MATRIX SERVICE CO
Form 10-Q
January 11, 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 November 30, 2007

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, or a non-accelerated filer. 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 ¨

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 January 8, 2008 there were 27,888,217 shares of the Company s common stock, $0.01 par value per share, issued and 26,669,699 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 November 30,		Six Months Ended November 30,	
	November 30, 2007	2006	November 30, 2007	2006
	(unaudited)		(unaudited)	
Revenues	$ 194,734	$ 166,366	$ 356,061	$ 293,225
Cost of revenues	183,488	144,464	325,911	258,016
Gross profit	11,246	21,902	30,150	35,209
Selling, general and administrative expenses	11,841	8,749	19,887	16,433
Operating income (loss)	(595)	13,153	10,263	18,776
Other income (expense):				
Interest expense	(273)	(759)	(577)	(1,505)
Interest income	15	29	31	58
Other	47	198	37	302
Income (loss) before income taxes	(806)	12,621	9,754	17,631
Provision (benefit) for federal, state and foreign income taxes	(1,016)	4,547	3,208	6,549
Net income	$ 210	$ 8,074	$ 6,546	$ 11,082
Basic earnings per common share	$ 0.01	$ 0.35	$ 0.25	$ 0.50
Diluted earnings per common share	$ 0.01	$ 0.31	$ 0.24	$ 0.43
Weighted average common shares outstanding:				
Basic	26,625	23,004	26,609	22,252
Diluted	27,131	26,589	27,109	26,572

See accompanying notes.

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Matrix Service Company

Consolidated Balance Sheets

(In thousands)

	November 30, 2007 (unaudited)	May 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 6,229	$ 9,147
Accounts receivable, less allowances (November 30, 2007-$192 and May 31, 2007-$260)	134,802	98,497
Costs and estimated earnings in excess of billings on uncompleted contracts	43,158	45,634
Inventories	4,866	4,891
Income tax receivable	3,104	
Deferred income taxes	5,819	3,283
Prepaid expenses	2,149	2,910
Other current assets	1,759	929
Total current assets	201,886	165,291
Property, plant and equipment at cost:		
Land and buildings	23,719	23,405
Construction equipment	43,583	39,958
Transportation equipment	15,203	14,380
Furniture and fixtures	11,102	10,116
Construction in progress	5,472	1,788
	99,079	89,647
Accumulated depreciation	(46,894)	(43,654)
	52,185	45,993
Goodwill	23,530	23,357
Other assets	660	8,268
Total assets	$ 278,261	$ 242,909

See accompanying notes.

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Matrix Service Company

Consolidated Balance Sheets

(In thousands, except share data)

	November 30, 2007 (unaudited)	May 31, 2007
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 63,414	$ 52,144
Billings on uncompleted contracts in excess of costs and estimated earnings	51,994	34,243
Accrued insurance	6,396	6,422
Accrued wages and benefits	9,980	15,442
Income tax payable		956
Current capital lease obligation	854	753
Current portion of acquisition payable	2,781	2,712
Other accrued expenses	1,553	1,313
Total current liabilities	136,972	113,985
Long-term capital lease obligation	521	836
Long-term debt	3,250	
Deferred income taxes	3,573	2,512
Stockholders equity:		
Common stock - $.01 par value; 60,000,000 shares authorized 27,888,217 shares issued as of November 30, 2007 and May 31, 2007	279	279
Additional paid-in capital	106,157	104,408
Retained earnings	29,953	23,422
Accumulated other comprehensive income	1,439	967
	137,828	129,076
Less: Treasury stock, at cost 1,218,518 and 1,297,466 shares as of November 30, 2007 and May 31, 2007	(3,883)	(3,500)
Total stockholders equity	133,945	125,576
Total liabilities and stockholders equity	$ 278,261	$ 242,909

See accompanying notes.

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Matrix Service Company

Consolidated Statements of Cash Flows

(In thousands)

	Six Months Ended November 30, 2007	Six Months Ended November 30, 2006
	(unaudited)	
Operating activities:		
Net income	$ 6,546	$ 11,082
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	3,813	3,031
Deferred income tax	(1,475)	2,143
Gain on sale of property, plant and equipment	(9)	(119)
Allowance for uncollectible accounts	1,084	65
Stock-based compensation expense	1,384	473
Accretion on acquisition payable	69	112
Amortization of debt issuance costs	104	263
Amortization of prepaid interest		642
Changes in operating assets and liabilities increasing (decreasing) cash Receivables	(29,876)	(5,572)
Costs and estimated earnings in excess of billings on uncompleted contracts	2,476	(2,643)
Inventories	25	(815)
Prepaid expenses and other assets	(208)	(3,094)
Accounts payable	9,801	(11,455)
Billings on uncompleted contracts in excess of costs and estimated earnings	17,751	8,736
Accrued expenses	(5,248)	(381)
Income tax receivable/payable	(4,060)	434
Net cash provided by operating activities	2,177	2,902
Investing activities:		
Acquisition of property, plant and equipment	(8,327)	(6,777)
Proceeds from asset sales	192	142
Net cash used by investing activities	$ (8,135)	$ (6,635)

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Matrix Service Company

Consolidated Statements of Cash Flows (continued)

(In thousands)

	Six Months Ended November 30, 2007	Six Months Ended November 30, 2006
	(unaudited)	
Financing activities:		
Advances under bank credit facility	$ 107,820	$ 85,635
Repayments of bank credit facility	(104,570)	(85,635)
Payment of credit facility refinancing fees		(25)
Capital lease payments	(416)	(254)
Issuances of common stock	239	437
Tax benefit of exercised stock options	428	235
Purchase of treasury shares	(700)	
Net cash provided by financing activities	2,801	393
Effect of exchange rate changes on cash	239	(153)
Net decrease in cash and cash equivalents	(2,918)	(3,493)
Cash and cash equivalents, beginning of period	9,147	8,585
Cash and cash equivalents, end of period	$ 6,229	$ 5,092
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$ 8,304	$ 3,732
Interest	$ 311	$ 608
Non-cash investing and financing activities:		
Equipment acquired through capital leases	$ 202	$ 197
Purchases of property, plant and equipment on account	$ 1,611	$ 443
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			6,546			6,546
Other comprehensive income					472	472
Comprehensive income						7,018
Exercise of stock options (42,550 shares)		112	(15)	142		239
Tax effect of exercised stock options		428				428
Stock based compensation expense		1,384				1,384
Issuance of deferred shares (59,590 shares)		(175)		175		
Purchase of treasury shares (23,192 shares)				(700)		(700)
Balances, November 30, 2007	$ 279	$ 106,157	$ 29,953	$ (3,883)	$ 1,439	$ 133,945
Balances, May 31, 2006	$ 226	$ 75,855	$ 4,316	$ (4,812)	$ 814	$ 76,399
Net income			11,082			11,082
Other comprehensive loss					(275)	(275)
Comprehensive income						10,807
Conversion of notes (2,091,539 shares)	21	9,099				9,120
Exercise of stock options (81,500 shares)		221	(24)	240		437
Tax effect of exercised stock options		235				235
Stock based compensation expense		473				473
Balances, November 30, 2006	$ 247	$ 85,883	$ 15,374	$ (4,572)	$ 539	$ 97,471

See accompanying notes.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

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 November 30, 2007, 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 or six-months ended November 30, 2007.

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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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

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 November 30, 2007 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 11.

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:

	November 30, 2007	May 31, 2007
	(In thousands)	
Costs incurred and estimated earnings recognized on uncompleted contracts	$ 830,589	$ 697,045
Billings on uncompleted contracts	839,425	685,654
	$ (8,836)	$ 11,391
Shown on balance sheet as:		
Costs and estimated earnings in excess of billings on uncompleted contracts	$ 43,158	$ 45,634
Billings on uncompleted contracts in excess of costs and estimated earnings	51,994	34,243
	$ (8,836)	$ 11,391

Progress billings in accounts receivable at November 30, 2007 and May 31, 2007 included retentions to be collected within one year of $20.4 million and $8.6 million, respectively. Contract retentions collectible beyond one year are included in other assets on the consolidated balance sheets and totaled $7.5 million at May 31, 2007. There were no contract retentions collectible beyond one year as of November 30, 2007. Billings on uncompleted contracts in excess of costs and estimated earnings at November 30, 2007 and May 31, 2007 included estimated accrued losses of $5.2 million and $3.8 million, respectively, on a construction project that was partially complete at those dates.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Gulf Coast LNG Project

We recorded a $16.0 million charge on the Gulf Coast LNG project in the second 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 December 31, 2007 when the project was 84% complete and detailed cost projections for all remaining activity. The current forecast also reflects the manpower and costs necessary to achieve our contractual delivery dates for each of the three tanks being constructed by Matrix Service.

Based on all available information, we believe we will achieve the delivery dates for all three tanks, and the forecasted revenues include receipt of incentive payments tied to meeting those dates. The contract also provides for liquidated damages as penalty for missing the delivery dates, none of which have been included in the current forecast as we believe we will meet the delivery dates. However, the schedule is not without some risk and it is possible an event or series of events could prevent us from meeting the delivery dates, resulting in additional loss on the project. While there are a number of issues that could impact the schedule, the most significant items include excessive weather delays, significant loss of craft labor, or delay by subcontractors.

If we fail to achieve the contractual delivery dates, we would begin to lose incentives and would begin to incur liquidated damages on a daily basis subject to contractual limitations. The current revenue forecast includes $7.8 million in incentive payments, tied to various delivery dates from February through April, 2008. Liquidated damages under the contract are $25,000 per tank per day up to an aggregate total of $6.5 million. In addition to lost incentives and payment of liquidated damages, 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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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 5 Debt

Availability under the senior credit facility is as follows:

	November 30, 2007	May 31, 2007
	(In thousands)	
Senior credit facility - revolver	$ 75,000	$ 75,000
Amounts borrowed	3,250	
Letters of credit	8,395	8,575
Availability under senior credit facility	$ 63,355	$ 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. The Company is currently seeking an increase in the total capacity to $100.0 million, and is negotiating an option to further expand the revolving credit facility to $125.0 million upon the Company s request and with the consent of the Administrative Agent.

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.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

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 November 30, 2007 and is 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 and the final payment of $2.8 million is due on March 7, 2008.

Pursuant to the purchase agreement, the former shareholders of the acquired entity agreed, jointly and severally, to indemnify Matrix Service 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 the acquired company of its contractual obligations and its obligations under applicable laws, including employment and environmental laws. As to these matters, Matrix Service 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 Service of any claims by it for indemnity, $10.0 million of the purchase price 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 Service from the deferred payments of the purchase price. Since the purchase date on March 7, 2003, claims have not exceeded $250,000, and thus no adjustment to the deferred purchase price has been made related to these provisions as of November 30, 2007.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

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, 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 $90.0 million through November 30, 2007. This bonding line was subsequently increased to $140.0 million on December 21, 2007.

Unapproved Change Orders and Claims

As of November 30, 2007 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 $4.6 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 to Matrix Service until final resolution of related claims, and accordingly, collection of these amounts may extend beyond one year.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

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.

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 November 30, 2007, expected remaining spending on capital projects that have been approved but are not yet completed total $6.8 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 fourth quarter of fiscal 2008. Total minimum lease payments under this arrangement are $4.6 million and will begin 5 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.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 9 Other Comprehensive Income

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

	Three Months Ended November 30,		Six Months Ended	
	November 30, 2007	2006	November 30, 2007	November 30, 2006
	(In thousands)		(In thousands)	
Net income	$ 210	$ 8,074	$ 6,546	$ 11,082
Other comprehensive income (loss)	364	(250)	472	(275)
Comprehensive income	$ 574	$ 7,824	$ 7,018	$ 10,807

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, as well as the dilutive effect of convertible securities. Stock options are considered antidilutive whenever the exercise price of the options exceed the average market price of the common stock during the period. Convertible debt is considered antidilutive whenever its interest (net of tax) per common share obtainable on conversion exceeds basic earnings per share. Stock options are considered dilutive whenever the exercise price is less than the average market price of the stock during the period. Dilutive convertible securities are calculated using the if converted method, in which all unconverted securities are assumed to be converted as of the beginning of the period. The if converted method also requires that any interest charges, net of tax, applicable to the securities be added back to net income for purposes of computing diluted earnings per share. Both stock options and convertible debt are considered antidilutive in the event of a net loss.

There were 238,104 and 368,081 antidilutive options for the three and six-month periods ending November 30, 2006. These options were not included in the calculation of diluted earnings per share. There were no antidilutive options for the three or six-month periods ending November 30, 2007.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

The computation of basic and diluted EPS is as follows:

	Three Months Ended November 30, 2007	Three Months Ended November 30, 2006	Six Months Ended November 30, 2007	Six Months Ended November 30, 2006
	(In thousands, except per share data)			
Basic EPS:				
Net income	$ 210	$ 8,074	$ 6,546	$ 11,082
Weighted average shares outstanding	26,625	23,004	26,609	22,252
Basic EPS	$ 0.01	$ 0.35	$ 0.25	$ 0.50
Diluted EPS:				
Net income	$ 210	$ 8,074	$ 6,546	$ 11,082
Convertible notes interest expense (net of tax)		180		442
Adjusted net income	$ 210	$ 8,254	$ 6,546	$ 11,524
Weighted average shares outstanding - basic	26,625	23,004	26,609	22,252
Dilutive stock options	398	387	395	376
Dilutive nonvested deferred shares	108		105	
Dilutive convertible note shares		3,198		3,944
Dilutive weighted average shares	27,131	26,589	27,109	26,572
Diluted EPS	$ 0.01	$ 0.31	$ 0.24	$ 0.43

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 11 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 se