

February 26, 2024

COMFORT SYSTEMS USA INC. | FIX

BUY

Reports 16% EBITDA Beat for Q4'23, Backlog +27%; Target to \$325

PRICE \$279.06

PRICE TARGET \$325.00

KEY TAKEAWAY

Comfort reported a 16% EBITDA beat for Q4'23 (\$141M vs. consensus of \$122M), driven by higher revenue and margins. Gross margin came in at 20.6%, its best result since Q3'20. Backlog surged to finish 2023, ending at a record \$5.2B, up 27% yr/yr and 20% sequentially. Management sees the potential for further backlog gains in early 2024 given robust demand in certain end markets: manufacturing, technology, and healthcare. We are raising our 2024 EBITDA forecast by 6% (to \$613M) and 2025 by 11% (to \$696M). Our 12-month price target jumps from \$250 to \$325 to reflect record backlog and strong demand.

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KEY POINTS

Delivers solid Q4'23 beat. Comfort reported Q4'23 adjusted EBITDA of \$141M (+42% yr/yr) versus our estimate of \$125M and consensus of \$122M. The beat was driven by a combination of higher revenue and margins. Total sales came in at \$1.4B (+22% yr/yr) versus our \$1.3B. Comfort generated an adjusted EBITDA margin of 10.4%, which was up 150 bps yr/yr and 80 bps above our forecast. *We believe that this was a record Q4 EBITDA margin for the company.*

Best gross margin performance in more than three years. Comfort generated a consolidated gross margin of 20.6% in Q4 versus our 19.3%, its best quarterly performance since Q3'20. Management noted that it targets a gross margin of 18%–20%. Thus, Q4'23 results were a positive outlier. Gross margin in the mechanical segment was solid in Q4 (19.8% vs. our 19.5%), but electrical segment gross margin was exceptional (22.9% vs. our 18.5%).

Backlog surges to a new record. Comfort ended 2023 with total backlog of \$5.2B, up 27% yr/yr and 20% sequentially. New orders were a record \$2.2B in Q4, driven by mechanical of \$1.9B. One thing we liked about the Q4 backlog performance was that it was broad-based (not just data centers).

The company did book sizable data center awards during the quarter (of \$267M), but backlog gains were also driven by manufacturing (of \$268M) and healthcare (of \$204M). Management noted that its project funnel remains full and backlog growth could continue in early 2024, we believe.

Free cash flow remains impressive. Comfort generated free cash flow of \$149M in Q4 versus our \$83M. For the full year, free cash flow came in at \$551M (\$15 per share), up 115% yr/yr. Comfort ended 2023 with net cash of \$161M; however, we estimate that it invested \$325M in Summit and J&S on February 1, 2024.

Raising estimates. Management forecasts mid-teens 2024 organic revenue growth versus our prior forecast of +10%. We are increasing our 2024 EBITDA forecast from \$579M to \$613M, primarily to reflect higher sales (\$6.5B vs. \$6.2B). Our 2025 forecast goes from \$628M to \$696M.

Target to \$325; Buy. Comfort is currently trading at 16.6x our 2024 EV/EBITDA forecast. Our new target of \$325 is based on 17.1x our 2025 EV/EBITDA forecast and assumes slight multiple expansion. While our target multiple is elevated, we expect Comfort to continue to benefit from strong heavy nonresidential demand.

COMPANY STATISTICS

| | |
|-----------------------------|-------------------|
| 52-Week Range | \$127.09-\$292.41 |
| Market Capitalization (M) | \$10,005 |
| Average Daily Volume (000s) | 299 |
| Debt/Total Cap | 3% |
| Dividend | \$1.00 |
| Shares Outstanding (M) fd | 35.9 |
| Estimated 3-yr EPS Growth | 34% |
| Enterprise Value (M) | \$10,169 |
| Float (M) | 35.2 |

FINANCIALS

| FYE Dec | 2022A | 2023E | 2024E | 2025E | |
|------------------|---------|---------------|---------------|----------------|----------------|
| P/E Ratio | 52.7x | 31.9x | 26.2x | 21.9x | |
| EV/EBITDA | 30.1x | 20.4x | 16.6x | 14.6x | |
| Revenue (M) | \$4,140 | \$5,207 | \$6,470 | \$7,035 | |
| Op Inc (M) | \$259 | \$420 | \$496 | \$579 | |
| EBITDA (M) | \$338 | \$499 | \$613 | \$696 | |
| | | | | | |
| EPS | Q1 | \$0.91 | \$1.51 | \$1.77 | \$2.09 |
| | Q2 | \$1.17 | \$1.93 | \$2.38 | \$2.97 |
| | Q3 | \$1.67 | \$2.74 | \$3.49 | \$4.09 |
| | Q4 | \$1.54 | \$2.55 | \$3.01 | \$3.59 |
| Total | | \$5.29 | \$8.74 | \$10.65 | \$12.75 |
| Consensus | | — | — | \$10.62 | \$12.88 |

Consensus estimates from Visible Alpha

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Valuation. On an EV/EBITDA basis, Comfort is currently trading at 16.6x our 2024 EV/EBITDA estimate. Over the past two years, Comfort has traded at 12.4x forward EV/EBITDA, on average. Our \$325 12-month price target is based on 17.1x our 2025 EV/EBITDA estimate, thus assuming slight multiple expansion. Given our outlook for double-digit EBITDA growth over the next two years, and the potential for further large awards in the manufacturing and technology sectors, we believe that Comfort's multiple can remain elevated versus its historical average.

Risks. Risks to the stock, as well as to the achievement of our price target, include macroeconomic weakness, tight labor, project execution risks, acquisition integration risks, and rising materials costs. The company's elevated multiple could limit further share price appreciation. Finally, we note that Summit Industrial is leveraged to U.S. chip plant construction. If the semiconductor buildout gets delayed or fails to materialize, projections related to that acquisition could prove aggressive.

Comfort Systems

Earnings Model

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| (\$ millions) | 2023A | | | | | 2024E | | | | | 2025E | | | | |
|--------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|---------------|---------------|---------------|---------------|----------------|
| | Mar | June | Sept | Dec | Dec | Mar | June | Sept | Dec | Dec | Mar | June | Sept | Dec | Dec |
| | Q1 | Q2 | Q3 | Q4 | Year | Q1 | Q2 | Q3 | Q4 | Year | Q1 | Q2 | Q3 | Q4 | Year |
| Revenue | \$1,174.6 | \$1,296.4 | \$1,378.1 | \$1,357.6 | \$5,206.8 | \$1,440.0 | \$1,635.0 | \$1,720.0 | \$1,675.0 | \$6,470.0 | \$1,590.0 | \$1,775.0 | \$1,865.0 | \$1,805.0 | \$7,035.0 |
| Cost of revenue | 969.2 | 1,068.5 | 1,100.6 | 1,077.9 | 4,216.3 | 1,191.6 | 1,348.9 | 1,380.3 | 1,348.4 | 5,269.2 | 1,311.8 | 1,455.5 | 1,492.0 | 1,448.5 | 5,707.8 |
| Gross profit | 205.4 | 227.9 | 277.5 | 279.7 | 990.5 | 248.4 | 286.1 | 339.7 | 326.6 | 1,200.9 | 278.3 | 319.5 | 373.0 | 356.5 | 1,327.2 |
| SG&A | 115.1 | 116.3 | 121.8 | 138.5 | 491.7 | 138.0 | 144.0 | 148.0 | 158.0 | 588.0 | 152.5 | 154.5 | 158.5 | 166.0 | 631.5 |
| D&A | 19.5 | 20.1 | 20.4 | 21.6 | 81.6 | 28.0 | 30.0 | 30.0 | 30.0 | 118.0 | 30.0 | 30.0 | 29.0 | 29.0 | 118.0 |
| (Gain) loss on sale of assets | (0.5) | (0.6) | (0.6) | (0.6) | (2.3) | (0.3) | (0.3) | (0.3) | (0.3) | (1.0) | (0.3) | (0.3) | (0.3) | (0.3) | (1.0) |
| Adj. EBITDA | 90.3 | 111.6 | 155.7 | 141.2 | 498.8 | 110.4 | 142.1 | 191.7 | 168.6 | 612.9 | 125.8 | 165.0 | 214.5 | 190.5 | 695.7 |
| Operating income | 71.3 | 92.1 | 135.9 | 120.3 | 419.5 | 82.7 | 112.4 | 162.0 | 138.9 | 495.9 | 96.0 | 135.3 | 185.8 | 161.7 | 578.7 |
| Interest (expense) income, net | (2.7) | (3.8) | (0.9) | 0.7 | (6.8) | (1.5) | (3.0) | (2.0) | (1.0) | (7.5) | 0.0 | 1.0 | 2.0 | 3.0 | 6.0 |
| Other (expense) income, net | (2.4) | (3.1) | (8.8) | (9.2) | (23.4) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pre-tax income | 66.2 | 85.2 | 126.2 | 111.7 | 389.3 | 81.2 | 109.4 | 160.0 | 137.9 | 488.4 | 96.0 | 136.3 | 187.8 | 164.7 | 584.7 |
| Income taxes | 12.1 | 15.7 | 27.7 | 20.1 | 75.6 | 17.4 | 23.5 | 34.4 | 29.6 | 105.0 | 20.6 | 29.3 | 40.4 | 35.4 | 125.7 |
| Net income (cont. ops.) | 54.2 | 69.5 | 98.5 | 91.6 | 313.7 | 63.7 | 85.9 | 125.6 | 108.2 | 383.4 | 75.4 | 107.0 | 147.4 | 129.3 | 459.0 |
| Noncontrolling interests | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net income from disc. ops. | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net income to Comfort | 54.2 | 69.5 | 98.5 | 91.6 | 313.7 | 63.7 | 85.9 | 125.6 | 108.2 | 383.4 | 75.4 | 107.0 | 147.4 | 129.3 | 459.0 |
| Adjusted EPS | \$1.51 | \$1.93 | \$2.74 | \$2.55 | \$8.74 | \$1.77 | \$2.38 | \$3.49 | \$3.01 | \$10.65 | \$2.09 | \$2.97 | \$4.09 | \$3.59 | \$12.75 |
| Shares outstanding (diluted) | 35.9 | 35.9 | 35.9 | 35.9 | 35.9 | 36.0 | 36.0 | 36.0 | 36.0 | 36.0 | 36.0 | 36.0 | 36.0 | 36.0 | 36.0 |
| Percent of Sales: | | | | | | | | | | | | | | | |
| Gross margin | 17.5% | 17.6% | 20.1% | 20.6% | 19.0% | 17.3% | 17.5% | 19.8% | 19.5% | 18.6% | 17.5% | 18.0% | 20.0% | 19.8% | 18.9% |
| Adj. EBITDA margin | 7.7% | 8.6% | 11.3% | 10.4% | 9.6% | 7.7% | 8.7% | 11.1% | 10.1% | 9.5% | 7.9% | 9.3% | 11.5% | 10.6% | 9.9% |
| Operating margin | 6.1% | 7.1% | 9.9% | 8.9% | 8.1% | 5.7% | 6.9% | 9.4% | 8.3% | 7.7% | 6.0% | 7.6% | 10.0% | 9.0% | 8.2% |
| Pre-tax margin | 5.6% | 6.6% | 9.2% | 8.2% | 7.5% | 5.6% | 6.7% | 9.3% | 8.2% | 7.5% | 6.0% | 7.7% | 10.1% | 9.1% | 8.3% |
| Net margin | 4.6% | 5.4% | 7.1% | 6.7% | 6.0% | 4.4% | 5.3% | 7.3% | 6.5% | 5.9% | 4.7% | 6.0% | 7.9% | 7.2% | 6.5% |
| SG&A as a % of sales | 9.8% | 9.0% | 8.8% | 10.2% | 9.4% | 9.6% | 8.8% | 8.6% | 9.4% | 9.1% | 9.6% | 8.7% | 8.5% | 9.2% | 9.0% |
| Tax rate | 18.2% | 18.5% | 22.0% | 18.0% | 19.4% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% | 21.5% |
| Yr/Yr Change: | | | | | | | | | | | | | | | |
| Revenues | 32.7% | 27.4% | 23.0% | 21.5% | 25.8% | 22.6% | 26.1% | 24.8% | 23.4% | 24.3% | 10.4% | 8.6% | 8.4% | 7.8% | 8.7% |
| Gross profit | 34.1% | 30.2% | 37.2% | 32.4% | 33.6% | 20.9% | 25.5% | 22.4% | 16.8% | 21.2% | 12.0% | 11.7% | 9.8% | 9.1% | 10.5% |
| SG&A | 24.4% | 18.6% | 20.4% | 24.1% | 21.9% | 19.9% | 23.8% | 21.5% | 14.1% | 19.6% | 10.5% | 7.3% | 7.1% | 5.1% | 7.4% |
| Adj. EBITDA | 48.9% | 45.1% | 54.1% | 41.7% | 47.5% | 22.2% | 27.4% | 23.1% | 19.4% | 22.9% | 13.9% | 16.1% | 11.9% | 13.0% | 13.5% |
| Operating income | 77.6% | 62.5% | 66.4% | 50.2% | 62.3% | 15.9% | 22.0% | 19.2% | 15.5% | 18.2% | 16.2% | 20.4% | 14.7% | 16.5% | 16.7% |
| Net income | 64.1% | 64.5% | 64.1% | 65.2% | 64.5% | 17.6% | 23.6% | 27.5% | 18.2% | 22.2% | 18.3% | 24.6% | 17.4% | 19.5% | 19.7% |
| EPS | 65.3% | 65.2% | 64.3% | 65.7% | 65.2% | 17.3% | 23.3% | 27.2% | 17.7% | 21.8% | 18.3% | 24.6% | 17.4% | 19.5% | 19.7% |

Source: Company reports and Thompson Davis & Co. estimates

IMPORTANT DISCLOSURES***Rating Definitions***

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Buy: Company/Industry has strong fundamentals, attractive valuation; outperforms the relevant indices in over the next 12–18 months

Hold: Stock is fairly valued; no compelling reason to buy or sell stock today; cautious about prospects over the next 6–12 months for industry or company; neutral performance relative to the relevant indices.

Sell: Fundamentals of industry or company are deteriorating; company not expected to have consistent earnings growth over next 12–18 months or business model is questionable; underperforms the relevant indices in the next 12–18 months.

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Price targets, when established, represent our best estimate of the market price of a stock in 12 months. A 12-month price target is highly subjective and the result of numerous assumptions, including company, industry, and market fundamentals, both on an absolute and relative basis, as well as investor sentiment, which can be highly volatile.

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Thompson Davis & Co., Inc., rating distribution by percentage (as of February 26, 2024):

| | # | % |
|--------------|----|--------|
| BUY | 24 | 96 |
| SELL | 0 | 0 |
| HOLD | 1 | 4 |
| TOTAL | 25 | 100.0% |

Rating and Price Target History for Comfort Systems USA Inc. (FIX) as of December 29, 2023

