COMFORT SYSTEMS USA INC
Form 10-Q/A
November 13, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q/A

(Amendment No. 1)

(Mark One)

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

For the quarterly period ended June 30, 2006

OR

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

For the transition period from to

Commission file number: **1-13011**

COMFORT SYSTEMS USA, INC.

(Exact name of registrant as specified in its charter)

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

777 Post Oak Boulevard

Suite 500

Houston, Texas 77056

(Address of Principal Executive Offices) (Zip Code)

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

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

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

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

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

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

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

Explanatory Note

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

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

COMFORT SYSTEMS USA, INC.
CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share Amounts)

	December 31, 2005	June 30, 2006 (Unaudited)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 55,593	$ 67,091
Accounts receivable, less allowance for doubtful accounts of $3,538 and $3,248, respectively	195,025	229,685
Receivable from sale of operations	23,800	
Other receivables	5,784	4,171
Inventories	8,083	9,569
Costs and estimated earnings in excess of billings	22,512	28,923
Prepaid expenses and other	11,282	11,056
Assets related to discontinued operations	3,996	992
Total current assets	326,075	351,487
PROPERTY AND EQUIPMENT, net	12,705	14,063
GOODWILL	62,954	62,954
OTHER NONCURRENT ASSETS	6,949	6,421
Total assets	$ 408,683	$ 434,925
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$	$
Accounts payable	71,922	76,231
Accrued compensation and benefits	29,347	25,729
Billings in excess of costs and estimated earnings	53,279	70,942
Accrued self insurance expense	17,350	19,093
Income taxes payable	7,615	
Other current liabilities	14,338	14,480
Liabilities related to discontinued operations	1,309	678
Total current liabilities	195,160	207,153
LONG-TERM DEBT, NET OF CURRENT MATURITIES		
Total liabilities	195,160	207,153
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY:		
Preferred stock, $.01 par, 5,000,000 shares authorized, none issued and outstanding		
Common stock, $.01 par, 102,969,912 shares authorized, 39,979,867 and 40,656,958 shares issued, respectively	400	407
Treasury stock, at cost, zero and 22,638 shares, respectively		(306)
Additional paid-in capital	340,264	341,429
Deferred compensation	(1,135)	
Retained earnings (deficit)	(126,006)	(113,758)
Total stockholders equity	213,523	227,772
Total liabilities and stockholders equity	$ 408,683	$ 434,925

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

1

COMFORT SYSTEMS USA, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

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

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

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

COMFORT SYSTEMS USA, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(In Thousands, Except Share Amounts)

	Common Stock Shares	**Amount**	**Treasury Stock Shares**	**Amount**	**Additional Paid-In Capital**	**Deferred Compensation**	**Retained Earnings (Deficit)**	**Total Stockholders Equity**
BALANCE AT DECEMBER 31, 2004	39,258,913	$ 393	(24,462)	$ (148)	$ 337,719	$ (1,587)	$ (119,780)	$ 216,597
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit	650,954	6	114,959	835	2,987			3,828
Issuance of restricted stock	82,500	1			574	(575)		
Shares received in lieu of tax witholding payment on vested restricted stock			(40,797)	(318)				(318)
Forfeiture of unvested restricted Stock	(12,500)		(50,000)	(372)	(74)	360		(86)
Dividends					(999)			(999)
Amortization of deferred compensation					60	667		727
Other			300	3	(3)			
Net loss							(6,226)	(6,226)
BALANCE AT DECEMBER 31, 2005	39,979,867	400			340,264	(1,135)	(126,006)	213,523
Issuance of Stock:								
Issuance of shares for options exercised including tax benefit (unaudited)	539,591	6	38,722	480	3,661			4,147
Issuance of restricted stock (unaudited)	137,500	1			(1)			
Shares received in lieu of tax witholding payment on vested restricted stock (unaudited)			(46,985)	(597)				(597)
FAS 123 (R) adoption (unaudited)					(1,135)	1,135		
Stock-based compensation expense, (unaudited)					999			999
Forfeiture of unvested restricted stock (unaudited)			(14,375)	(189)	151			(38)
Tax benefit from vesting of restricted stock (unaudited)					316			316
Dividends (unaudited)					(2,826)			(2,826)
Net income (unaudited)							12,248	12,248
BALANCE AT JUNE 30, 2006 (UNAUDITED)	40,656,958	$ 407	(22,638)	$ (306)	$ 341,429	$	$ (113,758)	$ 227,772

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

3

COMFORT SYSTEMS USA, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)
(Unaudited)

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

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

4

COMFORT SYSTEMS USA, INC.
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2006
(Unaudited)

1. Business and Organization

Comfort Systems USA, Inc., a Delaware corporation (Comfort Systems and collectively with its subsidiaries, the Company), is a national provider of comprehensive heating, ventilation and air conditioning (HVAC) installation, maintenance, repair and replacement services within the mechanical services industry. The Company operates primarily in the commercial, industrial and institutional HVAC markets, and performs most of its services within office buildings, retail centers, apartment complexes, manufacturing plants, and healthcare, education and government facilities. In addition to standard HVAC services, the Company provides specialized applications such as building automation control systems, fire protection, process cooling, electronic monitoring and process piping. Certain locations also perform related activities such as electrical service and plumbing. Approximately 61% of the Company s consolidated 2006 revenues to date are attributable to installation of systems in newly constructed facilities, with the remaining 39% attributable to maintenance, repair and replacement services. The following service activities account for the Company s consolidated 2006 revenues to date: HVAC 74%, plumbing 18%, building automation control systems 3%, and other 5%. These service activities are within the mechanical services industry which is the single industry segment served by Comfort Systems.

2. Summary of Significant Accounting Policies

Basis of Presentation

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

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

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

Cash Flow Information

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

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

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

Segment Disclosure

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

Use of Estimates

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

Income Taxes

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

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

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

6

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

New Accounting Pronouncements

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

Reclassifications

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

3. Discontinued Operations

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

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

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

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

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

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

	Six Months Ended June 30, 2005	2006
Revenues	$ 21,875	$ 2,518
Pre-tax loss	$ (1,507)	$ (317)

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

Sale of Companies to Emcor In March 2002, the Company sold 19 operations to Emcor Group, Inc. (Emcor). The total purchase price was $186.25 million, including the assumption by Emcor of approximately $22.1 million of subordinated notes to former owners of certain of the divested companies. Of Emcor s purchase price, $5 million was deposited into an escrow account to secure potential obligations on the Company s part to indemnify Emcor for future claims and contingencies arising from events and circumstances prior to closing, all as specified in the transaction documents. Of this escrow, $4 million has been applied in determining the Company s liability to Emcor in connection with the settlement of certain claims. The remaining $1 million of escrow is available for book purposes to apply to any future claims and contingencies in connection with this transaction, and has not been recognized as part of the Emcor transaction purchase price.

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

4. Restructuring Charges

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

8

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

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

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

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

5. Long-Term Debt Obligations

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

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

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

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

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

6. Commitments and Contingencies

Claims and Lawsuits

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

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

Surety

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

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

Self-Insurance

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

10

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

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

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

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

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

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

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

7. Stockholders Equity

Long-Term Incentive Plans

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

The Company will make all future grants und