MATRIX SERVICE CO
Form 10-Q
April 03, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended February 29, 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 number 001-15461

MATRIX SERVICE COMPANY

(Exact name of registrant as specified in its charter)

DELAWARE	**73-1352174**
(State of incorporation)	**(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 x 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 and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer x 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 x

As of April 1, 2008 there were 27,888,217 shares of the Company s common stock, $0.01 par value per share, issued and 25,996,617 shares outstanding.

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PART I

FINANCIAL INFORMATION

ITEM 1. Financial Statements

Matrix Service Company

Consolidated Statements of Operations

(In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	February 29, 2008	February 28, 2007	February 29, 2008	February 28, 2007
	(unaudited)		(unaudited)	
Revenues	$ 181,120	$ 168,700	$ 537,181	$ 461,925
Cost of revenues	160,119	149,776	486,030	407,792
Gross profit	21,001	18,924	51,151	54,133
Selling, general and administrative expenses	10,905	8,253	30,792	24,686
Operating income	10,096	10,671	20,359	29,447
Other income (expense):				
Interest expense	(183)	(475)	(760)	(1,980)
Interest income	26	79	57	137
Other	52	(24)	89	278
Income before income taxes	9,991	10,251	19,745	27,882
Provision for federal, state and foreign income taxes	3,989	4,101	7,197	10,650
Net income	$ 6,002	$ 6,150	$ 12,548	$ 17,232
Basic earnings per common share	$ 0.23	$ 0.27	$ 0.47	$ 0.76
Diluted earnings per common share	$ 0.22	$ 0.24	$ 0.46	$ 0.67
Weighted average common shares outstanding:				
Basic	26,464	23,103	26,561	22,533
Diluted	26,870	26,788	27,033	26,623

See accompanying notes.

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Matrix Service Company

Consolidated Balance Sheets

(In thousands)

	February 29, 2008 (unaudited)	May 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 8,270	$ 9,147
Accounts receivable, less allowances (February 29, 2008 - $264 and May 31, 2007 - $260)	112,634	98,497
Costs and estimated earnings in excess of billings on uncompleted contracts	40,398	45,634
Inventories	4,438	4,891
Income tax receivable	1,580	
Deferred income taxes	4,354	3,283
Prepaid expenses	2,545	2,910
Other current assets	1,903	929
Total current assets	176,122	165,291
Property, plant and equipment at cost:		
Land and buildings	24,002	23,405
Construction equipment	44,275	39,958
Transportation equipment	15,688	14,380
Furniture and fixtures	11,557	10,116
Construction in progress	6,724	1,788
	102,246	89,647
Accumulated depreciation	(48,305)	(43,654)
	53,941	45,993
Goodwill	23,506	23,357
Other assets	3,583	8,268
Total assets	$ 257,152	$ 242,909

See accompanying notes.

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Matrix Service Company

Consolidated Balance Sheets

(In thousands, except share data)

	February 29, 2008 (unaudited)	May 31, 2007
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 51,165	$ 52,144
Billings on uncompleted contracts in excess of costs and estimated earnings	47,822	34,243
Accrued insurance	7,235	6,422
Accrued wages and benefits	12,859	15,442
Income tax payable		956
Current capital lease obligation	998	753
Current portion of acquisition payable	2,817	2,712
Other accrued expenses	926	1,313
Total current liabilities	123,822	113,985
Long-term capital lease obligation	568	836
Deferred income taxes	4,060	2,512
Stockholders equity:		
Common stock - $.01 par value; 60,000,000 shares Authorized 27,888,217 shares issued as of February 29, 2008 and May 31, 2007	279	279
Additional paid-in capital	107,317	104,408
Retained earnings	35,950	23,422
Accumulated other comprehensive income	1,717	967
	145,263	129,076
Less: Treasury stock, at cost - 1,891,600 and 1,297,466 shares as of February 29, 2008 and May 31, 2007	(16,561)	(3,500)
Total stockholders equity	128,702	125,576
Total liabilities and stockholders equity	$ 257,152	$ 242,909

See accompanying notes.

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Matrix Service Company

Consolidated Statements of Cash Flows

(In thousands)

	Nine Months Ended February 29, 2008 (unaudited)	Nine Months Ended February 28, 2007 (unaudited)
Operating activities:		
Net income	$ 12,548	$ 17,232
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	6,030	4,695
Deferred income tax	565	1,997
Loss/(gain) on sale of property, plant and equipment	28	(139)
Allowance for uncollectible accounts	1,156	39
Stock-based compensation expense	2,158	947
Accretion on acquisition payable	105	170
Amortization of debt issuance costs	128	303
Amortization of prepaid interest		910
Changes in operating assets and liabilities increasing (decreasing) cash		
Receivables	(10,732)	(14,807)
Costs and estimated earnings in excess of billings on uncompleted contracts	5,236	(14,454)
Inventories	453	(1,242)
Prepaid expenses and other assets	(748)	(2,702)
Accounts payable	(1,290)	(3,415)
Billings on uncompleted contracts in excess of costs and estimated earnings	13,579	11,037
Accrued expenses	(2,157)	3,985
Income tax receivable/payable	(2,536)	1,536
Net cash provided by operating activities	24,523	6,092
Investing activities:		
Acquisition of property, plant and equipment	(13,118)	(9,436)
Proceeds from asset sales	282	217
Net cash used by investing activities	$ (12,836)	$ (9,219)

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Matrix Service Company

Consolidated Statements of Cash Flows

(In thousands)

	Nine Months Ended February 29, 2008	Nine Months Ended February 28, 2007
	(unaudited)	
Financing activities:		
Advances under bank credit facility	$ 149,760	$ 98,345
Repayments of bank credit facility	(149,760)	(98,345)
Payment of credit facility refinancing fees		(145)
Capital lease payments	(664)	(408)
Issuances of common stock	586	1,210
Tax benefit of exercised stock options	627	1,131
Open market purchase of treasury shares	(12,843)	
Other treasury share purchases	(700)	
Net cash provided (used) by financing activities	(12,994)	1,788
Effect of exchange rate changes on cash	430	(244)
Net decrease in cash and cash equivalents	(877)	(1,583)
Cash and cash equivalents, beginning of period	9,147	8,585
Cash and cash equivalents, end of period	$ 8,270	$ 7,002
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$ 8,515	$ 5,982
Interest	$ 456	$ 613
Non-cash investing and financing activities:		
Equipment acquired through capital leases	$ 641	$ 397
Purchases of property, plant and equipment on account	$ 453	$ 1,310
Conversion of convertible notes	$	$ 10,000

See accompanying notes.

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Matrix Service Company

Consolidated Statements of Changes in Stockholders Equity

(In thousands, except share data)

(unaudited)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Translation Adjustments	Total
Balances, May 31, 2007	$ 279	$ 104,408	$ 23,422	$ (3,500)	$ 967	$ 125,576
Net Income			12,548			12,548
Other comprehensive income					750	750
Comprehensive income						13,298
Exercise of stock options (99,450 shares)		299	(20)	307		586
Tax effect of exercised stock options		627				627
Stock-based compensation expense		2,158				2,158
Issuance of deferred shares (59,590 shares)		(175)		175		
Open market purchase of treasury shares (729,982 shares)				(12,843)		(12,843)
Other treasury share purchases (23,192 shares)				(700)		(700)
Balances, February 29, 2008	$ 279	$ 107,317	$ 35,950	$ (16,561)	$ 1,717	$ 128,702
Balances, May 31, 2006	$ 226	$ 75,855	$ 4,316	$ (4,812)	$ 814	$ 76,399
Net income			17,232			17,232
Other comprehensive loss					(411)	(411)
Comprehensive income						16,821
Conversion of notes (2,091,539 shares)	21	9,099				9,120
Exercise of stock options (244,800 shares)		500	(36)	746		1,210
Tax effect of exercised stock options		1,131				1,131
Stock-based compensation expense		947				947
Balances, February 28, 2007	$ 247	$ 87,532	$ 21,512	$ (4,066)	$ 403	$ 105,628

See accompanying notes.

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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 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, 2007, included in the Company s Annual Report on Form 10-K for the year then ended. Matrix Service 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 Recent Accounting Standards

FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109

Effective June 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 , as amended (FIN No. 48). Upon adoption of FIN No. 48 on June 1, 2007 and as of February 29, 2008, the Company had no material uncertain tax positions and no adjustments to the Company s opening financial position were required.

The Company files federal and various state income tax returns and tax returns in certain foreign jurisdictions. In the Company s significant tax jurisdictions, the tax years 2004 through 2007 are subject to examination by federal taxing authorities and the tax years 2003 through 2007 are subject to examination by state and foreign taxing authorities.

The Company accrues interest and penalties on underpayment of income taxes related to uncertain tax positions as a component of income tax expense in the consolidated statement of income. No amounts were recognized for interest and penalties upon adoption of FIN No. 48 or during the three and nine months ended February 29, 2008.

SFAS No. 157 Fair Value Measurements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). This Statement establishes a framework for fair value measurements in the financial statements by providing a definition of fair value, provides guidance on the methods used to estimate fair value and requires expanded disclosure about fair value measurements. SFAS No. 157 is effective for the Company s fiscal year beginning on June 1, 2008 and is generally applied prospectively. The Company is currently assessing the impact of SFAS No. 157 on its consolidated financial statements.

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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 159), The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 . SFAS 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 159 is effective for the Company s fiscal year beginning on June 1, 2008. The adoption of this statement is not expected to have a material effect on the consolidated financial statements of the Company.

Note 3 Assets Held for Sale

The Company holds excess land located in Orange, California, for which a sale is pending. The carrying value of the excess land at February 29, 2008 was $0.8 million, which approximates the expected net proceeds from the pending sale. The land is recorded in the Other Current Assets line in the Consolidated Balance Sheets and is reflected in the Company s Other segment in Note 12.

Note 4 Uncompleted Contracts

Contract terms of the Company s construction contracts generally provide for progress billings based on completion of certain phases of the work. The excess of costs incurred and estimated earnings recognized for construction contracts 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:

	February 29, 2008	May 31, 2007
	(In thousands)	
Costs incurred and estimated earnings recognized on uncompleted contracts	$ 869,858	$ 697,045
Billings on uncompleted contracts	877,282	685,654
	$ (7,424)	$ 11,391
Shown on balance sheet as:		
Costs and estimated earnings in excess of billings on uncompleted contracts	$ 40,398	$ 45,634
Billings on uncompleted contracts in excess of costs and estimated earnings	47,822	34,243
	$ (7,424)	$ 11,391

Progress billings in accounts receivable at February 29, 2008 and May 31, 2007 included retentions to be collected within one year of $20.7 million and $8.6 million, respectively. Contract retentions collectible beyond one year are included in other assets on the consolidated balance sheets and totaled $3.0 million and $7.5 million at February 29, 2008 and May 31, 2007. Billings on uncompleted contracts in excess of costs and estimated earnings at February 29, 2008 and May 31, 2007 included estimated accrued losses of $2.4 million and $3.8 million, respectively, on a construction project that was partially complete at those dates.

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Notes to Consolidated Financial Statements

Gulf Coast LNG Project

We have recorded $20.0 million of charges on the Gulf Coast LNG tank construction project during fiscal 2008 of which $2.5 million was recorded in the third quarter of fiscal 2008. This charge reflects management s best estimate of the total revenues to be realized, including incentives, and total costs at completion. The current forecast includes actual cost and productivity data as of February 29, 2008 when the project was 92% complete and detailed cost projections for all remaining activity.

The Company successfully achieved the contracted delivery date for tank one in February 2008 and tank two in March 2008, and, based on all available information, we believe we will also achieve the contractual delivery date for the third, and final, tank. The forecasted revenues include the projected receipt of incentive payments tied to meeting the contractual delivery dates. The contract also provides for liquidated damages as penalty for missing the delivery dates, which have not been included in the current forecast based on the achievement of the delivery dates for the first two tanks and the expected achievement of the delivery date for the third tank. However, the Company s ability to meet the schedule for the third tank is not without some risk, and it is possible an event or series of events could prevent us from meeting the delivery date, which will occur in the fourth fiscal quarter. While there are a number of issues that could impact our ability to meet the schedule, the most significant items include excessive weather delays, significant loss of craft labor, and delay caused by subcontractors.

If we fail to achieve the contractual delivery date for the third tank, we would begin to lose incentives. The current revenue forecast includes $2.2 million of incentive payments and assumes that the delivery date for the third tank will be met. In the event the delivery is delayed, the incentive will be reduced by $34.0 thousand per day until delivery. In addition to lost incentives, a delay in the schedule could also result in additional labor and equipment costs, which we are unable to estimate but which could be material.

Note 5 Debt

Availability under the senior credit facility is as follows:

	February 29, 2008	May 31, 2007
	(In thousands)	
Senior credit facility - revolver	$ 75,000	$ 75,000
Amounts borrowed		
Letters of credit	8,395	8,575
Availability under senior credit facility	$ 66,605	$ 66,425

Effective November 30, 2006, the Company entered into the Second Amended and Restated Credit Agreement (Credit Agreement), which provides for a five-year, $75.0 million senior revolving credit facility (Credit Facility). On July 6, 2007 the Company entered into the First Amendment to the Second Amended and Restated Credit Agreement (Amendment) which changed certain terms and extended the Revolving Credit Termination Date from November 30, 2011 to November 30, 2012.

Matrix Service Company

Notes to Consolidated Financial Statements

The Credit Agreement 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 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. 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 0.50%. The Amendment reduced additional margin ranges from between 0.00% and 0.75% to between 0.00% and 0.25% on the Alternate Base Rate loans and from between 1.50% and 2.25% to between 1.00% and 1.75% on LIBOR-based loans. The Company pays an Unused Revolving Credit Facility Fee of 0.175% to 0.375%. Since the closing date, the Company has been at the lowest rate tier on borrowings and for other fees.

Subsequent to February 29, 2008, the outstanding letters of credit were reduced by $3.5 million, of which $2.8 million was released upon final payment of the acquisition payable and $0.7 million related to a reduction in the collateral required for a workers compensation insurance program. After these reductions, the outstanding letters of credit totaled $4.9 million.

Convertible Debt

In connection with the private placement of $30.0 million of five-year convertible notes on April 25, 2005, the Company entered into a registration rights agreement with the investors in the convertible notes. The convertible notes bore interest at a rate of 7% per year. An initial interest pre-payment of $4.2 million was made on April 25, 2005 for the period to and including April 25, 2007. As of May 31, 2007 the prepayment of $4.2 million had been either amortized to interest expense or, in the case of conversions that occurred prior to April 25, 2007, charged to equity on a pro-rata basis.

The notes were convertible into shares of the Company s common stock at an initial conversion price of $4.69 per share, subject to adjustment for stock dividends, stock splits or other matters as provided for in the convertible notes. In fiscal 2006, $5.0 million of the convertible notes were converted by note holders into 1,002,275 shares of the Company s Common Stock. In fiscal 2007, the remaining note balance of $25.0 million was converted into 5,292,974 shares of common stock. On July 9, 2007, the Company filed a post-effective amendment to the resale registration statement deregistering all remaining unsold shares.

Note 6 Acquisition Payable

As part of an acquisition in fiscal 2003, the Company entered into an acquisition payable for a portion of the purchase price. The acquisition payable is recorded at $2.8 million at February 29, 2008 and is accreted for the change in its present value each period utilizing a 5.1% effective interest rate. On March 7, 2008 the Company paid $2.2 million, the remaining $0.6 million will be paid on behalf of the sellers to certain taxing agencies.

Matrix Service Company

Notes to Consolidated Financial Statements

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.

During the second quarter of fiscal 2008, the Company completed its assessment of current and future state taxable income and determined that sufficient taxable income was available to recognize a tax benefit of $0.7 million for prior and current state investment tax credits.

Note 8 Commitments and Contingencies

Insurance Reserves

The Company maintains insurance coverage for various aspects of our operations. However, we retain exposure to potential losses through the use of deductibles, coverage limits and self-insured retentions.

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 to us, or we may have to purchase special insurance policies or surety bonds for specific customers. Matrix Service generally requires its subcontractors to indemnify the Company and the Company s customer plus name the Company as an additional insured for activities arising out of the subcontractors presence at the customer s location. Certain subcontractors must also 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 protect us against a valid claim or loss under the contracts with our customers.

Matrix Service maintains a performance and payment bonding line, which was $140.0 million at February 29, 2008.

Unapproved Change Orders and Claims

As of February 29, 2008 and May 31, 2007, 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 $1.9 million and $5.1 million, respectively, and claims of $2.4 million and $1.5 million, respectively. Amounts disclosed for unapproved change orders and claims exclude amounts associated with the contract dispute disclosed elsewhere in this Note. 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.

Contract Dispute

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.

Matrix Service Company

Notes to Consolidated Financial Statements

The Oregon Court of Appeals subsequently ruled that the dispute should be settled in arbitration. That ruling has been upheld by the Oregon Supreme Court, and the Company had planned on proceeding with arbitration. However, on November 18, 2007 the owner filed for Chapter 11 bankruptcy protection. The Company s arbitration has been stayed and will not move forward until an order is received from the bankruptcy court to proceed. Based on these recent events, the Company now believes that collection is unlikely and charged off the recorded value of $1.0 million in the second quarter of fiscal 2008. The Company will continue to evaluate any additional collection alternatives.

Capital Commitments

At February 29, 2008, expected remaining spending on capital projects that have been approved but are not yet completed totaled $5.5 million.

New Operating Lease

On November 16, 2007 the Company entered into an operating lease on a facility that will be used primarily as the corporate headquarters. The lease term is for 89 months and will begin upon occupancy of the facility, which the Company expects to be in the first quarter of fiscal 2009. Total minimum lease payments are $4.6 million and will begin 6 months after occupancy.

Other

The Company and its subsidiaries are named as defendants in various other 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.

Note 9 Other Comprehensive Income

Other comprehensive income consisted of foreign currency translation adjustments.

	Three Months Ended		Nine Months Ended	
	February 29, 2008	February 28, 2007	February 29, 2008	February 28, 2007
	(In thousands)		(In thousands)	
Net income	$ 6,002	$ 6,150	$ 12,548	$ 17,232
Other comprehensive income (loss)	278	(136)	750	(411)
Comprehensive income	$ 6,280	$ 6,014	$ 13,298	$ 16,821

Note 10 Earnings per Common Share

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

There were 33,092 antidilutive options for the nine month period ending February 28, 2007. These options were not included in the calculation of diluted earnings per share. There were no antidilutive options for the three month period ending February 28, 2007, and there were no antidilutive options for the three or nine-month periods ending February 29, 2008.

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Matrix Service Company

Notes to Consolidated Financial Statements

The computation of basic and diluted EPS is as follows:

	Three Months Ended February 29, 2008	Three Months Ended February 28, 2007	Nine Months Ended February 29, 2008	Nine Months Ended February 28, 2007
	(In thousands, except per share data)			
Basic EPS:				
Net income	$ 6,002	$ 6,150	$ 12,548	$ 17,232
Weighted average shares outstanding	26,464	23,103	26,561	22,533
Basic EPS	$ 0.23	$ 0.27	$ 0.47	$ 0.76
Diluted EPS:				
Net income	$ 6,002	$ 6,150	$ 12,548	$ 17,232
Convertible notes interest expense (net of tax)		179		621
Adjusted net income	$ 6,002	$ 6,329	$ 12,548	$ 17,853
Weighted average shares outstanding - basic	26,464	23,104	26,561	22,533
Dilutive stock options	333	446	375	387
Dilutive nonvested deferred shares	73	40	97	5
Dilutive convertible note shares		3,198		3,698
Dilutive weighted average shares	26,870	26,788	27,033	26,623
Diluted EPS	$ 0.22	$ 0.24	$ 0.46	$ 0.67

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Matrix Service Company

Notes to Consolidated Financial Statements

Note 11 Treasury Stock

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. During the third quarter of fiscal 2008, the Company purchased 729,982 shares at an average price of $17.59. In addition to the stock buyback program, Matrix Service may withhold shares of common stock to satisfy the tax withholding obligation upon vesting of an employee s deferred shares. The Company withheld 23,192 shares of common stock during the nine months ended February 29, 2008 for this obligation. In addition to shares that may be repurchased in conjunction with the future issuance of deferred shares, Matrix Service has and may continue to repurchase shares under the stock buyback program if the Company determines the purchase is accretive to earnings per share. The Company has 1,891,600 treasury shares at February 29, 2008 and intends to utilize these treasury shares solely for the satisfaction of stock issuances under the Company s stock plans.

Note 12 Segments

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

The primary turnkey and specialty construction 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/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 grassroots construction of new facilities.

The primary services of our Repair and Maintenance Services segment are aboveground storage tank repair and maintenance, turnarounds and maintenance for the downstream petroleum industry, specialty repair and maintenance services and electrical/instrumentation repair and maintenance. These services include a wide range of routine, preventative and emergency repair and maintenance services, outage and turnaround services, including plant maintenance, electrical and instrumentation maintenance, tank inspection, repair and maintenance, industrial cleaning and ASME code repairs.

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 and there is no intercompany profit or loss on intersegment sales or transfers.

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

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Matrix Service Company

Notes to Consolidated Financial Statements

Results of Operations

	Construction Services	Repair & Maintenance Services	Other	Combined Total
		(In thousands)		
Three Months Ended February 29, 2008				
Gross revenues	$ 123,186	$ 62,165	$	$ 185,351
Less: Inter-segment revenues	3,644	587		4,231
Consolidated revenues	119,542	61,578		181,120
Gross profit	11,359	9,642		21,001
Operating income (loss)	5,141	5,061	(106)	10,096
Income (loss) before income tax expense	5,015	5,082	(106)	9,991
Net income (loss)	3,007	3,057	(62)	6,002
Segment assets	155,939	80,550	20,663	257,152
Capital expenditures	2,837	542	1,412	4,791
Depreciation and amortization expense	1,384	833		2,217
Three Months Ended February 28, 2007				
Gross revenues	$ 106,174	$ 65,730	$	$ 171,904
Less: Inter-segment revenues	2,853	351		3,204
Consolidated revenues	103,321	65,379		168,700
Gross profit	10,752	8,172		18,924
Operating income	6,221	4,450		10,671
Income before income tax expense	5,987	4,264		10,251
Net income	3,595	2,555		6,150
Segment assets	121,022	78,762	21,468	221,252
Capital expenditures	1,121	988	550	2,659
Depreciation and amortization expense	981	683		1,664
Nine Months Ended February 29, 2008				
Gross revenues	$ 345,646	$ 205,570	$	$ 551,216
Less: Inter-segment revenues	11,052	2,983		14,035
Consolidated revenues	334,594	202,587		537,181
Gross profit	18,193	32,958		51,151
Operating income (loss)	(204)	20,588	(25)	20,359
Income (loss) before income tax expense	(704)	20,474	(25)	19,745
Net income (loss)	(5)	12,567	(14)	12,548
Segment assets	155,939	80,550	20,663	257,152
Capital expenditures	6,743	3,084	3,291	13,118
Depreciation and amortization expense	3,615	2,415		6,030
Nine Months Ended February 28, 2007				
Gross revenues	$ 271,036	$ 199,541	$	$ 470,577
Less: Inter-segment revenues	7,603	1,049		8,652
Consolidated revenues	263,433	198,492		461,925

Gross Profit	28,571	25,562		54,133
Operating income (loss)	15,121	14,372	(46)	29,447
Income (loss) before income tax expense	14,185	13,743	(46)	27,882
Net income (loss)	8,767	8,493	(28)	17,232
Segment assets	121,022	78,762	21,468	221,252
Capital expenditures	5,314	2,923	1,199	9,436
Depreciation and amortization expense	2,676	2,019		4,695

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Matrix Service Company

Notes to Consolidated Financial Statements

Segment Revenue from External Customers by Industry Type

	Construction Services	Repair & Maintenance Services (In thousands)	Total
Three Months Ended February 29, 2008			
Aboveground Storage Tanks	$ 51,109	$ 38,901	$ 90,010
Downstream Petroleum	39,740	19,236	58,976
Electrical and Instrumentation	4,705	3,441	8,146
Specialty	23,988		23,988
Total	$ 119,542	$ 61,578	$ 181,120
Three Months Ended February 28, 2007			
Aboveground Storage Tanks	$ 42,786	$ 29,793	$ 72,579
Downstream Petroleum	38,240	26,788	65,028
Electrical and Instrumentation	11,892	8,798	20,690
Specialty	10,403		10,403
Total	$ 103,321	$ 65,379	$ 168,700
Nine Months Ended February 29, 2008			
Aboveground Storage Tanks	$ 148,908	$ 124,933	$ 273,841
Downstream Petroleum	112,791	66,583	179,374
Electrical and Instrumentation	12,116	11,071	23,187
Specialty	60,779		60,779
Total	$ 334,594	$ 202,587	$ 537,181
Nine Months Ended February 28, 2007			
Aboveground Storage Tanks	$ 119,137	$ 89,686	$ 208,823
Downstream Petroleum	78,327	89,269	167,596
Electrical and Instrumentation	23,666	19,537	43,203
Specialty	42,303		42,303
Total	$ 263,433	$ 198,492	$ 461,925

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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, 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 based 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.

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As of February 29, 2008 and May 31, 2007, 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 $1.9 million and $5.1 million, respectively, and claims of $2.4 million and $1.5 million, respectively. Historically, our collections for unapproved change orders and other claims have approximated the amount of revenue recognized.

The following table provides a rollforward of revenue recognized on claims and unapproved change orders. Amounts disclosed for unapproved change orders exclude amounts associated with the contract dispute disclosed in Note 8 to the Consolidated Financial Statements.

	Claims for Unapproved Change Orders	Other Claims	Total
		(In thousands)	
Balance at May 31, 2007	$ 5,129	$ 1,493	$ 6,622
Additions	2,991	897	3,888
Collections	(6,177)		(6,177)
Loss	(34)		(34)
Balance at February 29, 2008	$ 1,909	$ 2,390	$ 4,299
Balance at May 31, 2006	$ 3,845	$ 523	$ 4,368
Additions	1,014		1,014
Collections	(3,757)	(492)	(4,249)
Loss	(379)	(31)	(410)
Balance at February 28, 2007	$ 723	$	$ 723

Gulf Coast LNG Project

We have recorded $20.0 million of charges on the Gulf Coast LNG tank construction project during fiscal 2008 of which $2.5 million was recorded in the third quarter of fiscal 2008. This charge reflects management s best estimate of the total revenues to be realized, including incentives, and total costs at completion. The current forecast includes actual cost and productivity data as of February 29, 2008 when the project was 92% complete and detailed cost projections for all remaining activity.

The Company successfully achieved the contracted delivery date for tank one in February 2008 and tank two in March 2008, and, based on all available information, we believe we will also achieve the contractual delivery date for the third, and final, tank. The forecasted revenues include the projected receipt of incentive payments tied to meeting the contractual delivery dates. The contract also provides for liquidated damages as penalty for missing the delivery dates, which have not been included in the current forecast based on the achievement of the delivery dates for the first two tanks and the expected achievement of the delivery date for the third tank. However, the Company s ability to meet the schedule for the third tank is not without some risk, and it is possible an event or series of events could prevent us from meeting the delivery date, which will occur in the fourth fiscal quarter. While there are a number of issues that could impact our ability to meet the schedule, the most significant items include excessive weather delays, significant loss of craft labor, and delay caused by subcontractors.

If we fail to achieve the contractual delivery date for the third tank, we would begin to lose incentives. The current revenue forecast includes $2.2 million of incentive payments and assumes that the delivery date for the third tank will be met. In the event the delivery is delayed, the incentive will be reduced by $34.0 thousand per day until delivery. In addition to lost incentives, a delay in the schedule could also result in additional labor and equipment costs, which we are unable to estimate but which could be material.

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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, coverage limits and self-insured retentions. As of February 29, 2008 and May 31, 2007, insurance reserves totaled $7.2 and $6.4 million respectively and are reflected on our balance sheet. These amounts represent our best estimate of our ultimate obligations for asserted claims plus 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 or claims experience could result in changes to these estimates in the future. Additionally, the actual results of claim settlements could differ from the amounts estimated.

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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 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. However, given the excess of estimated fair value over carrying value of $120.6 million for the Construction Services segment and $35.0 million for the Repair and Maintenance Services segment at May 31, 2007 and the absence of any indicators of impairment at February 29, 2008, we do not currently anticipate recording a goodwill impairment charge for either of our operating units.

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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 2.0% of revenues generated in Canada during the current fiscal year. However, the Company does continue to seek opportunities for growth in both the domestic and international markets.

The primary turnkey and specialty construction 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/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 grassroots construction of new facilities.

The primary services of our Repair and Maintenance Services segment are aboveground storage tank repair and maintenance, turnarounds and maintenance for the downstream petroleum industry, specialty repair and maintenance services and electrical/instrumentation repair and maintenance. These services include a wide range of routine, preventative and emergency repair and maintenance services, outage and turnaround services, including plant maintenance, electrical and instrumentation maintenance, tank inspection, repair and maintenance, industrial cleaning and ASME code repairs.

Significant fluctuations in revenues, gross profits and operating results are discussed below on a consolidated basis and for each segment. Revenues fluctuate from quarter to quarter 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 February 29, 2008 Compared to Three Months Ended February 28, 2007

Consolidated

Consolidated revenues were $181.1 million in fiscal 2008, an increase of $12.4 million, or 7.4%, compared to consolidated revenues of $168.7 million for fiscal 2007. The improvement in consolidated revenues resulted from an increase of $16.2 million in Construction Services revenues partially offset by a decline of $3.8 million in Repair and Maintenance Services revenues.

Consolidated gross profit increased from $18.9 million in fiscal 2007 to $21.0 million in fiscal 2008. This improvement of $2.1 million, or 11.1%, was driven by the 7.4% revenue growth. Consolidated gross margins increased from 11.2% in fiscal 2007 to 11.6% in fiscal 2008 due to improvement experienced in the Repair and Maintenance Services segment, where the gross margin grew to 15.7% in the current fiscal year versus 12.5% in the prior fiscal year. Partially offsetting this improvement was a decline in the Construction Services segment s gross margin, which was 10.5% in fiscal 2007 versus 9.5% in fiscal 2008.

Consolidated SG&A expenses increased $2.6 million in the third quarter of fiscal 2008 to $10.9 million from $8.3 million in the same quarter of fiscal 2007. The increase was primarily caused by higher employee-related expenses and facility costs as the Company added staff to meet the demands of current and expected future growth domestically and in Western Canada. SG&A expense as a percentage of revenue increased to 6.0% in the third quarter of fiscal 2008 compared to 4.9% in the third quarter of fiscal year 2007.

Interest expense decreased to $0.2 million in fiscal 2008 compared to $0.5 million in fiscal 2007. The decline of $0.3 million was primarily due to reduced amortization of prepaid interest on the convertible notes and lower amortization of debt issuance costs. Current year interest expense was primarily related to the amortization of deal fees on the senior revolving credit facility and interest on short-term borrowings under this facility.

Income before income tax expense decreased to $10.0 million in fiscal 2008 from income of $10.3 million in fiscal 2007. This $0.3 million decline occurred primarily due to greater SG&A expenses despite improved gross profits.

The effective tax rate of 39.9% for the third quarter of fiscal 2008 was consistent with the effective tax rate experienced for the third quarter of fiscal 2007, which was 40.0%.

Net income for fiscal 2008 fell to $6.0 million, or $0.22 per fully diluted share, versus net income in fiscal 2007 of $6.2 million, or $0.24 per fully diluted share.

Construction Services

Construction Services revenues for the third quarter 2008 were $119.5 million compared to $103.3 million in the same period a year earlier. The $16.2 million increase was primarily a result of higher Specialty revenues, where third quarter revenues were $24.0 million compared to $10.4 million a year earlier, and higher Aboveground Storage Tank revenues, which improved to $51.1 million, from $42.8 million for the year-earlier period. In addition, Downstream Petroleum revenues experienced a marginal increase of 3.9% or $1.5 million. These improvements were partially offset by Electrical and Instrumentation revenues which fell $7.2 million to $4.7 million from $11.9 million in the year-earlier period.

Gross profit increased from $10.8 million in fiscal 2007 to $11.4 million in fiscal 2008. The improvement of $0.6 million was a result of the 15.7% increase in revenues, which was largely offset by a decline in gross margins attributable to an additional $2.5 million pre-tax charge for cost overruns related to a LNG construction project in the Gulf Coast Region. The additional cost overruns are primarily attributable to the Company incurring additional costs in order to meet the required mechanical completion dates for each tank despite continued harsh weather conditions. Construction Services gross margins dropped from 10.4% in fiscal 2007 to 9.5% in fiscal 2008 as a result of this additional charge.

Operating income and income before income tax expense were $5.1 million and $5.0 million in fiscal 2008 compared to $6.2 million and $6.0 million, respectively, in fiscal 2007.

Repair and Maintenance Services

Repair and Maintenance Services revenues were $61.6 million in the third quarter of 2008 versus $65.4 million in the same quarter in 2007. The decrease was primarily a result of lower Downstream Petroleum revenues, where third quarter revenues were $19.2 million compared to $26.8 million a year earlier, and by Electrical and Instrumentation revenues, which fell to $3.4 million, from $8.8 million for the year-earlier period. These declines were largely offset by Aboveground Storage Tank revenues which rose 30.5% to $38.9 million compared to $29.8 million in the year-earlier period.

Gross Profit increased from $8.2 million in fiscal 2007 to $9.6 million in fiscal 2008 while gross margins improved to 15.7% versus 12.5% in the third quarter a year ago. Repair and Maintenance Services gross margins benefited from greater levels of high margin callout work, particularly in Aboveground Storage Tank.

Operating income and income before income tax expense were each $5.1 million in fiscal 2008 compared to $4.5 million and $4.3 million, respectively, in fiscal 2007.

Nine Months Ended February 29, 2008 Compared to Nine Months Ended February 28, 2007

Consolidated

Consolidated revenues were $537.2 million in fiscal 2008, an increase of $75.3 million, or 16.3%, from consolidated revenues of $461.9 million for fiscal 2007. The improvement in consolidated revenues resulted from an increase of $71.2 million in Construction Services revenues combined with growth of $4.1 million in Repair and Maintenance Services revenues.

Consolidated gross profit decreased from $54.1 million in fiscal 2007 to $51.2 million in fiscal 2008. The decline of $2.9 million, or 5.4%, occurred despite the 16.3% growth in revenues due to the Construction Services segment experiencing low gross margins. Consolidated gross margins decreased from 11.7% in fiscal 2007 to 9.5% in fiscal 2008 due to lower margins in the Construction Services segment, which fell to 5.4% in the current fiscal year versus 10.9% in the prior fiscal year. Partially offsetting this decline was an improvement in the Repair and Maintenance Services segment, where the overall gross margin increased from 12.9% in fiscal 2007 to 16.3% in fiscal 2008.

Consolidated SG&A expenses increased $6.1 million in fiscal 2008 to $30.8 million from $24.7 million for fiscal 2007. The increase was primarily caused by higher employee-related expenses and facility costs resulting from the cost of additional hires and related benefits to meet the demands of current and anticipated growth domestically and in Western Canada. SG&A expense as a percentage of revenue increased to 5.7% in fiscal 2008 compared to 5.3% in the prior fiscal year as the benefit from the 16.3% growth in revenues largely offset the increase in SG&A expenses.

Interest expense decreased to $0.8 million in fiscal 2008 compared to $2.0 million in fiscal 2007. This decline of $1.2 million was primarily due to reduced amortization of prepaid interest on the convertible notes and lower amortization of debt issuance costs. Current year interest expense was primarily related to the amortization of deal fees on the senior revolving credit facility and interest on short-term borrowings under this facility.

Income before income tax expense decreased to $19.7 million in fiscal 2008 from $27.9 million in fiscal 2007. The $8.2 million decrease was due to lower gross margins realized in the Construction Services segment combined with increased SG&A expenses partially offset by improved gross profit in the Repair and Maintenance Services segment and a decline in interest expense.

The effective tax rates for fiscal 2008 and fiscal 2007 were 36.4% and 38.2%, respectively. The fiscal 2008 tax rate was reduced due to a $0.7 million tax benefit resulting from the continuing assessment of the realizability of state investment tax credits. The fiscal 2007 reduced rate was impacted by the utilization of losses on disputed contracts, the tax benefits of which had been reserved as a valuation allowance in previous years.

Net income for fiscal 2008 fell to $12.5 million, or $0.46 per fully diluted share, versus net income in fiscal 2007 of $17.2 million, or $0.67 per fully diluted share.

Construction Services

Revenues for the Construction Services segment were $334.6 million, compared with $263.4 million for the nine months ending February 28, 2007. The increase was primarily due to higher construction work in Downstream Petroleum, where revenues for the nine month period increased 44.1% to $112.8 million versus $78.3 million for the same nine month period last year. The increase was also driven by higher Aboveground Storage Tank revenues, which increased 25.0% to $148.9 million in the recent nine month period, versus $119.1 million a year earlier, and by higher Specialty revenues, which gained 43.7% to $60.8 million in the recent nine month period compared to $42.3 million a year earlier. These increases were partially offset by Electrical and Instrumentation revenues which fell $11.6 million.

Gross profit decreased from $28.6 million in fiscal 2007 to $18.2 million in fiscal 2008 despite the increase in revenues due to a decline in gross margins which dropped from 10.8% in fiscal 2007 to 5.4% in fiscal 2008. This decline in gross profit of $10.4 million was a result of $20.0 million of pre-tax charges for cost overruns related to a LNG construction project in the Gulf Coast Region. The cost overruns were primarily attributable to higher craft turnover and continued productivity and construction-related issues on an increasingly compressed schedule for the remaining portions of the project. Our remaining Construction Services projects are experiencing higher margins than those recognized in the prior fiscal period.

Operating loss and loss before income tax expense were $0.2 million and $0.7 million, respectively, in fiscal 2008 versus operating income and income before income tax expense of $15.1 million and $14.2 million in fiscal 2007.

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Repair and Maintenance Services

Revenues for Repair and Maintenance Services rose $4.1 million, or 2.1%, to $202.6 million, for the nine month period ending February 29, 2008, from $198.5 million for the nine month period ending February 28, 2007. The increase was primarily due to higher Aboveground Storage Tank revenues, which rose 39.2% to $124.9 million, versus $89.7 million for the same nine month period last year. This increase was largely offset by lower Downstream Petroleum revenues, which fell 25.4% to $66.6 million in the nine month period, from $89.3 million in the same nine month period last year, and by Electrical and Instrumentation revenues, which fell $8.4 million to $11.1 million in the nine month period from $19.5 million in the same nine month period last year.

Gross margins improved to 16.3% in fiscal 2008 as compared to gross margins of 12.9% in fiscal 2007 while gross profit improved from $25.6 million in fiscal 2007 to $33.0 million in fiscal 2008. Repair and Maintenance Services gross margins benefited from continued high levels of callout work, particularly in our Aboveground Storage Tank market.

Operating income and income before income tax expense climbed to $20.6 million and $20.5 million, respectively, in fiscal 2008 compared to $14.4 million and $13.7 million produced in fiscal 2007. This improvement was due to improved margins.

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. We have historically included estimated revenues on our fixed price contracts and certain cost plus contracts in backlog; however, we had included only a small portion of our time and material contract expected revenues because we had taken a conservative approach regarding what constituted a firm contract.

In the first quarter of fiscal 2008, we performed an assessment of our backlog recognition policy, specifically, to review and assess our interpretation of what constitutes a firm contract. In performing our analysis, we considered the predictability and certainty of future revenues both in timing and amount. Based on our analysis and consistent with predominant industry practice, we concluded that certain time and material and maintenance contracts that were previously excluded from backlog meet the definition of a firm contract, and therefore, are now included in our reported backlog amounts. We have modified our definition of contracts includable in backlog and will now include expected revenue from the following contract types:

- 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.

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The following provides a rollforward of our backlog for the three-months ended February 29, 2008:

	Construction Services	Repair and Maintenance Services	Total
		(In thousands)	
Backlog as of November 30, 2007	$ 372,636	$ 113,663	$ 486,299
New backlog awarded	105,113	74,278	179,391
Revenue recognized on contracts in backlog	(119,542)	(61,578)	(181,120)
Backlog as of February 29, 2008	$ 358,207	$ 126,363	$ 484,570

At February 29, 2008, the Construction Services segment had a backlog of $358.2 million, as compared to $372.6 million at November 30, 2007. The decrease in backlog of $14.4 million relates to a decrease of $20.7 million in Specialty, a decrease of $10.9 million in Downstream Petroleum, a decrease of $4.2 million in Aboveground Storage Tank partially offset by an increase of $21.4 million in Electrical and Instrumentation. The backlog at February 29, 2008 and November 30, 2007 for the Repair and Maintenance Services segment was $126.4 million and $113.7 million, respectively. The increase in backlog of $12.7 million includes an increase in Aboveground Storage Tank of $8.2 million, an increase of $4.0 million in Downstream Petroleum and an increase of $0.5 million in Electrical and Instrumentation.

The following provides a rollforward of our backlog for the nine-months ended February 29, 2008:

	Construction Services	Repair and Maintenance Services	Total
		(In thousands)	
Backlog as of May 31, 2007	$ 313,837	$ 42,566	$ 356,403
Impact of change in method	35,417	68,210	103,627
New backlog awarded	343,547	218,174	561,721
Revenue recognized on contracts in backlog	(334,594)	(202,587)	(537,181)
Backlog as of February 29, 2008	$ 358,207	$ 126,363	$ 484,570

At February 29, 2008, the Construction Services segment had backlog of $358.2 million, as compared to backlog of $349.3 million at May 31, 2007. The increase in backlog of $8.9 million relates to an increase of $39.4 million in Aboveground Storage Tank, an increase of $21.8 million in Electrical and Instrumentation, partially offset by decreases of $4.1 million and $48.2 million in Downstream Petroleum and Specialty, respectively. The backlog at February 29, 2008 and May 31, 2007 for the Repair and Maintenance Services segment was $126.4 million and $110.8 million, respectively. The increase in backlog of $15.6 million includes an increase in Downstream Petroleum of $6.3 million, an increase in Electrical and Instrumentation of $0.9 million and an increase of $8.4 million in Aboveground Storage Tank.

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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 operations 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 expense. Because we have borrowed money 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 and amortization expense. Because we use capital assets to generate revenue, depreciation and amortization expense is a necessary element of our cost structure. Therefore, any measure that excludes depreciation and amortization expense has material limitations.

EBITDA for the three and nine-month periods ended February 29, 2008 was $12.4 million and $26.5 million respectively, compared to EBITDA of $12.3 million and $34.4 million for the three and nine-month periods ended February 28, 2007. A reconciliation of EBITDA to net income follows:

	Three Months Ended		Nine Months Ended	
	February 29, 2008	February 28, 2007	February 29, 2008	February 28, 2007
	(In thousands)		(In thousands)	
Net income	$ 6,002	$ 6,150	$ 12,548	$ 17,232
Interest expense, net	157	396	703	1,843
Provision for income taxes	3,989	4,101	7,197	10,650
Depreciation and amortization	2,217	1,664	6,030	4,695
EBITDA	$ 12,365	$ 12,311	$ 26,478	$ 34,420

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Financial Condition & 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 nine months of fiscal 2008 were cash flows from operations and borrowings under our senior revolving credit facility. Although we routinely borrow under our senior revolving credit facility, there were no outstanding borrowings at February 29, 2008. At February 29, 2008, cash on hand totaled $8.3 million and availability under the senior revolving credit facility totaled $66.6 million resulting in total liquidity of $74.9 million.

Factors that routinely impact our short-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 collections from our customers.
  - Time and material contracts are normally billed in arrears. Therefore, we are routinely required to carry these costs until they can be billed and collected.
  - Some of our clients for large construction projects require retentions which can be significant and may have a material impact on liquidity if collection is delayed.
- Significant capital expenditures

Throughout the remainder of fiscal 2008, we expect cash flows from operations to be a significant source of liquidity, which we expect will fund additional investments in capital assets. However, we will continue to evaluate our working capital requirements and other factors to maintain sufficient liquidity. We are currently seeking to increase our revolving credit facility to $100.0 million. We are also negotiating to further expand the facility to $125.0 million at our option and with the consent of the Administrative Agent. We may also elect to raise additional capital by issuing common stock, convertible notes or term debt as necessary to fund our operations and capital spending or to acquire complementary assets or businesses.

Cash Flows from Operating Activities

Operations generated $24.5 million in cash in the first nine months of fiscal 2008. The cash generated from operations was due to profitable operating results and a favorable change in working capital. The favorable change in working capital primarily relates to a decrease in costs in excess of $5.2 million and an increase in billings in excess of $13.6 million partially offset by an increase in receivables of $10.7 million. The fluctuations are primarily due to the following:

- Costs in excess — The decrease is primarily due to favorable billing terms and a reduction of unbilled costs.
- Billings in excess — The increase is mainly due to increased operating activity and the timing of billings on our projects.

Receivables The increase is primarily due to the timing of billings, increased operating activity, and higher retention amounts. Our receivable aging continues to be favorable and we do not expect significant collection problems.

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Cash Flows from Investing Activities

Investing activities used $12.8 million in cash in the first nine months of fiscal 2008. This was due to capital expenditures of $13.1 million partially offset by proceeds from asset sales of $0.3 million. Capital expenditures included $6.4 million for the purchase of construction equipment, $1.9 million for transportation equipment, $1.8 million for furniture and fixtures, and $3.0 million for land and buildings. We also routinely acquire assets utilizing capital leases. Assets acquired through capital leases totaled $0.6 million in the first nine months of fiscal 2008 and are reported as non-cash additions to Property, Plant and Equipment.

The fiscal 2008 capital budget of $31.1 million, which was approved at the beginning of fiscal 2008, included $13.4 million of capital to replace equipment, $12.6 million of capital to increase fabrication capacity and to equip additional construction and maintenance crews in targeted growth markets, and $5.1 million of capital to purchase, expand or improve facilities to address the Company s need for additional office and shop space. Based on our current capital projections, we now expect our capital spending to be between $19.0 million and $21.0 million. The reduction in capital spending is primarily due to the deferral of certain projects into fiscal 2009 as well as fiscal 2008 capital requirements being less than anticipated. Any reductions to our fiscal 2008 capital budget or deferral of capital expenditures is not expected to impact our fiscal 2008 results or limit our future opportunities.

Cash Flows from Financing Activities

Financing activities used $13.0 million in cash in the first nine months of fiscal 2008. This was primarily due to open market treasury stock purchases of $12.8 million, treasury stock purchases made in conjunction with the issuance of deferred shares of $0.7 million, and capital lease payments of $0.7 million partially offset by the proceeds from the issuance of common stock caused by the exercise of stock options of $0.6 million, and the tax benefit received as a result of these option exercises of $0.6 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 February 29, 2008 was $75.0 million with $8.4 million outstanding for letters of credit that have been issued to support certain workers compensation insurance programs and to secure the final payment under the acquisition note payable. Subsequent to February 29, 2008, the outstanding letters of credit were reduced by $3.5 million, of which $2.8 million was released upon final payment of the acquisition payable and $0.7 million related to a reduction in the collateral required for a workers compensation insurance program. After these reductions, the outstanding letters of credit totaled $4.9 million.

Availability under our senior credit facility is as follows:

	February 29, 2008	May 31, 2007
	(In thousands)	
Senior credit facility - revolver	$ 75,000	$ 75,000
Amounts borrowed		
Letters of credit	8,395	8,575
Availability under senior credit facility	$ 66,605	$ 66,425

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. Any failure to comply with the financial and other covenants in our senior revolving credit facility could result in an event of default which could reduce our liquidity and our ability to issue new letters of credit. We are currently in compliance with all covenants and have full availability under the facility.

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Acquisition Payable

As part of an acquisition in fiscal 2003, the Company entered into an acquisition payable for a portion of the purchase price. The acquisition payable is recorded at $2.8 million at February 29, 2008 and is accreted for the change in its present value each period utilizing a 5.1% effective interest rate. On March 7, 2008 the Company paid $2.2 million, the remaining $0.6 million will be paid on behalf of the sellers to certain taxing agencies.

New Operating Lease

On November 16, 2007 the Company entered into an operating lease on a facility that will be used primarily as the corporate headquarters. The lease term is for 89 months and will begin upon occupancy of the facility, which the Company expects to be in the first quarter of fiscal 2009. Total minimum lease payments are $4.6 million and will begin 6 months after occupancy.

Dividend Policy

We have never paid cash dividends on our Common Stock. We currently intend to retain earnings to finance the growth and development 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. Our credit agreement limits the amount of cash dividends we can pay.

Stock Repurchase Program

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. During the third quarter of fiscal 2008, the Company purchased 729,982 shares at an average price of $17.59. In addition to the stock buyback program, Matrix Service may withhold shares of common stock to satisfy the tax withholding obligation upon vesting of an employee s deferred shares. The Company withheld 23,192 shares of common stock during the nine months ended February 29, 2008 for this obligation. In addition to shares that may be repurchased in conjunction with the future issuance of deferred shares, Matrix Service has and may continue to repurchase shares under the stock buyback program if the Company determines the purchase is accretive to earnings per share. The Company has 1,891,600 treasury shares at February 29, 2008 and intends to utilize these treasury shares solely for the satisfaction of stock issuances under the Company s stock plans.

Outlook

Business continues to be strong particularly in the Aboveground Storage Tank and Downstream Petroleum industries, which experienced a combined year-over-year revenue increase of more than 20%. Backlog stood at $484.6 million at February 29, 2008, with new awards of nearly $562 million through the first nine months of this fiscal year. In the Aboveground Storage Tank, Downstream Petroleum, and Electrical and Instrumentation industries, we have seen backlog growth of nearly $73 million, or 18.4% from May 31, 2007 to February 29, 2008. Recently, we renewed a refinery maintenance contract, which is expected to generate revenues in excess of $150 million over the next three years and added a new alliance agreement associated with our work in Aboveground Storage Tanks.

We see a strong finish to our fiscal year. We expect fiscal 2008 revenue to be between $720.0 million and $740.0 million, and expect to see annual gross margins in the range of 10% to 11% and annual SG&A expense between 5.5% and 6.0% of consolidated revenues.

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 may include, among others, such things as:

- amounts and nature of future revenues and margins from our Construction Services segment and Repair and Maintenance Services segment;
- our ability to generate sufficient cash from operations, borrow under our senior revolving credit facility or raise cash in order to meet our short and long-term capital requirements;
- our ability to continue to comply with the financial covenants in our Credit Agreement;
- our ability to collect amounts billed to our customers and the adequacy of our reserves for accounts receivable;
- the adequacy of our reserves for contingencies and insurance losses;
- the likely impact of new or existing regulations 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, 2007 and listed from time to time in our filings with the Securities and Exchange Commission;
- our ability to achieve project milestones and earn incentive payments or avoid liquidated damages, especially on our larger contracts;
- general economic, market or business conditions;
- changes in laws or regulations; and

other factors, most 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.

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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, 2007, filed with the Securities and Exchange Commission. For more information on market risk, see Part II, Item 7A in our fiscal 2007 Annual Report on Form 10-K.

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 29, 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 February 29, 2008.

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PART II

OTHER INFORMATION

ITEM 1. Legal Proceedings

For information regarding legal proceedings, see Note 8 in Item 1 of Part 1 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 IA. of Part I of our Annual Report on Form 10-K for the fiscal year ended May 31, 2007.

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 the 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 intends to utilize these purchased treasury shares solely for the satisfaction of stock issuance under the 1990, 1991 and 2004 stock plans and the 1995 Nonemployee Directors Stock Option Plan:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Shares That May Yet Be Purchased Under the Plans or Programs
December 1 31, 2007		$	2,116,800	1,330,706
January 1 31, 2008	350,683	$ 17.28	2,467,483	980,023
February 1 29 2008	379,299	$ 17.88	2,846,782	600,724
Total	729,982	$ 17.59		

Dividend Policy

We have never paid cash dividends on our Common Stock. We currently intend to retain earnings to finance the growth and development 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. Our credit agreement limits the amount of cash dividends we can pay.

ITEM 3. Defaults Upon Senior Securities

Not applicable

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ITEM 4. Submission of Matters to a Vote of Security Holders

Not applicable

ITEM 5. Other Information

Not applicable

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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: April 3, 2008

By: /s/ Kevin S. Cavanah
Kevin S. Cavanah, Vice President-Accounting and Financial Reporting signing on behalf of the registrant and as the registrant s principal accounting officer

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