140	23.3 %	349,456	15.8 %
Total	$ 3,023,176	100.0 %	$ 2,217,552	100.0 %

Revenue for our mechanical services segment increased $449.9 million, or 24.1%, to $2.32 billion for the first nine months of 2022 compared to the same period in 2021. The increase was broad-based and included the acquisition of Ivey ($134.6 million), as well as an increase in activity in the industrial sector at our North Carolina operation ($64.0 million) and our Wisconsin operation ($20.0 million), and an increase in activity in the retail, restaurants and entertainment sector at one of our Florida operations ($25.9 million) and our Arizona operation ($21.9 million).

Revenue for our electrical services segment increased $355.7 million to $705.1 million for the first nine months of 2022 compared to the same period in 2021. The increase primarily resulted from the acquisitions of Amteck ($110.2 million), MEP Holdings ($67.5 million) and Atlantic ($23.6 million), as well as an increase in activity in the industrial sector at our Texas electrical operation ($125.1 million).

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

The following table presents our operating segment backlog (in thousands, except percentages):

	September 30, 2022		December 31, 2021		September 30, 2021	
Backlog:						
Mechanical Services	$ 2,536,049	78.0 %	$ 1,753,340	75.8 %	$ 1,458,652	75.1 %
Electrical Services	714,487	22.0 %	558,544	24.2 %	482,725	24.9 %
Total	$ 3,250,536	100.0 %	$ 2,311,884	100.0 %	$ 1,941,377	100.0 %

Backlog as of September 30, 2022 was $3.25 billion, a 15.8% increase from June 30, 2022 backlog of $2.81 billion, and a 67.4% increase from September 30, 2021 backlog of $1.94 billion. The sequential backlog increase was broad-based, and was primarily a result of increased project bookings at one of our Texas operations ($109.8 million), our North Carolina operation ($52.0 million), one of our Indiana operations ($50.4 million) and one of our Tennessee operations ($28.1 million). The year-over-year backlog increase included the acquisitions of Ivey ($132.3 million), MEP Holdings ($50.6 million) and Atlantic ($24.8 million), as well as a same-store increase of $1.10 billion, or 56.7%. Same-store year-over-year backlog growth was broad-based, including increased project bookings at one of our Texas operations ($240.4 million), our North Carolina operation ($200.7 million), our Texas electrical operation ($141.0 million) and one of our Indiana operations ($57.9 million).

Gross Profit—Gross profit increased $43.0 million, or 27.0%, to $202.2 million for the third quarter of 2022 as compared to the same period in 2021. The increase included an 11.7% increase related to the Atlantic, Ivey, MEP Holdings and Amteck acquisitions, as well as a 15.3% increase in same-store activity. The same-store increase in gross profit was broad-based and was primarily driven by higher revenues in the current year, including increased volumes at our Texas electrical operation ($16.0 million) and our North Carolina operation ($6.7 million). Additionally, we achieved improvements in project execution at our Arizona operation ($3.9 million). Furthermore, we recorded an increase of $4.3 million in gross profit related to positive developments on legal matters in the third quarter of 2022. As a percentage of revenue, gross profit for the third quarter decreased from 19.1% in 2021 to 18.1% in 2022 primarily due to project mix differences, as well as materials and equipment being a higher percentage of our costs in the current year.

Gross profit increased $121.2 million, or 29.6%, to $530.4 million for the first nine months of 2022 as compared to the same period in 2021. The increase included a 13.2% increase related to the Atlantic, Ivey, MEP Holdings and Amteck acquisitions, as well as a 16.4% increase in same-store activity. The same-store increase in gross profit was broad-based and was primarily driven by the higher revenues in the current year including increased volumes at our Texas electrical operation ($22.6 million) and our North Carolina operation ($14.3 million). Additionally, we achieved improvements in project execution at one of our Florida operations ($8.2 million) and our Arizona operation ($5.4 million). Furthermore, we recorded an increase of $4.3 million in gross profit related to positive developments on legal matters in the third quarter of 2022. As a percentage of revenue, gross profit for the nine-month period decreased from 18.4% in 2021 to 17.5% in 2022 primarily due to product mix differences, including a higher percentage of electrical segment revenue and new construction revenue in the current year, as well as materials and equipment being a higher percentage of our costs in the current year.

Selling, General and Administrative Expenses ("SG&A")—SG&A increased $25.9 million, or 27.2%, to $121.2 million for the third quarter of 2022 as compared to 2021. On a same-store basis, excluding amortization expense, SG&A increased $12.1 million, or 13.9%. The same-store increase is primarily due to higher same-store revenue and increased compensation costs attributable to increased headcount ($7.1 million), as well as an increase in travel-related expenses ($0.7 million), which were lower in the prior year due to the impacts of COVID-19 on travel. Additionally, bad debt expense increased $1.5 million on a same-store basis, primarily due to benefits recorded in the prior period when we lowered reserves to reflect the business impacts relating to COVID-19 stabilizing. Amortization expense increased $1.4 million during the period, primarily as a result of the Atlantic, Ivey, MEP Holdings and Amteck acquisitions. As a percentage of revenue, SG&A for the third quarter decreased from 11.4% in 2021 to 10.8% in 2022.

SG&A increased $86.6 million, or 32.0%, to $357.7 million for the first nine months of 2022 as compared to 2021. On a same-store basis, excluding amortization expense, SG&A increased $38.3 million, or 15.4%. The same-store increase is primarily due to higher same-store revenue, an increase in consulting fees and other expenses of $4.7 million related to the credit for increasing research activities (the "R&D tax credit") for prior tax years and increased compensation costs attributable to increased headcount ($20.8 million), as well as an increase in travel-related expenses ($3.1 million), which were lower in the prior year due to the impacts of COVID-19 on travel. Additionally, bad debt expense increased $3.2 million on a same-store basis, primarily due to benefits recorded in the prior period when we lowered reserves to reflect the business impacts relating to COVID-19 stabilizing. Amortization expense increased $5.3 million during the period, primarily as a result of the Atlantic, Ivey, MEP Holdings and Amteck acquisitions. As a percentage of revenue, SG&A for the nine-month period decreased from 12.2% in 2021 to 11.8% in 2022.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
	(in thousands)		(in thousands)	
SG&A	$ 121,194	$ 95,287	$ 357,694	$ 271,050
Less: SG&A from companies acquired	(12,332)	—	(43,034)	—
Less: Amortization expense	(9,194)	(7,751)	(27,231)	(21,967)
Same-store SG&A, excluding amortization expense	$ 99,668	$ 87,536	$ 287,429	$ 249,083

Interest Expense—Interest expense increased $2.0 million, or 127.6%, to $3.6 million for the third quarter of 2022 as compared to the same period in 2021. Interest expense increased $4.3 million for the first nine months of 2022 as compared to the same period in 2021. The increase in interest expense for both the quarter and first nine months of 2022 is due to an increase in our average interest rate on our outstanding borrowings in 2022 compared to the prior year as well as a higher average outstanding debt balance as compared to the prior year. Additionally, we expensed $0.2 million in the second quarter of 2022 related to the unamortized debt issuance costs for the term loan, which was refinanced in the amendment of our senior credit facility.

Changes in the Fair Value of Contingent Earn-out Obligations—The contingent earn-out obligations are measured at fair value each reporting period, and changes in estimates of fair value are recognized in earnings. Expense from changes in the fair value of contingent earn-out obligations for the third quarter of 2022 increased $2.2 million as compared to the same period in 2021. Income from changes in the fair value of contingent earn-out obligations for the first nine months of 2022 decreased $4.0 million as compared to the same period in 2021. These changes in value were primarily the result of higher earn-out expenses associated with our electrical operation in Texas, driven by higher earnings than previously forecasted in the current year and strong market conditions and backlog, which also lead to higher future forecasted financial results.

Provision (Benefit) for Income Taxes—Our benefit for income taxes for the nine months ended September 30, 2022 was $24.9 million with a negative effective tax rate of 15.0% as compared to a provision for income taxes of $33.6 million with an effective tax rate of 24.1% for the same period in 2021. The effective tax rate for 2022 was significantly lower than the 21% federal statutory rate primarily due to a reduction in unrecognized tax benefits from settlement with the Internal Revenue Service for the 2016, 2017 and 2018 tax years (18.4%), the filing, and expected filing, of returns to claim the R&D tax credit for the 2019, 2020 and 2021 tax years (17.4%) and inclusion of the R&D tax credit for the current year 2022 (5.0%). These benefits were partially offset by net state income taxes (4.2%) and nondeductible expenses, including nondeductible expenses related to the TAS Energy Inc. ("TAS") acquisition (1.4%). The effective tax rate for 2021 was higher than the 21% federal statutory rate primarily due to net state income taxes (4.0%) and nondeductible expenses, including nondeductible expenses related to TAS (1.0%), partially offset by deductions for stock-based compensation (1.2%) and benefits from claiming the energy efficient commercial buildings deduction (the "179D deduction") allocated to us (0.7%).

Outlook

We are experiencing strong demand in 2022, and we believe that we have largely recovered from negative impacts to industry demand in our business due to the business disruption caused by COVID-19. We continue to see instances of delayed starts, and we continue to experience increased labor costs. We also are experiencing supply constraints and cost increases, reduced availability, and delays in delivery of various materials and equipment. We are recognizing these challenges in our job planning and pricing, and we are working to order materials earlier than usual and seeking to collaborate with customers to share supply risks and to mitigate the effects of these challenges.

We have a good pipeline of opportunities and potential backlog, and we have been generally successful in maintaining activity levels and productivity and in procuring needed materials despite ongoing challenges. Considering all these factors, we currently anticipate solid earnings and cash flow in 2022. We continue to prepare for a wide range of challenges and economic circumstances, including a potential recession; however, despite challenges, we currently expect supportive conditions for our industry are likely to continue in 2023.

Liquidity and Capital Resources (in thousands):

	Nine Months Ended September 30,	
	2022	**2021**
Cash provided by (used in):		
Operating activities	$ 169,524	$ 152,654
Investing activities	(82,759)	(119,605)
Financing activities	(74,402)	(20,224)
Net increase (decrease) in cash and cash equivalents	$ 12,363	$ 12,825
Free cash flow:		
Cash provided by operating activities	$ 169,524	$ 152,654
Purchases of property and equipment	(34,793)	(15,864)
Proceeds from sales of property and equipment	2,151	1,802
Free cash flow	$ 136,882	$ 138,592

Cash Flow

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

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

Cash provided by operating activities was $169.5 million during the first nine months of 2022 compared with $152.7 million during the same period in 2021. The $16.8 million increase in cash provided was primarily driven by a $103.1 million benefit from billings in excess of costs, attributable to the timing of billings and various project work, an $83.7 million benefit from increased accounts payable and accrued liabilities, and $33.3 million of tax refunds received in the first nine months of 2022. These benefits were partially offset by a $250.0 million change in receivables, net driven by the increase in revenue compared to the prior year.

Cash Used in Investing Activities—During the first nine months of 2022, cash used in investing activities was $82.8 million compared to $119.6 million during the same period in 2021. The $36.8 million decrease in cash used primarily relates to a decrease in cash paid (net of cash acquired) for acquisitions, partially offset by higher purchases of property and equipment in the current year compared to the same period in 2021.

Cash Used in Financing Activities—Cash used in financing activities was $74.4 million for the first nine months of 2022 compared to $20.2 million during the same period in 2021. The $54.2 million increase in cash used is primarily due to a decrease in net proceeds from debt, which was driven by higher payments in the current year, as well as due to an increase in share repurchases in 2022.

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

Share Repurchase Program

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from time to time increased the number of shares that may be acquired under the program and approved extensions of the program. On May 17, 2022, the Board approved an extension to the program by increasing the shares authorized for repurchase by 0.7 million shares. Since the inception of the repurchase program, the Board has approved 10.9 million shares to be repurchased. As of September 30, 2022, we have repurchased a cumulative total of 10.1 million shares at an average price of $24.39 per share under the repurchase program.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. During the nine months ended September 30, 2022, we repurchased 0.4 million shares for approximately $36.4 million at an average price of $85.74 per share.

Debt

Revolving Credit Facility

On May 25, 2022, we amended our senior credit facility (as amended, the "Facility") arranged by Wells Fargo Bank, National Association, as administrative agent, and provided by a syndicate of banks, increasing our borrowing capacity from $562.5 million (of which $450 million was a revolving credit facility) to $850 million. As amended, the

Facility is composed of a revolving credit line guaranteed by certain of our subsidiaries, in the amount of $850.0 million, and the previous term loan has been eliminated. The amended Facility also provides for an accordion or increase option not to exceed the greater of (a) $250 million and (b) 1.0x Credit Facility Adjusted EBITDA (as defined below), as well as a sublimit of up to $175.0 million issuable in the form of letters of credit. The Facility expires in July 2027 and is secured by a first lien on substantially all of our personal property except for assets related to projects subject to surety bonds and the equity of, and assets held by, certain unrestricted subsidiaries and our wholly owned captive insurance company, and a second lien on our assets related to projects subject to surety bonds. In 2022, we incurred approximately $2.3 million in financing and professional costs in connection with the amendment to the Facility, which, combined with previously unamortized costs of $1.2 million, are being amortized on a straight-line basis as a non-cash charge to interest expense over the remaining term of the Facility. As of September 30, 2022, we had $335.0 million of outstanding borrowings on the revolving credit facility, $55.6 million in letters of credit outstanding and $459.4 million of credit available.

There are two interest rate options for borrowings under the Facility, the Base Rate Loan (as defined in the Facility) option and the Secured Overnight Financing Rate (“SOFR”) Loan option. These rates are floating rates determined by the broad financial markets, meaning they can and do move up and down from time to time. Additional margins are then added to these two rates.

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. Such letters of credit are issued under the Facility for a fee. The letter of credit fees range from 1.00% to 2.00% per annum, based on the Net Leverage Ratio.

Commitment fees are payable on the portion of the revolving loan capacity not in use for borrowings or letters of credit at any given time. These fees range from 0.15% to 0.25% per annum, based on the Net Leverage Ratio.

The Facility contains financial covenants defining various financial measures and the levels of these measures with which we must comply. Covenant compliance is assessed as of each quarter end. Credit Facility Adjusted EBITDA is defined under the Facility for financial covenant purposes as consolidated net income for the four fiscal quarters ending as of any given quarterly covenant compliance measurement date, plus the corresponding amounts for (a) interest expense; (b) provision for income taxes; (c) depreciation and amortization; (d) stock or equity compensation; (e) other non-cash charges; and (f) pre-acquisition results of acquired companies. The Facility’s principal financial covenants include:

Net Leverage Ratio—The Facility requires that the ratio of (a) our Consolidated Total Indebtedness (as defined in the Facility) minus unrestricted cash and cash equivalents up to $100,000,000, to (b) our Credit Facility Adjusted EBITDA not exceed 3.50 to 1.00 as of the end of each fiscal quarter.

Interest Coverage Ratio—The Facility requires that the ratio of (a) Credit Facility Adjusted EBITDA to (b) consolidated interest expense, defined as all interest paid or accrued on indebtedness during the period excluding amortization of debt incurrence expenses, original issue discount, and mark-to-market interest expense, be at least 3.00 to 1.00. Credit Facility Adjusted EBITDA and consolidated interest expense are calculated for purposes of this covenant for the four fiscal quarters ending as of any given quarterly covenant compliance measurement date.

Other Restrictions—The Facility (a) permits unlimited acquisitions when the Company’s Net Leverage Ratio is less than or equal to 3.25 to 1.00, (b) expands certain baskets for permitted indebtedness and liens, and (c) permits unlimited distributions, stock repurchases, and investments when the Net Leverage Ratio is less than or equal to 2.75 to 1.00.

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

We were in compliance with all of our financial covenants as of September 30, 2022.

Notes to Former Owners

As part of the consideration used to acquire nine companies, we have outstanding notes to the former owners. Together, these notes had an outstanding balance of $45.4 million as of September 30, 2022. At September 30, 2022, future principal payments of notes to former owners by maturity year are as follows (dollars in thousands):

	Balance at September 30, 2022	Range of Stated Interest Rates
2022	$ 400	2.5 %
2023	9,400	2.5 %
2024	10,800	2.5 - 3.0 %
2025	22,175	2.3 - 2.5 %
2026	2,625	2.5 %
Total	$ 45,400	

Outlook

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

Material Cash Requirements and Other Commitments

Certain of our vendors require letters of credit to ensure reimbursement for amounts they are disbursing on our behalf, such as to beneficiaries under our self-funded insurance programs. We have also occasionally used letters of credit to guarantee performance under our contracts and to ensure payment to our subcontractors and vendors under those contracts. The letters of credit we provide are actually issued by our lenders through the Facility as described above. A letter of credit commits the lenders to pay specified amounts to the holder of the letter of credit if the holder demonstrates that we have failed to perform specified actions. If this were to occur, we would be required to reimburse the lenders. Depending on the circumstances of such a reimbursement, we may also have to record a charge to earnings for the reimbursement. Absent a claim, there is no payment or reserving of funds by us in connection with a letter of credit. However, because a claim on a letter of credit would require immediate reimbursement by us to our lenders, letters of credit are treated as a use of the Facility’s capacity just the same as actual borrowings. Claims against letters of credit are rare in our industry.

As of September 30, 2022, we have $55.6 million in letter of credit commitments, of which $28.2 million will expire in 2022 and $27.4 million will expire in 2023. The substantial majority of these letters of credit are posted with insurers who disburse funds on our behalf in connection with our workers’ compensation, auto liability and general liability insurance program. These letters of credit provide additional security to the insurers that sufficient financial resources will be available to fund claims on our behalf, many of which develop over long periods of time, should we ever encounter financial duress. Posting of letters of credit for this purpose is a common practice for entities that manage their self-insurance programs through third-party insurers as we do. While some of these letter of credit commitments expire in the next twelve months, we expect nearly all of them, particularly those supporting our insurance programs, will be renewed annually.

Many customers, particularly in connection with new construction, require us to post performance and payment bonds issued by a financial institution known as a surety. If we fail to perform under the terms of a contract or to pay subcontractors and vendors who provided goods or services under a contract, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the sureties for any expenses or outlays they incur.

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 15% to 25% of our business has required bonds. While we currently have strong surety relationships to support our bonding needs, future market conditions or changes in our sureties' assessment of our operating and financial risk could cause our sureties to decline to issue bonds for our work. If that were to occur, our alternatives include doing more business that does not require bonds, posting other forms of collateral for project performance, such as letters of credit or cash, and seeking bonding capacity from other sureties. We would likely also encounter concerns from customers, suppliers and other market participants as to our creditworthiness. While we believe our general operating and financial characteristics would enable us to ultimately respond effectively to an interruption in the availability of bonding capacity, such an interruption would likely cause our revenue and profits to decline in the near term.

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

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

We have exposure to changes in interest rates under our revolving credit facility. The weighted average interest rate applicable to the borrowings under the revolving credit facility was approximately 4.4% as of September 30, 2022. Our debt with fixed interest rates consists of notes to former owners of acquired companies and acquired notes payable.

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

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

Item 4. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the three months ended September 30, 2022 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. *Legal Proceedings*

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

During the third quarter of 2022, we recorded a net gain of $4.5 million related to legal matters that merited changes to our assessments of the related accruals in the ordinary course of our business based on information received in the third quarter of 2022. The largest change in the third quarter resulted from favorable developments related to a dispute with a customer regarding the outcome of a completed project as well as the obligation to perform subcontract work under two executed letters of intent for subsequent projects that we believed were not enforceable. The net gain of $4.5 million has been recorded primarily as an increase in gross profit in our Consolidated Statements of Operations.

As of September 30, 2022, we recorded an accrual for unresolved matters, which is not material to our financial statements, based on our analysis of likely outcomes related to the respective matters; however, it is possible that the ultimate outcome and associated costs will deviate from our estimates and that, in the event of an unexpectedly adverse outcome, we may experience additional costs and expenses in future periods.

Item 1A. *Risk Factors*

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part 1, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2021, which could materially affect our business, financial condition, or future results. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, or future results.

Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds*

Recent Sales of Unregistered Securities

None.

Issuer Purchases of Equity Securities

On March 29, 2007, our Board of Directors (the "Board") approved a stock repurchase program to acquire up to 1.0 million shares of our outstanding common stock. Subsequently, the Board has from time to time increased the number of shares that may be acquired under the program and approved extensions of the program. On May 17, 2022, the Board approved an extension to the program by increasing the shares authorized for repurchase by 0.7 million shares. Since the inception of the repurchase program, the Board has approved 10.9 million shares to be repurchased. As of September 30, 2022, we have repurchased a cumulative total of 10.1 million shares at an average price of $24.39 per share under the repurchase program.

The share repurchases will be made from time to time at our discretion in the open market or privately negotiated transactions, as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The Board may modify, suspend, extend or terminate the program at any time. During the nine months ended September 30, 2022, we repurchased 0.4 million shares for approximately $36.4 million at an average price of $85.74 per share.

During the quarter ended September 30, 2022, we purchased our common shares in the following amounts at the following average prices:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 - July 31	4,496	$ 82.13	10,067,596	876,529
August 1 - August 31	—	$ —	10,067,596	876,529
September 1 - September 30	32,050	$ 99.97	10,099,646	844,479
	36,546	$ 97.78	10,099,646	844,479

(1) Purchased as part of a program announced on March 29, 2007 under which, since the inception of this program, 10.9 million shares have been approved for repurchase.

Under our 2012 Equity Incentive Plan and 2017 Omnibus Incentive Plan, employees may elect to have us withhold common shares to satisfy statutory federal, state and local tax withholding obligations arising on the vesting of restricted stock awards and exercise of options. When we withhold these shares, we are required to remit to the appropriate taxing authorities the market price of the shares withheld, which could be deemed a purchase of the common shares by us on the date of withholding.

Item 6. ***Exhibits***

Exhibit Number	Description of Exhibits	Incorporated by Reference to the Exhibit Indicated Below and to the Filing with the Commission Indicated Below: Exhibit Number	Filing or File Number
3.1	Second Amended and Restated Certificate of Incorporation of the Registrant	3.1	333-24021
3.2	Certificate of Amendment dated May 21, 1998	3.2	1998 Form 10-K
3.3	Certificate of Amendment dated July 9, 2003	3.3	2003 Form 10-K
3.4	Certificate of Amendment dated May 20, 2016	3.1	May 20, 2016 Form 8-K
3.5	Amended and Restated Bylaws of Comfort Systems USA, Inc.	3.1	March 25, 2016 Form 8-K
10.1	Form of Restricted Stock Unit Agreement with a Blank Vesting Schedule under the Company's 2017 Omnibus Incentive Plan	10.2	Second Quarter 2022 Form 10-Q
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002		
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002		
32.1**	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002		
32.2**	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002		
101.INS*	Inline XBRL Instance Document		
101.SCH*	Inline XBRL Taxonomy Extension Schema Document		
101.CAL*	Inline XBRL Taxonomy Extension Calculation Linkbase Document		
101.DEF*	Inline XBRL Taxonomy Extension Definition Linkbase Document		
101.LAB*	Inline XBRL Taxonomy Extension Label Linkbase Document		
101.PRE*	Inline XBRL Taxonomy Extension Presentation Linkbase		
104	Cover Page Interactive Data File (the cover page XBRL tags are embedded in the Inline XBRL document)		

*** Filed herewith.**
**** Furnished herewith.**

SIGNATURES

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

		COMFORT SYSTEMS USA, INC.
October 26, 2022	By:	/s/ BRIAN E. LANE
		Brian E. Lane
		President, Chief Executive Officer and Director
October 26, 2022	By:	/s/ WILLIAM GEORGE
		William George
		Executive Vice President and Chief Financial Officer
October 26, 2022	By:	/s/ JULIE S. SHAEFF
		Julie S. Shaeff
		Senior Vice President and Chief Accounting Officer

Exhibit 31.1

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

I, Brian E. Lane, certify that:

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

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

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

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

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

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

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

   d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

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

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

Date: October 26, 2022

/s/ BRIAN E. LANE
Brian E. Lane
President and Chief Executive Officer

Exhibit 31.2

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

I, William George, certify that:

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

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

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

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

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

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

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

   d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

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

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

Date: October 26, 2022

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

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002*

In connection with the Quarterly Report of Comfort Systems USA, Inc. (the “Company”) on Form 10-Q for the quarter ended September 30, 2022, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Brian E. Lane, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Date: October 26, 2022

/s/ Brian E. Lane
Brian E. Lane
President and Chief Executive Officer

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

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002*

In connection with the Quarterly Report of Comfort Systems USA, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2022, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William George, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

Date: October 26, 2022

/s/ William George
William George
Executive Vice President and Chief Financial Officer

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