MATRIX SERVICE CO
Form S-3
May 20, 2005
Table of Contents

As filed with the Securities and Exchange Commission on May 20, 2005

Registration No. 333-

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-3

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

MATRIX SERVICE COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**73-1352174**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

10701 E. Ute Street

Tulsa, Oklahoma 74116-1517

(918) 838-8822

(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant s Principal Executive Offices)

George L. Austin

10701 E. Ute Street

Tulsa, Oklahoma 74116-1517

(918) 838-8822

(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent for Service)

WITH A COPY TO:

Mark D. Berman, Esq.

Conner & Winters, LLP

3700 First Place Tower

15 East Fifth Street

Tulsa, Oklahoma 74103

(918) 586-5711

(918) 586-8548 (Facsimile)

Approximate date of commencement of proposed sale of the securities to the public: From time to time after this Registration Statement becomes effective.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box: ¨

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, other than securities offered only in connection with dividend or interest reinvestment plans, please check the following box: x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. ¨

CALCULATION OF REGISTRATION FEE

Title Of Each Class Of Securities To Be Registered	Amount To Be Registered	Proposed Maximum Offering Price Per Share (1)	Proposed Maximum Aggregate Offering Price	Amount Of Registration Fee
Common stock ($0.01 par value)	6,668,449(2)	$ 4.27	$ 28,474,277	$ 3,352
Preferred share purchase rights (3)	6,668,449			

(1) Estimated solely for purposes of calculating the registration fee, pursuant to Rule 457(c) of the Securities Act of 1933, as amended, on the basis of $4.27 per share, the average of the high and low sales prices of the common stock as reported on the Nasdaq National Market for May 19, 2005, which was one business days prior to this filing.

(2) Includes 6,396,594 shares of common stock issuable to the selling stockholders upon conversion of the registrant s convertible notes held by such holders, plus up to 111,940 shares issuable to the selling stockholders in respect of interest accruing on the convertible notes from time to time and up to 159,915 shares potentially issuable to the selling stockholders in respect of additional principal which may become payable as a result of the accretion of additional interest in accordance with the terms of the convertible notes. In addition to the shares of common stock set forth in the table above, pursuant to Rule 416 under the Securities Act, we are registering an indeterminate number of shares of common stock issuable upon conversion of the convertible notes in connection with an adjustment of the conversion price pursuant to the terms of the convertible notes, or in exchange or replacement of such shares of common stock.

(3) Each share of common stock is accompanied by a preferred share purchase right pursuant to a Rights Agreement, as amended, with UMB Bank, N.A., as Rights Agent. Because no separate consideration is paid for the rights, the registration fee therefor is included in the fee for the common stock.

The registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until this Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

Table of Contents

The information in this prospectus is not complete and may be changed. The selling stockholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED MAY 20, 2005

6,668,449 Shares

MATRIX SERVICE COMPANY

COMMON STOCK

This prospectus relates to the offer and sale from time to time of up to an aggregate of 6,668,449 shares of our common stock for the account of the selling stockholders named in this prospectus. The selling stockholders, or their transferees, pledgees, donees or other successors in interest, may sell their shares of common stock by the methods described under Plan of Distribution.

The shares of common stock being registered for resale consist of shares of common stock issuable upon the conversion of convertible notes sold in a private placement on April 22, 2005, which is more fully described under the heading Matrix Service Company Recent Events.

We will not receive any of the proceeds from the sale by the selling stockholders of the shares of common stock.

Our common stock is listed on the Nasdaq National Market under the symbol MTRX. On May 19, 2005, the last reported sales price for our common stock was $4.19.

There are significant risks associated with an investment in our securities. See Risk Factors beginning on page 5. You should also read carefully the risks we describe in our periodic reports that we file with the Securities and Exchange Commission, for a better understanding of the risks and uncertainties that investors in our common stock should consider.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is , .

TABLE OF CONTENTS

	Page
Matrix Service Company	3
Risk Factors	5
No Proceeds	21
Forward-Looking Statements.	21
Description of Capital Stock	22
Selling Stockholders	25
Plan of Distribution	28
Legal Matters	30
Experts	30
Where You Can Find More Information	30
Incorporation of Certain Documents By Reference	30

You should rely only on the information contained in or specifically incorporated by reference into this prospectus. We have not authorized anyone to provide you with information that is different. This prospectus may only be used where it is legal to sell these securities. The information in this prospectus or incorporated by reference into this prospectus may only be accurate on the date of those documents.

Table of Contents

MATRIX SERVICE COMPANY

Our Business

We provide construction services and repair and maintenance services primarily for facilities used in the downstream petroleum industry, such as petroleum refineries and petroleum and natural gas products storage, terminals and pipelines, and for facilities used in the power industry for the generation (by fossil, hydro, and nuclear) and transmission of power. Our construction services segment provides turnkey and specialty construction services, including civil, structural, mechanical piping, electrical, instrumentation, millwrighting, steel fabrication and erection, specialized heavy hauling and rigging, boiler work and fabrication and construction of aboveground storage tanks. Our repair and maintenance services segment provides routine, preventative and emergency maintenance and repair services, including services related to plant turnarounds, power outages, industrial cleaning and aboveground storage tank maintenance and repair. We believe that we excel as a full-service contractor, providing our clients with superior service through qualified professionals, technical expertise, skilled craftsmen and excellent project management.

Our Executive Offices

We are a Delaware corporation. Our principal offices are located at 10701 E. Ute Street, Tulsa, Oklahoma 74116-1517. Our telephone number is (918) 838-8822. Our internet website address is www.matrixservice.com. Information on our website is not a part of this prospectus.

Recent Events

On April 22, 2005, we completed a private placement of $30 million aggregate principal amount of our 7% Senior Unsecured Convertible Notes due 2010, which we refer to as the convertible notes.

The convertible notes were issued under a securities purchase agreement among us and certain investors. The securities purchase agreement and convertible notes provide, among other things, that the convertible notes will bear interest at a rate of 7% per year. Interest was paid in advance on April 25, 2005 for the period to and including April 25, 2007, which advance payment was $4.2 million. After April 25, 2007, interest is payable in arrears on each March 31, June 30, September 30 and December 31, beginning on June 30, 2007, at the rate of 7% per year. If we maintain a specified leverage ratio of total debt to EBITDA (as those terms are defined in the securities purchase agreement) and no default or event of default exists on the interest payment date, the interest rate will be 5% per annum after April 25, 2007. If, however, we fail to refinance our credit facility on or before September 30, 2005, the interest rate will be increased by 5% per annum beginning October 1, 2005 until the date the credit facility is refinanced. Any such additional interest which becomes payable due to our failure to refinance the credit facility will be accreted to the principal balance of the convertible notes then outstanding on each applicable interest payment date for the convertible notes and on the date on which the credit facility is refinanced.

The convertible notes are convertible into shares of our common stock at an initial conversion price of $4.69 per share. The conversion price is subject to adjustment in certain circumstances.

Under the securities purchase agreement and a subordination agreement entered into simultaneously therewith, in certain circumstances, our obligations to the investors in the convertible notes are subordinated to our existing and future senior obligations, which includes all of our existing and future indebtedness under our credit facility in an amount not to exceed $90 million. As long as any

Table of Contents

of the convertible notes are outstanding, we will not be permitted to incur any debt, except for, among other things:

- senior obligations permitted under the credit facility or the refinancing or replacement thereof, including new and replacement letters of credit, all in an amount not to exceed $90 million;
- capital leases not to exceed $1 million outstanding at any time;
- operating leases not to exceed $15 million outstanding at any time;
- purchase money financing in an amount not to exceed $1 million; and
- debt under our performance and bonding line, not to exceed $150 million.

At any time following the occurrence of an event of default under the convertible notes, the investors have a right to require us to purchase all or any part of the outstanding principal amount of the convertible notes at a purchase price in cash equal to the greater of: (A) 100% of such outstanding principal amount (except that such amount shall equal 110% in the case of any change of control transaction), plus all accrued but unpaid interest thereon and any unpaid liquidated damages and other amounts then owing to the investors, through the date of purchase, or (B) the event equity value (as defined in the securities purchase agreement) of the underlying shares of common stock that would be issuable upon conversion of such principal amount and payment in our common stock of all such accrued but unpaid interest thereon.

Pursuant to the securities purchase agreement, we have agreed to indemnify the investors, their affiliates and agents against certain liabilities.

We agreed, pursuant to a registration rights agreement entered into in connection with such transaction, to register for resale by the noteholders all of the shares of common stock issuable upon conversion of the convertible notes. This prospectus covers the resale by each of the noteholders of such shares.

Additional information about the convertible notes is available in our Current Report on Form 8-K filed with the SEC on April 25, 2005, which is incorporated by reference into this prospectus, as described in Incorporation of Certain Documents by Reference.

Table of Contents

RISK FACTORS

Before you invest in our securities, you should be aware that there are various risks. You should carefully consider the risk factors set forth in this prospectus and the reports we file with the SEC which are incorporated by reference into this prospectus, as well as other information we include or incorporate by reference in this prospectus, before you decide whether an investment in our securities is suitable for you. These are not the only risks and uncertainties we face. Additional risks and uncertainties that we are presently unaware of or currently consider immaterial may also adversely affect our business operations.

Risks Relating to Our Business

Adverse events have negatively affected our liquidity position.

Our liquidity consists primarily of cash from operations and advances under our revolving credit facility. We cannot assure you that we will have sufficient cash from operations or the credit capacity to meet all of our cash needs if we continue to encounter significant working capital requirements, including the requirement to carry our costs included in uncollected accounts receivable, contract dispute receivables, claims for increased costs caused by others, unapproved change orders and costs incurred in excess of contract billings.

Insufficient cash from operations and insufficient earnings from operations have recently and could in the future result in our failure to comply with the terms of our credit agreement. Primarily as a result of cost overruns on certain projects, lower than expected revenues in our construction services segment and lower cash from operations resulting from non-payment of contract dispute receivables, and claims against customers, we were not in compliance with certain of the financial covenants contained in our credit agreement as of May 31, 2004, August 31, 2004 and February 28, 2005. We obtained, at substantial cost, waivers from our lenders with respect to our non-compliance with specified covenants as of those dates.

On April 22, 2005, we completed a private placement of $30.0 million of 7.0% convertible notes due 2010. The proceeds to us, which were net of fees and prepaid interest for two years, were approximately $24.6 million. We used $20.0 million of the net proceeds to repay Term Note B under our credit facility, which included an escalating interest rate and was bearing interest of 18% at the time of its repayment on April 25, 2005. The remaining net proceeds were used to provide additional liquidity for working capital needs.

As of May 13, 2005, our credit facility currently consists of a $35 million revolver, a $22.4 million term loan and a $10 million revolving loan B.

Availability under the revolver is limited to the lesser of $35 million or 80% of the borrowing base, which is based on eligible accounts receivables. At February 28, 2005, $11.0 million was outstanding under the revolver and $9.3 million of the revolver was utilized by outstanding letters of credit, which mature in 2005 and 2006. At that date, remaining availability under the revolver was $14.7 million and as of May 13, 2005, availability under our revolver was $5.6 million. As of May 13, 2005, we are paying a weighted average interest rate of 8.25% on the revolver.

Under our term loan, principal payments of $1.2 million are due on the last day of each fiscal quarter, with the remaining principal due on March 31, 2008, the date on which the term loan matures. As of May 13, 2005, we are paying a weighted average interest rate of 8.25% on the term loan.

Table of Contents

The $10 million revolving loan B commitment was established in amendment nine to our credit agreement on April 22, 2005. The revolving loan B commitment bears cash interest at prime, expires on October 31, 2005 and is secured by various contract dispute receivables. Availability under the commitment is limited to $10 million less an amount equal to the value of all of our outstanding checks. The revolving loan B commitment will be further reduced by an amount equal to any funds collected with respect to large disputed accounts, and the net proceeds from the sale of any of our equity securities or any of our assets. In addition, the revolving B borrowing base and, consequently, the revolving B loan commitment, may be decreased by the revolver B lenders in their sole discretion. We have not borrowed under revolving loan B and as of May 13, 2005, availability under revolving loan B is $4.9 million.

Our credit agreement requires us to make mandatory prepayments in certain circumstances including upon the sale of assets in excess of $250,000, the sale of stock or the issuance of subordinated indebtedness, or in the event that we generate excess cash, incur a borrowing base deficiency or collect contract dispute receivables.

Amendment nine to our credit agreement eliminates certain financial covenants and includes new financial covenants. Under amendment nine, we are required to maintain minimum levels of consolidated EBITDA for various monthly test periods through March 31, 2006 as of designated monthly test dates. Consolidated EBITDA is defined to include consolidated net income, plus, to the extent deducted in determining consolidated net income, (i) consolidated interest expense, (ii) expense for taxes paid or accrued, (iii) depreciation, amortization, other non-cash charges, (iv) losses on sale of fixed assets, and (v) extraordinary losses incurred other than in the ordinary course of business, minus, to the extent included in consolidated net income, (i) gains on sales of fixed assets, (ii) extraordinary gains realized other than in the ordinary course of business, and (iii) income tax benefits. The minimum level of consolidated EBITDA for each monthly test period is as follows:

TEST PERIODS	MINIMUM EBITDA	TEST DATE
March 1, 2005 through April 30, 2005	$ 1,200,000.00	May 31, 2005
March 1, 2005 through May 31, 2005	$ 3,152,930.00	June 30, 2005
June 1, 2005 through June 30, 2005	$ 911,193.00	July 31, 2005
June 1, 2005 through July 31, 2005	$ 1,822,386.00	August 31, 2005
June 1, 2005 through August 31, 2005	$ 3,644,771.00	September 30, 2005
June 1, 2005 through September 30, 2005	$ 4,639,881.00	October 31, 2005
June 1, 2005 through October 31, 2005	$ 5,634,991.00	November 30, 2005
June 1, 2005 through November 30, 2005	$ 7,625,210.00	December 31, 2005
June 1, 2005 through December 31, 2005	$ 8,688,507.00	January 31, 2006
June 1, 2005 through January 31, 2006	$ 9,751,804.00	February 28, 2006
June 1, 2005 through February 28, 2006	$ 11,878,399.00	March 31, 2006

For purposes of determining compliance with this covenant, consolidated EBITDA will be increased by an amount equal to all non-recurring extraordinary professional fees and restructuring charges incurred by us during the applicable test period to the extent they were deducted from consolidated net income; provided that no such fees and charges incurred after November 30, 2005 may be included and the maximum aggregate amount of such fees and charges paid in cash as to all test periods that may be so included may not exceed $5 million. In addition, for purposes of determining compliance with this covenant solely for the test period beginning March 1, 2005 and ending May 31, 2005, consolidated EBITDA will be increased by the lesser of (i) $1.2 million, or (ii)(a) 28% times (b) the gross proceeds of the convertible notes, minus all prepaid interest thereon, fees paid by us in connection with the closing of the convertible notes, and $20 million.

Table of Contents

Amendment nine also requires us to maintain a minimum fixed charge coverage ratio of consolidated EBITDA minus cash dividends and distributions and cash taxes paid during the period to scheduled current maturities of long-term debt, plus consolidated interest expense, current maturities on capitalized leases and capital expenditures. The fixed charge coverage ratio increases from 1.00 for the fiscal quarter ending May 31, 2005 to 1.15 for the fiscal quarter ending August 31, 2005, 1.25 for the fiscal quarter ending November 30, 2005 and 1.33 for the fiscal quarter ending February 28, 2006.

Although our credit agreement provides us with sufficient liquidity in the short term, the revolving loan B expires on October 31, 2005 and the $35 million revolver expires on March 31, 2006. While we are currently working to obtain a new credit facility, we cannot assure you that our efforts will be successful. In addition, the failure to comply with the terms of our credit agreement has required us to incur significant fees to our lenders to obtain waivers and amendments and caused us to seek alternative financing. Without acceptable waivers or amendments from our lenders with respect to any future covenant violations or alternative financing on terms acceptable to us, our lenders would have the right, among others, to declare all amounts outstanding under the credit agreement to be immediately due and payable and foreclose upon and sell substantially all of our assets to repay such amounts.

Our sureties recently terminated our performance and bonding line. If we are unable to provide performance bonds for our projects, we may have less success in obtaining new work. Insufficient liquidity could have other important consequences to us. For example, we could:

- have reduced operating flexibility, such as in the levels of workforce we can maintain or by being required to use subcontractors to perform work that could otherwise be performed by us;
- be required to divert a substantial portion of our cash flow away from operations to the repayment of debt and the interest associated with that debt, particularly in the event of significant increases in interest rates as a substantial amount of our debt is at floating rates;
- be required to delay bidding for or accepting new projects;
- lose the services of skilled craftsmen and other experienced professionals if we are unable to retain them on our payroll during periods of idle time;
- be restricted in our ability to bid for new work that would require significant up-front expenditures for mobilization, equipment and raw materials; and
- experience difficulty in financing future acquisitions and/or continuing operations.

In addition, insufficient liquidity has recently and could in the future require us to negotiate extended payment terms with our vendors. To date, this has not materially affected our relationships with key vendors. However, if we are required to negotiate extended payment terms, we cannot assure you that we will not experience difficulty in ordering and obtaining equipment and raw materials from our vendors.

All or any of these consequences could place us at a disadvantage as compared with competitors with greater liquidity. This could have a negative impact upon our financial condition and results of operations.

7

Table of Contents

The interest rate on our existing indebtedness will increase if we are unable to refinance our revolving credit facility. We may be unable to refinance or repay our credit facility prior to or upon its maturity.

Pursuant to amendment nine to our credit agreement, all borrowings under our credit facility, other than revolving loan B, currently accrue interest at a base rate plus an applicable margin and an additional accrued margin. The additional accrued margin was 1.00% for the period April 22, 2005 through April 30, 2005, increased to 1.50% for the period May 1, 2005 through May 31, 2005 and will increase 0.50% on the first day of each month until capped at 5.00% beginning December 1, 2005. Interest at the prime rate and the applicable margin is payable monthly in cash and interest at the additional accrued margin is accrued monthly and is payable in cash at the time of payment of the principal amount of the applicable loan. In addition, if we fail to refinance our credit facility prior to September 30, 2005, additional interest of 5.00% per annum will accrue and be added to the principal balance of our convertible notes beginning October 1, 2005 and until our credit facility is refinanced.

We may be unable to refinance our credit facility in the next few months or at all. If we are unable to refinance our credit facility in the next few months, we may find it increasingly difficult or impossible to refinance our increasing debt burden. Moreover, the failure to refinance our credit facility on or before March 31, 2006 would constitute an event of default under the convertibles notes, which would allow the convertible note investors to require us to redeem the convertible notes for an amount which may exceed the outstanding principal amount plus all accrued and unpaid interest thereon. If we are not able to refinance our credit facility on or before its expiration, we could become subject to bankruptcy proceedings, and you may lose all of your investment because the claims of our creditors on our assets are prior to the claims of our stockholders. Moreover, even if we are successful in refinancing our credit facility, any future senior indebtedness could be at higher interest rates and may require us to comply with more onerous covenants which could further restrict our business operations.

If we fail to comply with our obligations under a registration rights agreement among us and the holders of the convertible notes, we may be required to pay additional interest on the convertible notes. Our failure to comply with our obligations under the registration rights agreement may also constitute an event of default under the convertible notes.

In connection with the private placement of the convertible notes, on April 22, 2005, we entered into a registration rights agreement with the investors in the convertible notes. The registration rights agreement requires us to file a registration statement with respect to the resale of the shares of the our common stock issuable upon conversion of the convertible notes within 30 days after the closing date and to cause the registration statement to be declared effective by the Securities and Exchange Commission, or SEC, no later than the effectiveness date, which is defined as the earlier of (i) 120 days after the closing, and (ii) five trading days after we are notified by the SEC that the registration statement will not be reviewed or is no longer subject to further review and comments. The registration rights agreement also requires us to use our best efforts to keep the registration statement continuously effective until the earlier of (a) the date on which all of our common stock covered by such registration statement has been sold or may be sold without volume restrictions pursuant to Rule 144(k) under the Securities Act of 1933, as amended, or Securities Act, or (b) the fifth anniversary of the closing date. If we fail to satisfy our obligations under the registration rights agreement, we will owe the holders of the convertible notes as partial liquidated damages an amount in cash equal to 1% of the aggregate amount paid for the convertible notes for each such event, and thereafter on each monthly anniversary of each such event (if the applicable failure shall not have been cured by such date) until the applicable failure is cured, we will owe the note holders an amount in cash equal to an additional 1% of the aggregate amount paid for the convertible notes.

Table of Contents

Moreover, the convertible notes provide that an event of default will occur if the registration statement is not declared effective within 30 days of the effectiveness date or if the registration statement does not remain available for use by the holders of convertible notes for in excess of an aggregate of 20 trading days (which need not be consecutive) in any 18-month period during the effectiveness period. The occurrence of an event of default would entitle the holders of the convertible notes to require us to redeem the convertible notes for an amount which may exceed the outstanding principal amount plus all accrued and unpaid interest thereon and would also constitute an event of default under the cross default provisions of our credit agreement.

Restructuring charges and increased professional fees associated with our restructuring program may reduce our operating results in future periods.

In March 2005, we began a restructuring program to reduce our cost structure and improve our operating results. This restructuring program could include reductions in workforce and changes to business plans including the consolidation and closure of certain facilities or business lines. We expect to incur restructuring charges of at least $2.1 million in the fourth quarter of fiscal 2005. We have engaged a financial consultant to assist senior management with all restructuring activities. As a result of these efforts, we also anticipate incurring $1.5 million in professional fees in the fourth quarter of fiscal 2005. We also expect these restructuring efforts to continue into the 2006 fiscal year.

Restructuring charges and higher professional fees may reduce our results of operations and our cash flow from operations over the next several quarters. In addition, any reductions in our workforce or closure of facilities or business lines could negatively affect our ability to pursue or obtain profitable new projects.

Our earnings for the third quarter of fiscal 2005 were negatively impacted by a preliminary impairment charge. Earnings for the future periods may be further affected by additional impairment charges.

Because we have grown in part through acquisitions, goodwill and other acquired intangible assets represent a substantial portion of our assets. We perform an annual goodwill impairment review in the fourth quarter of every fiscal year. In addition, we perform a goodwill impairment review whenever events or changes in circumstances indicate the carrying value may not be recoverable, such as the liquidity issues and operating results we are currently experiencing.

As a result, we performed a goodwill impairment test as of February 28, 2005. The process of evaluating the impairment of goodwill is highly subjective and requires significant judgment. Fair value of the reporting units was determined based on the probability-adjusted present value of future cash flows. A preliminary impairment charge of $25.0 million was recorded for our Construction Services segment in the quarter ended February 28, 2005. The cash flow assumptions were based on the best available information, but this information is considered preliminary due our current liquidity situation and restructuring efforts. The impairment evaluation will be completed in the fourth quarter of fiscal 2005. At that time, the preliminary impairment charge recorded in the third fiscal quarter may be adjusted upward. Moreover, at that time or on some future date, we may determine that an additional significant impairment has occurred in the value of our unamortized intangible assets, which could require us to write off an additional portion of our assets and could adversely affect our financial condition or results of operations.

Table of Contents

We are and will continue to be involved in litigation, which will increase our costs and, if adversely determined, could have a material adverse effect on our financial condition and results of operations.

We are and are likely to continue to be named as a defendant in legal actions claiming damages from us in connection with the operation of our business. Most of the actions against us arise out of the normal course of our performing services on project sites, and include claims for workers compensation, personal injury and property damage. From time to time we are also named as a defendant in contract disputes with customers relating to the timeliness and quality of the performance of our services and of equipment, materials, design or other services provided by our subcontractors and third-party suppliers. We also are and are likely to continue to be a plaintiff in legal actions against customers seeking to recover payment of contractual amounts due to us as well as claims for increased costs incurred by us resulting from, among other things, services performed by us at the request of a customer that are in excess of original project scope that are later disputed by the customer and customer caused delays in our contract performance.

We maintain insurance against operating hazards in amounts that we believe are customary in our industry. However, our insurance has deductibles and exclusions of coverage so we cannot provide assurance that we are adequately insured against all the types of risks that are associated with the conduct of our business. A successful claim brought against us in excess of, or outside of, our insurance coverage could have a material adverse effect on our financial condition and results of operations.

Litigation, regardless of its outcome, is expensive, typically diverts the efforts of our management away from operations for varying periods of time, and can disrupt or otherwise adversely impact our relationships with current or potential customers and suppliers. Payment and claim disputes with customers also cause us to incur increased interest costs resulting from drawing higher levels of debt under our revolving line of credit due to the failure to receive payment for disputed claims and accounts. For the nine months ended February 28, 2005, legal expenses and interest costs related to litigation with customers for payment of disputed claims and uncollected accounts totaled approximately $4.1 million, or $0.14 per fully diluted share. We expect to continue to incur legal costs and interest expense until the matters are resolved.

In February 2005, our board of directors authorized management to initiate an effort to accelerate the resolution and collection of the amounts owed to us on the disputed contracts, and to further limit the costs of litigation arising out of the various disputes. The action by the board was taken in connection with our current liquidity situation, restructuring plans and refinancing efforts. While we believe that allowing these disputes to be resolved through the normal course of arbitration or litigation would result in the recovery of amounts equal to or in excess of those previously recorded on the balance sheet, the board concluded that addressing the liquidity situation was of utmost importance. Therefore, in an effort to expedite the collection of these balances, the board authorized management to pursue resolution at amounts below those previously reflected on the balance sheet. As a result of this initiative, we recorded a reserve of $10.4 million in the third quarter of fiscal 2005. Although we believe that we are adequately reserved for the disputes, we will continue to assess the adequacy of our reserves as additional information becomes available and cannot assure you that further increases in our reserves will not be required.

The South Coast Air Management Quality District of California, or AQMD, filed a complaint against one of our customers seeking to recover from the customer in excess of $400 million in fines for alleged multiple violations of various environmental regulations at the customer s refinery operations in California. We were neither a party to, nor named in, the complaint. However, counsel for the customer made a formal demand upon us to defend the complaint and to indemnify the customer for any damages it may suffer based upon the terms of a master services agreement that we entered into with the customer to

Table of Contents

provide certain services at the refinery. We formally rejected the customer s demand and agreed with the customer to postpone any dispute between us until the dispute between the customer and the AQMD was resolved. We continue to provide services to the customer, including under new contracts entered into between us since the filing of the complaint by the AQMD. We have conducted no discovery other than to review our own records and the terms of the master services agreement.

In March 2005, the AQMD reached a settlement with our customer. The terms of the settlement have not been provided to us. Now that the dispute between the customer and the AQMD has been resolved, the customer may proceed with a claim against us. If a claim is made against us by the customer of the magnitude previously sought against the customer by the AQMD, we believe that the cost of defending against such a claim would be significant, and if the claim were to be adversely determined against us, it would have a material adverse effect upon our financial condition and results of operations.

Demand for our products and services is cyclical and is vulnerable to downturns in the industries and markets which we serve as well as conditions in the general economy.

The demand for our products and services depends significantly upon the existence of construction and repair and maintenance projects in the power and downstream petroleum industries in the United States and Canada. These projects may relate to power generation and transmission facilities, petroleum refineries and petroleum and natural gas products storage facilities, terminals and pipelines. Together, these industries accounted for approximately 99%, 98% and 97% of our total revenues for our fiscal years ended May 31, 2002, May 31, 2003 and May 31, 2004, respectively. Power industry related revenues accounted for approximately 55% of our total revenues in fiscal year 2004, as compared to approximately 24% in fiscal year 2003, primarily due to two large power projects performed during fiscal 2004 that were assumed in connection with our acquisition of the Hake Group, Inc. in March 2003. For the nine months ended February 28, 2005, power industry related revenues were 15% of our total revenues, primarily because these two power projects were completed in fiscal 2004.

These markets historically have been, and likely will continue to be, cyclical in nature and vulnerable to general downturns in the United States and Canadian economies, which could adversely affect the demand for our products and services. Occasionally, the timing of the demand for our products and services in certain of these markets, such as power generation facilities and petroleum refineries, can also be adversely affected during periods of strong economic growth as customers may postpone closing their facilities for maintenance, repair, turnaround or expansion projects while demand for their products remains high.

As a consequence of these and other factors, our results of operations have varied and are likely to continue to vary significantly depending on the demand for future projects from these industries.

Our results of operations depend upon the award of new contracts and the timing of those awards.

Our revenues are derived primarily from contracts awarded to us on a project-by-project basis. Generally, it is very difficult to predict whether and when we will be awarded a new contract since each potential contract typically involves a lengthy and complex bidding and selection process that may be affected by a number of factors, including changes in existing or assumed market conditions, financing arrangements, governmental approvals and environmental matters. Because our revenues are derived primarily from these contracts, our results of operations and cash flows can fluctuate materially from period to period depending on the timing of contract awards.

The uncertainty associated with the timing of contract awards also increases our cost of doing business, either over a short period or a comparatively longer term. For example, we may decide to

Table of Contents

maintain and bear the cost of a workforce in excess of our current contract needs in anticipation of future contract awards. If an expected contract award is delayed or not received, we could incur costs in maintaining an idle workforce that may have a material adverse effect on our results of operations. Or, we may decide that our long term interests are best served by reducing our workforce and incurring increased costs associated with severance and termination benefits which also could have a material adverse effect on our results of operations for the period when incurred.

The terms of our contracts could expose us to absorbing unforeseen costs and costs not within our control, which may not be recoverable and could adversely affect our results of operations and financial condition.

While the percentages vary from period to period, over the long term, approximately 50% of our revenues have been derived from fixed-price contracts and 50% from cost-plus contracts. We expect this ratio to continue. Under fixed-price contracts, we agree to perform the contract for a fixed-price and, as a result, can realize our expected profit or improve our expected profit by superior contract performance, productivity, worker safety and other factors resulting in costs savings. However, we could incur cost overruns above the approved contract price, which may not be recoverable. Under certain incentive fixed-price contracts, we may agree to share with a customer a portion of any savings we are able to generate while the customer agrees to bear a portion of any increased costs we may incur up to a negotiated ceiling. To the extent costs exceed the negotiated ceiling price, we may be required to absorb some or all of the cost overruns.

Fixed-price contract prices are established based largely upon estimates and assumptions relating to project scope and specifications and personnel and material needs. These estimates and assumptions may prove inaccurate or conditions may change, sometimes due to factors not within our control, resulting in cost overruns we are required to absorb that could have a material adverse effect on our business, financial condition and results of operations. In addition, our profits from these contracts could decrease and we could experience losses if we incur difficulties in performing the contracts or are unable to secure fixed-pricing commitments from our manufacturers, suppliers and subcontractors at the time we enter into fixed-price contracts with our customers.

Under cost-plus contracts, we perform our services in return for payment of our agreed upon reimbursable costs plus a profit. The profit component is typically expressed in the contract either as a percentage of the reimbursable costs we actually incur or is factored into the rates we charge for labor or for the cost of equipment and materials, if any, we are required to provide. Some cost-plus contracts provide for the customer s review of the accounting and cost control systems used by us to calculate these labor rates and to verify the accuracy of the reimbursable costs invoiced. These reviews could result in reductions in amounts previously billed to the customer and in an adjustment to amounts previously reported by us as our profit on the contract.

Many of our fixed-price or cost-plus contracts require us to satisfy specified progress milestones or performance standards in order to receive a payment. Under these types of arrangements, we may incur significant costs for labor, equipment and supplies prior to receipt of payment. If the customer fails or refuses to pay us for any reason, there is no assurance we will be able to collect amounts due to us for costs previously incurred. In some cases, we may find it necessary to terminate subcontracts with suppliers engaged by us to assist in performing a contract and we may incur costs or penalties for canceling our commitments to them.

Many of our customers for power generation projects are project-specific entities that do not have significant assets other than their interest in the project. In these cases, we typically obtain a guaranty of the obligations of the project-specific entity from its more creditworthy parent entity. It may be difficult for us to collect amounts owed to us by these customers and their more creditworthy parent entity.

Table of Contents

If we are unable to collect amounts owed to us under our contracts, we may be required to record a charge against previously recognized earnings related to the project and our liquidity, financial condition and results of operations could be adversely affected.

We may encounter difficulties during the course of performing our contracts that may result in additional costs to us and in a reduction in our revenues and earnings that could have an adverse effect upon our financial condition and results of operations.

Many of our construction and repair and maintenance projects are performed over extended periods of time and involve complex design and engineering specifications. In these cases, it is common for us to perform work from time-to-time over the life of the project that is outside the scope of the original contract with the expectation of receiving a signed change order from the customer. Our contracts for these projects also often require us to provide extensive project management and to obtain machinery, equipment, materials and services from third parties or the customer. We may encounter difficulties in obtaining these products and services on a timely basis. In some cases, these third-party provided products may not perform as expected or the services delivered may not meet contract specifications. These performance failures and other factors, some of which are beyond our control, may result in delays and additional costs to us including, in some cases, the cost of procuring alternate product or service providers, which may adversely impact our ability to complete a project on budget and in accordance with the original delivery schedule. To the extent these and the other matters referred to in the next paragraph occur, we may seek to recover any increased costs incurred by us from the responsible party; however, we cannot assure you that we will be successful in recovering all or a part of these costs in any or all circumstances.

In certain circumstances, we guarantee project completion or the achievement of certain acceptance and performance testing levels by a scheduled date. Failure to meet schedule or performance requirements could result in additional costs to us, including the payment of contractually agreed liquidated damages. The amount of such additional costs could exceed our profit margins on the project. While we may seek to recover these amounts as claims from the supplier, vendor, subcontractor or other third party responsible for the delay or for providing non-conforming products or services, we cannot assure you that we will recover all or any part of these costs in all circumstances. Performance problems for existing and future projects could cause our actual results of operations to differ materially from those anticipated by us and could damage our reputation within our industry and our customer base.

Our use of percentage-of-completion accounting for fixed-price contracts and our reporting of profits for cost-plus contracts prior to contract completion could result in a reduction or elimination of previously reported profits.

A material portion of our revenues are recognized using the percentage-of-completion method of accounting. The percentage-of-completion accounting practices that we use result in our recognizing fixed-price contract revenues and earnings ratably over the contract term in the proportion that our actual costs bear to our estimated contract costs. The earnings or losses recognized on individual fixed-price contracts are based on estimates of contract revenues, costs and profitability. We review our estimates of contract revenues, costs and profitability on an ongoing basis. Prior to contract completion, we may adjust our estimates on one or more occasions as a result of change orders to the original contract, collection disputes with the customer on amounts invoiced or claims against the customer for increased costs incurred by us due to customer-induced delays and other factors.

Table of Contents

Contract losses are recognized in the fiscal period when the loss is determined. Contract profit estimates are also adjusted in the fiscal period in which it is determined that an adjustment is required. No restatements are made to prior periods. Further, a number of our contracts contain various cost and performance incentives and penalties that impact the earnings we realize from our contracts, and adjustments related to these incentives and penalties are recorded in the period when estimable or finalized, which is generally during the latter stages of the contract.

As a result of the requirements of the percentage-of-completion method of accounting, the possibility exists, for example, that we could have estimated and reported a profit on a contract over several prior periods and later determined, usually near contract completion, that all or a portion of such previously estimated and reported profits were overstated. If this occurs, the full aggregate amount of the overstatement will be reported for the period in which such determination is made, thereby eliminating all or a portion of any profits from other contracts that would have otherwise been reported in such period or even resulting in a loss being reported for such period.

Our financial loss exposure on cost-plus contracts is generally limited to a portion of our profit on the contract. However, it is possible that the customer could successfully dispute the costs we believe we incurred on the contract or assert that our costs were excessive for reasons such as poor project management or labor productivity. In addition, some cost-plus contracts contain penalty provisions which require us to pay amounts to the customer for failure to achieve certain milestones or performance standards. To the extent we are not able to recover the full amount of our costs under a cost-plus contract, including as a result of payments by us under contract penalty provisions, there would be a reduction, or possibly an elimination, of previously recognized and reported earnings. In certain circumstances it is possible that such adjustments could be material to our operating results.

We may incur significant costs in providing services in excess of original project scope without having an approved change order.

After commencement of a contract, we may perform, without the benefit of an approved change order from the customer, additional services requested by the customer that were not contemplated in our contract price due to a change of mind by the customer or to incomplete or inaccurate engineering, project specifications and other similar information provided to us by the customer. Our construction contracts generally require the customer to compensate us for additional work or expenses incurred under these circumstances.

A failure to obtain adequate compensation for these matters could require us to record in the current period an adjustment to revenue and profit recognized in prior periods under the percentage-of-completion accounting method. Any such adjustments, if substantial, could have a material adverse effect on our results of operations and financial condition, particularly for the period in which such adjustments are made. While we believe that our success in obtaining mutually satisfactory approved change orders from our customers has been comparable to the experience of our competitors, we cannot assure you that we will be successful in obtaining, through negotiation, arbitration, litigation or otherwise, approved change orders from customers to pay us amounts adequate to compensate us for our additional work or expenses.

Actual results could differ from the estimates and assumptions that we use to prepare our financial statements.

To prepare financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions, as of the date of the financial statements,

Table of Contents

which affect the reported values of assets, liabilities, revenues and expenses and disclosures of contingent assets and liabilities. Areas requiring significant estimation by our management include:

- contract expenses and profits and application of percentage-of-completion accounting;
- costs and estimated earnings in excess of billings on uncompleted contracts;
- provisions for uncollectible receivables and other collection disputes with customers for invoiced amounts;
- the amount and collectibility of claims against customers, third-party suppliers, subcontractors and others for increased costs incurred by us that were caused by the actions or inactions of these parties, such as increased costs due to delays in their performance or the failure of machinery, equipment and supplies provided by them to perform to agreed specifications;
- provisions for income taxes and related valuation allowances;
- recoverability of goodwill;
- valuation of assets acquired and liabilities assumed in connection with business combinations; and
- accruals for estimated liabilities, including litigation and insurance reserves.

Our actual results could differ from these estimates.

If we are unable to attract and retain qualified personnel, and in particular, project managers, our ability to manage the performance of our contracts and our business will be harmed, which would impair our future revenues and profitability.

Our ability to attract and retain qualified engineers, skilled craftsmen and other experienced professional personnel in accordance with our needs will be an important factor in determining our future profitability. The market for these professionals is competitive and the supply extremely limited, and we cannot assure you that we will be successful in our efforts to retain these personnel or to attract them when needed. Therefore, when we anticipate or experience growing demand for our services and those of our competitors, we may incur the cost of maintaining a professional staff in excess of our current contract needs in an effort to have available sufficient qualified personnel to address this anticipated demand.

Competent and experienced project managers are especially critical to the profitable performance of our contracts, and in particular, on our fixed-price contracts where superior execution of the contract can result in profits greater than originally estimated or where inferior contract execution can reduce or eliminate estimated profits or even produce a loss. Our project managers are involved in all aspects of contracting and contract performance including, among other things:

supervising the bidding process, including providing estimates of significant cost components such as material and equipment needs and the size and composition of the workforce;

negotiating contracts;

Table of Contents

- supervising contract performance, including performance by our employees, subcontractors and other third party suppliers and vendors;
- determining the percentage of contract completion that is used by us to estimate amounts that can be reported as revenues and earnings on the contract under the percentage-of-completion method of accounting;
- negotiating requests for change orders and the final terms of an approved change order; and
- determining and documenting claims by us for increased costs incurred due to the failure of customers, subcontractors and other third-party suppliers of equipment and materials to perform on a timely basis and in accordance with contract terms.

Our projects expose us to potential professional liability, product liability, warranty and other claims, which could be expensive, damage our reputation and harm our business. We may not be able to obtain or maintain adequate insurance to cover these claims.

We construct, perform services at and, to a lesser extent, engineer large industrial facilities in which accidents or system failures can be disastrous. Any catastrophic occurrence in excess of our insurance limits at locations engineered or constructed by us or where our products are installed or services performed could result in significant professional liability, product liability, warranty and other claims against us by our customers, including claims for cost overruns and the failure of the project to meet contractually specified milestones or performance standards. Further, the rendering of our services on these projects could expose us to risks to, and claims by, third parties and governmental agencies for personal injuries, property damage and environmental matters, among others. Any claim, regardless of its merit or eventual outcome, could result in substantial costs to us, a substantial diversion of management s attention and adverse publicity, particularly for claims relating to environmental matters where the amount of the claim could be extremely large. Insurance coverage is increasingly expensive. We may not be able to obtain or maintain adequate protection against the types of claims described above. If we are unable to obtain insurance at an acceptable cost or otherwise protect against the claims described above, we will be exposed to significant liabilities, which may materially and adversely affect our financial condition and results of operations.

We are susceptible to adverse weather conditions in our regions of operation, which may harm our business and financial results.

Our business may be adversely affected by severe weather, particularly in the Northeastern, East Coast and Mid-west regions of the United States where we have significant operations. Repercussions of severe weather conditions may include:

- curtailment of services;
- suspension of operations;
- weather related damage to our facilities;
- inability to deliver machinery, equipment and materials to jobsites in accordance with contract schedules; and

loss of productivity.

Table of Contents

Work stoppages and other labor problems could adversely affect us.

Some of our employees in the United States are represented by labor unions. A lengthy strike or other work stoppage on any of our projects could have a material adverse effect on our business and results of operations due to an inability to complete contracted projects in a timely manner. From time to time, we have also experienced attempts to unionize certain of our non-union employees. While these efforts have achieved only limited success to date, we cannot provide any assurance that we will not experience additional and more successful union activity in the future.

We may incur unexpected liabilities associated with our acquisition of the Hake Group, Inc.

In March 2003, we acquired all of the capital stock of Hake Group, Inc. and its subsidiaries. Pursuant to the acquisition agreement, the former stockholders of Hake Group, Inc. indemnified us against certain liabilities related to the ownership and operation of the business prior to our acquisition. A portion of the acquisition purchase price consisted of promissory notes in the aggregate principal amount of $10 million which serve as collateral for certain of the indemnification obligations of the former Hake Group stockholders. These notes are payable in increasing annual installments over five years which, in turn, gradually reduces the amount of collateral remaining to secure any indemnification claims. We cannot assure you that the remaining outstanding principal amount of these notes will be adequate to cover any valid indemnification claims or any exposure related to the indemnified liabilities.

There are integration and consolidation risks associated with our growth strategy. Future acquisitions may also result in significant transaction expenses and risks associated with entering new markets and we may be unable to profitably operate our business.

An aspect of our growth strategy has been to grow through acquisitions. Our objective has been to pursue strategic acquisitions in markets where we currently operate as well as in markets in which we have not previously operated. We may have difficulties identifying attractive acquisition candidates or we may be unable to acquire desired businesses on economically acceptable terms. Additionally, existing or future competitors may desire to compete with us for acquisition candidates that may have the effect of increasing acquisition costs or reducing the number of suitable acquisition candidates. We may not have the financial resources necessary to consummate any acquisitions or the ability to obtain the necessary funds on satisfactory terms. Any future acquisitions may result in significant transaction expenses and risks associated with entering new markets in addition to the integration and consolidation risks described above. We may not have sufficient management, financial and other resources to integrate future acquisitions. In the event we are unable to complete future strategic acquisitions, we may not grow in accordance with our expectations.

If we make any future acquisitions, we likely will have exposure to third parties for liabilities of the acquired business that may or may not be adequately covered by insurance or by indemnification, if any, from the former owners of the acquired business. Any of these unexpected liabilities could have a material adverse effect on us.

The loss of one or a few of our significant customers could adversely affect us.

From time to time due to the size of one or more of our contracts, one or a few customers have in the past and may in the future contribute a material portion of our consolidated revenues in any one year. Because these significant customers generally con