

MATRIX SERVICE CO  
Form 10-Q  
October 02, 2008  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended August 31, 2008

or

☐ **Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 1-15461

**MATRIX SERVICE COMPANY**

(Exact name of registrant as specified in its charter)

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**DELAWARE**  
(State of incorporation)

**73-1352174**  
(I.R.S. Employer Identification No.)

**5100 East Skelly Drive, Suite 700, Tulsa, Oklahoma 74135**

(Address of principal executive offices and zip code)

**Registrant's telephone number, including area code: (918) 838-8822**

**10701 East Ute Street, Tulsa, Oklahoma 74116-1517**

(Former name, former address and former fiscal year, if changed since last report)

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 ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer", "large accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒  
Non-accelerated filer ☐ Smaller reporting company ☐

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

As of October 1, 2008 there were 27,888,217 shares of the Company's common stock, \$0.01 par value per share, issued and 26,082,067 shares outstanding.

**Table of Contents**

**TABLE OF CONTENTS**

|                                                                                                                       | <b>PAGE</b> |
|-----------------------------------------------------------------------------------------------------------------------|-------------|
| <b>PART I</b>                                                                                                         |             |
|                                                                                                                       |             |
|                                                                                                                       |             |
| <b><u>FINANCIAL INFORMATION</u></b>                                                                                   |             |
| Item 1. <u>Financial Statements (Unaudited)</u>                                                                       |             |
| <u>Consolidated Statements of Income for the Three Months Ended August 31, 2008 and 2007</u>                          | 1           |
| <u>Consolidated Balance Sheets as of August 31, 2008 and May 31, 2008</u>                                             | 2           |
| <u>Consolidated Statements of Cash Flows for the Three Months Ended August 31, 2008 and 2007</u>                      | 4           |
| <u>Consolidated Statements of Changes in Stockholders' Equity for the Three Months Ended August 31, 2008 and 2007</u> | 6           |
| <u>Notes to Consolidated Financial Statements</u>                                                                     | 7           |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                  | 15          |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>                                             | 25          |
| Item 4. <u>Controls and Procedures</u>                                                                                | 26          |
| <b>PART II</b>                                                                                                        |             |
|                                                                                                                       |             |
| <b><u>OTHER INFORMATION</u></b>                                                                                       |             |
| Item 1. <u>Legal Proceedings</u>                                                                                      | 27          |
| Item 1A. <u>Risk Factors</u>                                                                                          | 27          |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                                            | 27          |
| Item 3. <u>Defaults Upon Senior Securities</u>                                                                        | 27          |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u>                                                    | 27          |
| Item 5. <u>Other Information</u>                                                                                      | 27          |
| Item 6. <u>Exhibits</u>                                                                                               | 28          |
| <u>Signature</u>                                                                                                      | 28          |

**Table of Contents****PART I****FINANCIAL INFORMATION****Item 1. Financial Statements****Matrix Service Company****Consolidated Statements of Income**

(In thousands, except per share data)

|                                                       | <b>Three Months Ended</b> |                   |
|-------------------------------------------------------|---------------------------|-------------------|
|                                                       | <b>August 31,</b>         | <b>August 31,</b> |
|                                                       | <b>2008</b>               | <b>2007</b>       |
|                                                       | <b>(unaudited)</b>        |                   |
| Revenues                                              | \$ 186,650                | \$ 161,327        |
| Cost of revenues                                      | 159,979                   | 142,423           |
| Gross profit                                          | 26,671                    | 18,904            |
| Selling, general and administrative expenses          | 12,062                    | 8,046             |
| Operating income                                      | 14,609                    | 10,858            |
| Other income (expense):                               |                           |                   |
| Interest expense                                      | (114)                     | (304)             |
| Interest income                                       | 109                       | 16                |
| Other                                                 | 736                       | (10)              |
| Income before income taxes                            | 15,340                    | 10,560            |
| Provision for federal, state and foreign income taxes | 5,836                     | 4,224             |
| Net income                                            | \$ 9,504                  | \$ 6,336          |
| Basic earnings per common share                       | \$ 0.36                   | \$ 0.24           |
| Diluted earnings per common share                     | \$ 0.36                   | \$ 0.23           |
| Weighted average common shares outstanding:           |                           |                   |
| Basic                                                 | 26,073                    | 26,592            |
| Diluted                                               | 26,473                    | 27,083            |

*See accompanying notes.*

**Table of Contents****Matrix Service Company****Consolidated Balance Sheets**

(In thousands)

|                                                                                         | August<br>31,<br>2008 | May 31,<br>2008<br>(unaudited) |
|-----------------------------------------------------------------------------------------|-----------------------|--------------------------------|
| <b>Assets</b>                                                                           |                       |                                |
| Current assets:                                                                         |                       |                                |
| Cash and cash equivalents                                                               | \$ 18,819             | \$ 21,989                      |
| Accounts receivable, less allowances (August 31, 2008 - \$315 and May 31, 2008 - \$269) | 111,028               | 105,858                        |
| Costs and estimated earnings in excess of billings on uncompleted contracts             | 47,126                | 49,940                         |
| Inventories                                                                             | 5,870                 | 4,255                          |
| Deferred income taxes                                                                   | 4,993                 | 4,399                          |
| Prepaid expenses                                                                        | 4,426                 | 3,357                          |
| Other current assets                                                                    | 809                   | 809                            |
| Total current assets                                                                    | 193,071               | 190,607                        |
| Property, plant and equipment at cost:                                                  |                       |                                |
| Land and buildings                                                                      | 24,147                | 24,268                         |
| Construction equipment                                                                  | 47,861                | 47,370                         |
| Transportation equipment                                                                | 17,081                | 16,927                         |
| Furniture and fixtures                                                                  | 11,840                | 11,781                         |
| Construction in progress                                                                | 8,610                 | 6,712                          |
|                                                                                         | 109,539               | 107,058                        |
| Accumulated depreciation                                                                | (51,174)              | (49,811)                       |
|                                                                                         | 58,365                | 57,247                         |
| Goodwill                                                                                | 23,103                | 23,329                         |
| Other assets                                                                            | 2,781                 | 3,410                          |
| Total assets                                                                            | \$ 277,320            | \$ 274,593                     |

*See accompanying notes.*

**Table of Contents****Matrix Service Company****Consolidated Balance Sheets**

(In thousands, except share data)

|                                                                                                                               | August 31,<br>2008 | May 31,<br>2008 |
|-------------------------------------------------------------------------------------------------------------------------------|--------------------|-----------------|
|                                                                                                                               | (unaudited)        |                 |
| <b>Liabilities and stockholders' equity</b>                                                                                   |                    |                 |
| Current liabilities:                                                                                                          |                    |                 |
| Accounts payable                                                                                                              | \$ 51,236          | \$ 53,560       |
| Billings on uncompleted contracts in excess of costs and estimated earnings                                                   | 43,110             | 48,709          |
| Accrued insurance                                                                                                             | 8,771              | 8,451           |
| Accrued wages and benefits                                                                                                    | 10,361             | 14,976          |
| Income tax payable                                                                                                            | 6,047              | 2,028           |
| Current capital lease obligation                                                                                              | 1,107              | 1,042           |
| Other accrued expenses                                                                                                        | 2,046              | 1,015           |
| Total current liabilities                                                                                                     | 122,678            | 129,781         |
| Long-term capital lease obligation                                                                                            | 947                | 1,000           |
| Deferred income taxes                                                                                                         | 4,950              | 5,112           |
| Stockholders' equity:                                                                                                         |                    |                 |
| Common stock - \$.01 par value; 60,000,000 shares authorized; 27,888,217 shares issued as of August 31, 2008 and May 31, 2008 | 279                | 279             |
| Additional paid-in capital                                                                                                    | 109,528            | 108,402         |
| Retained earnings                                                                                                             | 54,312             | 44,809          |
| Accumulated other comprehensive income                                                                                        | 947                | 1,584           |
|                                                                                                                               | 165,066            | 155,074         |
| Less: Treasury stock, at cost 1,806,150 and 1,825,600 shares as of August 31, 2008 and May 31, 2008                           | (16,321)           | (16,374)        |
| Total stockholders' equity                                                                                                    | 148,745            | 138,700         |
| Total liabilities and stockholders' equity                                                                                    | \$ 277,320         | \$ 274,593      |

*See accompanying notes.*

**Table of Contents****Matrix Service Company****Consolidated Statements of Cash Flows**

(In thousands)

|                                                                                          | Three Months Ended |                    |
|------------------------------------------------------------------------------------------|--------------------|--------------------|
|                                                                                          | August 31,<br>2008 | August 31,<br>2007 |
|                                                                                          | (unaudited)        |                    |
| <b>Operating activities:</b>                                                             |                    |                    |
| Net income                                                                               | \$ 9,504           | \$ 6,336           |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: |                    |                    |
| Depreciation and amortization                                                            | 2,381              | 1,774              |
| Deferred income tax                                                                      | (756)              | (1,089)            |
| (Gain) loss on sale of property, plant and equipment                                     | (12)               | 28                 |
| Allowance for uncollectible accounts                                                     | 46                 | 75                 |
| Stock-based compensation expense                                                         | 1,011              | 500                |
| Other                                                                                    | 24                 | 64                 |
| Changes in operating assets and liabilities increasing (decreasing) cash:                |                    |                    |
| Receivables                                                                              | (5,216)            | 291                |
| Costs and estimated earnings in excess of billings on uncompleted contracts              | 2,814              | 3,568              |
| Inventories                                                                              | (1,615)            | (524)              |
| Prepaid expenses and other assets                                                        | (464)              | (186)              |
| Accounts payable                                                                         | (2,615)            | (7,924)            |
| Billings on uncompleted contracts in excess of costs and estimated earnings              | (5,599)            | 2,007              |
| Accrued expenses                                                                         | (3,264)            | (8,497)            |
| Income tax receivable/payable                                                            | 4,097              | 4,791              |
| Net cash provided by operating activities                                                | 336                | 1,214              |
| <b>Investing activities:</b>                                                             |                    |                    |
| Acquisition of property, plant and equipment                                             | (3,105)            | (2,888)            |
| Proceeds from asset sales                                                                | 102                | 133                |
| Net cash used by investing activities                                                    | \$ (3,003)         | \$ (2,755)         |
| <i>See accompanying notes.</i>                                                           |                    |                    |

**Table of Contents****Matrix Service Company****Consolidated Statements of Cash Flows (continued)**

(In thousands)

|                                                          | Three Months Ended |                    |
|----------------------------------------------------------|--------------------|--------------------|
|                                                          | August 31,<br>2008 | August 31,<br>2007 |
|                                                          | (unaudited)        |                    |
| <b>Financing activities:</b>                             |                    |                    |
| Exercise of stock options                                | \$ 82              | \$ 41              |
| Advances under bank credit facility                      |                    | 57,955             |
| Repayments of bank credit facility                       |                    | (57,955)           |
| Capital lease payments                                   | (285)              | (323)              |
| Tax benefit of exercised stock options                   | 85                 |                    |
| Net cash used by financing activities                    | (118)              | (282)              |
| Effect of exchange rate changes on cash                  | (385)              | 54                 |
| Net decrease in cash and cash equivalents                | (3,170)            | (1,769)            |
| Cash and cash equivalents, beginning of period           | 21,989             | 9,147              |
| Cash and cash equivalents, end of period                 | \$ 18,819          | \$ 7,378           |
| <b>Supplemental disclosure of cash flow information:</b> |                    |                    |
| Cash paid during the period for:                         |                    |                    |
| Income taxes                                             | \$ 2,439           | \$ 511             |
| Interest                                                 | \$ 94              | \$ 168             |
| Non-cash investing and financing activities:             |                    |                    |
| Equipment acquired through capital leases                | \$ 295             | \$ 92              |
| Purchases of property, plant and equipment on account    | \$ 775             | \$ 906             |

*See accompanying notes.*

**Table of Contents****Matrix Service Company****Consolidated Statements of Changes in Stockholders' Equity**

(In thousands, except share data)

(unaudited)

|                                           | <b>Common<br/>Stock</b> | <b>Additional<br/>Paid-In<br/>Capital</b> | <b>Retained<br/>Earnings</b> | <b>Treasury<br/>Stock</b> | <b>Translation<br/>Adjustments</b> | <b>Total</b> |
|-------------------------------------------|-------------------------|-------------------------------------------|------------------------------|---------------------------|------------------------------------|--------------|
| Balances, May 31, 2008                    | \$ 279                  | \$ 108,402                                | \$ 44,809                    | \$ (16,374)               | \$ 1,584                           | \$ 138,700   |
| Net income                                |                         |                                           | 9,504                        |                           |                                    | 9,504        |
| Other comprehensive loss                  |                         |                                           |                              |                           | (637)                              | (637)        |
| Comprehensive income                      |                         |                                           |                              |                           |                                    | 8,867        |
| Exercise of stock options (19,450 shares) |                         | 30                                        | (1)                          | 53                        |                                    | 82           |
| Tax benefit of exercised stock options    |                         | 85                                        |                              |                           |                                    | 85           |
| Stock-based compensation expense          |                         | 1,011                                     |                              |                           |                                    | 1,011        |
| Balances, August 31, 2008                 | \$ 279                  | \$ 109,528                                | \$ 54,312                    | \$ (16,321)               | \$ 947                             | \$ 148,745   |
| Balances, May 31, 2007                    | \$ 279                  | \$ 104,408                                | \$ 23,422                    | \$ (3,500)                | \$ 967                             | \$ 125,576   |
| Net income                                |                         |                                           | 6,336                        |                           |                                    | 6,336        |
| Other comprehensive income                |                         |                                           |                              |                           | 108                                | 108          |
| Comprehensive income                      |                         |                                           |                              |                           |                                    | 6,444        |
| Exercise of stock options (10,000 shares) |                         | 5                                         | (9)                          | 45                        |                                    | 41           |
| Stock-based compensation expense          |                         | 500                                       |                              |                           |                                    | 500          |
| Balances, August 31, 2007                 | \$ 279                  | \$ 104,913                                | \$ 29,749                    | \$ (3,455)                | \$ 1,075                           | \$ 132,561   |

*See accompanying notes.*

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**Table of Contents**

**Matrix Service Company**

**Notes to Consolidated Financial Statements**

**Note 1 Basis of Presentation**

The consolidated financial statements include the accounts of Matrix Service Company ( Matrix Service , we , our , us or the Company ) and its subsidiaries, all of which are wholly owned. Intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with Rule 10-01 of Regulation S-X for interim financial statements required to be filed with the Securities and Exchange Commission and do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. However, the information furnished reflects all adjustments, consisting of normal recurring adjustments and other adjustments described herein that are, in the opinion of management, necessary for a fair statement of the results for the interim periods.

The accompanying financial statements should be read in conjunction with the audited financial statements for the year ended May 31, 2008, included in the Company's Annual Report on Form 10-K for the year then ended. The Company's business is cyclical due to the scope and timing of projects released by its customer base. In addition, Matrix Service generates a significant portion of its revenues under a comparatively few major contracts which often do not commence or terminate in the same period from one year to the next. Accordingly, results for any interim period may not necessarily be indicative of future operating results.

**Note 2 Pending Purchase of Engineering and Construction Assets and Technology**

On September 15, 2008, the Company announced an agreement with CB&I, Inc., a subsidiary of Chicago Bridge & Iron Company N.V. ( CB&I ) to acquire engineering and construction resources and technology used to design, engineer and construct single and full containment LNG storage tanks, LIN/LOX storage tanks, LPG storage tanks and thermal vacuum chambers. The purchase, which is subject to approval by the Federal Trade Commission, includes approximately 70 engineering and construction personnel, along with tools, equipment and up to \$20.0 million of backlog, which is expected to be completed over the next two years. Also included in the purchase is a perpetual license to use CB&I's technology necessary to design, engineer and construct LNG storage tanks, LIN/LOX storage tanks, LPG storage tanks and thermal vacuum chambers. The Company expects to close the transaction in the second quarter of fiscal 2009. The purchase price is not material to the Company's total assets or its property, plant and equipment.

**Note 3 Recently Issued Accounting Standards**

*SFAS No. 157 Fair Value Measurements*

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS No. 157 ). This Statement established a framework for fair value measurements in the financial statements by providing a definition of fair value, guidance on the methods used to estimate fair value and expanded disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. On June 1, 2008, the Company adopted the provisions of SFAS No. 157 related to financial and non-financial assets and liabilities measured at fair value on a recurring basis. The adoption of this accounting pronouncement did not result in a material impact to the consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position 157-2, Effective Date of FASB Statement No. 157 which defers the effective date of SFAS No. 157 for one year for certain non-financial assets and liabilities except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. We do not expect the provisions of SFAS No. 157 related to these items to have a material effect on the consolidated financial statements.

**Table of Contents**

**Matrix Service Company**

**Notes to Consolidated Financial Statements**

*SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 ( SFAS No. 159 ), The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 . SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. On June 1, 2008, the Company adopted SFAS No. 159. The Company elected not to apply the fair value option permitted under SFAS No. 159 to any financial assets or liabilities.

*SFAS No. 141(R) Business Combinations*

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations ( SFAS No. 141(R) ). SFAS No. 141(R) applies to all business combinations and establishes guidance for recognizing and measuring identifiable assets acquired, liabilities assumed, noncontrolling interests in the acquiree and goodwill. Most of these items are recognized at their full fair value on the acquisition date, including acquisitions where the acquirer obtains control but less than 100 percent ownership in the acquiree. SFAS No. 141(R) also requires transaction costs to be recognized as expense as incurred and establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for the Company for any business combination that occurs after May 31, 2009.

**Note 4 Asset Held for Sale**

At August 31, 2008, the Company held excess land in Orange, California that was under contract for sale. The carrying value of the land was \$0.8 million which approximated the expected net proceeds from the sale. The transaction was completed in September 2008 and the proceeds approximated the carrying value, therefore, no gain or loss was recognized. The land is classified as a current asset held for sale in the August 31, 2008 Consolidated Balance Sheet and is reflected in the Company's Other segment in Note 11.

**Table of Contents****Matrix Service Company****Notes to Consolidated Financial Statements****Note 5 Uncompleted Contracts**

Contract terms of the Company's construction contracts generally provide for progress billings based on project milestones. The excess of costs incurred and estimated earnings over amounts billed on uncompleted contracts is reported as a current asset. The excess of amounts billed over costs incurred and estimated earnings recognized for construction contracts on uncompleted contracts is reported as a current liability. Gross and net amounts on uncompleted contracts are as follows:

|                                                                             | August 31,<br>2008 | May 31,<br>2008 |
|-----------------------------------------------------------------------------|--------------------|-----------------|
|                                                                             | (In thousands)     |                 |
| Costs incurred and estimated earnings recognized on uncompleted contracts   | \$ 963,349         | \$ 982,369      |
| Billings on uncompleted contracts                                           | 959,333            | 981,138         |
|                                                                             | \$ 4,016           | \$ 1,231        |
| Shown on balance sheet as:                                                  |                    |                 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | \$ 47,126          | \$ 49,940       |
| Billings on uncompleted contracts in excess of costs and estimated earnings | 43,110             | 48,709          |
|                                                                             | \$ 4,016           | \$ 1,231        |

Progress billings in accounts receivable at August 31, 2008 and May 31, 2008 included retentions to be collected within one year of \$15.8 million and \$16.3 million, respectively. Contract retentions collectible beyond one year are included in Other Assets on the Consolidated Balance Sheets and totaled \$2.0 million and \$1.7 million at August 31, 2008 and May 31, 2008, respectively.

**Table of Contents****Matrix Service Company****Notes to Consolidated Financial Statements****Note 6 Debt**

The Company has a five-year, \$75.0 million senior revolving credit facility ( Credit Facility ) that expires on November 30, 2012. The Credit Facility is guaranteed by substantially all of the Company's subsidiaries and is secured by a lien on substantially all of the Company's assets. The Company has the right to increase the total capacity of the Credit Facility up to \$100.0 million, with the approval of the administrative agent.

Availability under the Credit Facility is as follows:

|                                        | August 31,<br>2008 | May 31,<br>2008 |
|----------------------------------------|--------------------|-----------------|
|                                        | (In thousands)     |                 |
| Credit Facility                        | \$ 75,000          | \$ 75,000       |
| Letters of credit                      | 4,648              | 4,648           |
| Availability under the Credit Facility | \$ 70,352          | \$ 70,352       |

The Credit Facility may be used for working capital, issuance of letters of credit or other lawful corporate purposes. The Credit Agreement contains customary affirmative and negative covenants that place certain restrictions on the Company, including limits on new debt, operating and capital lease obligations, asset sales and certain distributions, including dividends. Significant financial covenants include the following:

Senior Leverage Ratio not to exceed 2.50 to 1.00;

Asset Coverage Ratio to be greater than 1.45 to 1.00;

Fixed Charge Coverage Ratio to be greater than 1.25 to 1.00; and

Tangible Net Worth must be greater than the sum of \$55.6 million plus 75% of positive net income after August 31, 2006 and net proceeds from the sale of any equity securities.

At the Company's option, amounts borrowed under the Credit Facility bear interest at LIBOR or an Alternate Base Rate, plus in each case, an additional margin based on the Senior Leverage Ratio. The Alternate Base Rate is the greater of the Prime Rate or the Fed Funds Effective Rate plus 0.5%. The additional margin ranges on the Alternate Base Rate loans are between 0.00% and 0.25% and from between 1.00% and 1.75% on LIBOR-based loans. The Company also pays an Unused Revolving Credit Facility Fee of between 0.175% and 0.375% based on the Senior Leverage Ratio. Since the closing date, the Company has been at the lowest additional margin tier for both LIBOR and Alternate Base Rate loans and the lowest fee tier for the Unused Revolving Credit Facility Fee.

**Note 7 Income Taxes**

Deferred income taxes are computed using the liability method whereby deferred tax assets and liabilities are recognized based on temporary differences between the financial statement and tax basis of assets and liabilities using presently enacted tax rates. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes.



**Table of Contents**

**Matrix Service Company**

**Notes to Consolidated Financial Statements**

**Note 8 Commitments and Contingencies**

*Insurance Reserves*

The Company maintains insurance coverage for various aspects of our operations. However, exposure to potential losses is retained through the use of deductibles and coverage limits.

Typically our contracts require us to indemnify our customers for injury, damage or loss arising from the performance of our services and provide for warranties for materials and workmanship. The Company may also be required to name the customer as an additional insured under certain insurance policies up to the limits of insurance available, or we may have to purchase special insurance policies or surety bonds for specific customers or provide letters of credit issued under our Credit Facility in lieu of bonds to satisfy performance and financial guarantees on some projects. Matrix Service currently maintains a performance and payment bonding line of \$140.0 million. The Company generally requires its subcontractors to indemnify the Company and the Company's customer and name the Company as an additional insured for activities arising out of the subcontractors' presence at the customer's location. We also require certain subcontractors to provide additional insurance policies, including surety bonds in favor of the Company, to secure the subcontractors' work or as required by the subcontract.

There can be no assurance that our insurance and the additional insurance coverage provided by our subcontractors will fully protect us against a valid claim or loss under the contracts with our customers.

*Unapproved Change Orders and Claims*

As of August 31, 2008 and May 31, 2008, costs and estimated earnings in excess of billings on uncompleted contracts included revenues for unapproved change orders of \$0.4 million and \$0.8 million, respectively. At August 31, 2008 costs and estimated earnings in excess of billings on uncompleted contracts included revenues for claims of \$0.1 million. There were no revenues related to claims included in costs and estimated earnings in excess of billings on uncompleted contracts at May 31, 2008. Generally, collection of amounts related to unapproved change orders and claims is expected within twelve months. However, customers generally will not pay these amounts until final resolution of related claims, and accordingly, collection of these amounts may extend beyond one year.

*Capital Commitments*

At August 31, 2008, expected spending on capital projects that have been approved but are not yet completed totaled \$3.8 million.

*Other*

The Company and its subsidiaries are named as defendants in various legal actions and are vigorously defending each of them. It is the opinion of management that none of the known legal actions will have a material adverse impact on the Company's financial position, results of operations or liquidity.

**Table of Contents****Matrix Service Company****Notes to Consolidated Financial Statements****Note 9 Other Comprehensive Income**

Other comprehensive income and accumulated other comprehensive income consisted of foreign currency translation adjustments.

|                                   | <b>Three Months Ended</b> |                        |
|-----------------------------------|---------------------------|------------------------|
|                                   | <b>August 31, 2008</b>    | <b>August 31, 2007</b> |
|                                   | <b>(In thousands)</b>     |                        |
| Net income                        | \$ 9,504                  | \$ 6,336               |
| Other comprehensive income (loss) | (637)                     | 108                    |
| Comprehensive income              | \$ 8,867                  | \$ 6,444               |

**Note 10 Earnings per Common Share**

Basic earnings per share ( EPS ) is calculated based on the weighted average shares outstanding during the period. Diluted EPS includes the dilutive effect of employee and director stock options as well as the dilutive effect of nonvested deferred shares.

There were no antidilutive options for the three months ended August 31, 2008 and August 31, 2007. There were 16,587 antidilutive nonvested deferred shares for the three months ended August 31, 2008 and no antidilutive nonvested deferred shares for the three months ended August 31, 2007. Antidilutive options and nonvested deferred shares are not included in the calculation of diluted earnings per share.

The computation of basic and diluted EPS is as follows:

|                                             | Three Months Ended                    |                    |
|---------------------------------------------|---------------------------------------|--------------------|
|                                             | August 31,<br>2008                    | August 31,<br>2007 |
|                                             | (In thousands, except per share data) |                    |
| <b>Basic EPS:</b>                           |                                       |                    |
| Net income                                  | \$ 9,504                              | \$ 6,336           |
| Weighted average shares outstanding         | 26,073                                | 26,592             |
| Basic EPS                                   | \$ 0.36                               | \$ 0.24            |
| <b>Diluted EPS:</b>                         |                                       |                    |
| Weighted average shares outstanding - basic | 26,073                                | 26,592             |
| Dilutive stock options                      | 269                                   | 390                |
| Dilutive nonvested deferred shares          | 131                                   | 101                |
| Dilutive weighted average shares            | 26,473                                | 27,083             |
| Diluted EPS                                 | \$ 0.36                               | \$ 0.23            |



**Table of Contents**

**Matrix Service Company**

**Notes to Consolidated Financial Statements**

**Note 11 Segment Information**

The Company has two reportable segments, the Construction Services segment and the Repair and Maintenance Services segment.

The primary services of our Construction Services segment are aboveground storage tanks for the bulk storage/terminal industry, capital construction for the downstream petroleum industry, specialty construction, and electrical/instrumentation services for various industries. These services, including civil/structural, mechanical, piping, electrical and instrumentation, millwrighting, and fabrication, are provided for projects of varying complexities, schedule durations, and budgets. Our project experience includes renovations, retrofits, modifications and expansions to existing facilities as well as construction of new facilities.

The primary services of our Repair and Maintenance Services segment are aboveground storage tank repair and maintenance services, planned major and routine maintenance for the downstream petroleum industry, specialty repair and maintenance services and electrical and instrumentation repair and maintenance.

Other consists of operating activity related to previously disposed-of businesses and certain corporate assets.

The Company evaluates performance and allocates resources based on profit or loss from operations before income taxes. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Intersegment sales and transfers are recorded at cost; therefore, no intercompany profit or loss is recognized.

**Table of Contents****Matrix Service Company****Notes to Consolidated Financial Statements****Results of Operations**

(In thousands)

|                                           | <b>Construction<br/>Services</b> | <b>Repair &amp;<br/>Maintenance<br/>Services</b> | <b>Other</b> | <b>Total</b> |
|-------------------------------------------|----------------------------------|--------------------------------------------------|--------------|--------------|
| <b>Three Months Ended August 31, 2008</b> |                                  |                                                  |              |              |
| Gross revenues                            | \$ 122,361                       | \$ 72,167                                        | \$           | \$ 194,528   |
| Less: Inter-segment revenues              | 7,603                            | 275                                              |              | 7,878        |
| Consolidated revenues                     | 114,758                          | 71,892                                           |              | 186,650      |
| Gross profit                              | 15,045                           | 11,626                                           |              | 26,671       |
| Operating income                          | 7,492                            | 7,117                                            |              | 14,609       |
| Income before income tax expense          | 7,703                            | 7,637                                            |              | 15,340       |
| Net income                                | 4,379                            | 5,125                                            |              | 9,504        |
| Segment assets                            | 150,322                          | 91,116                                           | 35,882       | 277,320      |
| Capital expenditures                      | 1,039                            | 930                                              | 1,136        | 3,105        |
| Depreciation expense                      | 1,412                            | 969                                              |              | 2,381        |
| <b>Three Months Ended August 31, 2007</b> |                                  |                                                  |              |              |
| Gross revenues                            | \$ 103,017                       | \$ 63,985                                        | \$           | \$ 167,002   |
| Less: Inter-segment revenues              | 4,238                            | 1,437                                            |              | 5,675        |
| Consolidated revenues                     | 98,779                           | 62,548                                           |              | 161,327      |
| Gross profit                              | 8,673                            | 10,231                                           |              | 18,904       |
| Operating income (loss)                   | 3,924                            | 7,019                                            | (85)         | 10,858       |
| Income (loss) before income tax expense   | 3,713                            | 6,932                                            | (85)         | 10,560       |
| Net income (loss)                         | 2,227                            | 4,160                                            | (51)         | 6,336        |
| Segment assets                            | 135,094                          | 86,732                                           | 19,301       | 241,127      |
| Capital expenditures                      | 1,506                            | 672                                              | 710          | 2,888        |
| Depreciation and amortization expense     | 1,053                            | 721                                              |              | 1,774        |

**Segment revenue from external customers by market is as follows:**

|                                           | <b>Construction<br/>Services</b> | <b>Repair &amp;<br/>Maintenance<br/>Services<br/>(In thousands)</b> | <b>Total</b> |
|-------------------------------------------|----------------------------------|---------------------------------------------------------------------|--------------|
| <b>Three Months Ended August 31, 2008</b> |                                  |                                                                     |              |
| Aboveground Storage Tanks                 | \$ 55,869                        | \$ 47,897                                                           | \$ 103,766   |
| Downstream Petroleum                      | 38,547                           | 21,245                                                              | 59,792       |
| Electrical and Instrumentation            | 11,474                           | 2,750                                                               | 14,224       |
| Specialty                                 | 8,868                            |                                                                     | 8,868        |
| Total                                     | \$ 114,758                       | \$ 71,892                                                           | \$ 186,650   |

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**Three Months Ended August 31, 2007**

|                                |           |           |            |
|--------------------------------|-----------|-----------|------------|
| Aboveground Storage Tanks      | \$ 39,474 | \$ 41,529 | \$ 81,003  |
| Downstream Petroleum           | 33,551    | 17,537    | 51,088     |
| Electrical and Instrumentation | 2,172     | 3,482     | 5,654      |
| Specialty                      | 23,582    |           | 23,582     |
| Total                          | \$ 98,779 | \$ 62,548 | \$ 161,327 |

-14-

## **Table of Contents**

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations** **CRITICAL ACCOUNTING ESTIMATES**

The following is a discussion of the most critical accounting policies, estimates, judgments and uncertainties that are inherent in our application of generally accepted accounting principles (GAAP).

#### ***Revenue Recognition***

Matrix Service records profits on fixed-price contracts on a percentage-of-completion basis, primarily based on costs incurred to date compared to the total estimated contract cost. Matrix Service records revenue on reimbursable and time and material contracts on a proportional performance basis as costs are incurred. Contracts in process are valued at cost plus accrued profits less billings on uncompleted contracts. Contracts are generally considered substantially complete when field construction is completed. The elapsed time from award of a contract to completion of performance may be in excess of one year. Matrix Service includes pass-through revenue and costs on cost-plus contracts, which are customer-reimbursable materials, equipment and subcontractor costs, when Matrix Service determines that it is responsible for the procurement and management of such cost components on behalf of the customer.

Matrix Service has numerous contracts that are in various stages of completion which require estimates to determine the appropriate cost and revenue recognition. Matrix Service has a history of making reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs, and accordingly, does not believe significant fluctuations are likely to materialize. However, current estimates may be revised as additional information becomes available. If estimates of costs to complete fixed-price contracts indicate a loss, a provision is made through a contract write-down for the total loss anticipated. A number of our contracts contain various cost and performance incentives and penalties that impact the earnings we realize from our contracts. Adjustments related to these incentives and penalties are recorded in the period on a percentage-of-completion basis when estimable and probable.

Indirect costs (such as salaries and benefits, supplies and tools, equipment costs and insurance costs) are charged to projects based upon direct labor hours and overhead allocation rates per direct labor hour. Warranty costs are normally incurred prior to project completion and are charged to project costs as they are incurred. Warranty costs incurred subsequent to project completion were not material for the periods presented. Overhead allocation rates are established annually during the budgeting process and evaluated for accuracy throughout the year based upon actual direct labor hours and actual costs incurred.

#### ***Claims Recognition***

Claims are amounts in excess of the agreed contract price (or amounts not included in the original contract price) that we seek to collect from customers or others for delays, errors in specifications and designs, contract terminations, change orders in dispute or unapproved as to both scope and price or other causes of anticipated additional costs incurred by us. Recognition of amounts as additional contract revenue related to claims is appropriate only if it is probable that the claims will result in additional contract revenue and if the amount can be reliably estimated. We must determine if:

there is a legal basis for the claim;

the additional costs were caused by circumstances that were unforeseen by the Company and are not the result of deficiencies in our performance;

the costs are identifiable or determinable and are reasonable in view of the work performed; and

the evidence supporting the claim is objective and verifiable.

If all of these requirements are met, revenue from a claim is recorded only to the extent that we have incurred costs relating to the claim.



## Table of Contents

As of August 31, 2008 and May 31, 2008, costs and estimated earnings in excess of billings on uncompleted contracts included revenues for unapproved change orders of \$0.4 million and \$0.8 million, respectively. At August 31, 2008 costs and estimated earnings in excess of billings on uncompleted contracts included revenues for claims of \$0.1 million. There were no revenues related to claims included in costs and estimated earnings in excess of billings on uncompleted contracts at May 31, 2008.

The following table provides a rollforward of revenue recognized on claims and unapproved change orders:

|                            | Claims<br>for<br>Unapproved<br>Change Orders | Other<br>Claims<br>(In thousands) | Total    |
|----------------------------|----------------------------------------------|-----------------------------------|----------|
| Balance at May 31, 2008    | \$ 804                                       | \$                                | \$ 804   |
| Additions                  | 6                                            | 75                                | 81       |
| Collections                | (404)                                        |                                   | (404)    |
| Gain(Loss)                 |                                              |                                   |          |
| Balance at August 31, 2008 | \$ 406                                       | \$ 75                             | \$ 481   |
| Balance at May 31, 2007    | \$ 5,129                                     | \$ 1,493                          | \$ 6,622 |
| Additions                  | 432                                          |                                   | 432      |
| Collections                | (39)                                         |                                   | (39)     |
| Gain(Loss)                 |                                              |                                   |          |
| Balance at August 31, 2007 | \$ 5,522                                     | \$ 1,493                          | \$ 7,015 |

## Loss Contingencies

Various legal actions, claims, and other contingencies arise in the normal course of our business. Contingencies are recorded in the consolidated financial statements, or are otherwise disclosed, in accordance with SFAS No. 5 Accounting for Contingencies. Specific reserves are provided for loss contingencies to the extent we conclude their occurrence is both probable and estimable. We use a case-by-case basis evaluation of the underlying data and update our evaluation as further information becomes known. We believe that any amounts exceeding our recorded accruals should not materially affect our financial position, results of operations or liquidity. However, the results of litigation are inherently unpredictable and the possibility exists that the ultimate resolution of one or more of these matters could result in a material adverse effect on our financial position, results of operations or liquidity.

Legal costs are expensed as incurred.

## Insurance Reserves

We maintain insurance coverage for various aspects of our operations. However, we retain exposure to potential losses through the use of deductibles and coverage limits. As of August 31, 2008 and May 31, 2008, insurance reserves totaling \$8.8 million and \$8.5 million, respectively, are included on our balance sheet. These amounts represent our best estimate of our ultimate obligations for asserted claims, insurance premium obligations and claims incurred but not yet reported at the balance sheet date. We establish specific reserves for claims using a case-by-case evaluation of the underlying claim data and update our evaluations as further information becomes known. Judgments and assumptions are inherent in our reserve accruals; as a result, changes in assumptions, claims experience, and the actual results of claim settlements could result in changes to these estimates in the future.

## **Table of Contents**

### ***Goodwill***

Goodwill and intangible assets with indefinite useful lives are not amortized and are tested at least annually for impairment. We perform our annual analysis during the fourth quarter of each fiscal year and in any other period in which indicators of impairment warrant an additional analysis. Goodwill represents the excess of the purchase price of acquisitions over the fair value of the net assets acquired. Goodwill is evaluated for impairment by first comparing management's estimate of the fair value of a reporting unit with its carrying value, including goodwill. Reporting units for purposes of goodwill impairment calculations are our reportable segments.

Management utilizes a discounted cash flow analysis to determine the estimated fair value of our reporting units. Significant judgments and assumptions including the discount rate, anticipated revenue growth and gross margins, estimated operating and interest expense, and capital expenditures are inherent in these fair value estimates which are based on our internal operating budgets. As a result, actual results may differ from the estimates utilized in our discounted cash flow analysis. The use of alternate judgments and/or assumptions could result in a fair value that differs from our estimate and could result in the recognition of an impairment charge in the financial statements.

As a result of these uncertainties, we utilize multiple scenarios and assign probabilities to each of the scenarios in the discounted cash flow analysis. The results of the discounted cash flow analysis are then compared to the carrying value of the reporting unit. If the carrying value of a reporting unit exceeds its fair value, a computation of the implied fair value of goodwill is compared with its related carrying value. If the carrying value of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in the amount of the excess. If an impairment charge is incurred, it would negatively impact our results of operations and financial position.

We do not currently anticipate a goodwill impairment for either our Construction Services or Repair and Maintenance Services segments. However, certain events may occur that might adversely affect the reported value of goodwill. Such events could include, but are not limited to, strategic decisions made in response to economic or competitive conditions, a significant change in the project plans of our customers, the economic condition of the customers and industries we serve, and a material negative change in the relationships with one or more of our significant customers. If our judgments and assumptions change as a result of the occurrence of any of these events or other events that we do not currently anticipate, our expectations as to future results and our estimate of the implied value of one or more of our reporting units also may change.

Our significant assumptions, including revenue growth, gross margins, operating and interest expense and other factors, have been reasonably accurate in recent years, but are likely to change in light of the dynamic competitive environment in which we operate. At May 31, 2008 the estimated fair value of the Construction Services segment exceeded its carrying value by 220% and the estimated fair value of the Repair and Maintenance Services segment exceeded its carrying value by 74%. Based on the excess of estimated fair value over carrying value at May 31, 2008 and the absence of any indicators of impairment at August 31, 2008, we do not currently anticipate recording a goodwill impairment charge for either of our operating units.

## **Table of Contents**

### **Results of Operations**

#### ***Overview***

The Company has two reportable segments, Construction Services and Repair and Maintenance Services. The majority of the work for both segments is performed in the United States with less than 4.0% of revenues generated in Canada during the first quarter of fiscal 2009. However, the Company does continue to seek opportunities for growth in both the domestic and international markets.

The primary services of our Construction Services segment are aboveground storage tanks for the bulk storage/terminal industry, capital construction for the downstream petroleum industry, specialty construction, and electrical/instrumentation services for various industries. These services, including civil/structural, mechanical, piping, electrical and instrumentation, millwrighting, and fabrication, are provided for projects of varying complexities, schedule durations, and budgets. Our project experience includes renovations, retrofits, modifications and expansions to existing facilities as well as construction of new facilities.

The primary services of our Repair and Maintenance Services segment are aboveground storage tank repair and maintenance services, planned major and routine maintenance for the downstream petroleum industry, specialty repair and maintenance services and electrical and instrumentation repair and maintenance.

Significant fluctuations in revenues, gross profits and operating results are discussed below on a consolidated basis and for each segment. Revenues fluctuate due to many factors, including the changing product mix and project schedules, which are dependent on the level and timing of customer releases of new business.

### **Three Months Ended August 31, 2008 Compared to the Three Months Ended August 31, 2007**

#### ***Consolidated***

Consolidated revenues were \$186.7 million in fiscal 2009, an increase of \$25.4 million, or 15.7%, from consolidated revenues of \$161.3 million for fiscal 2008. The improvement in consolidated revenues was the result of increases in the Construction Services segment of \$16.0 million and in the Repair and Maintenance Services segment of \$9.4 million.

Consolidated gross profit increased from \$18.9 million in fiscal 2008 to \$26.7 million in fiscal 2009. The improvement of \$7.8 million, or 41.3% was due to an increase in revenue of \$25.4 million and an increase in gross margins, which improved from 11.7% in fiscal 2008 to 14.3% in fiscal 2009. The gross margin improvement was due to higher margins in the Construction Services segment, where the gross margin increased to 13.1% in the current fiscal year versus 8.8% in the prior fiscal year. Repair and Maintenance Services segment gross margins were 16.2% in the current year compared to 16.4% in fiscal 2008.

Consolidated SG&A expenses increased \$4.1 million, or 51.3%, in fiscal 2009 to \$12.1 million from \$8.0 million for fiscal 2008. The increase was primarily due to the addition of key resources necessary to execute our growth strategy. SG&A expense as a percentage of revenue increased to 6.5% in fiscal 2009 compared to 5.0% in the prior fiscal year.

There was no net interest expense in fiscal 2009 compared to \$0.3 million in fiscal 2008. In the current year, the non-cash amortization of deal fees relating to the senior revolving credit facility and cash interest on our capital leases was offset by interest income generated from the investment of excess cash. The prior year net interest expense was primarily related to the amortization of deal fees on the senior revolving credit facility and interest on short-term borrowings under the facility.

Other income in fiscal 2009 was \$0.7 million and related primarily to insurance proceeds received. There were no similar items in fiscal 2008.

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**Table of Contents**

Income before income tax expense increased to \$15.3 million in fiscal 2009 from \$10.6 million in fiscal 2008. This \$4.7 million increase occurred due to higher gross profits partially offset by higher SG&A expenses.

The effective tax rate for fiscal 2009 was 38.0% compared to 40.0% in fiscal 2008.

Net income for fiscal 2009 grew to \$9.5 million, or \$0.36 per fully diluted share, versus net income in fiscal 2008 of \$6.3 million, or \$0.23 per fully diluted share.

***Construction Services***

Revenues for the Construction Services segment were \$114.8 million, compared with \$98.8 million in the same period a year earlier. The increase of \$16.0 million, or 16.2%, was due to higher Aboveground Storage Tank revenues, which increased 41.5% to \$55.9 million in fiscal 2009, compared to \$39.5 million a year earlier, higher revenues in Electrical and Instrumentation, which increased \$9.3 million to \$11.5 million in fiscal 2009, compared to \$2.2 million a year earlier, and higher Downstream Petroleum revenues, which increased 14.6% to \$38.5 million in fiscal 2009 compared to \$33.6 million a year earlier. These increases were partially offset by lower Specialty revenues, which fell \$14.7 million as the construction of the tanks on a Gulf Coast LNG project was completed in the fourth quarter of fiscal 2008.

At August 31, 2008, the Construction Services segment had a backlog of \$300.3 million, as compared to a backlog of \$325.3 million as of May 31, 2008. The decrease of \$25.0 million is due to declines in Aboveground Storage Tank and Electrical and Instrumentation of \$30.8 million and \$4.2 million, partially offset by increases in Downstream Petroleum of \$8.4 million and Specialty of \$1.6 million.

Gross profit increased from \$8.7 million in fiscal 2008 to \$15.0 million in fiscal 2009 due to the 16.2% growth in revenues and improved gross margins, which increased from 8.8% in fiscal 2008 to 13.1% in fiscal 2009. The prior year's gross margins of 8.8% included a \$1.5 million pretax charge for cost overruns related to a Gulf Coast LNG project.

Operating income and income before income tax expense were \$7.5 million and \$7.7 million in fiscal 2009 compared to \$3.9 million and \$3.7 million in fiscal 2008.

***Repair and Maintenance Services***

Revenues for the Repair and Maintenance Services segment were \$71.9 million in fiscal 2009 compared to \$62.5 million in fiscal 2008. The improvement was due to higher Aboveground Storage Tank revenues, which increased 15.4% to \$47.9 million in fiscal 2009, compared to \$41.5 million in the prior fiscal year and by higher Downstream Petroleum revenues, which increased 21.1% to \$21.2 million in fiscal 2009, compared to \$17.5 million a year earlier. These increases were partially offset by lower Electrical and Instrumentation revenues, which decreased \$0.7 million to \$2.8 million in fiscal 2009 from \$3.5 million during fiscal 2008.

Backlog at August 31, 2008 and May 31, 2008 for the Repair and Maintenance Services segment was \$158.5 million and \$142.0 million, respectively. The increase of \$16.5 million was due to increases in Downstream Petroleum of \$11.9 million and Aboveground Storage Tank of \$4.6 million. The Electrical and Instrumentation backlog was unchanged.

Gross profit increased from \$10.2 million in fiscal 2008 to \$11.6 million in fiscal 2009 due to an increase in revenues. Gross margins were 16.2% in fiscal 2009 and 16.4% in fiscal 2008.

Operating income and income before income tax expense increased to \$7.1 million and \$7.6 million, respectively, in fiscal 2009 compared to \$7.0 million and \$6.9 million in fiscal 2008.

**Table of Contents*****Backlog***

We define backlog as the total dollar amount of revenues that we expect to recognize as a result of performing work that has been awarded to us through a signed contract that we consider firm. The following contract types are considered firm:

fixed-price arrangements;

minimum customer commitments on cost plus arrangements; and

certain time and material contracts in which the estimated contract value is firm or can be estimated with a reasonable amount of certainty in both timing and amounts.

For long-term maintenance contracts we include only the amounts that we expect to recognize into revenue over the next 12 months. For all other arrangements, we calculate backlog as the estimated contract amount less the revenue recognized as of the reporting date.

The following table provides a rollforward of our backlog from May 31, 2008 to August 31, 2008:

|                                            | <b>Construction<br/>Services</b> | <b>Repair and<br/>Maintenance<br/>Services<br/>(In thousands)</b> | <b>Total</b> |
|--------------------------------------------|----------------------------------|-------------------------------------------------------------------|--------------|
| Backlog as of May 31, 2008                 | \$ 325,341                       | \$ 141,967                                                        | \$ 467,308   |
| New backlog awarded                        | 89,707                           | 88,396                                                            | 178,103      |
| Revenue recognized on contracts in backlog | (114,758)                        | (71,892)                                                          | (186,650)    |
| Backlog as of August 31, 2008              | \$ 300,290                       | \$ 158,471                                                        | \$ 458,761   |

**Table of Contents*****Non-GAAP Financial Measure***

EBITDA is a supplemental, non-GAAP financial measure. EBITDA is defined as earnings before net interest expense, income taxes, depreciation and amortization. We have presented EBITDA because it is used by the financial community as a method of measuring our performance and of evaluating the market value of companies considered to be in similar businesses. We believe that the line item on our Consolidated Statements of Income entitled *Net Income* is the most directly comparable GAAP measure to EBITDA. Since EBITDA is not a measure of performance calculated in accordance with GAAP, it should not be considered in isolation of, or as a substitute for, net earnings as an indicator of operating performance. EBITDA, as we calculate it, may not be comparable to similarly titled measures employed by other companies. In addition, this measure is not necessarily a measure of our ability to fund our cash needs. As EBITDA excludes certain financial information compared with net income, the most directly comparable GAAP financial measure, users of this financial information should consider the type of events and transactions that are excluded. Our non-GAAP performance measure, EBITDA, has certain material limitations as follows:

It does not include interest income or expense. Because we borrow money from time to time to finance our operations, interest expense is a necessary and ongoing part of our costs and has assisted us in generating revenue. Therefore, any measure that excludes interest expense has material limitations.

It does not include income taxes. Because the payment of income taxes is a necessary and ongoing part of our operations, any measure that excludes income taxes has material limitations.

It does not include depreciation expense. Because we use capital assets to generate revenue, depreciation expense is a necessary element of our cost structure. Therefore, any measure that excludes depreciation expense has material limitations.

A reconciliation of EBITDA to net income follows:

|                               | <b>Three Months Ended</b> |                        |
|-------------------------------|---------------------------|------------------------|
|                               | <b>August 31, 2008</b>    | <b>August 31, 2007</b> |
|                               | <b>(In thousands)</b>     |                        |
| Net income                    | \$ 9,504                  | \$ 6,336               |
| Interest expense, net         | 5                         | 288                    |
| Provision for income taxes    | 5,836                     | 4,224                  |
| Depreciation and amortization | 2,381                     | 1,774                  |
| <b>EBITDA</b>                 | <b>\$ 17,726</b>          | <b>\$ 12,622</b>       |

## **Table of Contents**

### **FINANCIAL CONDITION AND LIQUIDITY**

#### *Overview*

We define liquidity as the ongoing ability to pay our liabilities as they become due, fund business operations and meet all monetary contractual obligations. Our primary sources of liquidity in the first quarter of fiscal 2009 were cash on hand at the beginning of the quarter and cash flows from operations. Cash on hand at August 31, 2008 totaled \$18.8 million and availability under the senior revolving credit facility totaled \$70.4 million resulting in total liquidity of \$89.2 million. Factors that routinely impact our short-term liquidity and may impact our long-term liquidity include, but are not limited to:

Changes in working capital

Contract terms that determine the timing of billings to customers and the collection of those billings

Some cost plus and fixed price customer contracts are billed based on milestones which may require us to incur significant expenditures prior to collecting from our customers.

Time and material contracts are normally billed in arrears. Therefore, we are required to carry these costs until they can be billed and collected.

Some of our large construction projects require retentions.

Capital expenditures

Strategic investments in new operations

Acquisitions of new businesses

Purchases of shares under our existing or any future stock buyback program

Contract disputes or collection issues resulting from the failure of a significant customer

In the future we may elect to raise additional capital by issuing common stock, convertible notes or term debt as necessary to fund our operations or to fund the acquisition of new businesses. In fiscal 2009, we expect cash flows from operations to be a significant source of liquidity, which we expect will provide funding for additional investments in capital assets and our planned acquisition of the engineering and construction assets and technology from CB&I. We will continue to evaluate our working capital requirements and other factors to maintain sufficient liquidity.

#### *Cash Flows from Operating Activities*

Operations generated \$0.3 million in cash in the first quarter of fiscal 2009. The cash generated from operations was due primarily to profitable operating results substantially offset by an increase in working capital.



## **Table of Contents**

### *Cash Flows from Investing Activities*

Investing activities used \$3.0 million of cash in the first quarter of fiscal 2009 due to capital expenditures of \$3.1 million partially offset by proceeds from asset sales of \$0.1 million. Capital expenditures included \$1.0 million for the purchase of construction equipment, \$0.7 million for transportation equipment, \$0.2 million for furniture and fixtures, and \$1.2 million for land and buildings. The \$1.2 million of capital expenditures included in the land and buildings category related primarily to leasehold improvements to the office building that now functions as our corporate headquarters and provides office space for certain operations personnel. We routinely acquire assets utilizing capital leases. Assets acquired through capital leases totaled \$0.3 million in the first quarter of fiscal 2009 and are reported as non-cash additions to Property, Plant and Equipment in the Consolidated Statement of Cash Flows.

### *Cash Flows from Financing Activities*

Financing activities used \$0.1 million in cash in the first quarter of fiscal 2009 due to capital lease payments of \$0.3 million partially offset by proceeds from stock option activity of \$0.2 million.

### *Senior Revolving Credit Facility*

The senior revolving credit facility is primarily used to fund short-term changes in working capital and issuance of letters of credit. The total capacity of the facility at August 31, 2008 was \$75.0 million with \$4.6 million outstanding for letters of credit that have been issued to support certain workers' compensation insurance programs resulting in an availability of \$70.4 million. The Company currently believes that sufficient liquidity exists but has the right to increase the facility to \$100.0 million in the future if considered necessary. We believe the facility provides adequate liquidity and financial flexibility to support our expected growth in fiscal 2009 and beyond.

The facility contains customary negative covenants including limits on other indebtedness, operating and capital lease obligations, asset sales, dividends and certain other distributions. The facility also contains financial covenants that require us to maintain certain financial ratios including a senior leverage ratio, an asset coverage ratio, a fixed charge coverage ratio and a tangible net worth requirement. Non-compliance with any of these ratios or the tangible net worth requirement or a violation of other covenants could result in an event of default and reduce the availability under the facility. We are currently in compliance with all covenants and have full availability under the facility.

## **Table of Contents**

### *Dividend Policy*

We have never paid cash dividends on our common stock, and the terms of our credit agreement limits the amount of cash dividends we can pay. We currently intend to retain earnings to finance the growth of our business. Any payment of cash dividends in the future will depend upon our financial condition, capital requirements and earnings as well as other factors the Board of Directors may deem relevant.

### *Stock Repurchase Program and Treasury Shares*

In October 2000, the Board of Directors authorized a stock buyback program, which permitted the purchase of up to 20% (i.e., 3,447,506 shares) of our common stock outstanding at that time. To date, Matrix Service has purchased 2,846,782 shares under the program and has authorization to purchase an additional 600,724 shares. The Company did not repurchase any common shares during the first quarter of fiscal 2009, the Company intends to repurchase shares in future periods if accretive to earnings per share. The Company has 1,806,150 treasury shares remaining at August 31, 2008 and intends to utilize these treasury shares solely for the satisfaction of stock issuances under the Company's equity incentive compensation plans.

## **Outlook**

We produced strong results in the first fiscal quarter and the fundamentals of our industry remain sound. We anticipate that demand from our customers combined with our efforts to diversify our services and to expand our geographic footprint will enable us to maintain significant growth in revenues and earnings per share over the prior fiscal year. The current uncertainty in the financial and capital markets have not had a significant direct or indirect impact on our business. We believe our industry is as well insulated as any; however, it is possible that our results of operations may be negatively affected if the current financial crisis is prolonged and causes our customers to reduce or delay spending for our services.

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

This Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical facts, included in this Form 10-Q which address activities, events or developments which we expect, believe or anticipate will or may occur in the future are forward-looking statements. The words believes, intends, expects, anticipates, projects, estimates, predicts and similar expressions are intended to identify forward-looking statements.

These forward-looking statements include, among others, such things as:

amounts and nature of future revenues and margins from our Construction Services and Repair and Maintenance Services segments;

our ability to generate sufficient cash from operations or to raise cash in order to meet our short and long-term capital requirements;

our ability to continue to comply with the covenants in our credit agreement;

the adequacy of our reserves for contingencies and insurance losses;

the likely impact of new or existing regulations or market forces on the demand for our services; and

expansion and other development trends of the industries we serve.

These statements are based on certain assumptions and analyses we made in light of our experience and our perception of historical trends, current conditions and expected future developments as well as other factors we believe are appropriate in the circumstances. However, whether actual results and developments will conform with our expectations and predictions is subject to a number of risks and uncertainties which could cause actual results to differ materially from our expectations, including:

the risk factors discussed in our Form 10-K for the fiscal year ended May 31, 2008 and listed from time to time in our filings with the Securities and Exchange Commission;

economic, market or business conditions in general and in the oil and gas, power and petrochemical industries in particular;

changes in laws or regulations; and

other factors, many of which are beyond our control.

Consequently, all of the forward-looking statements made in this Form 10-Q are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected consequences to or effects on us or our business or operations. We assume no obligation to update publicly any such forward-looking statements, whether as a result of new information, future events or otherwise.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There have been no material changes in market risk faced by us from those reported in our Annual Report on Form 10-K for the fiscal year ended May 31, 2008, filed with the Securities and Exchange Commission. For more information on market risk, see Part II, Item 7A in our 2008 Annual Report on Form 10-K.

**Table of Contents**

**Item 4. Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based on the definition of disclosure controls and procedures in Rule 13a-15(e). In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of August 31, 2008. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There have been no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting during the quarter ended August 31, 2008.

**Table of Contents****PART II****OTHER INFORMATION****Item 1. Legal Proceedings**

For information regarding legal proceedings, see Note 8 in Item 1 of Part I of this Quarterly Report on Form 10-Q, which information is incorporated by reference into this Part II, Item 1.

**Item 1A. Risk Factors**

There were no material changes in our Risk Factors from those reported in Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended May 31, 2008.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**  
**Issuer Purchases of Equity Securities**

In October 2000, the Board of Directors authorized a stock buyback program, which permitted the purchase of up to 20% (i.e., 3,447,506 shares) of our common stock outstanding at that time. To date, Matrix Service has purchased 2,846,782 shares under the program and has authorization to purchase an additional 600,724 shares. The Company did not repurchase any common shares during the first quarter of fiscal 2009, the Company intends to repurchase shares in future periods if accretive to earnings per share. The Company has 1,806,150 treasury shares remaining at August 31, 2008 and intends to utilize these treasury shares solely for the satisfaction of stock issuances under the Company's equity incentive compensation plans.

|                      | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price Paid<br>per Share | Total Number of<br>Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number of<br>Shares That<br>May Yet Be<br>Purchased<br>Under the Plans<br>or Programs |
|----------------------|-------------------------------------------|------------------------------------|----------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|
| June 1 to 30, 2008   |                                           | \$                                 | 2,846,782                                                                                          | 600,724                                                                                          |
| July 1 to 31, 2008   |                                           |                                    | 2,846,782                                                                                          | 600,724                                                                                          |
| August 1 to 31, 2008 |                                           |                                    | 2,846,782                                                                                          | 600,724                                                                                          |
| Total                |                                           | \$                                 |                                                                                                    |                                                                                                  |

**Dividend Policy**

We have never paid cash dividends on our Common Stock, and our credit agreement limits the amount of cash dividends we can pay. We currently intend to retain earnings to finance the growth of our business. Any payment of cash dividends in the future will depend upon our financial condition, capital requirements and earnings as well as other factors the Board of Directors may deem relevant.

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Submission of Matters to a Vote of Security Holders**  
None

**Item 5. Other Information**  
None

-27-

**Table of Contents**

**Item 6. Exhibits:**

- Exhibit 31.1: Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002 CEO.  
Exhibit 31.2: Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002 CFO.  
Exhibit 32.1: Certification Pursuant to 18 U.S.C. 1350 (section 906 of Sarbanes-Oxley Act of 2002) CEO.  
Exhibit 32.2: Certification Pursuant to 18 U.S.C. 1350 (section 906 of Sarbanes-Oxley Act of 2002) CFO.  
Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**MATRIX SERVICE COMPANY**

Date: October 2, 2008

By: /s/ Thomas E. Long  
Thomas E. Long Vice President Finance and Chief Financial Officer  
signing on behalf of the registrant and as the registrant's principal  
financial officer

-28-

**Table of Contents**

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-29-