UNITED STATES SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 1-13011

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

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

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

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (713) 830-9600

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

The number of shares outstanding of the issuer's common stock, as of November 9, 2001, was 37,509,579.

COMFORT SYSTEMS USA, INC.

INDEX TO FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2001

COMFORT SYSTEMS USA, INC.

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	DECEMBER 31, 2000	SEPTEMBER 30, 2001
		(UNAUDITED)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 16,021	$ 15,135
Accounts receivable, less allowance of $6,789 and $10,296	334,152	341,424
Other receivables	5,879	5,421
Inventories	19,399	19,670
Prepaid expenses and other	10,568	10,412
Costs and estimated earnings in excess of billings	44,078	47,453
Net assets held for sale	3,197	--
Total current assets	433,294	439,515
PROPERTY AND EQUIPMENT, net	40,085	35,466
GOODWILL, less accumulated amortization of $32,904 and $41,738	450,493	441,459
OTHER NONCURRENT ASSETS	2,538	2,854
Total assets	$926,410	$919,294
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 216	$ 93
Current maturities of notes to affiliates and former owners	8,850	5,826
Accounts payable	114,613	116,476
Accrued compensation and benefits	40,880	43,051
Billings in excess of costs and estimated earnings	68,574	81,043
Income taxes payable	--	3,578
Other current liabilities	26,942	30,067
Total current liabilities	260,075	280,134
LONG-TERM DEBT, NET OF CURRENT MATURITIES	224,111	190,355
NOTES TO AFFILIATES AND FORMER OWNERS, NET OF CURRENT MATURITIES	41,424	37,634
OTHER LONG-TERM LIABILITIES	561	441
Total liabilities	526,171	508,564
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, $.01 par, 5,000,000 shares authorized, none issued and outstanding	--	--
Common stock, $.01 par, 102,969,912 shares authorized, 39,258,913 shares issued	393	393
Treasury stock, at cost, 2,002,629 and 1,749,334 shares, respectively	(13,119)	(10,924)
Additional paid-in capital	341,923	340,186
Retained earnings	71,042	81,075
Total stockholders' equity	400,239	410,730
Total liabilities and stockholders' equity	$926,410	$919,294

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,	
	2000	2001	2000	2001
REVENUES	$423,922	$408,935	$1,191,458	$1,169,204
COST OF SERVICES	352,838	335,797	978,869	963,098
Gross profit	71,084	73,138	212,589	206,106
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	58,021	52,735	169,182	158,230
GOODWILL AMORTIZATION	3,151	3,021	9,483	9,063
RESTRUCTURING CHARGES	9,959	--	10,313	238
Operating income (loss)	(47)	17,382	23,611	38,575
OTHER INCOME (EXPENSE):				
Interest income	105	38	483	108
Interest expense	(7,122)	(5,171)	(19,900)	(17,878)
Other	588	157	678	531
Other income (expense)	(6,429)	(4,976)	(18,739)	(17,239)
REDUCTIONS IN NON-OPERATING ASSETS AND LIABILITIES, NET	--	--	(5,190)	--
INCOME (LOSS) BEFORE INCOME TAXES	(6,476)	12,406	(318)	21,336
INCOME TAX EXPENSE (BENEFIT)	(2,787)	6,764	268	11,303
NET INCOME (LOSS)	$ (3,689)	$ 5,642	$ (586)	$ 10,033
NET INCOME (LOSS) PER SHARE:				
Basic	$ (0.10)	$ 0.15	$ (0.02)	$ 0.27
Diluted	$ (0.10)	$ 0.15	$ (0.02)	$ 0.27
SHARES USED IN COMPUTING NET INCOME (LOSS) PER SHARE:				
Basic	37,265	37,468	37,429	37,411
Diluted	37,265	37,773	37,429	37,449

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

COMFORT SYSTEMS USA, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	COMMON STOCK		TREASURY STOCK		ADDITIONAL		TOTAL
	SHARES	AMOUNT	SHARES	AMOUNT	PAID-IN CAPITAL	RETAINED EARNINGS	STOCKHOLDERS' EQUITY
BALANCE AT DECEMBER 31, 1999......	39,258,913	$393	(1,695,524)	$(11,978)	$342,655	$87,895	$418,965
Issuance of Common Stock:							
Issuance of Employee Stock Purchase Plan shares........	--	--	329,212	2,254	(732)	--	1,522
Common Stock repurchases........	--	--	(175,513)	(1,224)	--	--	(1,224)
Shares exchanged in repayment of notes receivable.............	--	--	(385,996)	(1,975)	--	--	(1,975)
Shares received from sale of businesses...................	--	--	(74,808)	(196)	--	--	(196)
Net loss.......................	--	--	--	--	--	(16,853)	(16,853)
BALANCE AT DECEMBER 31, 2000......	39,258,913	393	(2,002,629)	(13,119)	341,923	71,042	400,239
Issuance of Common Stock:							
Issuance of Employee Stock Purchase Plan shares (unaudited)..............	--	--	398,287	2,570	(1,737)	--	833
Shares received from sale of businesses (unaudited)........	--	--	(144,992)	(375)	--	--	(375)
Net income (unaudited)..........	--	--	--	--	--	10,033	10,033
BALANCE AT SEPTEMBER 30, 2001 (unaudited)....................	39,258,913	$393	(1,749,334)	$(10,924)	$340,186	$81,075	$410,730

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,	
	2000	2001
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (586)	$ 10,033
Adjustments to reconcile net income (loss) to net cash provided by operating activities --		
Restructuring charges	10,313	238
Depreciation and amortization expense	18,413	18,072
Bad debt expense	3,864	5,041
Deferred tax expense	101	1,638
Gain on sale of property and equipment	(636)	(195)
Reduction in non-operating assets and liabilities, net	5,190	--
Changes in operating assets and liabilities --		
(Increase) decrease in --		
Receivables, net	(54,815)	(8,246)
Inventories	867	(477)
Prepaid expenses and other current assets	1,919	(1,142)
Costs and estimated earnings in excess of billings	6,615	(2,547)
Other noncurrent assets	1,533	(367)
Increase (decrease) in --		
Accounts payable and accrued liabilities	16,272	8,482
Billings in excess of costs and estimated earnings	15,446	11,803
Other, net	(1,192)	(555)
Net cash provided by operating activities	23,304	41,778
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(14,687)	(4,642)
Proceeds from sales of property and equipment	1,477	460
Proceeds from businesses sold	--	964
Net cash used in investing activities	(13,210)	(3,218)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt	(235,772)	(186,373)
Borrowings of long-term debt	229,416	146,094
Proceeds from issuance of common stock	1,522	833
Repurchases of common stock	(1,224)	--
Net cash used in financing activities	(6,058)	(39,446)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,036	(886)
CASH AND CASH EQUIVALENTS, beginning of period	3,664	16,021
CASH AND CASH EQUIVALENTS, end of period	$ 7,700	$ 15,135

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

COMFORT SYSTEMS USA, INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2001
(UNAUDITED)

1. BUSINESS AND ORGANIZATION:

Comfort Systems USA, Inc., a Delaware corporation ("Comfort Systems" and collectively with its subsidiaries, the "Company"), is a leading national provider of comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services. The Company operates primarily in the commercial and industrial HVAC markets, and performs most of its services within manufacturing plants, office buildings, retail centers, apartment complexes, and healthcare, education and government facilities. In addition to standard HVAC services, the Company provides specialized applications such as process cooling, building automation control systems, electronic monitoring and process piping. Certain locations also perform related services such as electrical and plumbing.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation

These interim statements should be read in conjunction with the historical Consolidated Financial Statements and related notes of Comfort Systems included in the Annual Report on Form 10-K as filed with the Securities and Exchange Commission for the year ended December 31, 2000 (the "Form 10-K").

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

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

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, disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Flow Information

Cash paid for interest for the nine months ended September 30, 2000 and 2001 was approximately $18.8 million and $16.5 million, respectively. Cash paid for income taxes for the nine months ended September 30, 2000 and 2001 was approximately $12.1 million and $6.3 million, respectively.

Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS No. 141 also specifies criteria for recording intangible assets other than goodwill in connection with business combinations. SFAS No. 142 requires companies to assess goodwill assets for impairment each year, and more frequently if circumstances suggest an impairment may have occurred. SFAS No. 142 also introduces a more stringent framework for assessing goodwill impairment than the approach required under existing rules. In addition, SFAS No. 142 discontinues the regular charge, or amortization, of goodwill assets against income.

SFAS No. 141 is effective immediately. SFAS No. 142 is effective for the Company beginning January 1, 2002 and early adoption is not allowed for calendar year companies. Any impairment loss recognized in accordance with SFAS No. 142 will be shown as the cumulative effect of a change in accounting principle in the Company's income statement. Under this treatment, the Company's income statement would show after-tax results of operations both with and without the cumulative effect of the change in accounting principle recognizing an impairment.

The Company is currently reviewing these new accounting standards. Under existing standards, the Company recognizes a non-cash charge of approximately $3 million per quarter in its income statement to amortize its goodwill assets over 40-year lives. This amortization will be discontinued beginning on January 1, 2002 under the new standards.

The new requirements for assessing whether these goodwill assets have been impaired involve market-based information that may change prior to the new rules' effective date of January 1, 2002, and as noted above, early adoption is not allowed for the Company. As a result, the Company cannot yet determine whether it will have to recognize a goodwill impairment when the new rules become effective. However, based on a preliminary review of the new standards, and based on currently available information, the Company believes it is likely that it will have to record a non-cash goodwill impairment charge, and that the amount of that charge will be significant in relation to the Company's unamortized goodwill balance, which is expected to be approximately $438 million at December 31, 2001. If such a charge is necessary, the Company anticipates it would be recorded in the first quarter of 2002 when the new standards become effective. As noted above, if an impairment charge is recorded upon transition to the new standards, it will be reflected as the cumulative effect of a change in accounting principle.

The Company has specifically provided for the possibility of a non-cash goodwill impairment charge in its lending agreements with its banks, and accordingly expects no impact on its current bank credit facility if recognition of such an impairment charge becomes necessary.

In August 2001, the FASB issued SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." This Statement supercedes SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and the accounting and reporting provisions of APB 30, "Reporting the Results of Operations -- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The new standard will be effective beginning January 1, 2002, and the Company is currently reviewing and evaluating the effects this standard will have on the Company's reported financial condition, results of operations, and accounting policies and practices.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This standard requires entities to recognize all derivative instruments (including certain derivative instruments embedded in other contracts) as assets or liabilities in its balance sheet and measure them at fair value. The statement requires that changes in the derivatives' fair value be recognized currently in earnings unless specific hedge accounting criteria are met. The Company adopted this standard effective January 1, 2001 and there was no impact as the Company does not currently hold or trade derivative instruments.

Reclassifications

Certain reclassifications have been made in prior period financial statements to conform to current period presentation.

3. RESTRUCTURING CHARGES:

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

During the three and nine months ended September 30, 2000, the Company recorded restructuring charges of approximately $10.0 million and $10.3 million, respectively. During the remainder of fiscal 2000, the Company recorded restructuring charges of approximately $15.0 million. These charges were primarily associated with restructuring efforts at certain underperforming operations and the Company's decision to cease its e-commerce activities at Outbound Services, a subsidiary of the Company. As announced by the Company in the third quarter of 2000, management performed an extensive review of its operations during the second half of 2000. As part of this review, management decided to cease operating at three locations, sell five operations (including two smaller satellite operations), and merge two companies into other operations. The restructuring charges were primarily non-cash and included goodwill impairments of approximately $11.5 million and the writedown of other long-lived assets of approximately $8.5 million. The remaining restructuring items primarily include severance and lease termination costs. These restructuring actions are substantially complete. During the third quarter of 2001, the Company decided to retain one of the operations that was previously held for sale and reversed approximately $0.3 million of non-cash charges related to the anticipated loss on the sale of this operation. This amount was offset by an additional loss on the sale in late September 2001 of the final operation that was identified as part of this restructuring program. The losses associated with the other operations that were sold were consistent with the amounts recorded as restructuring charges in 2000.

Severance costs recorded in 2000 and 2001 relate to the termination of 147 employees (all of these employees were terminated as of June 30, 2001) including certain corporate personnel and the management and employees of certain underperforming locations, and to the departure of the Company's former chief executive officer. The following table shows the remaining liabilities associated with the cash portion of the restructuring charges as of September 30, 2001 (in thousands):

	BALANCE AT JANUARY 1, 2001	ADDITIONS	PAYMENTS	BALANCE AT SEPTEMBER 30, 2001
Severance	$1,218	$350	$(1,137)	$ 431
Lease termination costs and other	2,312	--	(1,152)	1,160
Total	$3,530	$350	$(2,289)	$1,591

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

	NINE MONTHS ENDED SEPTEMBER 30, 2000	2001
Revenues	$ 41,537	$ 6,337
Operating loss	$(12,853)	$(2,666)

4. REDUCTIONS IN NON-OPERATING ASSETS AND LIABILITIES, NET:

During the quarter ended June 30, 2000, the Company recorded a non-cash charge of approximately $5.2 million primarily related to the impairment of certain non-operating assets, principally notes receivable from former owners of businesses acquired by the Company. In addition, the Company recorded an impairment of approximately $0.8 million to its minority investment in two entities associated with the distribution and implementation of high-end engineering and design software. The Company also recorded a gain of approximately $0.6 million on the reduction of its subordinated note payable to a former owner in connection with the settlement of claims with this former owner.

5. LONG-TERM DEBT OBLIGATIONS:

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

	DECEMBER 31, 2000	SEPTEMBER 30, 2001 (UNAUDITED)
Revolving credit facility	$223,700	$190,000
Notes to affiliates and former owners	50,274	43,460
Other	627	448
Total debt	274,601	233,908
Less: current maturities	9,066	5,919
	$265,535	$227,989

Revolving Credit Facility

The Company amended its revolving credit facility (the "Credit Facility" or the "Facility") provided by Bank One, Texas, N.A. ("Bank One") and other banks (the "Bank Group") in March 2001. As amended, the Credit Facility provides the Company with a revolving line of credit of up to the lesser of $270 million or 80% of net accounts receivable. The Facility decreases to the lesser of $250 million or 80% of net accounts receivable as of December 31, 2001, and to the lesser of $240 million or 80% of net accounts receivable as of June 30, 2002. Borrowings under the Facility are secured by accounts receivable, inventory, fixed assets other than real estate, and the shares of capital stock of the Company's subsidiaries. The Credit Facility expires on January 1, 2003, at which time all amounts outstanding are due.

The Company has a choice of two interest rate options under the Facility. Under one option, the interest rate is determined based on the higher of the Federal Funds Rate plus 0.5% or Bank One's prime rate. An additional margin of 1% to 2% is then added to the higher of these two rates. Under the other interest rate option, borrowings bear interest based on designated short-term Eurodollar rates (which generally approximate London Interbank Offered Rates or "LIBOR") plus 2.5% to 3.5%. The additional margin for both options depends on the ratio of the Company's debt to earnings before interest, taxes, depreciation and amortization ("EBITDA"), as defined. Commitment fees of 0.375% to 0.5% per annum, also depending on the ratio of debt to EBITDA, are payable on the unused portion of the Facility.

The Credit Facility prohibits payment of dividends and the repurchase of shares by the Company, limits certain non-Bank Group debt, and restricts outlays of cash by the Company relating to certain investments, capital expenditures, vehicle leases, acquisitions and subordinate debt. The Credit Facility also provides for the maintenance of certain levels of shareholder equity and EBITDA, and for the maintenance of certain ratios of the Company's EBITDA to interest expense and debt to EBITDA.

Under the terms of the Credit Facility that were in effect as of June 30 and September 30, 2000, the Company was in violation of certain of the Facility's financial balance and ratio requirements. The Bank Group waived these violations. The Facility's current restrictions and financial balance and ratio requirements generally reflect tighter restrictions, greater specificity and smaller allowable variances on most financial balances and ratios than is typical for such agreements due to the Company's weaker results in 2000. The

Facility's current requirements also call for the Company to achieve comparable or modestly higher levels of quarterly EBITDA in 2002 as compared to the Company's actual results in the first three quarters of 2001, as well as lower ratios of debt to EBITDA, beginning in the fourth quarter of 2001, than the Company has achieved in recent quarters. While management believes its restructuring efforts and operating strategies along with general market conditions in the commercial/industrial HVAC and building automation controls industry will enable the Company to meet the Facility's requirements, there can be no assurance that the Company will be successful in doing so. Management intends to seek more flexible terms under its borrowing relationships as its results and credit market conditions allow.

As of September 30, 2001, the Company had $190.0 million in borrowings outstanding under the Credit Facility and had incurred interest expense at an average rate of approximately 9.2% per annum for the first nine months of 2001. The Credit Facility's interest rate terms as summarized above are effective as of March 22, 2001 and currently result in an all-in floating interest rate under the Facility of approximately 6.1%. As of September 30, 2001, the Company also had $2.6 million in letters of credit outstanding under the Facility, and unused borrowing capacity under the Facility of $77.4 million. As of November 9, 2001, $183.0 million in borrowings and $3.0 million in letters of credit were outstanding under the Facility, and $84.0 million in unused capacity was available.

Notes to Affiliates and Former Owners

Subordinated notes were issued to former owners of certain purchased companies as part of the consideration used to acquire their companies. These notes had an outstanding balance of $43.5 million as of September 30, 2001. These notes bear interest, payable quarterly, at a weighted average interest rate of 9.73%. In addition, $0.6 million of these notes are convertible by the holders into shares of the Company's common stock ("Common Stock") at a weighted average price of $24.25 per share.

As a result of the Company's covenant violations in 2000 under the Credit Facility, the Bank Group required that originally scheduled principal payments to subordinate debt holders be suspended. This requirement took effect in October 2000. The holders of the Company's subordinate debt generally must wait one year from any payment defaults to pursue collection remedies against the Company. In March 2001, the Company entered into amended agreements with subordinate debt holders representing $46.3 million in principal, including all the principal originally scheduled to be paid through 2001. These amended agreements allow for partial payments against certain originally scheduled payment amounts, defer remaining principal balances to April 2003, and increase the interest rate on this debt to 10% per annum, payable quarterly. Under these amended agreements, $6.6 million of principal has been paid from April 1, 2001 to November 9, 2001. The amended agreements also cured all defaults that arose from the suspension of principal payments to subordinate debt holders that began in October 2000. As a result of these amended agreements, the Company's annual maturities of subordinate debt are now $2.5 million for the remainder of 2001, $3.6 million in 2002, and $37.4 million in 2003.

Other Long-Term Obligation Disclosures

The Company anticipates that available borrowings under its Credit Facility and cash flow from operations will be sufficient to meet the Company's normal working capital and capital expenditure needs. As noted above, the Company has agreed to relatively tight restrictions under the Credit Facility. If the Company violates any of these restrictions, it will be required to negotiate new terms with its banks. There can be no assurance that in that event, the Company will receive satisfactory new terms from its banks, or that if the Company needs additional financing, that such financing can be secured when needed or on terms the Company deems acceptable.

6. COMMITMENTS AND CONTINGENCIES:

Claims and Lawsuits

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

Self-Insurance

The Company retains the risk for worker's compensation, employer's liability, auto liability, general liability and employee group health claims resulting from uninsured deductibles per accident or occurrence. Losses up to the deductible amounts are accrued based upon the Company's known claims incurred and an estimate of claims incurred but not reported. The accruals are based upon known facts and historical trends, and management believes such accruals to be adequate. A wholly owned insurance company subsidiary reinsures a portion of the risk associated with surety bonds issued by a third party insurance company. Because no claims have been made against these financial instruments in the past, management does not expect these instruments will have a material effect on the Company's consolidated financial statements.

7. STOCKHOLDERS' EQUITY:

Treasury Stock

On October 5, 1999, the Company announced that its Board of Directors had approved a share repurchase program authorizing the Company to buy up to 4.0 million shares of its Common Stock. During 1999, the Company purchased approximately 1.8 million shares at a cost of approximately $12.9 million. During 2000, the Company purchased approximately 0.2 million shares at a cost of approximately $1.2 million. Under the current terms of the Credit Facility, the Company is prohibited from purchasing additional shares of its Common Stock.

Restricted Common Stock

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

Each share of Restricted Voting Common Stock will automatically convert to Common Stock on a share-for-share basis (i) in the event of a disposition of such share of Restricted Voting Common Stock by the holder thereof (other than a distribution which is a distribution by a holder to its partners or beneficial owners, or a transfer to a related party of such holders (as defined in Sections 267, 707, 318 and/or 4946 of the Internal Revenue Code of 1986, as amended)), (ii) in the event any person acquires beneficial ownership of 15% or more of the total number of outstanding shares of Common Stock of the Company, or (iii) in the event any person offers to acquire 15% or more of the total number of outstanding shares of Common Stock of the Company. After July 1, 1998, the Board of Directors may elect to convert any remaining shares of Restricted Voting Common Stock into shares of Common Stock in the event 80% or more of the originally outstanding shares of Restricted Voting Common Stock have been previously converted into shares of Common Stock. As of September 30, 2001, there are 1,283,912 shares of Restricted Voting Common Stock remaining.

Earnings Per Share

Basic earnings per share ("EPS") is computed by dividing net income by the weighted average number of shares of common stock outstanding during the year. Diluted EPS is computed considering the dilutive effect of stock options and convertible subordinated notes. Options to purchase 4.0 million shares of Common Stock at prices ranging from $3.63 to $21.438 per share were outstanding for the three months and nine months ended September 30, 2001, respectively, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the respective average market price of the Common Stock. Options had an anti-dilutive effect for the three and nine months ended September 30, 2000 because the Company reported a net loss during these periods, and therefore, are not included in the diluted EPS calculation. Diluted EPS is also computed by adjusting both net earnings and shares outstanding as if the conversion of the convertible subordinated notes occurred on the first day of the year. The convertible subordinated notes had an anti-dilutive effect during the three months and nine months ended September 30, 2000 and 2001, and therefore, are not included in the diluted EPS calculation.

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,	
	2000	2001	2000	2001
Common shares outstanding, end of period	37,331	37,510	37,331	37,510
Effect of using weighted average common shares outstanding	(66)	(42)	98	(99)
Shares used in computing earnings per share -- basic	37,265	37,468	37,429	37,411
Effect of shares issuable under stock option plans based on the treasury stock method	--	305	--	38
Shares used in computing earnings per share -- diluted	37,265	37,773	37,429	37,449

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

INTRODUCTION

The following discussion should be read in conjunction with the historical Consolidated Financial Statements of Comfort Systems USA, Inc. ("Comfort Systems" and collectively with its subsidiaries, the "Company") and related notes thereto included elsewhere in this Form 10-Q and the Annual Report on Form 10-K as filed with the Securities and Exchange Commission for the year ended December 31, 2000 (the "Form 10-K"). This discussion contains forward-looking statements regarding the business and industry of Comfort Systems within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on the current plans and expectations of the Company and involve risks and uncertanties that could cause actual future activities and results of operations to be materially different from those set forth in the forward-looking statements. Important factors that could cause actual results to differ include risks set forth in "Factors Which May Affect Future Results," included in the Form 10-K.

The Company is a leading national provider of comprehensive heating, ventilation and air conditioning ("HVAC") installation, maintenance, repair and replacement services. The Company operates primarily in the commercial and industrial HVAC markets, and performs most of its services within manufacturing plants, office buildings, retail centers, apartment complexes, and healthcare, education and government facilities. In addition to standard HVAC services, the Company provides specialized applications such as process cooling, building automation control systems, electronic monitoring and process piping. Certain locations also perform related services such as electrical and plumbing.

RESULTS OF OPERATIONS

	THREE MONTHS ENDED SEPTEMBER 30,				NINE MONTHS ENDED SEPTEMBER 30,			
	2000		2001		2000		2001	
	(IN THOUSANDS)							
Revenues	$423,922	100.0%	$408,935	100.0%	$1,191,458	100.0%	$1,169,204	100.0%
Cost of services	352,838	83.2%	335,797	82.1%	978,869	82.2%	963,098	82.4%
Gross profit	71,084	16.8%	73,138	17.9%	212,589	17.8%	206,106	17.6%
Selling, general and administrative expenses	58,021	13.7%	52,735	12.9%	169,182	14.2%	158,230	13.5%
Goodwill amortization	3,151	0.7%	3,021	0.7%	9,483	0.8%	9,063	0.8%
Restructuring charges	9,959	2.3%	--	--	10,313	0.9%	238	--
Operating income (loss)	(47)	--	17,382	4.3%	23,611	2.0%	38,575	3.3%
Other income (expense)	(6,429)	(1.5)%	(4,976)	(1.2)%	(18,739)	(1.6)%	(17,239)	(1.5)%
Reductions in non-operating assets and liabilities, net	--	--	--	--	(5,190)	(0.4)%	--	--
Income (loss) before income taxes	(6,476)	(1.5)%	12,406	3.0%	(318)	--	21,336	1.8%
Income tax expense (benefit)	(2,787)		6,764		268		11,303	
Net income (loss)	$ (3,689)	(0.9)%	$ 5,642	1.4%	$ (586)	--	$ 10,033	

0.9% ======== ======== ==========
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Revenues -- Revenues decreased $15.0 million, or 3.5%, to $408.9 million for the third quarter of 2001 and decreased $22.3 million, or 1.9%, to $1.169 billion for the first nine months of 2001, compared to the same periods in 2000. The 3.5% decline in revenue for the quarter was comprised of a 2.4% decline in revenue related to operations that were sold or shut down since the third quarter of last year and a 1.1% decrease in revenues at ongoing operations. The 1.9% decline in revenue for the first nine months of 2001 was comprised of a 2.6% decline in revenue related to operations that were sold or shut down since the third quarter of last year which was partially offset by 0.7% of internal growth.

The Company's internal revenue growth rates are lower than the growth rates it experienced throughout 2000. This results in part from a general slowing in economic growth in the U.S. economy. The Company's revenue growth rates are also consistent with management's decreased emphasis on revenue growth in favor of improvement in profit margins, operating efficiency, and cash flow. In view of these factors, the Company may continue to experience modest revenue growth in upcoming periods. There can be no assurance, however, that this strategy will continue to lead to improved profit margins in the near term. In addition, if general economic activity in the U.S. slows significantly from current levels, the Company may realize further decreases in revenue growth and operating margins.

Gross Profit -- Gross profit increased $2.1 million, or 2.9%, to $73.1 million for the third quarter of 2001 and decreased $6.5 million, or 3.0%, to $206.1 million for the first nine months of 2001, compared to the same periods in 2000. As a percentage of revenues, gross profit increased from 16.8% for the three months ended September 30, 2000 to 17.9% for the three months ended September 30, 2001 and decreased from 17.8% for the first nine months of 2000 to 17.6% for the first nine months of 2001.

The Company's improvement in quarter-over-quarter gross profit percentage primarily resulted from significantly improved quarter-over-quarter results at three operations that performed poorly in the third quarter of 2000 due to execution shortfalls on certain sizeable projects.

The decline in year-to-date gross profit percentages is due to subpar gross profit performance from certain operations that are undergoing operational and management changes. The results of these operations generally improved in the third quarter as compared to the first half of 2001. The negative effect on gross profit percentage of these operations was largely offset by the divestiture of certain operations that performed poorly in 2000 and by the improvement in one of the Company's larger operations that performed poorly in 2000 due to execution shortfalls on a sizeable project.

Selling, General and Administrative Expenses ("SG&A") -- SG&A decreased $5.3 million, or 9.1%, to $52.7 million for the third quarter of 2001 and decreased $11.0 million, or 6.5%, to $158.2 million for the first nine months of 2001, compared to the same periods in 2000. As a percentage of revenues, SG&A decreased from 13.7% for the three months ended September 30, 2000 to 12.9% for the three months ended September 30, 2001, and decreased from 14.2% for the first nine months of 2000 to 13.5% for the first nine months of 2001. Excluding divested operations, SG&A decreased $1.9 million, or 3.5%, to $52.2 million for the third quarter of 2001, and decreased $2.3 million, or 1.5%, to $156.2 million for the first nine months of 2001, as compared to the same periods in 2000. Excluding divested operations, SG&A as a percentage of revenues decreased from 13.2% for the three months ended September 30, 2000 to 12.8% for the three months ended September 30, 2001, and decreased from 13.8% for the first nine months of 2000 to 13.4% for the first nine months of 2001. The decreases in SG&A primarily related to operations that were sold or shut down as well as a concerted effort to reduce SG&A throughout the Company.

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

During the three and nine months ended September 30, 2000, the Company recorded restructuring charges of approximately $10.0 million and $10.3 million, respectively, primarily associated with restructuring efforts at certain underperforming operations and its decision to cease its e-commerce activities at Outbound Services, a subsidiary of the Company. As announced by the Company in the third quarter of 2000, management performed an extensive review of its operations during the second half of 2000. As part of this review, management decided to cease operating at three locations, sell five operations (including two smaller satellite operations), and merge two companies into other operations. The restructuring charges were primarily non-cash and included goodwill impairments of approximately $11.5 million and the writedown of other long-lived assets of approximately $8.5 million. The remaining restructuring items primarily include severance and lease termination costs. These restructuring actions are substantially complete. During the third quarter of 2001, the Company decided to retain one of the operations that was previously held for sale and reversed approximately $0.3 million of non-cash charges related to the anticipated loss on the sale of this operation. This amount was offset by an additional loss on the sale in late September 2001 of the final operation that was identified as part of this restructuring program. The losses associated with the other operations that were sold were consistent with the amounts recorded as restructuring charges in 2000.

Reductions in Non-Operating Assets and Liabilities, Net -- During the quarter ended June 30, 2000, the Company recorded a non-cash charge of approximately $5.2 million primarily related to the impairment of certain non-operating assets, principally notes receivable from former owners of businesses acquired by the Company. In addition, the Company recorded an impairment of approximately $0.8 million to its minority investment in two entities associated with the distribution and implementation of high-end engineering and design software. The Company also recorded a gain of approximately $0.6 million on the reduction of its subordinated note payable to a former owner in connection with the settlement of claims with this former owner.

Income Tax Expense -- The Company's effective tax rates for the nine months ended September 30, 2001 and 2000 were 53.0% and (84.3%), respectively. The Company's provision for income taxes differs from the federal statutory rate primarily due to state income taxes (net of federal income tax benefit) and the non-deductibility of the amortization of goodwill attributable to certain acquisitions.

NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS No. 141 also specifies criteria for recording intangible assets other than goodwill in connection with business combinations. SFAS No. 142 requires companies to assess goodwill assets for impairment each year, and more frequently if circumstances suggest an impairment may have occurred. SFAS No. 142 also introduces a more stringent framework for assessing goodwill impairment than the approach required under existing rules. In addition, SFAS No. 142 discontinues the regular charge, or amortization, of goodwill assets against income.

SFAS No. 141 is effective immediately. SFAS No. 142 is effective for the Company beginning January 1, 2002 and early adoption is not allowed for calendar year companies. Any impairment loss recognized in accordance with SFAS No. 142 will be shown as the cumulative effect of a change in accounting principle in the Company's income statement. Under this treatment, the Company's income statement would show after-tax results of operations both with and without the cumulative effect of a change in accounting principle recognizing an impairment.

The Company is currently reviewing these new accounting standards. Under existing standards, the Company recognizes a non-cash charge of approximately $3 million per quarter in its income statement to amortize its goodwill assets over 40-year lives. This amortization will be discontinued beginning on January 1, 2002 under the new standards.

The new requirements for assessing whether these goodwill assets have been impaired involve market-based information that may change prior to the new rules' effective date of January 1, 2002, and as noted above, early adoption is not allowed for the Company. As a result, the Company cannot yet determine whether it will have to recognize a goodwill impairment when the new rules become effective. However, based on a preliminary review of the new standards, and based on currently available information, the Company believes it is likely that it will have to record a non-cash goodwill impairment charge, and that the amount of that charge will be significant in relation to the Company's unamortized goodwill balance, which is expected to be approximately $438 million at December 31, 2001. If such a charge is necessary, the Company anticipates it would be recorded in the first quarter of 2002 when the new standards become effective. As noted above, if an impairment charge is recorded upon transition to the new standards, it will be reflected as the cumulative effect of a change in accounting principle.

The Company has specifically provided for the possibility of a non-cash goodwill impairment charge in its lending agreements with its banks, and accordingly expects no impact on its current bank credit facility if recognition of such an impairment charge becomes necessary.

In August 2001, the FASB issued SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." This Statement supercedes SFAS No. 121 "Accounting for the Impairment of Long-Lived

Assets and for Long-Lived Assets to Be Disposed Of," and the accounting and reporting provisions of APB 30, "Reporting the Results of Operations -- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The new standard will be effective beginning January 1, 2002, and the Company is currently reviewing and evaluating the effects this standard will have on the Company's reported financial condition, results of operations, and accounting policies and practices.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow -- Cash provided by operating activities less customary capital expenditures plus the proceeds from asset sales is generally called free cash flow and, if positive, represents funds available to invest in significant operating initiatives, to acquire other companies or to reduce a company's outstanding debt or equity. If free cash flow is negative, additional debt or equity is generally required to fund the outflow of cash.

For the nine months ended September 30, 2001, the Company had free cash flow of $37.6 million, an increase of $27.5 million as compared to free cash flow of $10.1 million in the first nine months of 2000. This improvement primarily resulted from faster billing by the Company for its project work while modestly improving the average days to collect receivables once billed, as well as a decrease in net capital expenditures versus the prior year.

Cash used in financing activities for the nine months ended September 30, 2001 was $39.4 million and was primarily attributable to net payments of long-term debt of $40.3 million. Net cash used in financing activities for the nine months ended September 30, 2000 was $6.1 million and was primarily attributable to net payments of long-term debt primarily used for working capital and capital expenditures.

Revolving Credit Facility -- The Company amended its revolving credit facility (the "Credit Facility" or the "Facility") provided by Bank One, Texas, N.A. ("Bank One") and other banks (the "Bank Group") in March 2001. As amended, the Credit Facility provides the Company with a revolving line of credit of up to the lesser of $270 million or 80% of net accounts receivable. The Facility decreases to the lesser of $250 million or 80% of net accounts receivable as of December 31, 2001, and to the lesser of $240 million or 80% of net accounts receivable as of June 30, 2002. Borrowings under the Facility are secured by accounts receivable, inventory, fixed assets other than real estate, and the shares of capital stock of the Company's subsidiaries. The Credit Facility expires on January 1, 2003, at which time all amounts outstanding are due.

The Company has a choice of two interest rate options under the Facility. Under one option, the interest rate is determined based on the higher of the Federal Funds Rate plus 0.5% or Bank One's prime rate. An additional margin of 1% to 2% is then added to the higher of these two rates. Under the other interest rate option, borrowings bear interest based on designated short-term Eurodollar rates (which generally approximate London Interbank Offered Rates or "LIBOR") plus 2.5% to 3.5%. The additional margin for both options depends on the ratio of the Company's debt to earnings before interest, taxes, depreciation and amortization ("EBITDA"), as defined. Commitment fees of 0.375% to 0.5% per annum, also depending on the ratio of debt to EBITDA, are payable on the unused portion of the Facility.

The Credit Facility prohibits payment of dividends and the repurchase of shares by the Company, limits certain non-Bank Group debt, and restricts outlays of cash by the Company relating to certain investments, capital expenditures, vehicle leases, acquisitions and subordinate debt. The Credit Facility also provides for the maintenance of certain levels of shareholder equity and EBITDA, and for the maintenance of certain ratios of the Company's EBITDA to interest expense and debt to EBITDA.

Under the terms of the Credit Facility that were in effect as of June 30 and September 30, 2000, the Company was in violation of certain of the Facility's financial balance and ratio requirements. The Bank Group waived these violations. The Facility's current restrictions and financial balance and ratio requirements generally reflect tighter restrictions, greater specificity and smaller allowable variances on most financial balances and ratios than is typical for such agreements due to the Company's weaker results in 2000. The Facility's current requirements also call for the Company to achieve comparable or modestly higher levels of quarterly EBITDA in 2002 as compared to the Company's actual results in the first three quarters of 2001, as well as lower ratios of debt to EBITDA, beginning in the fourth quarter of 2001, than the Company has achieved in recent quarters. While management believes its restructuring efforts and operating strategies along with general market conditions in the commercial/industrial HVAC and building automation controls industry will enable the Company to meet the Facility's requirements, there can be no assurance that the Company will be successful in doing so. Management intends to seek more flexible terms under its borrowing relationships as its results and credit market conditions allow.

As of September 30, 2001, the Company had $190.0 million in borrowings outstanding under the Credit Facility and had incurred interest expense at an average rate of approximately 9.2% per annum for the first nine months of 2001. The Credit Facility's interest rate terms as summarized above are effective as of March 22, 2001 and currently result in an all-in floating interest rate under the Facility of approximately 6.1%. As of September 30, 2001, the Company also had $2.6 million in letters of credit outstanding under the Facility, and unused borrowing capacity under the Facility of $77.4 million. As of November 9, 2001, $183.0 million in borrowings and 3.0 million in letters of credit were outstanding under the Facility, and $84.0 million in unused capacity was available.

Notes to Affiliates and Former Owners -- Subordinated notes were issued to former owners of certain purchased companies as part of the consideration used to acquire their companies. These notes had an outstanding balance of $43.5 million as of September 30, 2001. These notes bear interest, payable quarterly, at a weighted average interest rate of 9.73%. In addition, $0.6 million of these notes are convertible by the holders into shares of the Company's common stock ("Common Stock") at a weighted average price of $24.25 per share.

As a result of the Company's covenant violations in 2000 under the Credit Facility, the Bank Group required that originally scheduled principal payments to subordinate debt holders be suspended. This requirement took effect in October 2000. The holders of the Company's subordinate debt generally must wait one year from any payment defaults to pursue collection remedies against the Company. In March 2001, the Company entered into amended agreements with subordinate debt holders representing $46.3 million in principal, including all the principal originally scheduled to be paid through 2001. These amended agreements allow for partial payments against certain originally scheduled payment amounts, defer remaining principal balances to April 2003, and increase the interest rate on this debt to 10% per annum, payable quarterly. Under these amended agreements, $6.6 million of principal has been paid from April 1, 2001 to November 9, 2001. The amended agreements also cured all defaults that arose from the suspension of principal payments to subordinate debt holders that began in October 2000. As a result of these amended agreements, the Company's annual maturities of subordinate debt are now $2.5 million for the remainder of 2001, $3.6 million in 2002, and $37.4 million in 2003.

Outlook -- The Company anticipates that available borrowings under its Credit Facility and cash flow from operations will be sufficient to meet the Company's normal working capital and capital expenditure needs. As noted above, the Company has agreed to relatively tight restrictions under the Credit Facility. If the Company violates any of these restrictions, it will be required to negotiate new terms with its banks. There can be no assurance that in that event, the Company will receive satisfactory new terms from its banks, or that if the Company needs additional financing, that such financing can be secured when needed or on terms the Company deems acceptable.

Treasury Stock -- On October 5, 1999, the Company announced that its Board of Directors had approved a share repurchase program authorizing the Company to buy up to 4.0 million shares of its Common Stock. During 1999, the Company purchased approximately 1.8 million shares at a cost of approximately $12.9 million. During 2000, the Company purchased approximately 0.2 million shares at a cost of approximately $1.2 million. Under the current terms of the Credit Facility, the Company is prohibited from purchasing additional shares of its Common Stock.

SEASONALITY AND CYCLICALITY

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk primarily related to potential adverse changes in interest rates. Management is actively involved in monitoring exposure to market risk and continues to develop and utilize appropriate risk management techniques.

COMFORT SYSTEMS USA, INC.

PART II -- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 2. RECENT SALES OF UNREGISTERED SECURITIES

During the three month period ended September 30, 2001, the Company did not issue any unregistered shares of its common stock.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None.

(b) Reports on Form 8-K

None.

ITEM 9. CHANGES AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

SIGNATURE

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.

By: /s/ J. GORDON BEITTENMILLER

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

Dated: November 13, 2001