

MATRIX SERVICE CO
Form 10-Q
November 08, 2018

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

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2018

or

Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission File No. 1-15461

MATRIX SERVICE COMPANY
(Exact name of registrant as specified in its charter)

DELAWARE 73-1352174
(State of incorporation) (I.R.S. Employer Identification No.)
5100 East Skelly Drive, Suite 500, Tulsa, Oklahoma 74135
(Address of principal executive offices and zip code)
Registrant's telephone number, including area code: (918) 838-8822
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Inter Active Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of November 5, 2018 there were 27,888,217 shares of the Company's common stock, \$0.01 par value per share, issued and 27,071,755 shares outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Matrix Service Company
Condensed Consolidated Statements of Income
(In thousands, except per share data)
(unaudited)

	Three Months Ended	
	September 30, 2018	September 30, 2017
Revenues	\$318,511	\$ 269,910
Cost of revenues	295,090	241,019
Gross profit	23,421	28,891
Selling, general and administrative expenses	21,201	21,570
Operating income	2,220	7,321
Other income (expense):		
Interest expense	(292) (618
Interest income	282	39
Other	546	149
Income before income tax expense	2,756	6,891
Provision for federal, state and foreign income taxes	451	3,067
Net income	\$2,305	\$ 3,824
Basic earnings per common share	\$0.09	\$ 0.14
Diluted earnings per common share	\$0.08	\$ 0.14
Weighted average common shares outstanding:		
Basic	26,921	26,655
Diluted	27,589	26,762

See accompanying notes.

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Matrix Service Company
 Condensed Consolidated Statements of Comprehensive Income
 (In thousands)
 (unaudited)

	Three Months Ended	
	September 30,	September 30,
	2018	2017
Net income	\$2,305	\$ 3,824
Other comprehensive income, net of tax:		
Foreign currency translation gain (net of tax expense of \$62 and \$16 for the three months ended September 30, 2018 and 2017, respectively)	401	1,107
Comprehensive income	\$2,706	\$ 4,931
See accompanying notes.		

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Matrix Service Company
Condensed Consolidated Balance Sheets
(In thousands)
(unaudited)

	September 30, 2018	June 30, 2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 74,736	\$64,057
Accounts receivable, less allowances (September 30, 2018— \$6,359 and June 30, 2018—\$6,327)	214,763	203,388
Costs and estimated earnings in excess of billings on uncompleted contracts	75,972	76,632
Inventories	6,514	5,152
Income taxes receivable	3,350	3,359
Other current assets	10,214	4,458
Total current assets	385,549	357,046
Property, plant and equipment at cost:		
Land and buildings	40,508	40,424
Construction equipment	89,482	89,036
Transportation equipment	47,913	48,339
Office equipment and software	41,622	41,236
Construction in progress	2,411	1,353
Total property, plant and equipment - at cost	221,936	220,388
Accumulated depreciation	(150,438) (147,743)
Property, plant and equipment - net	71,498	72,645
Goodwill	93,451	96,162
Other intangible assets	22,007	22,814
Deferred income taxes	5,559	4,848
Other assets	9,130	4,518
Total assets	\$ 587,194	\$558,033
See accompanying notes.		

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Matrix Service Company
Condensed Consolidated Balance Sheets
(In thousands, except share data)
(unaudited)

	September 30, 2018	June 30, 2018
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 94,845	\$ 79,439
Billings on uncompleted contracts in excess of costs and estimated earnings	118,380	120,740
Accrued wages and benefits	29,151	24,375
Accrued insurance	9,689	9,080
Income taxes payable	—	7
Other accrued expenses	9,079	4,824
Total current liabilities	261,144	238,465
Deferred income taxes	1,440	429
Borrowings under senior secured revolving credit facility	1,549	—
Other liabilities	280	296
Total liabilities	264,413	239,190
Commitments and contingencies		
Stockholders' equity:		
Common stock—\$.01 par value; 60,000,000 shares authorized; 27,888,217 shares issued as of September 30, 2018 and June 30, 2018; 27,019,817 and 26,853,823 shares outstanding as of September 30, 2018 and June 30, 2018		279
Additional paid-in capital	129,885	132,198
Retained earnings	213,799	211,494
Accumulated other comprehensive loss	(7,010)	(7,411)
	336,953	336,560
Less: Treasury stock, at cost — 868,400 shares as of September 30, 2018, and 1,034,394 shares as of June 30, 2018	(14,172)	(17,717)
Total stockholders' equity	322,781	318,843
Total liabilities and stockholders' equity	\$ 587,194	\$ 558,033
See accompanying notes.		

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Matrix Service Company
Condensed Consolidated Statements of Cash Flows
(In thousands)
(unaudited)

	Three Months Ended	
	September 30, 2018	September 30, 2017
Operating activities:		
Net income	\$2,305	\$ 3,824
Adjustments to reconcile net income to net cash provided by operating activities, net of effects from acquisitions and disposals:		
Depreciation and amortization	4,543	5,593
Stock-based compensation expense	2,585	2,086
Deferred income tax	362	2,711
Gain on disposal of business (Note 3)	(427)	—
Gain on sale of property, plant and equipment	(171)	(121)
Provision for uncollectible accounts	76	7
Other	101	93
Changes in operating assets and liabilities increasing (decreasing) cash, net of effects from acquisitions and disposals:		
Accounts receivable	(11,284)	(7,734)
Costs and estimated earnings in excess of billings on uncompleted contracts	302	25,227
Inventories	(1,369)	(532)
Other assets and liabilities	(10,860)	(5,291)
Accounts payable	15,261	(14,463)
Billings on uncompleted contracts in excess of costs and estimated earnings	(2,229)	(9,568)
Accrued expenses	9,624	4,998
Net cash provided by operating activities	8,819	6,830
Investing activities:		
Proceeds from disposal of business (Note 3)	3,693	—
Acquisition of property, plant and equipment	(2,482)	(1,878)
Proceeds from asset sales	267	248
Net cash provided (used) by investing activities	\$1,478	\$ (1,630)

See accompanying notes.

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Matrix Service Company
Condensed Consolidated Statements of Cash Flows
(In thousands)
(unaudited)

	Three Months Ended	
	September 30, 2018	September 30, 2017
Financing activities:		
Advances under senior secured revolving credit facility	\$2,298	\$ 24,890
Repayments of advances under senior secured revolving credit facility	(765)	(27,496)
Payment of debt amendment fees	—	(340)
Issuances of common stock	128	—
Proceeds from issuance of common stock under employee stock purchase plan	78	66
Repurchase of common stock for payment of statutory taxes due on equity-based compensation	(1,559)	(454)
Net cash provided (used) by financing activities	180	(3,334)
Effect of exchange rate changes on cash and cash equivalents	202	414
Increase in cash and cash equivalents	10,679	2,280
Cash and cash equivalents, beginning of period	64,057	43,805
Cash and cash equivalents, end of period	\$74,736	\$ 46,085
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	\$66	\$ 98
Interest	\$456	\$ 582
Non-cash investing and financing activities:		
Purchases of property, plant and equipment on account	\$274	\$ 191

See accompanying notes.

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Matrix Service Company
Condensed Consolidated Statements of Changes in Stockholders' Equity
(In thousands, except share data)
(unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income(Loss)	Total
Balances, July 1, 2018	\$ 279	\$ 132,198	\$ 211,494	\$(17,717)	\$ (7,411)	\$ 318,843
Net income	—	—	2,305	—	—	2,305
Other comprehensive income	—	—	—	—	401	401
Treasury shares sold to Employee Stock Purchase Plan (4,323 shares)	—	(4)	—	82	—	78
Exercise of stock options (12,500 shares)	—	(126)	—	254	—	128
Issuance of deferred shares (221,775 shares)	—	(4,768)	—	4,768	—	—
Treasury shares purchased to satisfy tax withholding obligations (72,604 shares)	—	—	—	(1,559)	—	(1,559)
Stock-based compensation expense	—	2,585	—	—	—	2,585
Balances, September 30, 2018	\$ 279	\$ 129,885	\$ 213,799	\$(14,172)	\$ (7,010)	\$ 322,781
Balances, July 1, 2017	\$ 279	\$ 128,419	\$ 222,974	\$(22,539)	\$ (7,324)	\$ 321,809
Net income	—	—	3,824	—	—	3,824
Other comprehensive income	—	—	—	—	1,107	1,107
Treasury shares sold to Employee Stock Purchase Plan (7,121 shares)	—	(96)	—	162	—	66
Issuance of deferred shares (163,201 shares)	—	(2,883)	—	2,883	—	—
Treasury shares purchased to satisfy tax withholding obligations (42,909 shares)	—	—	—	(454)	—	(454)
Stock-based compensation expense	—	2,086	—	—	—	2,086
Balances, September 30, 2017	\$ 279	\$ 127,526	\$ 226,798	\$(19,948)	\$ (6,217)	\$ 328,438
See accompanying notes.						

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Matrix Service Company

Notes to Condensed Consolidated Financial Statements

(unaudited)

Note 1 – Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements include the accounts of Matrix Service Company (“Matrix”, “we”, “our”, “us”, “its” or the “Company”) and its subsidiaries, unless otherwise indicated. Intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited condensed 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 U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. The information furnished reflects all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair statement of the results of operations, cash flows and financial position for the interim periods presented. The accompanying condensed financial statements should be read in conjunction with the audited financial statements for the year ended June 30, 2018, included in the Company’s Annual Report on Form 10-K for the year then ended. The results of operations for the three month period ended September 30, 2018 may not necessarily be indicative of the results of operations for the full year ending June 30, 2019.

Significant Accounting Policies

We have updated our revenue recognition accounting policy as a result of adopting the Financial Accounting Standards Board (“FASB”) Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers (Topic 606). Our other significant accounting policies are detailed in “Note 1 - Summary of Significant Accounting Policies” of our Annual Report on Form 10-K for the year ended June 30, 2018.

Revenue Recognition

Adoption of New Revenue Recognition Standard

The Company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) on July 1, 2018. The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance, and is applicable to all of the Company's contracts with customers. The core principle of the revenue model is that “an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” The Company used the modified retrospective method of application. Under the modified retrospective method, revenue recognized on completed contracts is not restated, however contracts in progress are accounted for as if they were under this new standard at inception. Any difference between historical revenue and revenue under the new standard is recorded as a cumulative effect adjustment to retained earnings as of the date of adoption. The cumulative impact of adopting Topic 606 was immaterial and did not require an adjustment to retained earnings. See Note 2 – Revenue for new disclosures required as a result of adopting Topic 606.

General Information about our Contracts with Customers

Our revenues come from contracts to provide engineering, procurement, construction, repair and maintenance and other services. Our engineering, procurement and construction services are usually provided in association with capital projects, which commonly are fixed price contracts and are billed based on project milestones. Our repair and maintenance services typically are cost reimbursable or time and material based contracts and are billed monthly or, for projects of short duration, at the conclusion of the project. The elapsed time from award to completion of performance may be in excess of one year for capital projects.

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Matrix Service Company
Notes to Condensed Consolidated Financial Statements
(unaudited)

Step 1: Contract Identification

We do not recognize revenue unless we have identified a contract with a customer. A contract with a customer exists when it has approval and commitment from both parties, the rights and obligations of the parties are identified, payment terms are identified, the contract has commercial substance, and collectibility is probable. We also evaluate whether a contract should be combined with other contracts and accounted for as one single contract. This evaluation requires judgment and could change the timing of the amount of revenue and profit recorded for a given period.

Step 2: Identify Performance Obligations

Next, we identify each performance obligation in the contract. A performance obligation is a promise to provide a distinct good or service or a series of distinct goods or services to the customer. Revenue is recognized separately for each performance obligation in the contract. Many of our contracts have one clearly identifiable performance obligation. However, many of our contracts provide the customer an integrated service that includes two or more of the following services: engineering, procurement, fabrication, construction, repair and maintenance services. For these contracts, we do not consider the integrated services to be distinct within the context of the contract when the separate scopes of work combine into a single commercial objective or capability for the customer. Accordingly, we generally identify one performance obligation in our contracts. The determination of the number of performance obligations in a contract requires significant judgment and could change the timing of the amount of revenue and profit recorded for a given period.

Step 3: Determine Contract Price

After determining the performance obligations in the contract, we determine the contract price. The contract price is the amount of consideration we expect to receive from the customer for completing the performance obligation(s). In a fixed price contract, the contract price is a single lump-sum amount. In reimbursable and time and materials based contracts, the contract price is determined by the agreed upon rates or reimbursements for time and materials expended in completing the performance obligations(s) in the contract.

A number of our contracts contain various cost and performance incentives and penalties that can either increase or decrease the contract price. These variable consideration amounts are generally earned or incurred based on certain performance metrics, most commonly related to project schedule or cost targets. We estimate variable consideration at the most likely amount of additional consideration to be received (or paid in the case of penalties), provided that meeting the variable condition is probable. We include estimated amounts of variable consideration in the contract price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Our estimates of variable consideration and determination of whether to include estimated amounts in the contract price are based largely on an assessment of our anticipated performance and all information (historical, current and forecasted) that is reasonably available to us. We reassess the amount of variable consideration each accounting period until the uncertainty associated with the variable consideration is resolved. Changes in the assessed amount of variable consideration are accounted for prospectively as a cumulative adjustment to revenue recognized in the current period.

Step 4: Assign Contract Price to Performance Obligations

After determining the price of the contract, we assign the contract price to the performance obligation(s) in the contract. Since nearly all of our contracts have only one performance obligation, all of the contract price is assigned to the single performance obligation. If a contract has multiple performance obligations, we assign the contract price to each performance obligation based on the stand-alone selling prices of the distinct services that comprise each performance obligation.

Step 5: Recognize Revenue as Performance Obligations are Satisfied

We record revenue for contracts with our customers as we satisfy the contracts' performance obligations. We recognize revenue on performance obligations associated with fixed price contracts for engineering, procurement and construction services over time since these services create or enhance assets the customer controls as they are being created or enhanced. We measure progress of satisfying these performance obligations by using the percentage-of-completion method, which is based on costs incurred to date compared to the total estimated costs at completion, since it best depicts the transfer of control of assets being created or enhanced to the customer.

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Matrix Service Company
Notes to Condensed Consolidated Financial Statements
(unaudited)

We recognize revenue over time for reimbursable and time and material based repair and maintenance contracts since the customer simultaneously receives and consumes the benefit of those services as we perform work under the contract. As a practical expedient allowed under ASC 606, we record revenue for these contracts in the amount to which we have a right to invoice for the services performed provided that we have a right to consideration from the customer in an amount that corresponds directly with the value of the performance completed to date.

Costs incurred may include direct labor, direct materials, subcontractor costs and indirect costs, such as salaries and benefits, supplies and tools, equipment costs and insurance costs. Indirect costs are charged to projects based upon direct costs and overhead allocation rates per dollar of direct costs incurred or direct labor hours worked. Typically, customer contracts will include standard warranties that provide assurance that products and services will function as expected. The Company does not sell separate warranties.

We have numerous contracts that are in various stages of completion which require estimates to determine the forecasted costs at completion. Due to the nature of the work left to be performed on many of our contracts, the estimation of total cost at completion for fixed price contracts is complex, subject to many variables and requires significant judgment. Estimates of total cost at completion are made each period and changes in these estimates are accounted for prospectively as cumulative adjustments to revenue recognized in the current period. If estimates of costs to complete fixed price contracts indicate a loss, a provision is made through a contract write-down for the total loss anticipated.

Change Orders

Contracts are often modified through change orders, which are changes to the agreed upon scope of work. Most of our change orders, which may be priced or unpriced, are for goods or services that are not distinct from the existing contract due to the significant integration of services provided in the context of the contract and are accounted for as if they were part of that existing contract. The effect of a change order on the contract price and our measure of progress for the performance obligation to which it relates, is recognized as an adjustment to revenue on a cumulative catch-up basis. For unpriced change orders, we estimate the increase or decrease to the contract price using the variable consideration method described in the Step 3: Determine Contract Price paragraph above. Unpriced change orders are more fully discussed in Note 7 - Commitments and Contingencies.

Claims

Sometimes we seek claims for amounts in excess of the contract price for delays, errors in specifications and designs, contract terminations, change orders in dispute or other causes of additional costs incurred by us. Recognition of amounts as additional contract price related to claims is appropriate only if there is a legal basis for the claim. The determination of our legal basis for a claim requires significant judgment. We estimate the change to the contract price using the variable consideration method described in the Step 3: Determine Contract Price paragraph above. Claims are more fully discussed in Note 7 - Commitments and Contingencies.

Recently Issued Accounting Standards

Accounting Standards Update 2016-02, Leases (Topic 842)

On February 25, 2016, the FASB issued ASU 2016-02 that amends accounting for leases. Under the new guidance, lessees will recognize the following for all leases (with the exception of short-term leases) at the lease commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Prior to the issuance of ASU 2018-11 in July 2018, lessees and lessors were required to adopt the new standard using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, even though those leases may have expired before the new standard's effective date. The amendments in ASU 2018-11 provide, among

other things, an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, the Company may apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption rather than having to apply the new standard to the earliest comparative period presented in the financial statements.

Both amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption of the amendments is permitted, but we do not plan to do so at this time.

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Matrix Service Company
Notes to Condensed Consolidated Financial Statements
(unaudited)

We are currently evaluating the ASU's expected impact on our financial statements. As of June 30, 2018 the Company had \$33.1 million of future minimum lease payments under non-cancelable operating leases, primarily for facilities. See Note 8 of Item 8. Financial Statements and Supplementary Data in our 2018 Form 10-K for more information about the timing and amount of future operating lease payments, which we believe is indicative of the materiality of adoption of the ASU to our financial statements.

Accounting Standards Update 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

On June 16, 2016, the FASB issued ASU 2016-13, which will change how the Company accounts for its allowance for uncollectible accounts. The amendments in this update require a financial asset (or a group of financial assets) to be presented at the net amount expected to be collected. The income statement will reflect any increases or decreases of expected credit losses that have taken place during the period. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the reported amount.

Current GAAP delays the recognition of the full amount of credit losses until the loss is probable of occurring. The amendments in this update eliminate the probable initial recognition threshold and, instead, reflect the Company's current estimate of all expected credit losses. In addition, current guidance limits the information the Company may consider in measuring a credit loss to its past events and current conditions.

The amendments in this update broaden the information the Company may consider in developing its expected credit loss estimate to include forecasted information. The amendments in this update are effective for the Company on July 1, 2020 and the Company may early adopt on July 1, 2019. The Company must apply the amendments in this update through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. At this time, the Company does not expect this update to have a material impact to its estimate of the allowance for uncollectible accounts.

Accounting Standards Update 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting

In May 2017, the FASB issued ASU 2017-09 which clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as a modification. Entities should apply the modification accounting guidance if the value, vesting conditions or classification of the award changes. The Company adopted ASU 2017-09 on July 1, 2018, which did not have a material impact on our financial position, results of operations or cash flows.

Note 2 – Revenue

Remaining Performance Obligations

The Company had \$958.9 million of remaining performance obligations yet to be satisfied as of September 30, 2018. The Company expects to recognize \$733.7 million of its remaining performance obligations as revenue within the next twelve months.

Contract Balances

Contracts terms with customers include the timing of billing and payment, which usually differs from the timing of revenue recognition. As a result, we carry contract assets and liabilities in our balance sheet. These contract assets and liabilities are calculated on a contract-by-contract basis and reported on a net basis at the end of each period and are classified as current. We present our contract assets in the balance sheet as Costs and Estimated Earnings in Excess of Billings on Uncompleted Contracts ("CIE"). CIE consists of revenue recognized in excess of billings. We present our contract liabilities on the balance sheet as Billings on Uncompleted Contracts in Excess of Costs and Estimated Earnings ("BIE"). BIE consists of advance payments and billings in excess of revenue recognized. The following table provides information about CIE and BIE:

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	September 30,	June 30,	Change
	2018	2018	
	(in thousands)		
Costs and estimated earnings in excess of billings on uncompleted contracts	\$75,972	\$76,632	\$(660)
Billings on uncompleted contracts in excess of costs and estimated earnings	(118,380)	(120,740)	2,360
Net contract liabilities	\$(42,408)	\$(44,108)	\$1,700

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Notes to Condensed Consolidated Financial Statements
(unaudited)

The difference between the beginning and ending balances of the Company's CIE and BIE primarily results from the timing of the Company's performance and its billings. The amount of revenue recognized in the three months ended September 30, 2018 that was included in the prior period BIE balance was \$66.3 million. This revenue consists primarily of work performed during the period on contracts with customers that had advance billings.

Gross amounts of contract assets and liabilities on uncompleted contracts are as follows:

	September 30, 2018	June 30, 2018
	(in thousands)	
Costs incurred and estimated earnings recognized on uncompleted contracts	\$2,318,949	\$2,081,799
Billings on uncompleted contracts	2,361,357	2,125,907
Net contract liabilities	\$(42,408)	\$(44,108)

Progress billings in accounts receivable at September 30, 2018 and June 30, 2018 included retentions to be collected within one year of \$20.4 million and \$25.9 million, respectively. Contract retentions collectible beyond one year are included in other assets in the Condensed Consolidated Balance Sheet and totaled \$7.4 million as of September 30, 2018 and \$2.6 million as of June 30, 2018.

Disaggregated Revenue

Revenue disaggregated by reportable segment is presented in Note 9 - Segment Information. The following table presents revenue disaggregated by the geographic area where the work was performed:

	Three Months Ended	
	September 30, 2018	September 30, 2017
	(In thousands)	
United States	\$310,137	\$ 221,772
Canada	7,081	46,860
Other international	1,293	1,278
Total Revenue	\$318,511	\$ 269,910

Note 3 – Disposals**Sale of Process Heating Business**

In August 2018, the Company sold non-core assets associated with a business that marketed process heating equipment for \$3.9 million in cash, including \$0.2 million of customary final post-closing adjustments paid in October 2018. The Company recognized a gain of \$0.4 million on the sale, which was included in Other in the Condensed Consolidated Statements of Income. The revenues and operating results of the business, which were included in the Oil Gas & Chemical segment, are not material.

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Matrix Service Company
Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 4 – Intangible Assets Including Goodwill

Goodwill

The changes in the carrying value of goodwill by segment are as follows:

	Electrical & Infrastructure	Oil Gas & Chemical	Storage Solutions	Industrial	Total
	(In thousands)				
Net balance at June 30, 2018	\$24,826	\$33,604	\$ 16,760	\$ 20,972	\$96,162
Disposal of business ⁽¹⁾	—	(2,775)	—	—	(2,775)
Translation adjustment ⁽²⁾	21	—	39	4	64
Net balance at September 30, 2018	\$24,847	\$30,829	\$ 16,799	\$ 20,976	\$93,451

The Company disposed of a business that marketed process heating equipment. See Note 3 - Disposals for more information about the disposal. The business disposed of constituted its own reporting unit and the amount of goodwill written off was all of the goodwill assigned to that reporting unit. None of the goodwill was considered impaired since the Company recorded a gain on the disposal.

The translation adjustments relate to the periodic translation of Canadian Dollar and South Korean Won denominated goodwill recorded as a part of prior acquisitions in Canada and South Korea, in which the local currency was determined to be the functional currency.

The Company did not note any impairment indicators as of September 30, 2018. However, if our market view of project opportunities or gross margins deteriorates materially from the date of our last test, the Company may need to perform an interim analysis, which could result in the recognition of an additional material impairment to goodwill.

Other Intangible Assets

Information on the carrying value of other intangible assets is as follows:

	Useful Life (Years)	Gross Carrying Amount (In thousands)	Accumulated Amortization (In thousands)	Net Carrying Amount
	At September 30, 2018			
Intellectual property	10 to 15	\$2,579	\$ (1,647)	\$ 932
Customer-based	6 to 15	38,632	(17,590)	21,042
Non-compete agreements	4	1,453	(1,420)	33
Total amortizing intangible assets		\$42,664	\$ (20,657)	\$ 22,007

	Useful Life (Years)	Gross Carrying Amount (In thousands)	Accumulated Amortization (In thousands)	Net Carrying Amount
	At June 30, 2018			
Intellectual property	9 to 15	\$2,579	\$ (1,603)	\$ 976
Customer-based	6 to 15	38,562	(16,763)	21,799
Non-compete agreements	4	1,453	(1,414)	39
Total amortizing intangible assets		\$42,594	\$ (19,780)	\$ 22,814

Amortization expense totaled \$0.8 million and \$1.6 million during the three months ended September 30, 2018 and September 30, 2017, respectively.

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We estimate that the remaining amortization expense related to September 30, 2018 amortizing intangible assets will be as follows (in thousands):

Period ending:

Remainder of Fiscal 2019	\$2,872
Fiscal 2020	3,697
Fiscal 2021	3,678
Fiscal 2022	2,823
Fiscal 2023	2,369
Fiscal 2024	2,094
Thereafter	4,474
Total estimated remaining amortization expense at September 30, 2018	\$22,007

Note 5 – Debt

On February 8, 2017, the Company entered into the Fourth Amended and Restated Credit Agreement (the "Credit Agreement"), by and among the Company and certain foreign subsidiaries, as Borrowers, various subsidiaries of the Company, as Guarantors, JPMorgan Chase Bank, N.A., as Administrative Agent, Sole Lead Arranger and Sole Bookrunner, and the other Lenders party thereto.

The Credit Agreement provides for a five-year senior secured revolving credit facility of \$300.0 million that expires February 8, 2022. The credit facility may be used for working capital, acquisitions, capital expenditures, issuances of letters of credit and other lawful purposes.

The Credit Agreement includes the following covenants and borrowing limitations:

Our Leverage Ratio, determined as of the end of each fiscal quarter, may not exceed 3.00 to 1.00.

We are required to maintain a Fixed Charge Coverage Ratio, determined as of the end of each fiscal quarter, greater than or equal to 1.25 to 1.00.

Asset dispositions (other than dispositions in which all of the net cash proceeds therefrom are reinvested into the Company and dispositions of inventory and obsolete or unneeded equipment in the ordinary course of business) are limited to \$20.0 million per 12-month period.

The credit facility includes a sub-facility for revolving loans denominated in Australian Dollars, Canadian Dollars, Euros and Pounds Sterling in an aggregate amount not to exceed the U.S. Dollar equivalent of \$75.0 million and a \$200.0 million sublimit for letters of credit.

Each revolving borrowing under the Credit Agreement will bear interest at a rate per annum equal to:

- The ABR or the Adjusted LIBO Rate, in the case of revolving loans denominated in U.S. Dollars;
- The Canadian Prime Rate or the CDOR rate, in the case of revolving loans denominated in Canadian Dollars;
- The Adjusted LIBO Rate, in the case of revolving loans denominated in Pounds Sterling or Australian Dollars; or
- The EURIBO Rate, in the case of revolving loans denominated in Euros,

in each case, plus the Applicable Margin, which is based on the Company's Leverage Ratio. The Applicable Margin on ABR loans ranges between 0.625% and 1.625%. The Applicable Margin for Adjusted LIBO, EURIBO and CDOR loans ranges between 1.625% and 2.625% and the Applicable Margin for Canadian Prime Rate loans ranges between 2.125% and 3.125%.

The unused credit facility fee is between 0.25% and 0.45% based on the Leverage Ratio.

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The Credit Agreement includes a Leverage Ratio covenant, which provides that Consolidated Funded Indebtedness, as of the end of any fiscal quarter, may not exceed 3.0 times Consolidated EBITDA, as defined in the Credit Agreement, or "Covenant EBITDA," over the previous four quarters. For the four quarters ended September 30, 2018, Covenant EBITDA was \$31.3 million. Consolidated Funded Indebtedness at September 30, 2018 was \$39.2 million.

Availability under the senior secured revolving credit facility at September 30, 2018 was as follows:

	September 30, 2018	September 30, 2018
	(In thousands)	
Senior secured revolving credit facility	\$300,000	\$300,000
Capacity constraint due to the Leverage Ratio	206,208	189,741
Capacity under the credit facility	93,792	110,259
Borrowings outstanding	1,549	—
Letters of credit	37,684	37,073
Availability under the senior secured revolving credit facility	\$54,559	\$73,186

At September 30, 2018, the Company was in compliance with all affirmative, negative, and financial covenants under the Credit Agreement.

Note 6 – Income Taxes

Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The Act makes broad and complex changes to the U.S. tax code, which have affected our current results and will affect our future results.

The following are significant changes in the tax code that are effective for the Company beginning July 1, 2018:

- eliminating the deduction for domestic production activity;
- limiting the annual deduction for business interest;
- taxing global intangible low-tax income;
- allowing a deduction for domestically earned foreign intangible income; and
- establishing a new base erosion and anti-abuse tax on payments between U.S. taxpayers and foreign related parties.

The SEC staff issued SAB 118 which provides guidance on accounting for the tax effects of the Act. SAB 118 provides a measurement period that should not extend beyond one year from the Act's enactment date for companies to complete the accounting under ASC 740. As of September 30, 2018, we have not completed our accounting for the tax effect of the Act. In accordance with SAB 118 and as discussed below, we have reflected the income tax effects of the those items where the accounting is complete; have recorded a provisional amount with regards for those items where the accounting is not complete but we have made a reasonable estimate; and have continued to account for items based on our existing accounting under ASC 740 in those areas where we have not been able to make a reasonable estimate.

Accounting Complete

Deferred Taxes Remeasurement

We remeasured our domestic deferred tax assets and liabilities based on the rates at which we expect them to reverse in the future. At June 30, 2018, we completed the remeasurement of our domestic deferred tax assets and liabilities which resulted in an income tax benefit of \$0.5 million included in fiscal 2018.

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Accounting not Complete - Provisional Amount Recorded

One-time Transition Tax on Unrepatriated Earnings of Certain Foreign Subsidiaries

The Act includes a one-time transition tax based on our total post-1986 foreign earnings and profits (E&P) which we have previously deferred from U.S. income taxes. We have not completed the calculations surrounding this tax, but based on our preliminary calculations, our foreign subsidiaries have overall negative E&P. Therefore, we do not anticipate incurring tax related to this provision of the Act since any return of assets would be a return of capital, not earnings. Due to the preliminary nature of our calculations, no additional income taxes have been provided for any remaining undistributed foreign earnings not subject to the transition tax and any outside basis difference inherent in these entities as these amounts continue to be indefinitely reinvested in foreign operations.

Global Intangible Low-Tax Income (“GILTI”)

The Act creates a new requirement that certain income earned by controlled foreign corporations must be included currently in the gross income of the U.S. shareholder. Because of the complexity of the new GILTI rules, we are continuing to evaluate this provision of the Act and the application of ASC 740. Under U.S. GAAP, we are allowed to make an accounting policy choice of either: 1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred or 2) factoring such amounts into the measurement of our deferred taxes. Our preliminary analysis indicates that we will treat GILTI taxes as a current period expense when incurred. Currently we project the tax impact of GILTI for fiscal 2019 to be immaterial.

Accounting not Complete - Using Existing Accounting Under ASC 740

Valuation Allowances on Foreign Tax Credit Carryforwards

We are currently assessing and have not completed our analysis of how various aspects of the Act such as deemed repatriation of foreign income, base erosion and anti-abuse tax (“BEAT”), deduction for foreign-derived intangible income (“FDII”), and new categories of foreign tax credits affect our ability to utilize our existing foreign tax credit carryforwards before they expire. Currently, we have stated our foreign tax credits at the amount at which we are more likely than not to realize the tax benefit before consideration of the tax law changes under the Act. Our completed analysis may result in an increased valuation allowance against our current foreign tax credit carryforwards.

Indefinite Reinvestment Assertion

Currently we do not provide for outside basis differences under the indefinite reinvestment assertion of ASC 740-30. Our complete analysis of the Act may require us to provide for additional taxes to basis differences or withholding taxes on remitted foreign earnings.

Effective Tax Rate

Our effective tax rate for the three months ended September 30, 2018 was 16.4% compared to 44.5% in the same period last year. The effective tax rate for the three months ended September 30, 2018 was positively impacted by \$0.3 million of excess tax benefits related to the vesting of stock-based compensation awards. The effective tax rate for the three months ended September 30, 2017 was negatively impacted by a higher mix of income in the U.S., which was taxed at a higher rate than the Company's foreign operations. In addition, the prior year effective tax rate was negatively affected by a \$0.5 million tax shortfall on the vesting of stock-based compensation awards. We expect our effective income tax rate to be approximately 27.0% during fiscal 2019.

Note 7 – Commitments and Contingencies

Insurance Reserves

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

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

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

Unpriced Change Orders and Claims

Costs and estimated earnings in excess of billings on uncompleted contracts included revenues for unpriced change orders and claims of \$18.8 million at September 30, 2018 and \$15.0 million at June 30, 2018. Generally, collection of amounts related to unpriced change orders and claims is expected within twelve months. However, since customers may not pay these amounts until final resolution of related claims, collection of these amounts may extend beyond one year.

Other

The Company and its subsidiaries are participants in various legal actions. It is the opinion of management that none of the known legal actions will have a material impact on the Company's financial position, results of operations or liquidity.

Note 8 – Earnings per Common Share

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

The computation of basic and diluted earnings per share is as follows:

	Three Months Ended	
	September 30, 2018	September 30, 2017
	(In thousands, except per share data)	
Basic EPS:		
Net income	\$ 2,305	\$ 3,824
Weighted average shares outstanding	26,921	26,655
Basic earnings per share	\$ 0.09	\$ 0.14
Diluted EPS:		
Weighted average shares outstanding – basic	26,921	26,655
Dilutive stock options	31	10
Dilutive nonvested deferred shares	637	97
Diluted weighted average shares	27,589	26,762
Diluted earnings per share	\$ 0.08	\$ 0.14

The following securities are considered antidilutive and have been excluded from the calculation of Diluted EPS:

Three Months Ended

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September 30,
2018 2017
(In thousands)

Nonvested deferred shares 167 718

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Note 9 – Segment Information

We operate our business through four reportable segments: Electrical Infrastructure; Oil Gas & Chemical; Storage Solutions; and Industrial.

The Electrical Infrastructure segment consists of high voltage services provided to investor owned utilities, including construction of new substations, upgrades of existing substations, short-run transmission line installations, distribution upgrades and maintenance, as well as emergency and storm restoration services. We also provide construction and maintenance services to a variety of power generation facilities, such as combined cycle plants, and natural gas fired power stations.

The Oil Gas & Chemical segment serves customers primarily in the downstream and midstream petroleum industries who are engaged in refining crude oil and processing, fractionating, and marketing of natural gas and natural gas liquids. We also perform work in the petrochemical, upstream petroleum, and sulfur extraction, recovery and processing markets. Our services include turnarounds, plant maintenance, engineering and capital construction. We also offer industrial cleaning services including hydro-blasting, hydro-excavating, advanced chemical cleaning and vacuum services.

The Storage Solutions segment consists of work related to aboveground storage tanks ("AST") and terminals. Also included in this segment are cryogenic and other specialty storage tanks and terminals including liquefied natural gas, liquid nitrogen/liquid oxygen, liquid petroleum, other specialty vessels such as spheres as well as marine structures and truck and rail loading/offloading facilities. Our services include engineering, fabrication and construction, maintenance and repair, which includes planned and emergency services for both tanks and full terminals. Finally, we offer AST products, including geodesic domes, aluminum internal floating roofs, floating suction and skimmer systems, roof drain systems and floating roof seals.

The Industrial segment consists of work for integrated iron and steel companies, major mining and minerals companies engaged primarily in the extraction of copper, as well as other companies in aerospace and defense, cement, agriculture and grain, food and other industries. Our services include engineering, fabrication and construction, maintenance and repair, which includes planned and emergency services. We also design instrumentation and control systems and offer specialized expertise in the design and construction of bulk material handling systems.

The Company evaluates performance and allocates resources based on operating income. The accounting policies of the reportable segments are the same as those described in the Summary of Significant Accounting Policies footnote included in the Company's Annual Report on Form 10-K for the year ended June 30, 2018. Intersegment sales and transfers are recorded at cost; therefore, no i