

With headquarters in Houston Texas, Comfort Systems USA, Inc. is a leader in installation and service for building mechanical systems. The company builds, services or retrofits mechanical, HVAC, and electrical systems in a variety of industries. The company provides comprehensive mechanical contracting services for heating, ventilation and air conditioning, plumbing, piping, and system controls. Comfort Systems also operate as an off-site provider of construction, electrical, monitoring, and fire protection necessities. After merging with the best regional experts, Comfort Systems now operates nationwide through 36 subsidiary companies.

BUY/HOLD/SELL

Current Price:	\$43.05
Target Price:	\$50.98
Market Cap:	1.6B
Volume:	93,963
Sales Growth:	5.71%
EBITDA Growth	8.00%
ROIC:	15.92
WACC:	11.6



Thesis:

Comfort Systems' stock will experience strong gains in upcoming quarters as the company will experience strong revenue growth, improving operations, and expansion of their service and maintenance segment. The stock will gain from consumer investment within the industrial market and demand for Comfort Systems' necessity based products. The industry must soon expand to meet the demand from millennial investors creating more opportunity for Comfort Systems. The company's operations will continue to improve, providing stronger margins and a more efficient conversion of backlog through the recent acquisition of BCH Holdings. Currently Comfort Systems' operations outperform its peers.

Catalysts:

- Short Term(within the year): Improvement to operating margins and portfolio diversification following the acquisition of BCH Holdings.
- Mid Term(1-2 years): Industry demand stimulated by millennial consumption and consumer optimism.
- Long Term(3+): Improving conversion ratio of backlog to revenue.

Earnings Performance and Operations:

Comfort Systems operate under one business segment that the company identifies as *General Contracting*. Looking at their general contracting segment, revenues are divided into four portions. HVAC services made up 75% of revenues, plumbing made up 15%, building automation control systems made up 6%, and the remaining 4% of revenue was made up from the company's "other" classification. Comfort Systems' most recent earnings report recognizes that ~40% of revenue was derived from installation services in newly constructed facilities, while the remaining 60% was derived from renovation, expansion, maintenance, repair and replacement services in existing structures.

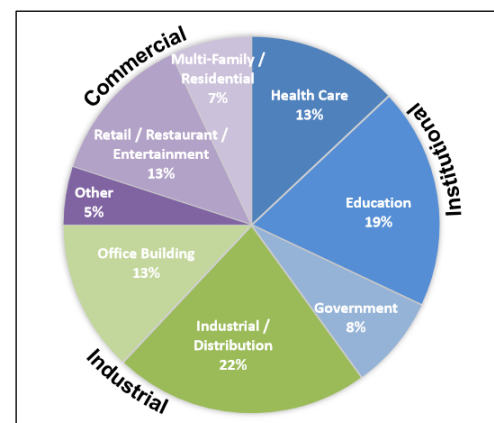
Comfort Systems revenue growth has outpaced its industry average of 5.4% as revenue growth compared to the previous year's quarter grew at 12.1%. Despite the disastrous conditions of the hurricanes effecting the Houston and Florida markets, Comfort Systems ended their third quarter with a double-digit increase in revenue compared to 2016's third quarter earnings. Ending the quarter Comfort Systems recorded revenues totaling 481 million up \$52 million from the previous year's corresponding quarter. Management recognizes that a majority of contributions came from their Northeast and upper Midwest segments that experienced a very busy summer. Strong contributions came from the acquisition of BCH Holdings and the Southeast region as well. Management provided a guidance for revenue growth of 8-9% for the upcoming quarters of 2018. Comfort Systems' growth in revenue has positively affected the company's bottom line, contributing to improved earning per share. Earnings per share have improved by 9.3% prior to the previous year's quarter, strongly outperforming Comfort System's peers.

Revenue growth has stimulated from the growth in the industrial industry itself, and consumer confidence within the economy. Currently the housing market and commercial building market are favorable for consumers. Consumers are investing in the economy, taking advantage of low interest rates and strong employment availability. I expect this consumer confidence to continue into upcoming quarters, further increasing Comfort Systems' revenue growth.

Comfort Systems engineer a product that is in high demand throughout all industries. The company's HVAC and air filtration segments are necessities required within every market. Every commercial building is required by law to maintain an air-circulating product similar to the one Comfort Systems offer. Regardless whether the facility is new or pre-existing, HVAC systems play a role in the operations of the facility. The system require service and maintenance, something I expect to contribute to Comfort Systems' growth of revenue as well.

The following chart represents the markets Comfort Systems preform business in. It is important to recognize Comfort Systems' diverse segments of revenue generation, as each segment represents new potential from a variety of markets.

Historically, Comfort Systems have been able to perform at a rate where operating margin and EBITDA growth out-preform revenue growth. This has lead to value creation within the company and something I expected to continue in upcoming quarters. The current trend in operations will be crucial to maintain as Comfort Systems looks to take on more large-scale projects in upcoming quarters. In the most recent earnings conference, CEO Brian E. Lane addresses that recently the company began hiring new sales and service technicians. Brian mentions that with the additional SG&A expenses and amortization expenses from their recent acquisition of BCH, operating margins have been slightly constrained. Brian assured shareholders that the company has had great success in training new employees and expects operating margins to preform stronger in upcoming quarters. It is significant to recognize that Comfort Systems currently outperform their peers with regard to EBITDA and operating margins.



The two charts below highlight the strength of Comfort Systems' operations. The first chart is of data gathered from Bloomberg. It is a comparison of Comfort Systems' performance for each measurement displayed in yellow, and compares them to their closest competitor's average; highlighted in white. The second table compares Comfort System's cash adjusted EBITDA margin to its competitors. For this comparison, the company performs near the top of its competitors. Management mentions that the company's underlying EBITDA margin in 2018 is expected to "meaningfully (W.George)" exceed 2016's and 2017's performance ending the fourth quarter.

Name (BICS Best Fit)	Sales Growth (%)	EBITDA Growth (%)	EBITDA Margin	Operating Income Margin	Net Income Growth (%)	Return on Rev - 1 Yr Gr: Invested Capital	
Median	5.71%	8.00%	6.53%	5.89%	11.01%	9.34%	-0.45
COMFORT SYSTEMS USA INC	5.71%	8.00%	7.86%	5.89%	11.06%	15.92%	3.41

Cash Base TTM EBITDA:

Granite Construction Inc	0.05264
KBR, Inc	0.00452
MYR Group	0.05635
Jacobs Engineering Group Inc.	0.0452
AECOM	0.0395

Comfort Systems operate through a national network of contracting segments within each market the company performs business. The company performs their operations through contracted work in which a Comfort Systems representative assesses and facilitates necessary requirements. Once a representative has gathered all of the appropriate information they will generate a "bid" for the contracted work in desire. Terms, price, and timing of a project are all negotiated with the customer prior to Comfort Systems interacting further than the planning and development phase. "Our bid price and terms are intended to cover our estimated costs on the project and provide a profit margin to us commensurate with the value of the installed system to the customer. The risk that project costs and the duration will vary from estimate. The schedule on which we will be paid, the opportunities for other work that we might forego by committing capacity to this project, and other costs that we incur to support our operations are brought into consideration.(10-)" Comfort Systems representatives are trained through extensive programs ensuring any contracts entered are deemed most profitable for the company and in the company's best interest.

Once an agreement has been established Comfort Systems order the necessary materials and equipment for delivery to meet the specifications of the project schedule. In many instances, Comfort Systems have the ability to manufacture and assemble the materials in desire, eliminating the need to subcontract fabrication. For projects requiring materials and equipment to be outsourced, Comfort Systems have developed strong relations with suppliers nationwide. Comfort System's 2016 annual report mentions raw materials for operations as being "generally available." HVAC system components such as ductwork, steel, sheet metal, and copper tubing and piping are acquired from a large variety of domestic or foreign suppliers. The company hedges their supply risk through contracted agreements using time or market based escalations and escape provisions.

The company is exposed to the risk of supply shortages and increased pricing, but this is something the industry itself will experience. The company's project completion time is approximately six to nine months, with an

average contract price of ~\$516,000. The company is not constrained to contracts around their average selling price; in the previous year, the company completed a contract worth \$26.2 million. Ending 2016, Comfort Systems recognized the stratification of projects in progress with the following characteristics:

Contract Price of Project	No. of Projects	Aggregate Contract Price Value (millions)
Under \$1 million	3,415	\$ 422.9
\$1 million - \$5 million	328	744.4
\$5 million - \$10 million	59	397.4
\$10 million - \$15 million	19	235.9
Greater than \$15 million	9	174.4
Total	3,830	\$ 1,975.0

Gross profit preformed at a lower measure compared to the previous year's third quarter performance. Gross profit of 21.0% compared to 2016's 21.6% were affected by the amortization expenses contributed by the BCH acquisition, as capital payments were recognized during the period. Management mentions in the earnings call that, "excluding amortization expenses gross profit preformed similar to the previous year's quarter."

Net income for the quarter was up compared to the previous year's corresponding quarter. Comfort systems recognized a net income for the quarter of \$22.3 million compared to 2016's third quarter net income of \$20.5 million. Free cash flows for the quarter totaled 39.5 million, setting a company historical record for third quarter performance. One year ago from the most recent earnings call Comfort systems recognized a free cash flow of 7.3 million. Currently the group's free cash flow is 49.6 million.

Millennial Driven Demand and Consumer Optimism:

For a majority of my stock picks I have been selecting stocks that will continue to, and have been influenced by the U.S housing and commercial residency market. The reasoning behind this is the optimism I have for the housing market and the input components associated with the industry. One component in the residential and commercial building industry are operational systems, more precisely HVAC systems, air filtration systems, and plumbing and pipeline systems. As millennial homebuyers and "home seekers" enter the market place the increasing demand will correlate directly with the demand of the HVAC industry and companies such as Comfort Systems within the industry. Increased investment within the commercial building industry will cause a greater demand for Comfort System products, and products offered by their peers. The commercial cooling and commercial refrigeration and ventilation industry is expected to grow at a compound annual growth rate of 8.2% through 2020. With managements guidance of revenue growth of 8-9% I believe that Comfort Systems have enough market share to meet these expectations year over year.

As previously mentioned Comfort Systems operate with a strong national presence and national footprint. The company resides in 109 locations and 98 cities. Of their current presence, a large majority of facilities occupy the locations of California, Texas, Florida, New York, Massachusetts and the Carolinas. Comfort Systems also occupy a large mid-west presence. Recent studies suggest that these locations are all in high demand from millennial homebuyers entering the new home or existing markets. For the previous quarter of 2017, HVAC and Plumbing revenues have dominated all other contributions to revenue. Making up 91% of year to date revenue, Comfort Systems will highly focus their operations toward their HVAC and Plumbing activities. The company will use their large market share, and geographical presence to take advantage of high demand industries and locations.

The following chart is a comparison of revenue from each portion of operations:

Service Activity	Revenue	
	\$ in thousands	%
HVAC and Plumbing	\$ 1,207,434	91 %
Building Automation Control Systems	66,343	5 %
Other	53,073	4 %
Total	<u>\$ 1,326,850</u>	<u>100 %</u>

Using data provided from previous quarter's 10-Q and 10-K statements I was able to collect each quarter's revenue for Comfort System's HVAC and Plumbing activities. I performed a compound quarterly growth rate analysis for the HVAC and plumbing segment and concluded that the segment's revenue growth rate was 6.7% over the past 5 quarters. The HVAC industry itself performed at a 5% CAGR for the corresponding quarters. Comfort Systems outperformance of the industry highlight the company's capitalization of market share and national presence.

Looking to future quarters, the U.S HVAC industry is predicted to grow at a CAGR of 5.5% between 2017-2020. For Comfort Systems I predict a growth rate for the segment closer to 7%. I've justified this premium based of Comfort Systems' previous outperformance of the industry. Millennial entrance into new and existing commercial living complexes, residential housing, and commercial real estate will contribute to increasing demand within this "necessity" based segment.

Current complexes within the market will require maintenance and upgrades, as new complexes will need new systems and strategy. Whether it is modifications of existing units or new construction the demand from millennials will increase the segments growth as Comfort Systems occupy a majority of these high demand millennial locations. Comparing 2016 revenue with current levels of revenue more contributions are being made from the company's *existing building construction* market and their *service and maintenance* market. I expect this to be a continuing factor as supply within the commercial and residential industry has become more limited. Management mentions that Comfort System executives will focus more of their attention toward their service and maintenance markets as these markets have provided more opportunity over previous years. The service market provides stable revenue cycles as reoccurring maintenance and service of system is expected and needed within all industries. Maintenance and service have a direct affect on energy efficiency which user pay close attention to while monitoring operations. User want to keep their systems running as efficient as possible as efficiency will contribute to lower operating expenses in comparison to an inefficient system.

Acquisition of BCH Holdings:

Recently Comfort Systems completed its acquisition of the privately held BCH Holdings. BCH Holdings is a regional mechanical contractor in Florida that operates in a variety of regions throughout Florida and 11 surrounding southeast states. Comfort Systems agreed to pay \$100 million for BCH Holding and the family of companies it occupied. \$85.7 million was paid in cash while the remaining \$14.3 million was performed through a promissory payable in two equal installments of \$7.15 million due in April 2020 and 2021. Both promissory notes contained a weighted average interest rate of 3%. Additionally Comfort systems agreed to pay an earn-out if BCH financial targets were met after the acquisition reached completion.

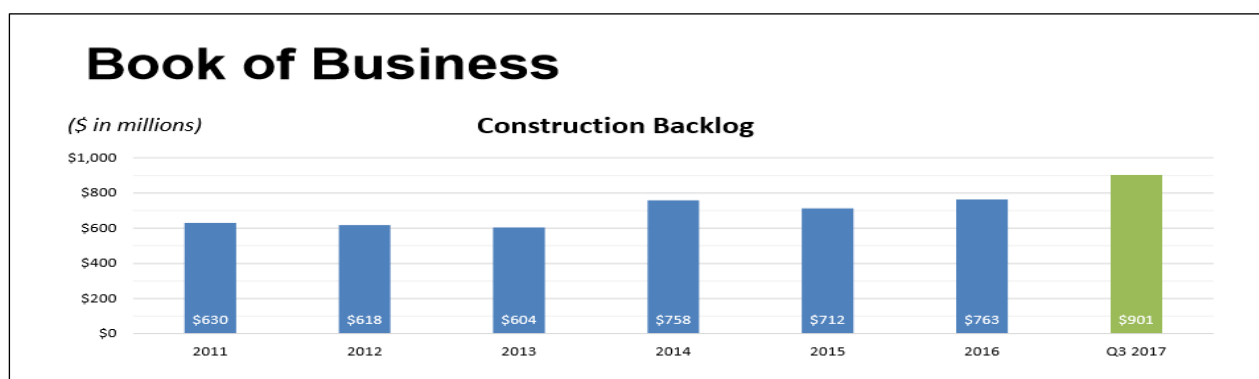
Further expanding Comfort Systems national presence the acquisition is projected to contribute annualized revenues of approximately \$100 - \$110 million. The acquisition contributed \$42 million in backlog value for Comfort Systems. Analysts of the acquisition predict that profitability levels can be, “expected to perform above those of the existing Comfort Systems USA operations. (B.Wire)” The acquisition is expected to expand Comfort System’s healthcare market segment, providing more revenue opportunities from an industry expected to grow in 2018. Looking at the company’s most recent earnings, their healthcare sector contributed 13% of revenue ending the third quarter. In the acquisition Comfort Systems acquired BCH medical, one of Florida’s and the Southeast’s largest medical providers. BCH Medical serves health care, research laboratories, industrial and manufacturing facilities, and institutional facilities.

To date the acquisition of BCH has contributed approximately 35 million in revenue. In the most recent earning call Brian Lane mentions, “We had few hospitals prior to the acquisition. We are continuing to see strong end-of-life care facilities growth, but I think we will see a few more hospitals being built as we go on. (B.Lane)” Brian Lane mentions that the acquisition will further grow Comfort Systems’ maintenance and service base for the Southeast regions. Currently Comfort Systems has the largest service base the company has ever had, with customers that are going to need services on a yearly base. The company’s service and maintenance segment is something they look to expand looking forward. Comfort Systems is constantly hiring new technicians, equipping them with necessary training to meet the company’s growing target market. A large majority of Comfort System products have a 10-20 year replacement cycle. Although the company will not see as strong revenue growth from replacing and implementing new systems, Comfort Systems will experience higher contributions to revenue from service and maintenance.

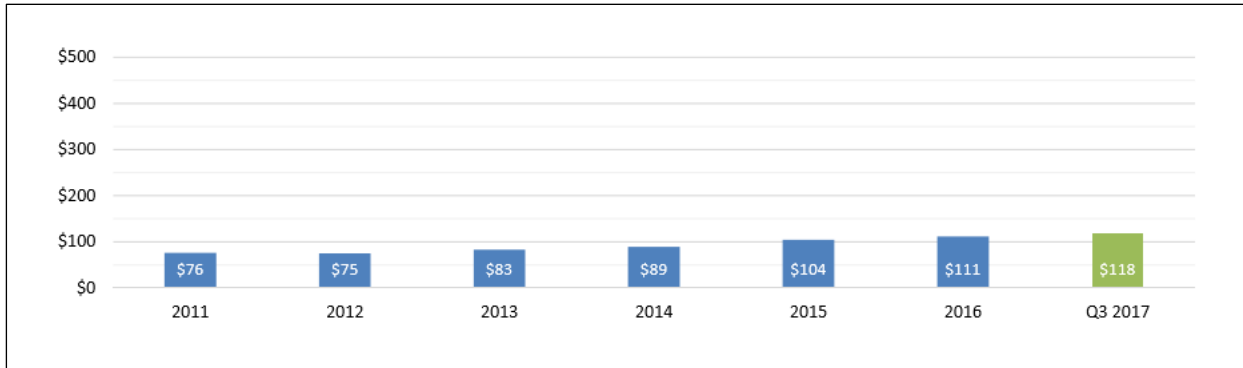
Growing Backlog Value and Conversion Ratio:

Comfort System’s backlog of operations will contribute to strong revenue growth in the upcoming quarters. The company’s backlog reflects revenues, yet to be recognized, under contracted or committed installation and replacement of project work; ending the company’s third quarter backlog at a record value totaling 901 million. This value was a 25% increase from the previous year’s corresponding quarter. Comparing second quarter backlog to third quarter backlog, the values of quarter three were slightly decreased. This was something management expected as backlog and revenue historically grow at stronger rates during the summer months. A year over year comparison clarifies that Comfort Systems’ backlog value has already grown past 2016’s value. Comfort Systems have a diverse project mix within the backlog as well. Approximately 23% of backlog had a median value of \$546.7 million, 36% of backlog had a median value of \$856.8 million and the remaining 41% had a value of greater than \$977.0 million. Comfort Systems’ backlog consists mainly of new construction projects, which will eventually roll over into maintenance and service revenues after the company has completed construction. As previously mentioned, the service and maintenance segment is something Comfort Systems looks to expand on in upcoming quarters.

The following chart is a comparison of Comfort Systems new construction backlog year over year:



The company's investor presentation also provided some insight for their service and maintenance backlog. As presented below, service backlog has already surpassed the previous year's value increasing year over year trailing back to 2012. I believe Comfort System's will continue to see increasing value of backlog on a year over year scale from the new construction and service and maintenance segments.



When looking at Comfort Systems backlog, I chose to do a backlog conversion ratio on a quarterly basis to analyze how effect the company was at converting to backlog to recognized revenue. The conversion ratio is expressed as the number of days required to recognize backlog as revenue. Positively Comfort Systems' backlog conversion ratio for the past two quarters has been decreasing. A decreasing ratio suggests that operations are becoming more efficient and backlog can contribute to revenue within a shorter time period. The value of backlog itself is growing at a CAGR of 3.71%; I compared this to the conversion ratio, which is growing at a rate of 2.24%. In the previous quarter, Comfort Systems experienced stronger operating margins from the acquisition of BCH Holdings which I believe will contribute to stronger conversion ratios. With the acquisition Comfort Systems expanded their economies of scale with regard to production as the company acquired more skilled laborers and operating facilities. This efficiency is something I presume will continue in upcoming quarters. Comfort Systems will continue to grow their backlog of business while improving the time it takes to recognize backlog as revenue.

The below chart demonstrates the analysis I discussed above with regard to backlog growth and conversion rate improvements.

Income Statement							
For the Fiscal Period Ending	3 months Q2 Jun-30-2016	3 months Q3 Sep-30-2016	3 months Q4 Dec-31-2016	3 months Q1 Mar-31-2017	3 months Q2 Jun-30-2017	3 months Q3 Sep-30-2017	CAGR
Currency	USD	USD	USD	USD	USD	USD	
Revenue	427.5	428.8	392.1	380.6	465.4	480.9	
Other Revenue	-	-	-	-	-	-	
Total Revenue	427,538.0000	428,760.0000	392,100.0000	380,588.0000	465,411.0000	480,851.0000	
Backlog Value	724,300.00	719,300.00	763,400.00	863,000.00	937,800.00	901,200.00	3.71%
Backlog Conversion	618.35	612.33	710.64	827.65	735.47	684.07	2.24%

Conclusion:

Comfort Systems' stock is trading at an undervalued price within the market. It is currently trading at \$43.05 and I believe the true intrinsic value is \$45.31. I have predicted a target price of \$50.98 generating a return of 19.15%. The stock will gain from strong revenue growth in the upcoming quarters paired with decreasing operating expenses. Comfort Systems will continue to improve bottom line values as their operations will become more efficient through expanding economies of scale and production efficiencies. The recent acquisition of BCH Holdings has strongly contributed to the company's expanding market share and national presence. The acquisition has also introduced the possibility of expanding the company's healthcare industry segment. BCH Medical will expand in upcoming quarters by introducing new medical facilities, hospitals, and other health care related segments. The company offers multiple products, which are necessities in every residential and commercial building. HVAC, air circulation, plumbing, and electronic systems are all required, many of which are mandated by law to be implemented, and serviced. Demand for these products will continue to grow as consumer confidence gains in the industrial and commercial development industries. Service and maintenance segments will expand in upcoming quarters as Comfort Systems has been expanding the company's service members and specialist. The company is currently training and developing new employees with expectations of increasing future demand.

Comfort Systems USA, Inc.
(FIX)

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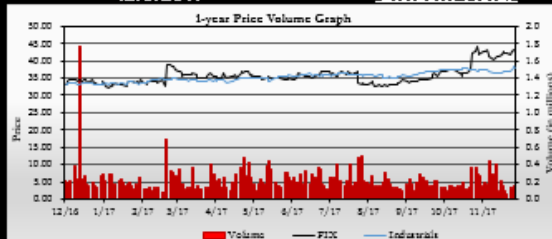
NEUTRAL

Analysis by Michael Diotalevi
12/18/2017

Current Price: \$43.05
Dividend Yield: 0.7%

Intrinsic Value: \$45.31
Target Price: \$50.98

Target 1 year Return: 19.15%
Probability of Price Increase: 9%



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

General Information
Sector: Industrials
Industry: Construction and Engineering
Last Guidance: November 3, 2015
Next earnings date: February 23, 2018
Estimated Country Risk Premium: 6.72%
Effective Tax rate: 24%
Effective Operating Tax rate: 24%

Market Data
Market Capitalization: \$1,531.36
Daily volume (mil): 0.10
Shares outstanding (mil): 36.97
Diluted shares outstanding (mil): 37.68
% shares held by institutions: 87%
% shares held by investments Managers: 87%
% shares held by hedge funds: 4%
% shares held by insiders: 2.08%
Short interest: 1.42%
Days to cover short interest: 3.03
52 week high: \$44.68
52-week low: \$31.90
Volatility: 28.50%

Quarter ending	Revenue	EBITDA
3/30/2016	-0.23%	-0.01%
12/31/2016	-5.00%	-10.66%
3/31/2017	-6.03%	-17.04%
6/30/2017	0.80%	4.45%
9/30/2017	1.30%	1.57%
Mean	-1.84%	-4.34%
Standard error	1.5%	4.1%

Management	Position	Total compensation growth	Total return to shareholders
Lane, Brian	Chief Executive Officer, Pre	23.05% per annum over 5y	-1.88% per annum over 5y
George, William	Chief Financial Officer and	10.48% per annum over 5y	-1.88% per annum over 5y
Shaeff, Julie	Chief Accounting Officer and	10.21% per annum over 5y	-1.88% per annum over 5y
McKenna, Trent	Senior Vice President, Gen	17.71% per annum over 5y	-1.88% per annum over 5y
Giardinelli, Alfred	Co-Founder, Director and Pre	N/M	N/M
Dilts, Charles	Senior Vice President of Nat	N/M	N/M

Profitability	FIX (LTM)	FIX (5 years historical ave)	Peers' Median (LTM)
Return on Capital (GAAP)	16.4%	3.67%	7.51%
Operating Margin	4%	2.27%	2.53%
Revenue/Capital (GAAP)	4.25	4.26	2.90
ROE (GAAP)	18.3%	12.8%	16.2%
Net margin	4.2%	2.5%	3.5%
Revenue/Book Value (GAAP)	4.53	5.02	4.53

Invested Funds	FIX (LTM)	FIX (5 years historical ave)	Peers' Median (LTM)
Cash/Capital	14.4%	13.4%	18.4%
NWC/Capital	9.1%	13.8%	11.6%
Operating Assets/Capital	39.2%	40.7%	40.7%
Goodwill/Capital	37.2%	32.1%	29.3%

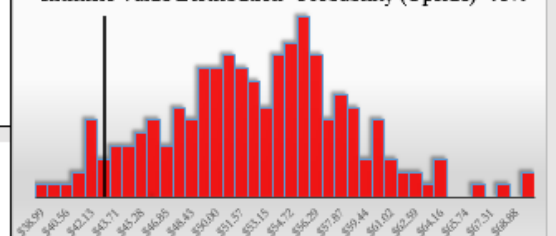
Capital Structure	FIX (LTM)	FIX (5 years historical ave)	Peers' Median (LTM)
Total Debt/Market Capitalization	0.30	0.20	0.42
Cost of Existing Debt	5.2%	12.6%	4.3%
CGFS Rating (F-score, Z-score, and default Proba)	AA	A	BBB
WACC	11.6%	18.1%	9.6%

Porter's 5 forces (scores are out of 100)

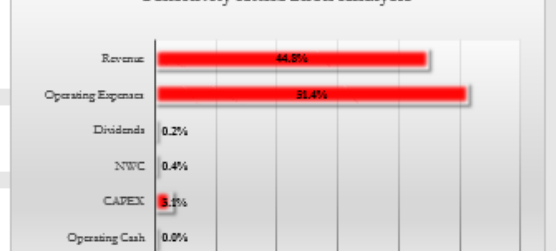


Peers
MYR Group Inc.
Primoris Services Corporation
IES Holdings, Inc.
EMCOR Group, Inc.
Aegion Corporation
MazTec, Inc.
Granite Construction Incorporated
Sterling Construction Company, Inc.

Intrinsic Value Distribution--Probability (Upside)=93%



Sensitivity Attribution Analysis



Period	Revenue Growth Forecast
Base Year	6%
3/30/2018	3%
3/30/2019	7%
3/30/2020	5%
3/30/2021	1%
3/30/2022	1%
3/30/2023	1%
3/30/2024	1%
3/30/2025	2%
3/30/2026	2%
3/30/2027	2%
Continuing Period	2%

Period	Return on Capital Forecast
Base Year	20.1%
3/30/2018	9.7%
3/30/2019	10.3%
3/30/2020	10.3%
3/30/2021	9.3%
3/30/2022	14.3%
3/30/2023	13.8%
3/30/2024	12.3%
3/30/2025	12.2%
3/30/2026	11.6%
3/30/2027	11.0%
Continuing Period	10.6%

Valuation	NOPAT Margin Forecast	Revenue to Capital Forecast
Base Year	6.2%	3.23
3/30/2018	3.6%	2.72
3/30/2019	4.2%	2.63
3/30/2020	4.1%	2.53
3/30/2021	4.0%	2.35
3/30/2022	6.8%	2.20
3/30/2023	7.0%	1.96
3/30/2024	7.3%	1.77
3/30/2025	7.6%	1.61
3/30/2026	7.3%	1.47
3/30/2027	8.1%	1.36
Continuing Period	8.4%	1.26

Period	WACC Forecast	Price per share Forecast
Base Year	11.6%	\$45.46
3/30/2018	9.8%	\$51.34
3/30/2019	10.1%	\$56.18
3/30/2020	10.1%	\$61.18
3/30/2021	9.3%	\$66.22
3/30/2022	9.3%	\$71.43
3/30/2023	9.3%	\$76.75
3/30/2024	9.3%	\$82.19
3/30/2025	9.3%	\$87.72
3/30/2026	10.0%	\$93.35
3/30/2027	10.0%	\$99.05
Continuing Period	10.0%	