

MATRIX SERVICE CO
Form 10-Q/A
June 03, 2005
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended February 28, 2005

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 number 001-15461

MATRIX SERVICE COMPANY

(Exact name of registrant as specified in its charter)

DELAWARE
(State of incorporation)

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

10701 E. Ute St., Tulsa, Oklahoma 74116-1517

(Address of principal executive offices and zip code)

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

Not Applicable

(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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of April 8, 2005, there were 19,285,276 shares of the Company's common stock, \$0.01 par value per share, issued and 17,375,526 shares outstanding.

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EXPLANATORY NOTE

This Form 10-Q/A is being filed as Amendment No. 1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended February 28, 2005 to revise Part I, Items 1 and 4 and Part II, Item 5 in the original Form 10-Q. The amendment:

revises the discussion of the preliminary goodwill impairment charge recorded in the third fiscal quarter to remove all references that the charge could be adjusted downward; and

adds additional discussion of internal control issues identified, compensating controls and the status of the Company's remediation efforts.

This Amendment No. 1 to our Quarterly Report on Form 10-Q/A amends and restates Items 1 and 4 of Part I and Item 5 of Part II of our original Quarterly Report on Form 10-Q. The information included in these items has not been updated to reflect events or developments which may have occurred subsequent to February 28, 2005.

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PART I

FINANCIAL INFORMATION

ITEM 1. Financial Statements

Matrix Service Company

Consolidated Statements of Operations

(In Thousands, except share and per share data)

	Three Months Ended		Nine Months Ended	
	February 28, 2005	February 29, 2004	February 28, 2005	February 29, 2004
	(unaudited)		(unaudited)	
Revenues	\$ 111,447	\$ 145,175	\$ 309,908	\$ 474,850
Cost of revenues	105,573	133,354	286,352	436,871
Gross profit	5,874	11,821	23,556	37,979
Selling, general and administrative expenses	18,076	7,610	32,949	21,612
Restructuring, impairment and abandonment	25,002	16	25,150	68
Operating income (loss)	(37,204)	4,195	(34,543)	16,299
Other income (expense):				
Interest expense	(1,637)	(708)	(3,634)	(2,149)
Interest income		8	1	22
Other	84	306	98	489
Income (loss) before income tax expense	(38,757)	3,801	(38,078)	14,661
Provision (benefit) for federal, state and foreign income tax expense	(3,288)	1,542	(3,010)	5,955
Net earnings of joint venture				510
Net income (loss)	\$ (35,469)	\$ 2,259	\$ (35,068)	\$ 9,216
Earnings (loss) per share of common stock:				
Basic	\$ (2.05)	\$ 0.13	\$ (2.03)	\$ 0.56
Diluted	\$ (2.05)	\$ 0.13	\$ (2.03)	\$ 0.52
Weighted average number of common shares:				
Basic	17,339,069	17,030,824	17,309,133	16,569,531
Diluted (includes dilutive effect of stock options)	17,339,069	17,839,007	17,309,133	17,567,510

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See Notes to Consolidated Financial Statements

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Matrix Service Company

Consolidated Balance Sheets

(In Thousands)

	February 28, 2005	May 31, 2004
	(unaudited)	
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 1,972	\$ 752
Accounts receivable, less allowances (February 28, 2005 - \$424, May 31, 2004 - \$337)	59,228	56,974
Contract dispute receivables, net	20,975	31,456
Costs and estimated earnings in excess of billings on uncompleted contracts	22,576	18,854
Inventories	6,504	4,584
Income tax receivable	2,200	3,220
Deferred income taxes	4,352	1,493
Prepaid expenses	2,985	2,368
	<u>120,792</u>	<u>119,701</u>
Property, plant and equipment at cost:		
Land and buildings	25,194	24,518
Construction equipment	31,868	31,294
Transportation equipment	12,471	12,445
Furniture, fixtures and office equipment	8,962	8,743
Construction in progress	684	1,593
	<u>79,179</u>	<u>78,593</u>
Accumulated depreciation	37,297	32,939
	<u>41,882</u>	<u>45,654</u>
Net property, plant and equipment	41,882	45,654
Goodwill	24,872	49,666
Other assets	1,259	1,253
	<u>\$ 188,805</u>	<u>\$ 216,274</u>

See Notes to Consolidated Financial Statements

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Matrix Service Company

Consolidated Balance Sheets

(In Thousands, except share data)

	February 28, 2005	May 31, 2004
	<u> </u>	<u> </u>
	(unaudited)	
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	\$ 43,361	\$ 27,528
Billings on uncompleted contracts in excess of costs and estimated earnings	9,450	8,115
Accrued insurance	4,603	2,152
Other accrued expenses	11,753	11,264
Current capital lease obligation	58	
Current portion of long-term debt	54,946	4,893
Current portion of acquisition payable	1,904	1,835
	<u> </u>	<u> </u>
Total current liabilities	126,075	55,787
Long-term debt		64,209
Acquisition payable	5,832	5,614
Long-term capital lease obligation	112	
Deferred income taxes	5,129	4,949
Stockholders' equity:		
Common stock - \$.01 par value; 30,000,000 shares authorized and 19,285,276 shares issued as of February 28, 2005 and May 31, 2004	193	193
Additional paid-in capital	56,291	56,101
Retained earnings	482	35,585
Accumulated other comprehensive income (loss)	46	(395)
	<u> </u>	<u> </u>
	57,012	91,484
Less: Treasury stock, at cost 1,929,750 shares as of February 28, 2005 and 2,084,950 shares as of May 31, 2004	(5,355)	(5,769)
	<u> </u>	<u> </u>
Total stockholders' equity	51,657	85,715
	<u> </u>	<u> </u>
Total liabilities and stockholders' equity	\$ 188,805	\$ 216,274
	<u> </u>	<u> </u>

See Notes to Consolidated Financial Statements

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Matrix Service Company

Consolidated Cash Flow Statements

(In Thousands)

	Nine Months Ended	
	February 28, 2005	February 29, 2004
	(unaudited)	
Cash flow from operating activities:		
Net income (loss)	\$ (35,068)	\$ 9,216
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	5,171	4,791
Deferred income tax	(2,679)	960
Impairment of goodwill	25,000	
Contract dispute reserve	10,448	
Gain (loss) on sale of equipment	(93)	(242)
Allowance for uncollectible accounts	125	450
Accretion of acquisition payable	287	279
Earnings of joint venture		(857)
Change in value of interest rate swap	(158)	(175)
Amortization of accumulated loss on interest rate swap	116	168
Amortization of debt issuance costs	468	113
Changes in current assets and liabilities increasing (decreasing) cash:		
Accounts receivable	(2,379)	(7,410)
Contract disputes receivable	33	
Costs and estimated earnings in excess of billings on uncompleted contracts	(3,722)	4,620
Inventories	(1,920)	(212)
Prepaid expenses	(272)	117
Accounts payable	15,833	(12,961)
Billings on uncompleted contracts in excess of costs and estimated earnings	1,335	(6,575)
Accrued expenses	2,940	5,164
Income taxes receivable	1,157	2,073
Other	(28)	(108)
	<hr/>	<hr/>
Net cash provided (used) by operating activities	16,594	(589)
Cash flow from investing activities:		
Capital expenditures	(1,323)	(3,953)
Distribution from joint venture		701
Net effect of dissolution of joint venture		2,738
Proceeds from other investing activities	136	2,015
	<hr/>	<hr/>
Net cash provided (used) by investing activities	\$ (1,187)	\$ 1,501

See Notes to Consolidated Financial Statements

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Matrix Service Company

Consolidated Cash Flow Statements

(In Thousands)

	Nine Months Ended	
	February 28, 2005	February 29, 2004
	(unaudited)	
Cash flows from financing activities:		
Advances under bank credit agreement	\$ 124,162	\$ 219,512
Repayments on bank credit agreement	(138,160)	(221,865)
Capital lease borrowings	198	
Capital lease repayments	(28)	
Issuance of common stock	432	2,250
Payment of debt issuance costs	(834)	(145)
	<u> </u>	<u> </u>
Net cash used by financing activities	(14,230)	(248)
Effect of exchange rate changes on cash	43	41
	<u> </u>	<u> </u>
Increase in cash and cash equivalents	1,220	705
Cash and cash equivalents at beginning of period	752	775
	<u> </u>	<u> </u>
Cash and cash equivalents at end of period	<u>\$ 1,972</u>	<u>\$ 1,480</u>
Supplemental disclosure of cash flow information:		
Cash paid (received) during the period for:		
Income Taxes	\$ (1,399)	\$ 3,895
	<u> </u>	<u> </u>
Interest	<u>\$ 3,054</u>	<u>\$ 1,707</u>

See Notes to Consolidated Financial Statements

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Matrix Service Company

Consolidated Statements of Changes in Stockholders' Equity

(In Thousands)

(unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)		Total
					Translation	Derivative	
Balances, May 31, 2004	\$ 193	\$ 56,101	\$ 35,585	\$ (5,769)	\$ (239)	\$ (156)	\$ 85,715
Net loss			(35,068)				(35,068)
Other comprehensive income Translation adjustment					376		376
Derivative activity						65	65
Comprehensive loss							(34,627)
Exercise of stock options (155,200)		53	(35)	414			432
Tax effect of exercised stock options		137					137
Balances, February 28, 2005	\$ 193	\$ 56,291	\$ 482	\$ (5,355)	\$ 137	\$ (91)	\$ 51,657
Balances, May 31, 2003	\$ 96	\$ 52,527	\$ 26,304	\$ (8,179)	\$ (278)	\$ (289)	\$ 70,181
Net income			9,216				9,216
Other comprehensive income Translation adjustment					111		111
Derivative activity						104	104
Comprehensive income							9,431
Exercise of stock options (994,370)		217	(221)	2,254			2,250
Tax effect of exercised stock options		3,053					3,053
Stock Dividend	97	(97)					
Balances, February 29, 2004	\$ 193	\$ 55,700	\$ 35,299	\$ (5,925)	\$ (167)	\$ (185)	\$ 84,915

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1 - BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Matrix Service Company (Matrix or the Company) and its subsidiaries, all of which are wholly owned. All significant inter-company balances and transactions have been eliminated in consolidation. Effective July 28, 2003, a construction joint venture partnership obtained in the Hake acquisition was dissolved. From the effective date of the dissolution forward, the operations of the joint venture assumed by Matrix are included in the Company s results of operations.

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 only 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.

Certain amounts in prior period financial statements have been reclassified to conform to the current financial statement presentation.

The accompanying financial statements should be read in conjunction with the audited financial statements for the year ended May 31, 2004, included in Matrix s Annual Report on Form 10-K for the year then ended. Matrix s business is seasonal. In addition, Matrix often 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 STOCK OPTION PLANS

Employee stock options are accounted for under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations. Under APB 25, because the exercise price of the Company s employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

In December 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123(R) (revised 2004), Share-Based Payment , which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation (SFAS 123). Statement 123(R) supersedes APB 25. Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. Statement 123(R) is effective for public companies at the beginning of the first interim or annual period beginning after June 15, 2005. The Company plans to adopt Statement 123(R) effective June 1, 2005.

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Pro forma information regarding net income and earnings per share, as required by SFAS 123, will be provided until Statement 123(R) is adopted. The pro forma information has been determined as if the Company had accounted for its employee stock options under the fair value method of SFAS 123. The fair value for employee stock options outstanding as of the end of the periods presented was estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions:

	February 28, 2005	February 29, 2004
Risk-free interest rate	3.7%	4.0%
Expected volatility	60.9%	54.4%
Expected life in years	4.8	4.8
Expected dividend yield		

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The following table illustrates the pro forma effect on net income (loss) and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 using the Black-Scholes option valuation model:

	Three Months Ended		Nine Months Ended	
	February 28, 2005	February 29, 2004	February 28, 2005	February 29, 2004
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Net Income (Loss) as Reported	\$ (35,469)	\$ 2,259	\$ (35,068)	\$ 9,216
Compensation Expense from Stock Options	(118)	(145)	(298)	(352)
Pro Forma Net Income (Loss)	\$ (35,587)	\$ 2,114	\$ (35,366)	\$ 8,864
Earnings per Common Share as Reported:				
Basic	\$ (2.05)	\$ 0.13	\$ (2.03)	\$ 0.56
Diluted	\$ (2.05)	\$ 0.13	\$ (2.03)	\$ 0.52
Pro Forma Earnings per Common Share:				
Basic	\$ (2.05)	\$ 0.12	\$ (2.04)	\$ 0.53
Diluted	\$ (2.05)	\$ 0.12	\$ (2.04)	\$ 0.50

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NOTE 3 RESTRUCTURING

On March 28, 2005, Bradley S. Vetal resigned from his positions as Chairman of the Board, President and Chief Executive Officer of the Company, effective immediately. Mr. Ed Hendrix, an independent director of the Company since 2000, was elected Chairman of the Board of Directors to replace Mr. Vetal. The Company's Board of Directors appointed Michael J. Hall, currently a member of the Board of Directors and formerly the Company's Chief Financial Officer, as the Company's interim President and Chief Executive Officer. The Company granted Mr. Hall 100,000 stock options which vest at the earlier of the achievement of specified objectives or one year. The remainder of Mr. Hall's compensation program has not been finalized.

In March 2005, the Company began a restructuring program to reduce its cost structure and improve operating results. This restructuring program is expected to include reductions in workforce and changes to business plans including the consolidation or closure of certain facilities or business lines. The Company expects these restructuring efforts to continue into fiscal 2006 and the Company expects to incur restructuring charges of at least \$2.1 million in the fourth quarter of fiscal 2005, primarily in the Construction Services segment.

As part of the restructuring efforts, the Company has engaged a financial consultant to assist senior management with the following:

Determining short-term and long-term liquidity needs;

Improving forecasting tools;

Providing oversight of all restructuring activities;

Identifying cost reduction and operations improvement opportunities;

Reviewing operating and financial plans and cash flow forecasts at corporate and divisional levels;

Assessing core business, management, policy operations, facilities, equipment and operating practices;

Conducting feasibility analyses in connection with debt restructuring efforts; and

Interfacing with credit constituencies.

The Company also anticipates incurring approximately \$1.5 million in professional fees in the fourth quarter of fiscal 2005 related to restructuring efforts.

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Based upon the current status of the senior credit facility (Discussed in Note 4 Debt), total liquidity has been constrained due to shortfalls in operating performance. As a result of the liquidity issues, the Company has extended the timing of payments to vendors until the liquidity issues improve. Management has initiated a number of steps to improve the Company's liquidity situation including the following:

Improving overall operating performance based upon the restructuring efforts currently underway;

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Evaluating alternatives to accelerate collection of amounts due on the contract disputes; and

Raising of additional capital through debt refinancing efforts or alternative means.

The Company has engaged an investment banking firm to assist the Board of Directors in evaluating refinancing and other strategic alternatives. These alternatives include the possible issuance of convertible subordinated securities.

As discussed in Note 4, Debt, the current bank group has amended our credit agreement and provided waivers for specified covenant violations through June 15, 2005. They have also increased our revolver from \$29 million to the lesser of \$32 million or 75% of the borrowing base immediately and to the lesser of \$35 million or 80% of the borrowing base upon completion of a proposed private placement of convertible subordinated junior securities. The net proceeds of the convertible subordinated junior securities would be used to retire Term Loan B, which is due in August 2005 and currently bears interest at 18% per year and, if sufficient, to provide additional liquidity. The bank group has also indicated they would provide an incremental \$10 million of short-term financing to provide additional liquidity primarily for trade creditors. The documentation is in process and we anticipate having these funds available simultaneously with the closing of the convertible subordinated junior securities.

We cannot assure that the private placement will be completed or that the incremental revolver will be provided. If we are successful in completing the private placement and obtaining the incremental revolver, our liquidity issues would be alleviated for the short-term and we would then focus on returning the Company to profitability and refinancing our senior debt for a longer term. If the efforts are not successful, we cannot assure you that other financing can be arranged, that we would be able to meet existing debt covenants or that the bank would not foreclose on the Company. In that event, we would be required to explore other strategic alternatives.

NOTE 4 DEBT

Debt consists of the following:

	February 28, 2005	May 31, 2004
	(In Thousands)	
Borrowings under bank credit facility:		
Revolving credit facility	\$ 11,035	\$ 40,390
Term note	23,798	28,441
Term B note	20,000	
Interest rate swap liability	113	271
	<u>54,946</u>	<u>69,102</u>
Less current portion:		
Revolving credit facility	11,035	
Term note	23,798	4,643
Term B note	20,000	
Interest rate swap liability	113	250

Long-term debt	<u> </u> \$	<u> </u> \$ 64,209
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Credit Agreement and Revolving Credit Facility

On March 7, 2003, we replaced our prior credit agreement with an \$87.5 million senior credit facility entered into with a group of banks. The credit agreement originally consisted of a five-year term loan of \$32.5 million and a three-year \$55 million revolving credit facility. Substantially all of our properties and assets and those of our domestic subsidiaries secure the senior credit facility. Under the original agreement, we pay LIBOR-based interest on funds borrowed under the term loan and funds borrowed on a revolving basis bear interest on a Prime or LIBOR-based option.

In August 2004, the senior credit facility was amended to convert \$20 million of the revolver balance to a term loan (Term Loan B), which matures August 31, 2005 and to reduce the credit commitment on the revolver by an equal amount from \$55 million to \$35 million. The facility was further amended in December 2004 to provide that interest on Term Loan B would accrue at a 12.5% per annum fixed rate from November 30, 2004 until March 31, 2005, when the interest rate increased to an 18% per annum fixed rate. The interest rate further increases to a 21% per annum fixed rate on June 30, 2005.

Effective November 30, 2004, we amended our credit agreement to require mandatory prepayment of indebtedness outstanding under the credit agreement with proceeds collected by us from certain disputed accounts and claims that are currently the subject of litigation initiated by us. Pursuant to the mandatory prepayment provision, we are required to apply such proceeds, first, to the payment in full of Term Loan B, next, at our option, to the payment of remaining term loans or to the payment of amounts outstanding under the revolving credit facility.

Effective March 23, 2005, the facility was amended, reducing the credit commitment on the revolver from \$35.0 million to the lesser of \$29.0 million or 70% of the borrowing base. Effective April 8, 2005, the facility was further amended to increase the credit commitment on the revolver from \$29.0 million to the lesser of \$32.0 million or 75% of the borrowing base. The amendment also provided that the commitment will further increase to the lesser of \$35.0 million or 80% of the borrowing base upon the full and final closing and funding of either a subordinated loan to the Company or an offering of junior securities by the Company in an amount acceptable to the lenders. Finally, the amendment converted interest on the term loan to Prime plus 175 basis points and interest on the revolver borrowings to Prime plus 150 basis points. Beginning in May, the rates will increase 25 basis points per month until August at which time they will increase 50 basis points per month until March 2006. The amendment did not change the interest rate applicable to Term Loan B.

At February 28, 2005, \$11.0 million was outstanding under the revolver, \$23.8 million was outstanding under the five-year term loan and \$20.0 million was outstanding under Term Loan B. In addition, \$9.3 million of the revolver was utilized by outstanding letters of credit, which mature in 2005 and 2006. At February 28, 2005, remaining availability under the credit facility consisted of \$14.6 million available under the revolver as the total revolver facility was \$35.0 million. Had the current amendments been in place, availability would have been reduced to \$11.6 million. At April 8, availability under our revolver was \$6.1 million. We were paying a weighted average interest rate of 9.3% on the term loans and 6.75% on the revolver at February 28, 2005.

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Our credit agreement requires us to maintain certain financial ratios, limits the amount of our capital expenditures, limits the amount of additional borrowings we may incur and prohibits the payment of cash dividends.

Financial ratios currently contained in our credit agreement are as follows:

A fixed charge coverage ratio of not less than 1.15 to 1.0 through February 28, 2005; 1.0 to 1.0 from March 1, 2005 through May 31, 2005; and 1.25 to 1.0 thereafter. The fixed charge coverage ratio is calculated as (i) consolidated EBITDA for the then most recently ended fiscal four quarters less dividends paid in cash, taxes paid in cash and capital expenditures for the same period to (ii) scheduled current maturities of long-term debt for the following four fiscal quarters plus consolidated interest expense for the then most recently ended fiscal four quarters. Consolidated EBITDA is defined in the credit agreement as consolidated net income plus, to the extent included in determining consolidated net income, consolidated (i) interest expense, (ii) tax expense, (iii) depreciation, amortization and other non-cash charges, (iv) losses on the sale of fixed assets and (v) extraordinary losses realized other than in the ordinary course of business minus (i) gains on sales of fixed assets and (ii) extraordinary gains realized other than in the ordinary course of business.

A total debt leverage ratio not to exceed 4.5 to 1.0 through February 28, 2005 and 3.50 to 1.0 thereafter. The total debt leverage ratio is calculated as (i) consolidated debt plus the face value of the acquisition payable to the former shareholders of Hake, to (ii) consolidated EBITDA for the then most recently ended four fiscal quarters.

A senior debt leverage ratio not to exceed 3.0 to 1.0 through February 28, 2005 and 2.25 to 1.0 thereafter. The senior debt leverage ratio is calculated as (i) total debt outstanding under the credit facility excluding Term Loan B plus the face value of the acquisition payable to the former shareholders of Hake, to (ii) consolidated EBITDA for the then most recently ended four fiscal quarters.

A minimum net worth of at least \$75 million plus one hundred percent of quarterly positive net income less dividends paid and treasury stock purchased commencing with the fiscal quarter ended August 31, 2004.

The credit agreement also limits our capital expenditures to \$8 million for fiscal 2005 and \$9 million annually thereafter, limits unsecured indebtedness we may borrow for general operating purposes to \$1 million, limits capital lease obligations to \$15 million and limits the amount of letters of credit we may have outstanding to \$15 million.

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In connection with the August 2004 amendment to our Credit Agreement, we also amended the terms of our financial covenants and in October 2004, we further amended our credit agreement to ease the restrictiveness of our financial covenants. The following table presents the required and actual financial covenant measures in effect as of May 31, 2004 and February 28, 2005:

	February 28, 2005	May 31, 2004
Fixed Charge Ratio		
Minimum Ratio Required	1.15	1.40
Actual Ratio	(0.20)(A)	1.66
Total Debt Leverage Ratio		
Maximum Ratio Allowed	4.50	2.50
Actual Ratio	(51.06)(A)	3.06(B)
Senior Debt Leverage Ratio		
Maximum Ratio Allowed	3.00	N/A
Actual Ratio	(34.85)(A)	N/A
Net Worth		
Minimum Net Worth Required	\$ 75,000,000	\$ 66,596,000
Actual Net Worth	51,657,000 (A)	85,715,000

- (A) Consolidated EBITDA, as defined in the Senior Credit Facility, was a loss for the twelve-month period ended February 28, 2005. The non-compliance was primarily attributable to operating results that were significantly lower than expectations and a \$10.4 million charge for disputed contracts reserve, producing negative ratios which resulted in non-compliance with the required covenants.
- (B) Based on our forecasted results of operations and our amended covenants, our prospective covenant calculations indicated compliance with our covenants for the upcoming 12 months at May 31, 2004. However, we exceeded the maximum Total Debt Leverage Ratio allowed under our credit agreement at that date. The non-compliance with the Total Debt Leverage Ratio at May 31, 2004 was primarily attributable to operating results for the fourth quarter of fiscal 2004, which were negatively impacted by projects that experienced significant cost overruns during that period.

On April 8, 2005, the Company received a waiver letter and amendment from the lenders whereby the lenders agreed to waive all rights and remedies under the Credit Agreement arising from events of default specified in the waiver, which is effective through June 15, 2005. The waiver may be withdrawn upon the occurrence of certain specified events. The fee for the waiver letter and amendment will range from \$0.2 million to \$1.0 million. The fee increases over a period of time defined in the agreement with the full \$1.0 million being payable if certain events do not occur before September 11, 2005.

If, as of the end of a fiscal quarter, we violate a financial covenant and conclude that it is probable that we would continue to violate one or more of our covenants over the next 12 months, we would be required to reclassify our indebtedness under the credit agreement as current. Because of the decline in operating results, delays in the start-up of projects included in our backlog, costs associated with contract disputes, low-margin maintenance contracts, anticipated restructuring costs and capital expenditure requirements, we have concluded that it is probable that we will continue to violate one or more of the existing covenants over the next twelve months. Therefore, our debt is classified as current at February 28, 2005.

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The failure to comply with the terms of our credit agreement has required us to incur significant fees to our lenders to obtain waivers and amendments and caused us to seek alternative financing. Without acceptable waivers or amendments from our lenders or alternative financing on terms acceptable to us, our lenders would have the right, among others, to declare all amounts outstanding under the credit agreement to be immediately due and payable and foreclose upon and sell substantially all of our assets to repay such amounts.

See Note 3, Restructuring, for a discussion of Management's plans related to the Company's credit facility.

NOTE 5 ACQUISITION PAYABLE

As part of the purchase of the Hake group of companies in Fiscal 2003, the Company entered into an acquisition payable for a portion of the purchase price. The acquisition payable is recorded at its fair value of \$7.7 million and accreted for the change in its present value each period utilizing a 5.1% effective interest rate. Payments related to the acquisition payable are due annually on March 7 with \$1.9 million due annually in 2005, 2006 and 2007, and \$2.7 million due in 2008. The Company did not pay the \$1.9 million payment due March 7, 2005 to the former shareholders of Hake as a result of the Company's exposure from certain issues with tax filings by the Hake Group of Companies. These issues relate to periods prior to the acquisition by Matrix. Because the Company was indemnified by the former shareholders for such pre-acquisition tax contingencies and it is not probable it will have a negative impact on the Company, no amounts have been reflected in the accompanying financial statements related to this matter.

Pursuant to the purchase agreement, the former shareholders of Hake agreed, jointly and severally, to indemnify Matrix for damages it suffers due to breaches of representations and warranties made by the shareholders with respect to, among other things, its employee benefit plans; the ownership, use and condition of its assets and the performance by Hake of its contractual obligations and its obligations under applicable laws, including employment and environmental laws. As to these matters, Matrix may recover its damages only if its claims for damages are made by March 7, 2008, the amount of damages claimed as to any single event exceeds a de minimus amount of \$10,000, and only after the aggregate amount of all such claims excluding de minimus claims exceeds \$250,000. In order to better assure the payment to Matrix of any claims by it for indemnity, \$10 million of the purchase price for Hake was withheld in the form of a deferred purchase price payable to the former shareholders or their designee. Upon final determination that a claim for indemnity is proper, the amount of the claim can be deducted by Matrix from the deferred payments of the purchase price. The remaining deferred purchase obligations to be paid in the future total approximately \$8.4 million. Since the purchase date on March 7, 2003, Matrix claims have not exceeded \$250,000, and thus no adjustment to the deferred purchase price was made related to indemnifications by the former shareholders of Hake prior to March 2005.

NOTE 6 GOODWILL IMPAIRMENT

The Company performs an annual goodwill impairment review in the fourth quarter of every year. In addition, the Company performs a goodwill impairment review whenever events or changes in circumstances indicate the carrying value may not be recoverable, such as the liquidity issues and operating results the Company is currently experiencing.

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As a result, the Company performed a goodwill impairment test as of February 28, 2005. The process of evaluating the impairment of goodwill is highly subjective and requires significant judgment. Fair value of the reporting units was determined based on the probability-adjusted present value of future cash flows. A preliminary impairment charge of \$25 million was recorded for the Construction Services segment in the quarter ended February 28, 2005 and is reflected in Restructuring, impairment and abandonment on the Consolidated Statements of Operations. The cash flow assumptions are based on the best available information, but such information is considered preliminary due to the Company's current liquidity situation and restructuring efforts. The impairment evaluation will be completed in the fourth quarter of fiscal 2005. At such time, the preliminary impairment charge recorded in the third fiscal quarter may be adjusted upward.

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.

In February 2005, the Company established valuation allowances of approximately \$1.6 million for deferred tax assets including certain net operating loss carryforwards and tax credit carryforwards. The realization of these carryforwards is dependent on certain of our operations recognizing taxable income on a stand-alone basis in future periods which is no longer certain. Therefore, these deferred tax assets were reserved as of February 28, 2005.

The difference between the expected income tax provision applying the domestic federal statutory tax rate and the current state rates is illustrated as follows:

	Three Months Ended		Nine Months Ended	
	February 28, 2005		February 28, 2005	
	<i>(Amounts in thousands)</i>			
Expected provision for federal income tax benefit at the statutory rate	\$ (13,565)	(35.0)%	\$ (13,327)	(35.0)%
Expected state income tax benefit, net of federal benefit	(2,132)	(5.5)%	(2,094)	(5.5)%
Charges without tax benefit, primarily goodwill impairment	10,125	26.1%	10,125	26.6%
Valuation allowance or tax benefit of contract dispute reserve	679	1.8%	679	1.8%
Valuation allowance on deferred tax assets	1,600	4.1%	1,600	4.2%
Other	5		7	
Total	\$ (3,288)	(8.5)%	\$ (3,020)	(7.9)%

In fiscal 2004, the actual federal and state income tax provision did not differ from the expected income tax provision.

Table of Contents**NOTE 8 CONTRACT DISPUTES****Contract Disputes Summary**

(in 000 s)

Dispute	Total Claim	Net Receivable	
		As of February 28, 2005	As of May 31, 2004
Contract Dispute I	\$ 26,262	\$ 14,943	\$ 14,926
Contract Dispute II	14,619	11,322	11,300
Contract Dispute III	6,431	4,183	4,255
Contract Dispute IV	2,054	975	975
	49,366	31,423	31,456
Contract Dispute Reserve		(10,448)	
Total	\$ 49,366	\$ 20,975	\$ 31,456

Contract Dispute I

Four subsidiaries of the Company performed work from March 2003 to November 2003 under several subcontracts with a general contractor (GC) to erect a combined cycle power plant. In October 2003 with the project 85% complete, the GC terminated the Company from one subcontract due to contractual disputes and claims against the GC for additional monies owed related to significant increased costs stemming from alleged mismanagement of the project by the GC. Other subcontracts were substantially completed but were consequently terminated for convenience by the GC.

The Company, through a subsidiary, consequently filed suit against the general contractor in November 2003. Other subsidiaries of the Company filed suit for non-payment in December 2003. Mediation occurred in August 2004, however, no resolution was reached. The subsidiaries of the Company, along with their independent contract forensics experts, believe the claims are valid and expect a ruling in the Company's favor regarding these matters. The three suits have been combined into one forum of litigation by the presiding judge. The Company expects a trial date to be set for some time in the first quarter of fiscal 2006 and expects full resolution in these matters to occur in fiscal 2006.

The Company's total claim in this matter is approximately \$26.3 million and the Company has, in accordance with SOP 81-1, a \$14.9 million net receivable recorded in our balance sheet, excluding the contract dispute reserve discussed below.

Contract Dispute II

In the fourth quarter of fiscal 2003, a subsidiary of the Company was subcontracted by a general contractor (GC) to erect two Selective Catalytic Reactor (SCR) Units for an owner. The Company subsidiary had performed all of its obligations to the GC in accordance with the parties Subcontractor Agreement, along with significant extra work that the GC directed the Company's subsidiary to perform to cure design defects, mis-fabrications, and project delays attributable to the GC. The GC refused to sign certain change orders for the additional work performed and alleged that the services and materials provided by the Company were defective and behind schedule. In June 2004, the owner terminated the GC for cause. The owner subsequently retained the subsidiary of the Company to complete the project. The

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owner refused to pay the subsidiary of the Company the amounts owed by the GC because the owner had previously paid the GC for the work. The Company has subsequently completed work on the SCR units to the satisfaction of the owner.

Under the terms of the owner's original contract with the GC, the GC provided the owner with an unconditional and irrevocable guarantee of its parent, a non-USA based holding company. Under this guarantee, the parent guaranteed the GC's performance and payment obligations, including the obligations that the GC owed to the Company and other subcontractors. The Company has subsequently filed suit against the GC's parent pursuant to the contractual parental guarantee but expects the proceedings to be stayed until arbitration between the GC and the Company is completed. If the proceedings are not successful against the GC, the Company believes it can seek recovery under the parental guarantee. Currently, an arbitration date has been scheduled for the first quarter of 2006. The Company, along with our independent contract forensics firm believes that we have valid claims and expect a decision in our favor regarding this matter. The Company expects a full resolution in this matter to occur in fiscal 2006.

The Company's total claim in this matter is approximately \$14.6 million and the Company has, in accordance with SOP 81-1, a \$11.3 million net receivable recorded in our balance sheet, excluding the contract dispute reserve discussed below.

Contract Dispute III

In fiscal year 2003, the two of the Company's subsidiaries entered into sub-subcontract agreements with another subcontractor (Sub) to provide all necessary supervision, labor, materials, and equipment necessary to install a heater foundation, on a time and material basis at an owner's facility. The Sub was previously contracted by the general contractor (GC) on the project, to perform foundation installation, equipment, piping and steel erection, other construction work and construction management. As the project progressed, the Sub opted to increase the Company's subsidiaries scope of work.

On September 30, 2003, the Sub filed for Chapter 11 bankruptcy protection. At the date of the bankruptcy filing, the Company subsidiaries were substantially complete with all work at the job site. Subsequent to the Sub's bankruptcy filing, the GC assumed all of the Sub's obligations that are subject to valid liens associated with the project. The Company's subsidiaries subsequently filed valid construction lien claims totaling approximately \$5.8 million against the owner, GC and Sub. These lien claims have been consolidated with six other sub-subcontractor lien claims associated with the project and the lien claims have been fully bonded by the GC, although the GC disputes the lien amounts and seeks to have a smaller lien fund fixed. Therefore, the Company is not required to proceed through the Sub's bankruptcy proceedings to collect on amounts owed. The Court has ruled that initial discovery be limited to matters relevant to the computation of the lien fund that is available to satisfy the liens that have been asserted against the project. Currently, the Company is in dispute with the owner and the GC as to the appropriate calculation of the available lien fund. The Company believes that we have a valid claim and that the value of the lien fund will be established at an amount adequate to fund the associated claim by the Company. Currently, there is a settlement discussion mandated by the courts scheduled for the first quarter of 2006. The Company expects a full resolution in this matter to occur in fiscal 2006.

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The Company's total claim in this matter is approximately \$6.4 million and the Company has in accordance with SOP 81-1, a \$4.2 million net receivable recorded in our balance sheet, excluding the contract dispute reserve discussed below.

Contract Dispute IV

In March 2000, the Company entered into a joint venture partnership (JV) agreement for the construction of a pulp and paper project for an owner, which was completed late in 2000. The services provided by the JV consisted primarily of a labor contract with the owner supplying the engineering and the majority of the materials to be installed. The claim arises out of a contractual dispute in which the Company believes the JV incurred substantial work because the owner's planning and engineering on the project was not adequate. The owner did not pay amounts owed and claims that the JV was not properly licensed by the Oregon Contractors Licensing Board, and therefore not eligible to file a lawsuit under Oregon law. An Oregon state court ruled in favor of the owner regarding the licensing issue and the Company appealed the decision.

Oral arguments were held in Court of Appeals on March 8, 2005. Although the appellate panel of judges is under no time constraint, the Company expects a decision in the next nine months. If the court rules in favor of the Company, the case will proceed to trial. The Company and its external counsel believe that we have valid claims under state law and expect a decision in our favor from the Court of Appeals. The Company also believes that a recent state court ruling supports our position regarding the claim. The Company expects a full resolution in this matter to occur in fiscal 2006.

The Company's total claim in this matter is approximately \$2.1 million, excluding legal costs, and the Company, in accordance with SOP 81-1, has a \$1.0 million net receivable recorded in our balance sheet, excluding the contract dispute reserve.

Contract Dispute Reserve

In February 2005, the Board of Directors authorized management to initiate an effort to accelerate the resolution and collection of the amounts owed on the disputed contracts, and further limit the costs of litigation to the Company arising out of the various disputes. The action by the Board was taken in connection with the Company's current liquidity situation, restructuring plans and refinancing efforts. While the Company believes that allowing these disputes to be resolved through the normal course of arbitration or litigation would result in the recovery of amounts equal to or in excess of the previously recorded balances, the Board concluded that addressing the liquidity situation was of utmost importance. Therefore, in an effort to expedite the collection of these balances, the Board authorized management to pursue resolution at amounts below that previously reflected on the balance sheet. As a result of the Company's initiative, the Company recorded a reserve of \$10.4 million in the third quarter of fiscal 2005.

The Company believes it is adequately reserved for the disputes and will continue to assess the adequacy of the reserves as additional information becomes available.

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NOTE 9 CONTINGENCIES

Insurance Reserves

The Company maintains workers' compensation insurance, with statutory limits; general liability insurance; auto liability insurance in the primary amount of \$2.0 million per occurrence; contractor's pollution liability insurance in the amount of \$10.0 million per occurrence; and pollution legal liability for owned and leased properties in the amount of \$2.0 million per occurrence. The Company has deductibles or self-insured retentions in the amount of \$10,000 for damage to owned or leased properties; \$250,000 for workers' compensation, \$100,000 for general liability, \$0 for auto liability, \$50,000 for contractor's pollution liability and \$25,000 for pollution legal liability. Matrix also maintains an umbrella policy with coverage limits of \$25.0 million per project, policies to cover our equipment and other property with coverage limits of \$16.0 million per occurrence, and policies for construction with coverage limits of \$16.0 million per project. Most policies provide for coverage on an occurrence basis rather than a claims made basis. Matrix maintains a performance and payment bonding line of \$150.0 million. However, our current liquidity and financial situation makes it difficult to utilize the bonding line for new projects.

Management estimates the reserve for self-insurance retention based on knowledge of the circumstances surrounding the claims, the nature of any injuries involved, historical experience and estimates of future costs provided by certain third parties. Changes in the assumptions underlying the accrual could cause actual results to differ from the amounts reserved.

Legion Insurance Dispute

Matrix, as plaintiff, is currently in litigation in the Tulsa County District Court in the State of Oklahoma over matters arising out of a workers compensation program with a former insurance provider. These matters involve contests over a letter of credit (LC) for \$2.0 million, a bond for \$2.1 million and a deposit of \$0.5 million pledged to secure Matrix's obligations under this prior program. As a part of its insurance program with Legion Insurance Company (Legion), Legion used an offshore insurance company, Mutual Indemnity (Mutual), which was domiciled in Bermuda. Matrix purchased preferred stock in Mutual, which then reinsured part of the workers' compensation exposure that was underwritten by Legion. Matrix assumed the first \$250,000 of any occurrence involving injury to Matrix employees. If there was an occurrence, Legion would process and pay all claims for all Matrix employees injured in that occurrence. On a monthly basis, Legion would then be reimbursed by Mutual for the actual claim payments made, up to \$250,000 per occurrence. Matrix would then reimburse Mutual for the amount of the claims paid by Legion during that month.

Matrix funded two escrow accounts, one of which was used to administer individual claims and the other of which acted as a working escrow account to reimburse Mutual. Mutual's insurance regulators also required Matrix to post an LC for \$2.0 million and a surety bond in the amount of \$2.1 million as security for its potential future claim payment liability.

On April 1, 2002, the Insurance Commissioner for the State of Pennsylvania placed Legion into rehabilitation. Matrix was concerned that the security held by Mutual would be commingled with other shareholder assets and not used exclusively to pay Matrix claims. Matrix filed suit in the Tulsa County district court to require a full accounting of all funds held

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by Mutual and restrain Mutual from drawing on the LC or surety bond. The court granted a temporary restraining order prohibiting the use of such assets for the payment of claims other than Matrix claims.

On July 25, 2003, a Pennsylvania court placed Legion into liquidation. At that time, all open workers' compensation claims were sent to the various state guaranty funds for handling. Many of the states have denied responsibility with respect to Matrix claims because Matrix's net worth exceeded the statutory maximum as of December 31, 2002, the year preceding the Legion liquidation, under which claims would be handled by the individual state guaranty funds. Those states returned the claims back to Matrix for direct handling. In other states where Matrix has exposure, the state guaranty funds took over the claims. In recent months, however, some of those states have billed Matrix for reimbursement of payments made on Matrix claims.

Matrix is continuing to negotiate with Mutual for a reduction or elimination of the LC and surety bond. Matrix and Mutual have reached a tentative settlement in which a permanent injunction would replace the temporary restraining order prohibiting Mutual from drawing upon either the LC or bond, provided that Matrix continues to pay amounts owed directly to the Legion Liquidator or the individual state guaranty funds and works with the Liquidator to release Mutual from future liability with respect to Matrix claims. Matrix cannot predict when a final settlement will be reached due to difficulty in quantifying the precise exposure of Mutual for outstanding claims.

All claims that are outstanding with the Legion Liquidator, state guaranty funds and Mutual are claims that originated prior to May 1, 2002, the date on which Matrix replaced the Legion insurance program with workers' compensation insurance provided by A-rated workers compensation carriers, are reserved by the Company. Although the Company believed its previous reserve of \$0.8 million was adequate, recent claim settlements by state guaranty funds exceeded amounts accrued by the Company for the respective claims. In addition, during the quarter ending February 28, 2005, the Company obtained information regarding estimated settlements of open claims that were also higher than amounts previously accrued. As a result, the Company recorded an additional accrual of \$1.2 million for these claims in the third quarter of fiscal 2005, increasing the Company's reserve to \$2.0 million. Additionally, it is still possible that Matrix will experience some additional exposure from the total of \$4.6 million of existing security, consisting of the escrow accounts, LC and surety bond, until a final settlement agreement with Mutual is signed, a permanent injunction is entered and the LC and surety bond are cancelled. Matrix does not believe resolution of this issue will have a material effect on the Company's financial position, results of operations and liquidity.

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Environmental Dispute

In March 2005, the South Coast Air Quality Management District (AQMD) of the State of California settled a complaint filed in March 2003 in the Los Angeles County Superior Court for the Central District against a Matrix customer alleging multiple violations by the customer at its west coast refinery for failure to comply with certain District Rules of the AQMD that established a self-inspection and compliance reporting program for above ground stationary tanks used to store crude oil, gasoline, and other petroleum products.

Matrix was not named in the AQMD complaint; however, counsel for the customer made a formal demand upon Matrix to assume defense of the case and to indemnify the customer for any damages it may incur. The customer's demand was made pursuant to the terms of the Master Service Agreement entered into in May 1999 between Matrix and the customer. Matrix rejected the demands of the customer based upon its own belief as to the interpretation of the Master Services Agreement and the facts developed by Matrix since the AQMD filed its complaint in March 2003. Matrix and the customer mutually agreed to toll the dispute for at least four years and until there is a resolution of the complaint filed by the AQMD against the customer.

While the existing relationship between Matrix and its customer may be positive, the customer may still assert claims against Matrix that it believes may be valid under the Master Services Agreement. There can be no assurance that Matrix will not incur costs associated with this matter. The Company currently cannot provide any estimate of possible loss or range of possible loss, if any, for this matter.

Unapproved Change Orders and Claims

As of February 28, 2005 and May 31, 2004, accounts receivable and costs and estimated earnings in excess of billings on uncompleted contracts included revenues, to the extent of costs incurred, for unapproved change orders of approximately \$0.4 million and \$1.5 million, respectively, and claims of approximately \$0.4 million and \$1.3 million, respectively. Amounts disclosed for unapproved change orders and claims exclude amounts associated with contract disputes disclosed in Note 8 - Disputed Contracts. Generally, collection of amounts related to unapproved change orders and claims is expected within twelve months. However, customers generally will not pay these amounts to Matrix until final resolution of related claims, and accordingly, collection of these amounts may extend beyond one year.

Other

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

Table of Contents**NOTE 10 REPORTING ACCUMULATED OTHER COMPREHENSIVE INCOME**

Other comprehensive income and accumulated other comprehensive income consisted of foreign currency translation adjustments and fair value adjustments of derivative instruments.

	Three Months Ended		Nine Months Ended	
	February 28, 2005	February 29, 2004	February 28, 2005	February 29, 2004
	<i>(In Thousands)</i>		<i>(In Thousands)</i>	
Net Income (loss)	\$ (35,469)	\$ 2,259	\$ (35,068)	\$ 9,216
Other comprehensive income (loss)	(154)	(81)	441	215
Comprehensive income (loss)	\$ (35,623)	\$ 2,178	\$ (34,627)	\$ 9,431

NOTE 11 EARNINGS PER COMMON SHARE

Basic earnings per common share is calculated based on the weighted average shares outstanding during the period. Dilutive earnings per share includes the dilutive effect of employee stock options. Diluted earnings per share for the nine month period ending February 29, 2004 excludes 234,902 options which were antidilutive, as the exercise prices of the options exceeded the average market price of common stock for the first nine months of fiscal 2004. There were also 344,100 antidilutive options for both the three and nine month periods ending February 28, 2005. However, as the operating results of the Company are a net loss for both the three and nine month periods, the dilutive effect of stock options is not considered when reporting earnings per share.

NOTE 12 SEGMENT INFORMATION

The Company's operating segments have been aggregated into two reportable segments, Construction Services and Repair & Maintenance Services.

The Construction Services segment includes turnkey and specialty construction services provided primarily to the downstream petroleum and power industries. These services include civil/structural, mechanical, piping, electrical and instrumentation, millwrighting, steel fabrication and erection, specialized heavy hauling and rigging, boiler work, engineering, and fabrication and construction of aboveground storage tanks (AST).

The Repair & Maintenance Services segment provides routine, preventive and emergency-required maintenance and repair services primarily to the downstream petroleum and power industries. These services include plant turnarounds, power outages, industrial cleaning, facility and AST maintenance and repair.

Other consists of items related to previously disposed of businesses.

The Company evaluates performance and allocates resources based on profit or loss from operations before income taxes. Overhead costs are allocated to the segments based upon revenue.

Segment assets consist of accounts receivable, costs and estimated earnings in excess of billings on uncompleted contracts, property, plant and equipment and goodwill.

Table of Contents**Matrix Service Company****3rd Quarter Results of Operations****(In Thousands)**

	Construction Services	Repair & Maintenance Services	Other	Combined Total
Three Months ended February 28, 2005				
Gross revenues	\$ 51,618	\$ 63,018	\$	\$ 114,636
Less: Inter-segment revenues	(2,891)	(298)		(3,189)
Consolidated revenues	48,727	62,720		111,447
Gross profit	1,727	4,147		5,874
Operating income (loss)	(37,474)	272	(2)	(37,204)
Income (loss) before income tax expense	(38,483)	(272)	(2)	(38,757)
Net income (loss)	(35,305)	(163)	(1)	(35,469)
Segment assets	82,831	76,767	29,207	188,805
Capital expenditures	62	69	405	536
Depreciation and amortization expense	873	795		1,668
Three Months ended February 29, 2004				
Gross revenues	\$ 106,699	\$ 40,710	\$	\$ 147,409
Less: Inter-segment revenues	(2,135)	(99)		(2,234)
Consolidated revenues	104,564	40,611		145,175
Gross profit	7,041	4,780		11,821
Operating income (loss)	2,349	1,911	(65)	4,195
Income (loss) before income tax expense	2,112	1,754	(65)	3,801
Net income (loss)	1,189	1,109	(39)	2,259
Segment assets	113,695	61,761	21,930	197,386
Capital expenditures	165	441	780	1,386
Depreciation and amortization expense	834	777		1,611
Nine Months ended February 28, 2005				
Gross revenues	\$ 161,228	\$ 157,456	\$	\$ 318,684
Less: Inter-segment revenues	(8,229)	(547)		(8,776)
Consolidated revenues	152,999	156,909		309,908
Gross profit	9,959	13,597		23,556
Operating income (loss)	(37,164)	2,771	(150)	(34,543)
Income (loss) before income tax expense	(39,466)	1,538	(150)	(38,078)
Net income (loss)	(35,893)	914	(89)	(35,068)
Segment assets	82,831	76,767	29,207	188,805
Capital expenditures	318	277	728	1,323
Depreciation and amortization expense	2,675	2,496		5,171
Nine Months ended February 29, 2004				
Gross revenues	\$ 361,600	\$ 121,033	\$	\$ 482,633
Less: Inter-segment revenues	(7,627)	(156)		(7,783)

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Consolidated revenues	353,973	120,877		474,850
Gross profit	25,918	12,061		37,979
Operating income (loss)	12,185	4,179	(65)	16,299
Income (loss) before income tax expense	11,131	3,595	(65)	14,661
Net income (loss)	7,130	2,125	(39)	9,216
Segment assets	113,695	61,761	21,930	197,386
Capital expenditures	749	1,565	1,639	3,953
Depreciation and amortization expense	2,584	2,207		4,791

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Segment revenue from external customers by industry type are as follows:

	Construction Services	Repair & Maintenance Services	Total
	<u> </u>	<u> </u>	<u> </u>
Three Months Ended February 28, 2005			
Power Industry	\$ 3,193	\$ 8,161	\$ 11,354
Downstream Petroleum Industry	38,534	52,230	90,764
Other Industries	7,000	2,329	9,329
	<u> </u>	<u> </u>	<u> </u>
Total	\$ 48,727	\$ 62,720	\$ 111,447
	<u> </u>	<u> </u>	<u> </u>
Three Months Ended February 29, 2004			
Power Industry	\$ 76,991	\$ 3,115	\$ 80,106
Downstream Petroleum Industry	23,949	35,018	58,967
Other Industries	3,624	2,478	6,102
	<u> </u>	<u> </u>	<u> </u>
Total	\$ 104,564	\$ 40,611	\$ 145,175
	<u> </u>	<u> </u>	<u> </u>
Nine Months Ended February 28, 2005			
Power Industry	\$ 33,761	\$ 13,084	\$ 46,845
Downstream Petroleum Industry	96,287	135,732	232,019
Other Industries	22,951	8,093	31,044
	<u> </u>	<u> </u>	<u> </u>
Total	\$ 152,999	\$ 156,909	\$ 309,908
	<u> </u>	<u> </u>	<u> </u>
Nine Months Ended February 29, 2004			
Power Industry	\$ 253,473	\$ 9,775	\$ 263,248
Downstream Petroleum Industry	91,378	104,362	195,740
Other Industries	9,122	6,740	15,862
	<u> </u>	<u> </u>	<u> </u>
Total	\$ 353,973	\$ 120,877	\$ 474,850
	<u> </u>	<u> </u>	<u> </u>

Other Industries consists primarily of wastewater, food and beverage, electronics and paper industries.

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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 February 28, 2005. 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 February 28, 2005.

We are currently undergoing a comprehensive effort in preparation for compliance with Section 404 of the Sarbanes-Oxley Act of 2002 (Section 404). This effort includes the documentation, testing and review of our internal controls under the direction of senior management. During the course of these activities, we have identified certain internal control issues which senior management believes need to be improved. As a result, we are evaluating and implementing improvements to our internal controls over financial reporting and will continue to do so. These improvements include further formalization of policies and procedures, improved segregation of duties, and improved information technology system controls. For all internal control issues identified, we believe we have adequate compensating controls in place, such as reviews and reconciliations, to mitigate the risk to our disclosure controls and procedures. Our Chief Executive Officer and Chief Financial Officer's conclusion, that our disclosure controls and procedures were effective at the reasonable assurance level as of February 28, 2005 was based, in part, upon our evaluation of the control issues identified, including the presence of adequate compensating controls.

Control issues identified and the compensating controls relied on by management are as follows:

Segregation of duties Due to the small size of our administrative staff at certain regional locations and certain corporate functions, there are circumstances where duties are not adequately segregated. For example, some employees currently have the ability to set up new employees and also enter time for employees. Others can set-up a new vendor and also process an invoice for payment.

As segregation of duties issues are identified, we evaluate the circumstances, organizational structure and compensating controls when determining the

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appropriate remediation. For all segregation of duties issues identified to date, we believe we have compensating controls in place that are operating effectively, including general ledger account reconciliations, review of disbursements and financial analyses.

Policies and procedures During the course of our compliance effort for Section 404, we have identified instances where certain controls are performed as designed but documented evidence of the performance of the control does not exist. For example, reviews of general ledger account reconciliations, project estimates and financial analyses are performed but evidence of the review is not maintained or retained in all circumstances. Although the controls are operating effectively, remediation will be implemented to require better documentation of the performance of the controls.

Information systems controls Prior to our compliance effort for Section 404, we had identified areas within our information systems control structure that should be strengthened. The primary areas identified relate to change management controls and access controls. The Company is in the process of remediating these issues. In the meantime, the Company believes it has adequate compensating controls in place to mitigate the risk associated with these issues, including general ledger account reconciliations and financial analyses.

Certain of the internal control issues have been remediated. For others, we expect the remediation to be substantially complete and incorporated into our fiscal 2005 financial statement close process. As new internal control issues are identified during the completion of our compliance with Section 404 for fiscal 2005 or in future periods, remediation will be implemented in a timely manner.

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PART II

OTHER INFORMATION

ITEM 5. Other Information

Senior Credit Facility - Waiver Letter and Amendment

On April 8, 2005, the Company received a waiver letter and amendment from the lenders whereby the lenders agreed to waive all rights and remedies under the Credit Agreement arising from events of default specified in the waiver, which is effective through June 15, 2005. The waiver may be withdrawn upon the occurrence of certain specified events. The facility was also amended to increase the credit commitment on the revolver from \$29.0 million to the lesser of \$32.0 million or 75% of the borrowing base. The amendment also provided that the commitment will further increase to the lesser of \$35.0 million or 80% of the borrowing base upon the full and final closing and funding of either a subordinated loan to the Company or an offering of junior securities by the Company in an amount acceptable to the lenders. Finally, the amendment converted interest on the term loan and revolver borrowings to Floating Rate Advances. The amendment did not change the interest rate applicable to Term Loan B.

The fee for the waiver letter and amendment will range from \$0.2 million to \$1.0 million. The fee increases over a period of time defined in the agreement with the full \$1.0 million being applicable if certain events do not occur before September 11, 2005.

Other than in respect of the Credit Agreement and the Amendment, there are no material relationships between Matrix, its subsidiaries, the Lenders and their respective affiliates, except that some of the Lenders and their affiliates have engaged and may engage in commercial and investment banking transactions with Matrix in the ordinary course of business, and also provide or have provided advisory and financial services to Matrix.

A copy of the Amendment is attached to this Quarterly Report on Form 10-Q as Exhibit 10.1 and is incorporated by reference as though fully set forth herein. The foregoing summary description of the Amendment and the transactions contemplated therein is not intended to be complete and is qualified by in its entirety by the complete text of the Amendment.

Goodwill Impairment

The Company performs an annual goodwill impairment review in the fourth quarter of every year. In addition, the Company performs a goodwill impairment review whenever events or changes in circumstances indicate the carrying value may not be recoverable, such as the liquidity issues and operating results the Company is currently experiencing.

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The Company performed a goodwill impairment test as of February 28, 2005. The process of evaluating the impairment of goodwill is highly subjective and requires significant judgment. Fair value of the reporting units was determined based on the probability-adjusted present value of future cash flows. The cash flow assumptions are based on the best available information, but such information is considered preliminary due to the Company's current liquidity situation and restructuring efforts. On April 8, 2005, the Company concluded that a

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preliminary impairment charge of \$25 million was required for the Construction Services segment. The charge was recorded in the quarter ended February 28, 2005 and is reflected in Restructuring, impairment and abandonment on the Consolidated Statements of Operations. The impairment evaluation will be completed in the fourth quarter of fiscal 2005. At such time, the preliminary impairment charge recorded in the third fiscal quarter may be adjusted upward.

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ITEM 6. Exhibits:

Exhibit 10.1: Senior Credit Facility Waiver Letter and Amendment dated April 8, 2005.*

Exhibit 31.1: Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002 Interim 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) Interim CEO.

Exhibit 32.2: Certification Pursuant to 18 U.S.C. 1350 (section 906 of Sarbanes-Oxley Act of 2002) CFO.

* Previously reported in this Form 10-Q.

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: June 3, 2005

By: George L. Austin

George L. Austin Vice President-Finance and Chief Financial Officer signing on behalf of the registrant and as the registrant's

chief accounting officer.

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