

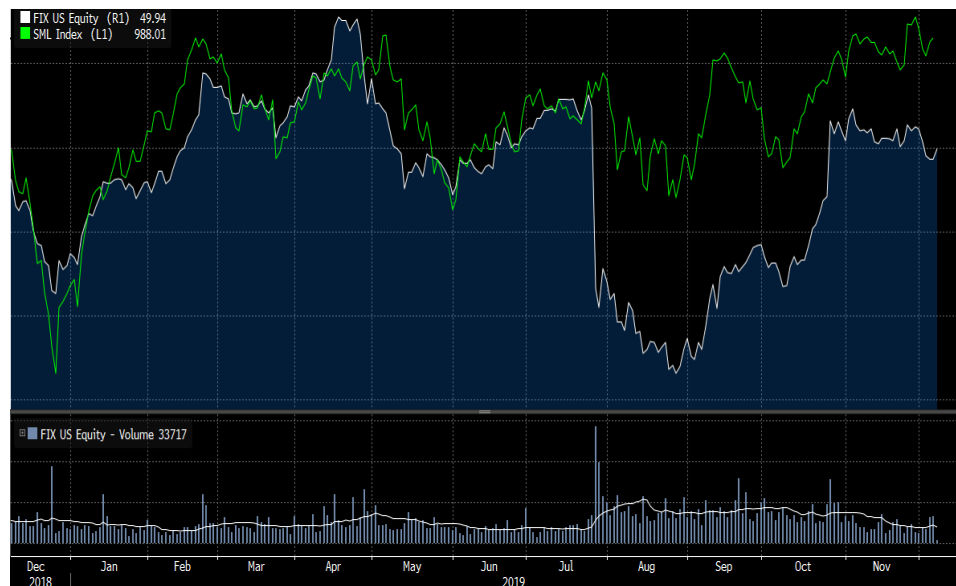
Comfort Systems USA, Inc. (FIX) is a domestically diversified industrials company whose business model revolves around providing an array of services that keep buildings, primarily commercial, comfortable, efficient, and safe. The company's operations involve a plethora of various business segments that can be divided into three main areas of focus; construction, building services and maintenance, and retrofit. Specifically, Comfort System's range of services includes heating, ventilation and air conditioning ("HVAC"), plumbing, piping and controls, as well as off-site construction, electrical, monitoring, and fire protection services. Comfort Systems primarily operates in the commercial and industrial markets, targeting industrial, healthcare, education, office, technology, retail, and government facilities throughout 36 operating units, with 128 locations in 114 cities throughout the United States.

Market Buy

Current Price: \$49.65
Target Price: \$58.23
Market Cap: 1.9B
Beta: 1.0

ROIC: 15.68%
WACC: 9.31%
Kd: 4.36%
Ke: 10.32%

Operating Margin: 6.24%
Gross Margin: 19.63%
ROE: 20.07%
D/E: .43x



Thesis:

I view FIX as an operationally *stable* and financially *consistent* industrials company. Comfort System's focus on key competencies including operating efficiencies, expertise in key target markets, a diverse revenue distribution model, and an emphasis on building and maintaining strong customer relationships through service and safety initiatives, have all contributed to the company's steady improvements in financials nearly across the board for several years. Comfort System's recent attention on strategic acquisitions as well as their industry topping multiples to date, including an ROE percentage better than 92% of peers, coupled by overall forward-looking revenues/earnings, all point to a continuation in the growth trends of FIX's operations and financial outlook. Lastly, Comfort System's diverse business model, by design, limits the company's exposure to macroeconomic declines in the United States that could adversely affect their earnings potential from both a supply chain and service provider perspective going forward. Hence, FIX offers significant upside, stemming from various structural pluses that far out way the operational risks that the company faces, thus supporting a long position for the coming year.

Stock Catalysts:

- Solid underlying income statement and balance sheet fundamentals (short term)
- Large increase in 2019 backlog (short term)
- Contributions of tuck-in acquisitions to Comfort System's bottom line (short-mid-term)
- Industry stability that Comfort System's low-cost, diverse business operations will seek to take advantage of in future years. (mid-long-term)

Business Operations Summary:

As you can see in figure 1, Comfort System's project base is spread out among several segments. Approximately 38% of revenue was attributable to installation services in newly constructed facilities and 62.0% was attributable to renovation, expansion, maintenance, repair and replacement services in existing buildings. Moreover, the majority of the company's overall business comes from the HVAC and plumbing business segments supporting just over 90.5% of total revenue in FY 2018.

Figure 1

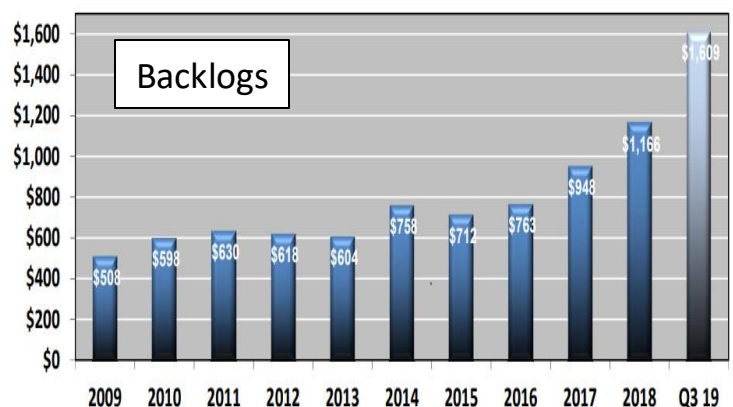
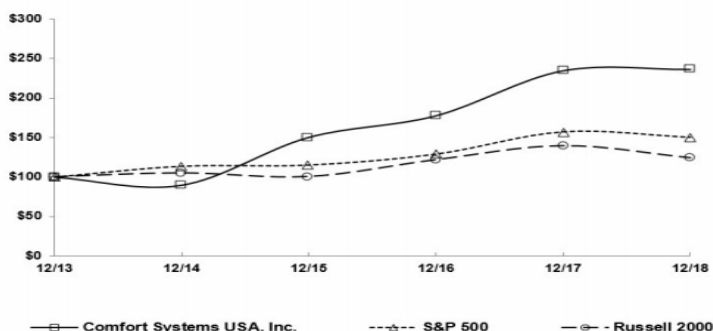
Industrial	27.3 %
Education	18.0 %
Office Buildings	13.2 %
Healthcare	14.7 %
Government	6.6 %
Retail, Restaurants and Entertainment	10.3 %
Multi-Family and Residential	6.2 %
Other	3.7 %
Total	100.0 %

Figure 2

Service Activity	Percentage of Revenue
HVAC and Plumbing	90.5 %
Building Automation Control Systems	4.4 %
Other	5.1 %
Total	100.0 %

Further, the historical success of Comfort System's operations is better depicted from its outperforming of not only its comparable small cap. index, the Russel 2000, but also the S&P 500 over the past 3.5 years. This illustrates how FIX is able to translate healthy operations into a healthy stock returns for investors. Moreover, I predict this trend to continue going forward, especially considering the consistent and lately explosive 38% increase in the company's backlog from 2018 to Q3 of this year. This illustrates that the demand for Comfort System's services have consistently been rising, and are certainly not going anywhere in the future. Investors can expect this increase to translate to improved revenues in the coming quarters. Much of the company's success in this regard can also be illustrated by their peer leading ROE multiple.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
Among Comfort Systems USA, Inc., the S&P 500 Index
and the Russell 2000 Index



Comfort Systems also attributes its operating success to its dedication to limiting costs via operating efficiencies. This includes an emphasis on improving the company's "job loop" at their locations by qualifying, estimating, pricing, and executing projects effectively and efficiently via purchasing advantages on products and services such as HVAC components, raw materials, services, vehicles, etc. Comfort Systems also actively implements cost saving measures in its operations by leveraging resources among operating locations. One such example of this practice includes shifting fabrication activities to centralized locations in order to increase asset utilization.

Comfort systems USA also uses relatively low amounts of debt to finance its operations compared to peers, with a D/E ratio of .43x opposed to the industry's 1.79x average, greatly reducing risk and interest expenses. To this end, the rise in long-term debt seen in the company's most recent 10Q is addressed latter in this report.

Industry Outlook:

Outlook:

Analysts predict that the Machinery, Equipment & Components industry will perform similarly to the market over the next year. Currently the industry ranks 28th out of 54 total industries to date. As illustrated by Comfort Systems business model, this industry primarily consists of tools, hardware, machinery, industrial components, and equipment, and is rather cyclical. Overall, the sector has performed well over the past couple years, seeing stable to rising valuation multiples. The industry's risk exposure includes volatility in equipment and commodity prices, shifts in demand for construction and energy services, as well as the overall outlook for the macro-economy. Further, according to analysts, the emergence of AI technologies may have a significant effect on how companies within this industry operate, forcing them to rework their business models by better integrating such AI technologies.

Fundamentals and performance:

The industry has seen revenue and EPS growth of 3% and 11% respectively over the last 12 months. The Industry's P/S and P/B ratios are also currently outpacing the sector average at 2.09x and 1.38x respectively. Moreover, the industrials sector as a whole has currently seen positive gains in line with the S&P 500 index as illustrated below.

- Year-to-date – up 24.4%, S&P 500 up 24.6%
- One year – up 14.0%, S&P 500 up 15.2%
- Five years - up 40.2%, S&P 500 up 50.0%

Index Performance Data by Lucas DeSantis, Analyst

Earnings and Income:

Comfort Systems has shown consistent growth in its earnings ability with 92% EBIDTA growth YTD since 2015 and steady 57% revenue growth of over the same time span. Moreover, with gross and operating margins at 19.63% and 6.24% TTM respectively, FIX has proven its capacity to maintain and increase profitability through healthy revenues and effective cost management. Despite the company's booming 2018 fiscal year, due in part to acquisitions, we see that FIX was able to generate consistent increases in earning and revenues for several years prior. As such, I see no reason to why the company cannot continue this trend going forward, following the company's pursuit for expansion via its acquisitions. To this end, the company's EPS has seen a pleasing spike for investors as of late, projected to remain constant through the coming years. Finally, Comfort Systems has experienced a slight decline in its overall net income in 2017 and 2019 LTM. However, this is no reason for major concern as these declines can be best personified as "growing pains" from acquisitions. FIX's steady increase in business and earnings throughout the past 5 years support the notion that various temporary increases in expenses on the company's balance sheet are playing a significant role offsetting net income

growth. Therefore, this decline can be viewed as temporary, as the company's income is forecasted to return to levels of growth next year.

In Millions of USD 12 Months Ending	2015 Y 12/31/2015	2016 Y 12/31/2016	2017 Y 12/31/2017	2018 Y 12/31/2018	Current/LTM 09/30/2019	2019 Y Est 12/31/2019	2020 Y Est 12/31/2020
Market Capitalization	1,063.7	1,239.1	1,623.2	1,611.5	1,874.1		
- Cash & Equivalents	56.5	32.1	36.5	45.6	40.4		
+ Preferred & Other	18.3	0.0	0.0	0.0	0.0		
+ Total Debt	11.5	2.8	60.5	76.9	328.8		
Enterprise Value	1,037.0	1,209.8	1,647.2	1,642.8	2,162.6		
Revenue, Adj	1,580.5	1,634.3	1,787.9	2,182.9	2,484.1	2,593.5	2,758.0
Growth %, YoY	12.0	3.4	9.4	22.1	20.8	18.8	6.3
Gross Profit, Adj	318.1	344.0	366.3	446.3	487.6	493.6	532.3
Margin %	20.1	21.0	20.5	20.4	19.6	19.0	19.3
EBITDA, Adj	112.6	127.0	137.2	192.0	215.9	208.0	223.5
Margin %	7.1	7.8	7.7	8.8	8.7	8.0	8.1
Net Income, Adj	48.6	63.9	44.0	110.5	109.0	107.3	120.7
Margin %	3.1	3.9	2.5	5.1	4.4	4.1	4.4
EPS, Adj	1.28	1.69	1.17	2.94	2.93	2.92	3.21
Growth %, YoY	106.9	32.3	-30.8	150.6	35.1	-0.6	10.0
Cash from Operations	97.9	91.2	114.1	147.2	178.9		
Capital Expenditures	-20.8	-23.2	-35.5	-27.3	-27.9	-30.0	-32.0
Free Cash Flow	77.1	68.0	78.6	119.9	151.1	100.0	113.0

Exhibit 1: Interest Expense—"Interest expense increased \$0.6 million, or 17.6%, in 2018. The increase reflects the increase in the variable interest rate on our revolving credit facility as well as an increase in notes to former owners as a result of our recent acquisitions." - 2019 10k

	Year Ended December 31,	
	2018	2017
	(in thousands)	
SG&A	\$ 296,986	\$ 266,586
Less: SG&A from companies acquired	(7,860)	—
Less: Amortization expense	(17,307)	(11,759)
Same-store SG&A, excluding amortization expense	\$ 271,819	\$ 254,827

Exhibit 2: Interest Expense—"Interest expense increased \$0.8 million, or 34.6%, in 2017. The increase reflects the increased borrowings on the revolving credit facility as well as notes to former owners used to fund the BCH acquisition during the second quarter of 2017." – 2019 10k

	Year Ended December 31,	
	2017	2016
	(in thousands)	
SG&A	\$ 266,586	\$ 243,201
Less: SG&A from companies acquired	(10,493)	—
Less: Amortization expense	(11,759)	(6,165)
Same-store SG&A, excluding amortization expense	\$ 244,334	\$ 237,036

Strategic Acquisitions:

Over the course of the company's existence, Comfort Systems has made several different strategic acquisition to help expand the company's scope of operations. Four of which have occurred over the past few years. The first was the acquisition of ShoffnerKalthoff Mechanical Electrical Service, Inc. based out of Tennessee in 2016. The second was the purchase of an Indiana based company whose operations similarly aligned with FIX. This tuck-in acquisition took place in 2018, increased the company's amount of operation location across the country to 36. The third purchase was of mechanical construction company, BCH holdings inc. in 2018. Finally, Comfort System's most recent acquisition was of

Texas based company, Walker TX Holding Company, LLC in April of 2019. Walker TX was a full-service electrical contracting and network infrastructure engineering business serving commercial and industrial clients. Overall, Comfort systems had been active over the past 4 years in acquiring companies that align with their current operation, and that can be easily integrated into their business model. The Comfort Systems has also recently amended its senior credit facility, now extending out into 2023. This, coupled with the above-mentioned acquisitions suggests that the company is ambitious in growing the size of its operation in the U.S.; a positive sign for revenues and earnings growth in the future. [The recent acquisitions of Walker and others, and therefore these companies' debt levels, in addition to the extension of Comfort System's credit line/loans from several syndicate banks also explains the spike in long-term debt seen on the company's financial statements.]

2019 Q3 Update:

Comfort Systems USA saw a positive third quarter this year, beating estimates for the first time since Q4 of 2018. Q3 2019 saw a 16.67% earnings surprise, beating EPS estimates by .14. Overall, financial results for the company are as follows:

- Q3 Revenue increased \$112.4 million to \$706.9 million YOY
- EPS was \$0.98 per diluted share
- Q3 2019 Cash Flow from Operations was \$73.1 million, up significantly from last quarter's \$25.6 million total; an increase of 186%
- Q3 2019 Backlog of \$1.61 billion
- The quarter did see a slight decline in gross profit of 1.3% YOY

Overall, FIX's latest quarter can be received a solid, driven by positive earnings growth and cash flow. The company is looking to ride this momentum into the coming quarters and increase its overall profitability, especially considering its rise in backlog going forward.

Value Creation:

We can see that since late 2014, the company has consistently been creating value from its operations. This is clearly illustrated by the adjacent graph. Comfort System's total cost to an investor, denoted by the firm's weighted average cost of capital has historically existed well below that of its total return on invested capital. This is an important historical trend to identify because it shows both Comfort System's continued ability to bring value the company and to its shareholders while also highlighting a proven track record of effective operations over the last five years. This illustrates Comfort System's financial dependability, which is especially crucial in clamming investor nerves in the wake of an ongoing trade war and an uncertain future for the United States economy.

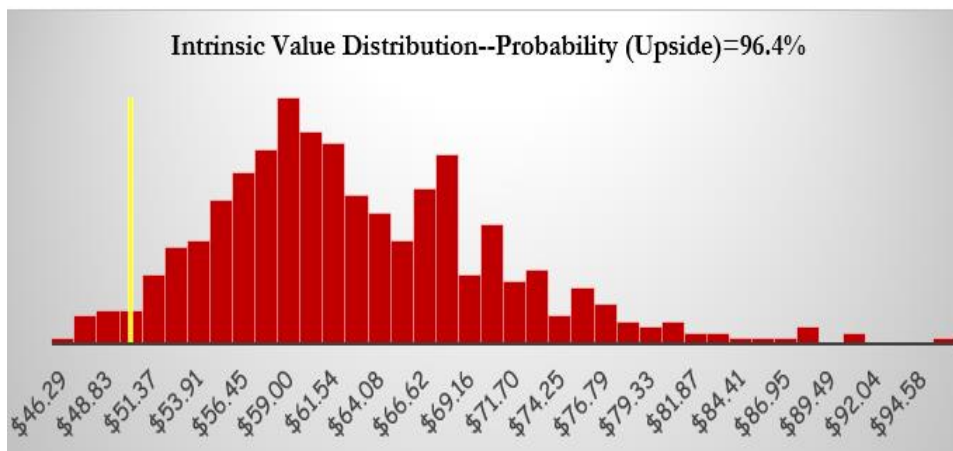


Conclusion:

Comfort Systems USA is in a good place both financially and especially operationally. The company has positive momentum going into the coming quarters as well as intriguing prospects for further growth in the long term. FIX has proven to be a consistent value creator, whose fundamentals have remained stable over the past several years, especially considering the tribulation in the recent macroeconomic scene as it relates to trade uncertainties and rising input prices for companies such as FIX. I believe that if Comfort Systems is further able to innovate its low cost structure, maintain pipeline business, as well as continue to grow, including the pursuit of acquisitions, that there is no reason why the company will not see both organic and inorganic growth as a whole. All considered, I believe that the purchase of FIX at a sub 50's price range is an ideal entry point for the stock that will fuel maximum return in a long position.

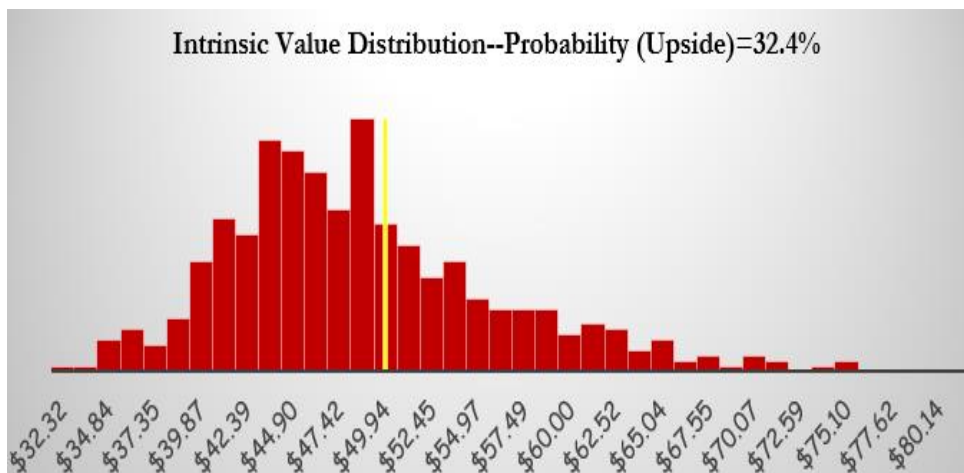
Base Case Valuation:

My base case valuation assumes what I have as identified as being the most accurate picture of the company and its stock price going forward. As such, it is the valuation model that I have used to arrive at my 1-year target price for the stock. It assumes modest, yet realistic risk premiums, tax rates, and revenue growth based upon the current landscape facing the company as well as taking into account other top rated analysts' projections for the company in the coming year. As you can see, this base model, despite a conservative valuation, still yields a 96.4% upside for the stock and supports a 1-year target price of \$58.23.



Extreme Bear Case Valuation:

My bear case valuation for this company is based on very aggressive cuts to the company's EBITDA margin and revenue growth, as well as increases to the company's capital expenditures and cost of debt; past levels identified as likely/justifiable by my proforma forecast. I have chosen to depress the company in these areas because they are the specific areas that prove the most sensitive to driving the stock price overall, based on a sensitivity analysis also constructed in my forecast. Overall, these changes reflect the event of a depressed economy and an increasingly risky landscape that could adversely affect the operations of Comfort Systems USA. Even so, this valuation still yields a 32.4% probability upside.



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FIX

Comfort Systems USA, Inc.

Symbol: FIX

Analyst

Alexander Zurlo

Buy below

\$50.94

Sell above

\$60.11

Probability of Price Increase

98%

Last Price

\$49.65

Intrinsic Value

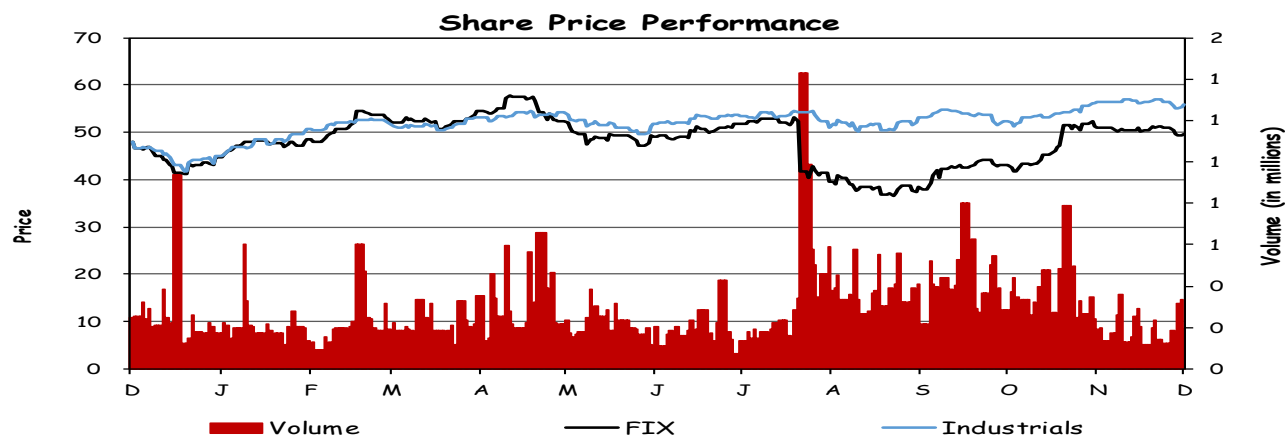
\$52.63

Target Dividends

\$0.36

Target Price

\$58.23



Description

Comfort Systems USA, Inc. provides mechanical installation, renovation, maintenance, repair, and replacement services for the mechanical services industry in the United States.

Sector

Industrials

Industry

Construction and Engineering

Last Guidance

December 11, 2018

Next earnings date

February 20, 2020

People

Lane, Brian, CEO, President & Director

George, William, Executive VP & CFO

Shaeff, Julie, Senior VP & Chief Accounting Officer

McKenna, Trent, Senior VP & VP - Region 4

Jones, Jeremy, VP & Chief Information Officer

Howell, Laura, VP, General Counsel & Corporate Secretary

Top Competitors

Dycom Industries, Inc.

Granite Construction Incorporated

MYR Group Inc.

Quanta Services, Inc.

Fluor Corporation

Primoris Services Corporation

Telidyne Inc.

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MasTec, Inc.

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CENTER FOR GLOBAL FINANCIAL STUDIES			FIX		Friday, December 6, 2019			Page 2
Comfort Systems USA, Inc.		Symbol: FIX	Cost of Capital Estimates					
Analyst	Alexander Zurlo			CGFS Credit Rating	Credit Rating Model	Probability of Default ModelModel		
Buy below	\$50.94		Implied Cost of Borrowing (FIX)	5.1%	5.1%	4.8%		
Sell above	\$60.11		Implied Cost of Borrowing (Peers)	6.3%	5.1%	6.4%		
Probability of Price Increase	98%			Base Year	Explicit Period (15 years)	Continuing Period		
Last Price	\$49.65		Cost of New Debt Estimate	3.76%		4.36%	4.36%	
Intrinsic Value	\$52.63		Country Risk Premium Estimate	5.96%		5.96%	5.96%	
Target Dividends	\$0.36		Cost of Equity Estimate	9.72%		10.32%	10.32%	
Target Price	\$58.23		WACC Estimate	8.65%		9.23%	9.23%	
Forecast Assumptions								
Fiscal Year	Revenue Growth	EBITDA Margin	CAPEX/Revenue	DPR/CAPEX	Other			
Base Year (Actual)	21.65%	8.0%	1.2%	1.57	SBC/Revenue	0.24%		
year 1	20.27%	4.9%	1.2%	1.66		Constant/same as LTM		
year 2	6.00%	7.7%	1.2%	1.56	Lease term	10		
year 3	9.00%	8.6%	1.2%	1.49	Rent Expense/Revenue	1.17%		
year 4	8.00%	8.4%	1.1%	1.45		Tappers off to historical average		
year 5	8.00%	8.3%	1.1%	1.41	R&D life	10		
year 6	7.00%	8.1%	1.0%	1.37	R&D Expense/Revenue	0.00%		
year 7	7.00%	7.9%	1.0%	1.34		Constant/same as LTM		
year 8	6.00%	7.7%	0.9%	1.30	LIFO Reserve	Tappers off to zero		
year 9	6.00%	7.5%	0.9%	1.26	Non-operating pension costs	Tappers off to zero		
year 10	5.00%	7.3%	0.8%	1.22	Net financing pensions costs	Tappers off to zero		
year 11	5.00%	7.2%	0.8%	1.19	Overfunded pension plans	Tappers off to zero		
year 12	4.00%	7.0%	0.7%	1.15	Capitalized interests	Constant/same as LTM		
year 13	4.00%	6.8%	0.7%	1.11	Dividends/Revenue	0.07%		
year 14	3.00%	6.6%	0.6%	1.07	Tax Rate	26.18%		
year 15	3.00%	6.2%	0.6%	1.04				
Continuing Period	2.50%	6.2%	1%	1.00				
Simulation Assumptions								
Random Variables	Distribution Assumption	MAX	Likely	MIN	Sensitivity: Price Variance Attribution Analysis			
Deviations in annual Revenue Growth--Expl. Per.	Triangular	2.24%	0%	-8.50%	6.14%	Revenue growth		
Deviations in annual Revenue Growth --Cont. Per.	Normal	1.41%	0%	-1.41%	30.91%	EBITDA Margin		
Deviations from EBITDA Margin base annual estimates	Triangular	1.98%	0%	-0.56%	41.76%	CAPEX/Rev		
Deviations from CAPEX/Revenue base annual estimates	Triangular	2.52%	0%	0.67%	15.32%	Discount Rate		
Deviations from Kd base annual estimates	Triangular	2.42%	0%	-2.95%	0.00%	TEV/Rev		
Deviations from CRP base annual estimates	Triangular	1.82%	0%	-1.92%	0.00%	TEV/EBITDA		
Deviations from TEV/Revenue base estimate	Triangular	0.30	0%	-0.36	0.00%	P/BV		
Deviations from TEV/Revenue base estimate	Triangular	0.91	0%	-2.02	0.00%	P/E		
Change in P/BV (TTM)	Triangular	1.21	0%	-0.63	0.00%	Asset Recovery Rate		
Change in P/E (FW)	Triangular	8.71	0%	-1.14	0.00%			
Recovery Rate	Triangular	10.00%	0%	-10%	0.00%			
Valuation								
DCF Valuation				Intrinsic Value Distribution--Probability (Upside)=97.6%				
	Base	Explicit Period (Average)	Continuing Period					
Revenues	\$2,484.05	\$4,095.00	\$5,836.99					
EBITDA Margin	7%	7%	6%					
UFCF	-\$15.97	\$191.91	\$257.75					
WACC	8.65%	9.23%	9.23%					
ROIC	10.42%	16.29%	18.05%					
Relative Valuation								
	Median Justified Multiple	Basis	Implied Equity Value					
EV/Rev (FW)	0.5x	\$2,634.29	\$916.00					
EV/EBITDA (FW)	7.1x	\$142.31	\$565.20					
P/BV (TTM)	1.6x	\$566.47	\$904.89					
P/E (FW)	11.9x	\$70.14	\$835.74					
Asset Based Valuation								
Recovery Rate	60%			Valuation Summary	Intrinsic Value	Target Price	Model Weight	
Capital	\$2,110.31			DCF Valuation	\$ 53.73	\$ 59.32	100%	
Intangibles	\$498.94			EV/Rev (FW)	\$ 24.42	\$ 26.14	0%	
Claims	\$525.50			EV/EBITDA (FW)	\$ 15.07	\$ 15.98	0%	
Implied Equity Value	\$441.33			P/BV (TTM)	\$ 24.12	\$ 25.82	0%	
				P/E (FW)	\$ 22.28	\$ 23.82	0%	
				Asset Based Valuation	\$ 11.77	\$ 12.39	0%	
				Price per Share	\$ 53.73	\$ 59.32	100%	