INTEGRATED ELECTRICAL SERVICES INC
Form 10-Q/A
May 29, 2007

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

FORM 10-Q/A
Amendment No. 2

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended December 31, 2005

OR

o **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. 1-13783

INTEGRATED ELECTRICAL SERVICES, INC.
(Exact name of registrant as specified in its charter)

Delaware	**76-0542208**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1800 West Loop South **Suite 500** **Houston, Texas**	**77027-3233**
(Address of principal executive offices)	**(zip code)**

Registrant s telephone number, including area code: (713) 860-1500

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 þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

The number of shares outstanding as of February 6, 2006 of the issuer s common stock was 36,876,929 and of the issuer s restricted voting common stock was 2,605,709. The number of shares outstanding as of June 22, 2006 of the issuer s common stock was 15,326,885.

INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES
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Explanatory Note

On February 9, 2006, Integrated Electrical Services, Inc, (the Company) filed its Quarterly Report on Form 10-Q for the quarter ended December 31, 2005 (the Original Quarterly Report). On June 29, 2006, the Company filed Amendment No. 1 to its Original Quarterly Report to correct a misstatement of insurance expense for the three months ended December 31, 2005 (Amendment No. 1). The Company is filing this Amendment No. 2 to its Amendment No. 1 Quarterly Report to correct a misstatement for inventory at one of the Company s subsidiaries for the three months ended December 31, 2005.

The misstatement of inventory understated cost of services on the Consolidated Statement of Operations by $0.2 million for the three months ended December 31, 2005. On the Consolidated Statements of Operations, net loss from continuing operations and net loss increased by this amount for the three months ended December 31, 2005. Accounts receivable and inventory on the Consolidated Balance Sheet at December 31, 2005 were understated by $0.1 million and overstated by $0.3 million, respectively. There was no effect on net cash flows from operating, investing or financing activities. In addition, during the financial reporting process for the restatement of these quarterly financial statements and subsequent to the filing of the Company s Form 10-K for the year ended September 30, 2006, the Company determined there were items that required reclassification between continuing and discontinued operations related to the three months ended December 31, 2004 and 2005. There was no impact to the overall financial results of the Company.

The Items of this Amendment No. 2 to the Amendment No. 1 Quarterly Report which are amended and restated are as follows: Item 1 Financial Statements (including Note 2, Restatement of Quarterly Financial Statements, Note 3, Business Divestitures, Note 5, Earnings Per Share, and Note 6, Operating Segments, to the Consolidated Financial Statements), Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations, and Item 4 Controls and Procedures. Further, this Form 10-Q/A Amendment No. 2 contains new Exhibits 31.1, 31.2, 32.1 and 32.2 dated the date of the filing of this Form 10-Q/A.

The remaining Items contained within this Form 10-Q/A consist of all other Items originally contained in the Original Quarterly Report and Amendment No. 1 Quarterly Report. This Form 10-Q/A does not reflect events occurring after the filing of the Original Quarterly Report, nor modifies or updates those disclosures in any way other than as required to reflect the effects of the restatement.

Unless the context otherwise indicates, all references in this report to IES, the Company, we, us, or our are to Integrated Electrical Services, Inc. and its subsidiaries.

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q/A includes certain statements that may be deemed forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, all of which are based upon various estimates and assumptions that the Company believes to be reasonable as of the date hereof. These statements involve risks and uncertainties that could cause the Company s actual future outcomes to differ materially from those set forth in such statements. Such risks and uncertainties include, but are not limited to:

the Company s ability to continue as a going concern;

the Company s ability to meet debt service obligations and related financial and other covenants, and the possible resulting material default under the Company s credit agreements which is not waived or rectified;

limitations on the availability of sufficient credit to fund working capital;

limitations on the availability and the increased costs of surety bonds required for certain projects;

inability to reach agreements with the Company s surety companies to provide sufficient bonding capacity;

risk associated with failure to provide surety bonds on jobs where the Company has commenced work or are otherwise contractually obligated to provide surety bonds;

the inherent uncertainties relating to estimating future operating results and the Company s ability to generate sales, operating income, or cash flow;

potential difficulty in addressing a material weakness in the Company s accounting systems that has been identified by the Company and its independent auditors;

fluctuations in operating results because of downturns in levels of construction, seasonality and differing regional economic conditions;

general economic and capital markets conditions, including fluctuations in interest rates;

inaccurate estimates used in entering into and executing contracts;

difficulty in managing the operation of existing entities;

the high level of competition in the construction industry both from third parties and ex-employees;

increases in costs or limitations on availability of labor, especially qualified electricians, steel, copper and gasoline;

accidents resulting from the numerous physical hazards associated with the Company s work;

loss of key personnel;

business disruption and costs associated with the Securities and Exchange Commission investigation or shareholder derivative action now pending;

litigation risks and uncertainties;

unexpected liabilities or losses associated with warranties or other liabilities attributable to the retention of the legal structure or retained liabilities of business units where the Company has sold substantially all of the assets;

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- the loss of productivity, either at the corporate office or operating level;
- disruptions or inability to effectively manage internal growth or consolidations;
- inability of subsidiaries to incorporate new accounting, control, and operating procedures;
- inaccuracies in estimating revenues and percentage of completion on contracts;
- recent adverse publicity about the Company, including its Chapter 11 filing and the receipt by IES of repurchase notices sent by the holders of the senior convertible notes, purportedly pursuant to the term of the senior convertible notes indenture, which IES believes were wrongfully sent, but which IES was required to publicly disclose; and
- lack of an established trading market for IES common stock.

You should understand that the foregoing as well as other risk factors discussed in this document, including those listed in Part II. Item 1A. of this report under the heading Risk Factors, and in our annual report on Form 10-K for the year ended September 30, 2005, all of which could cause future outcomes to differ materially from those expressed in such forward looking statements. We undertake no obligation to publicly update or revise information concerning the Company s restructuring efforts, borrowing availability, or its cash position or any forward-looking statements to reflect events or circumstances that may arise after the date of this report. Forward-looking statements are provided in this Form 10-Q/A pursuant to the safe harbor established under the private Securities Litigation Reform Act of 1995 and should be evaluated in the context of the estimates, assumptions, uncertainties, and risks described herein.

General information about us can be found at www.ies-co.com under Investor Relations. Our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments to those reports, are available free of charge through our website as soon as reasonably practicable after we file them with, or furnish them to, the Securities and Exchange Commission.

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INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE INFORMATION)

	September 30, 2005 (Audited)	December 31, 2005 (Unaudited) (Restated)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 28,349	$ 24,879
Restricted cash	9,596	19,090
Accounts receivable:		
Trade, net of allowance of $2,925 and $1,645 respectively	141,824	141,534
Retainage	33,878	31,487
Costs and estimated earnings in excess of billings on uncompleted contracts	17,699	15,837
Inventories	21,572	21,972
Prepaid expenses and other current assets	22,271	23,856
Assets held for sale associated with discontinued operations	75,233	55,548
Total current assets	350,422	334,203
PROPERTY AND EQUIPMENT, net	24,266	23,510
GOODWILL	24,343	24,343
OTHER NON-CURRENT ASSETS	13,823	14,389
Total assets	$ 412,854	$ 396,445
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 32	$ 26
Accounts payable and accrued expenses	100,570	99,303
Billings in excess of costs and estimated earnings on uncompleted contracts	26,868	26,705
Liabilities related to assets held for sale associated with discontinued operations	31,691	18,268
Senior convertible notes, net	50,691	50,711
Senior subordinated notes, net	173,134	173,115
Total current liabilities	382,986	368,128
LONG-TERM DEBT, net of current maturities	27	139
OTHER NON-CURRENT LIABILITIES	13,982	14,273
Total liabilities	396,995	382,540
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY:		
Preferred stock, $.01 par value, 10,000,000 shares authorized, none issued and outstanding		
	390	390

Common stock, $.01 par value, 100,000,000 shares authorized, 39,024,209 and 39,033,426 shares issued, respectively				
Restricted voting common stock, $.01 par value, 2,605,709 shares issued, authorized and outstanding		26		26
Treasury stock, at cost, 2,416,377 and 2,338,060 shares, respectively		(13,022)		(12,544)
Unearned restricted stock		(1,183)		
Additional paid-in capital		430,996		429,776
Retained deficit		(401,348)		(403,743)
Total stockholders equity		15,859		13,905
Total liabilities and stockholders equity	$	412,854	$	396,445

The accompanying notes to condensed consolidated financial statements are an integral part of these financial statements.

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INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT SHARE INFORMATION)

	Three Months Ended December 31, 2004	Three Months Ended December 31, 2005
	(Unaudited)	(Unaudited) (Restated)
Revenues	$ 205,678	$ 226,666
Cost of services	174,188	192,172
Gross profit	31,490	34,494
Selling, general and administrative expenses	29,522	29,740
Income from operations	1,968	4,754
Other (income) expense:		
Interest expense, net	8,844	5,882
Other (income) expense, net	268	(53)
Interest and other expense, net	9,112	5,829
Loss from continuing operations before income taxes	(7,144)	(1,075)
Provision for income taxes	1,681	699
Net loss from continuing operations	(8,825)	(1,774)
Discontinued operations (Note 3)		
Loss from discontinued operations (including gain (loss) on disposal of $(86) and $454)	(10,160)	(910)
Benefit for income taxes	(1,377)	(289)
Net loss from discontinued operations	(8,783)	(621)
Net loss	$ (17,608)	$ (2,395)
Basic loss per share:		
Continuing operations	$ (0.59)	$ (0.12)
Discontinued operations	$ (0.59)	$ (0.04)
Total	$ (1.18)	$ (0.16)
Diluted loss per share:		
Continuing operations	$ (0.59)	$ (0.12)
Discontinued operations	$ (0.59)	$ (0.04)

Total	$ (1.18)	$ (0.16)
Shares used in the computation of loss per share (Note 5):		
Basic	14,970,502	14,970,502
Diluted	14,970,502	14,970,502

The accompanying notes to condensed consolidated financial statements are an integral part of these financial statements.

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INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
(IN THOUSANDS, EXCEPT SHARE INFORMATION)

	Common Stock Shares	Common Stock Amount	Restricted Voting Common Stock Shares	Restricted Voting Common Stock Amount	Treasury Stock Shares	Treasury Stock Amount	Unearned Restricted Stock	Additional Paid-In Capital	Retained (Deficit)	Total Stockholders Equity
BALANCE, September 30, 2005	39,024,209	$ 390	2,605,709	$ 26	(2,416,377)	$ (13,022)	$ (1,183)	$ 430,996	$ (401,348)	$ 15,859
Issuance of restricted stock (unaudited)	9,217							23		23
Vesting of restricted stock (unaudited)					78,317	478		(478)		
Adoption of SFAS 123R							1,183	(1,183)		
Non-cash compensation (unaudited)								418		418
Net loss (unaudited) (restated)									(2,395)	(2,395)
BALANCE, December 31, 2005 (unaudited) (restated)	39,033,426	$ 390	2,605,709	$ 26	(2,338,060)	$ (12,544)		$ 429,776	$ (403,743)	$ 13,905

The accompanying notes to condensed consolidated financial statements are an integral part of these financial statements.

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INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	Three Months Ended December 31, 2004	Three Months Ended December 31, 2005
	(Unaudited)	(Unaudited) (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (17,608)	$ (2,395)
Adjustments to reconcile net income to net cash provided by operating activities:		
Net loss from discontinued operations	8,783	621
Bad debt expense	392	361
Deferred financing cost amortization	807	608
Depreciation and amortization	2,115	1,666
Impairment of long-lived assets	70	
Gain on sale of property and equipment	(89)	(41)
Non-cash compensation expense	210	441
Non-cash interest charge for embedded conversion option	2,676	
Equity in losses of investment	264	
Deferred income tax expense	183	6
Changes in operating assets and liabilities, net of the effect of discontinued operations:		
Accounts receivable	8,633	2,320
Inventories	(1,447)	(400)
Costs and estimated earnings in excess of billings on uncompleted contracts	(1,094)	1,862
Prepaid expenses and other current assets	(9,782)	(1,585)
Other non-current assets	(80)	(1,180)
Accounts payable and accrued expenses	(15,084)	(1,267)
Billings in excess of costs and estimated earnings on uncompleted contracts	5,061	(163)
Other current liabilities	45	
Other non-current liabilities	(244)	291
Net cash provided by (used in) continuing operations	(16,189)	1,145
Net cash provided by (used in) discontinued operations	7,085	(50)
Net cash provided by (used in) operating activities	(9,104)	1,095
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales of property and equipment	56	65
Purchases of property and equipment	(893)	(823)
Changes in restricted cash		(9,494)
Net cash used in investing activities of continuing operations	(837)	(10,252)
Net cash provided by investing activities of discontinued operations	11,489	5,691
Net cash provided by (used in) investing activities	10,652	(4,561)

CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings of debt	10,000	
Borrowings on Senior Convertible Notes	36,000	
Repayments of debt	(35,698)	(4)
Proceeds from issuance of stock	40	
Payments for debt issuance costs	(2,680)	
Proceeds from exercise of stock options	233	
Net cash provided by (used in) financing activities of continuing operations	7,895	(4)
Net cash used in financing activities of discontinued operations	(3)	
Net cash provided by (used in) financing activities	7,892	(4)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	9,440	(3,470)
CASH AND CASH EQUIVALENTS, beginning of period	22,232	28,349
CASH AND CASH EQUIVALENTS, end of period	$ 31,672	$ 24,879
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for		
Interest	$ 1,119	$ 2,424
Income taxes	277	452
Assets acquired under capital leases		111

The accompanying notes to condensed consolidated financial statements are an integral part of these financial statements.

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INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005
(UNAUDITED)

1. OVERVIEW

Integrated Electrical Services, Inc. (the Company or IES), a Delaware corporation, was founded in June 1997 to create a leading national provider of electrical services, focusing primarily on the commercial and industrial, residential, low voltage and service and maintenance markets.

The accompanying unaudited Condensed Consolidated Financial Statements (the Financial Statements) of the Company have been prepared in accordance with accounting principles generally accepted in the United States and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required for complete financial statements, and therefore should be reviewed in conjunction with the financial statements and related notes thereto contained in the Company s annual report for the year ended September 30, 2005, filed on Form 10-K with the Securities and Exchange Commission. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Actual operating results for the three months ended December 31, 2005 are not necessarily indicative of the results that may be expected for the fiscal year ended September 30, 2006.

Update on Financial Restructuring

During 2005, the Company announced its intention to strengthen and de-lever its balance sheet to improve its overall capital structure. As part of this initiative, the Company is seeking to reduce its long term debt, which will result in an increase in free cash flow from a reduction in cash interest expense. By strengthening the balance sheet in this manner, the Company expects to improve its credit ratings and enhance its surety bonding capability. To facilitate these efforts, on November 2, 2005, the Company announced that it had retained Gordian Group, LLC as a financial advisor. Gordian Group, LLC is a New York based investment bank with expertise in developing capital markets alternatives and providing financial advisory services.

As a result of the foregoing, the Company commenced discussions with an ad hoc committee of holders of a substantial portion of its senior subordinated notes due 2009 regarding a consensual restructuring of its debt obligations (the Restructuring). On December 14, 2005, the Company announced that it had reached a non-binding agreement in principle with an ad hoc committee of holders of approximately $101 million, or 58%, of its $172.9 million principal amount of senior subordinated notes for a potential restructuring pursuant to which the senior subordinated noteholders would receive in exchange for all of their notes shares representing approximately 82% of the common stock of the reorganized company. Holders of outstanding common stock and management would retain or receive shares representing approximately 15% and 3%, respectively, of the common stock of the reorganized company.

The agreement in principle contemplates that customers, vendors and trade creditors would not be impaired by the restructuring and would be paid in full in the ordinary course of business, and that the senior convertible notes with a current aggregate principal amount outstanding of approximately $50 million, would be reinstated or the holders otherwise provided the full value of their note claims. It is also contemplated that our senior bank credit facility would be reinstated or refinanced at the time of the restructuring.

If the Restructuring were to be consummated, the proposed plan currently contemplates the filing of a pre-arranged Chapter 11 plan of reorganization in order to achieve the exchange of all of the senior subordinated notes for common equity. Approval of a proposed plan in a pre-arranged proceeding would likely require, among other things, the affirmative vote of the holders of at least two-thirds in claim amount and one-half in number of the senior subordinated notes that vote on the plan. The Company would seek to enter into a plan support agreement with the holders of a majority of its senior subordinated notes and then formally solicit votes for a proposed joint plan of reorganization to be filed upon or shortly after filing voluntary petitions for reorganization under Chapter 11 of the Bankruptcy Code.

There is no assurance that the Company will successfully complete the Restructuring or any other restructuring. At this time neither the agreement in principle nor any other proposed restructuring terms have been agreed to by the requisite holders of the senior subordinated notes, or any other creditor constituency. The agreement in principle is subject to the negotiation of definitive documentation, approval by the requisite noteholders and a court in a Chapter 11 proceeding and customary closing conditions. Because the agreement in principle is not binding and because there is no assurance it will be consummated, the Company continues to evaluate other alternatives for restructuring its capital structure. In addition, the Company may be forced by its creditors to seek the protection of federal bankruptcy law. If the Company consummates any restructuring, it may do so outside of bankruptcy, or in a pre-arranged Chapter 11 proceeding or in another proceeding under federal bankruptcy law. Any restructuring could cause the holders of its outstanding securities, including its common stock, senior subordinated notes and senior convertible notes, to lose some or all of the value of their investment in our securities. Furthermore, such restructuring could result in material changes in the nature of its business and material adverse changes to its financial condition and results of operations. See Item 1A. Risk Factors .

Going Concern

Our independent registered public accounting firm, Ernst & Young LLP, included a going concern modification in its audit opinion on our consolidated financial statements for the fiscal year ended September 30, 2005 included in our Form 10-K as a result of our operating losses during fiscal 2005 and our non-compliance with certain debt covenants subsequent to September 30, 2005. The consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

For a description of these policies, refer to Note 2 of the Notes to the Consolidated Financial Statements included in the Company s annual report on Form 10-K for the year ended September 30, 2005.

REVENUE RECOGNITION

As of December 31, 2004 and 2005, costs and estimated earnings in excess of billings on uncompleted contracts include unbilled revenues for certain significant claims totaling approximately $2.1 million and $5.2 million, respectively. In addition, accounts receivable as of December 31, 2004 and 2005 related to these claims is approximately $2.5 million and $1.3 million, respectively. Included in the claims amount is approximately $ million and $2.8 million as of December 31, 2004 and 2005, respectively, related to a single contract at one of our subsidiaries. This claim relates to a dispute with the customer over defects in the customer s design specifications. The Company does not believe that we are required to remediate defects in the customer s design specifications. If it is later determined that we are required to remediate such defects, we could incur additional costs. Some or all of the costs, if any, may not be recoverable.

SUBSIDIARY GUARANTIES

All of the Company s operating income and cash flows are generated by its 100% owned subsidiaries, which are the subsidiary guarantors of the Company s outstanding 9 3/8% senior subordinated notes due 2009 (the Senior Subordinated Notes). The Company is structured as a holding company and substantially all of its assets and operations are held by its subsidiaries. There are currently no significant restrictions on the Company s ability to obtain funds from its subsidiaries by dividend or loan. The parent holding company s independent assets, revenues, income before taxes and operating cash flows are less than 3% of the consolidated total. The separate financial statements of the subsidiary guarantors are not included herein because (i) the subsidiary guarantors are all of the direct and indirect subsidiaries of the Company; (ii) the subsidiary guarantors have fully and unconditionally, jointly and severally guaranteed the Senior Subordinated Notes; and (iii) the aggregate assets, liabilities, earnings and equity of the subsidiary guarantors is substantially equivalent to the assets, liabilities, earnings and equity of the Company on a consolidated basis. As a result, the presentation of separate financial statements and other disclosures concerning the subsidiary guarantors is not deemed material.

USE OF ESTIMATES AND ASSUMPTIONS

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates and assumptions by management in determining the reported amounts of assets and liabilities, disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates are primarily used in the Company s revenue recognition of construction in progress, fair value assumptions in analyzing goodwill and long-lived asset impairments, allowance for doubtful accounts receivable, realizability of deferred tax assets and self-insured claims liabilities.

SEASONALITY AND QUARTERLY FLUCTUATIONS

The results of the Company s operations, primarily from residential construction, are seasonal, dependent upon weather trends, with higher revenues typically generated during the spring and summer and lower revenues during the fall and winter. The commercial and industrial aspect of its business is less subject to seasonal trends, as this work generally is performed inside structures protected from the weather. The Company s service business is generally not affected by seasonality. In addition, the construction industry has historically been highly cyclical. The Company s volume of business may be adversely affected by declines in construction projects resulting from adverse regional or national economic conditions. Quarterly results may also be materially affected by gross margins for both bid and negotiated projects, the timing of new construction projects and any acquisitions. Accordingly, operating results for any fiscal period are not necessarily indicative of results that may be achieved for any subsequent fiscal period.

STOCK-BASED COMPENSATION

On October 1, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)) which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options and employee stock purchases related to the employee stock purchase plan (employee stock purchases) based on estimated fair values. SFAS 123(R) supersedes the Company s previous accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

The Company adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of October 1, 2005, the first day of the Company s fiscal year 2006. The Company s consolidated financial statements as of and for the three months ended December 31, 2005 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, the Company s consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). Stock-based compensation expense recognized under SFAS 123(R) for the three months ended December 31, 2005 was $0.4 million, before tax, which consisted of stock-based compensation expense related to employee stock options and restricted stock grants (see Note 6). There was no stock-based compensation expense related to employee stock options recognized during the three months ended December 31, 2004. Additionally, the Company recorded no compensation expense associated with the Employee Stock Purchase Plan which is defined as a non-compensatory plan pursuant to Financial Accounting Standards Board Interpretation No. 44 (See Note 8).

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company s consolidated statement of operations. Prior to the adoption of SFAS 123(R), the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123). Under the intrinsic value method, no stock-based compensation expense had been recognized in the Company s consolidated statement of operations because the exercise price of the Company s stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant.

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the Company s consolidated statement of operations for the first quarter of fiscal 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of September 30, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to September 30, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). In conjunction with the adoption of SFAS 123(R), the Company changed its method of attributing the value of stock-based compensation expense related to stock options from the accelerated multiple-option approach to the straight-line single option method. Compensation expense for all share-based payment awards granted on or prior to September 30, 2005 will continue to be recognized using the accelerated multiple-option approach while compensation expense for all share-based payment awards granted subsequent to September 30, 2005 is recognized using the straight-line single-option method. As stock-based compensation expense recognized in the consolidated statement of operations for the first quarter of fiscal 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company s pro forma information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred. Furthermore, under the modified prospective transition method, SFAS 123 (R) requires that compensation costs recognized prior to adoption be reversed to the extent of estimated forfeitures and recorded as a cumulative effect of a change in accounting principle. The effect of this reversal was immaterial for the three months ended December 31, 2005.

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The Company s determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to the Company s expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. Option-pricing models were developed for use in estimating the value of traded options that have no vesting or hedging restrictions and are fully transferable. Because the Company s employee stock options have certain characteristics that are significantly different from traded options, and because changes in the subjective assumptions can materially affect the estimated value, in management s opinion, the existing valuation models may not provide an accurate measure of the fair value of the Company s employee stock options. Although the fair value of employee stock options is determined in accordance with SFAS 123(R) and SAB 107 using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

On November 10, 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 123(R)-3 Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards. The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS 123(R). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R).

Pro Forma Information Under SFAS 123 for Periods Prior to Fiscal 2006

The following table illustrates the effect on net income and earnings per share assuming the compensation costs for the Company s stock option and purchase plans had been determined using the fair value method at the grant dates amortized on a pro rata basis over the vesting period as required under Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* for the three months ended December 31, 2004 (in thousands, except for per share data):

	Three months ended December 31, 2004
Net loss, as reported	$ (17,608)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	216
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	178
Pro forma net loss for SFAS No. 123	$ (17,570)
Earnings (loss) per share:	
Basic as reported	$ (1.18)
Basic pro forma for SFAS No. 123	$ (1.18)
Earnings (loss) per share:	
Diluted as reported	$ (1.18)
Diluted pro forma for SFAS No. 123	$ (1.18)

2. RESTATEMENT OF QUARTERLY FINANCIAL STATEMENTS

During the financial statement reporting process for the year ended September 30, 2006, management determined that an error occurred, which warranted revision to the previously reported results for the quarters ended December 31, 2005, March 31, 2006 and June 30, 2006. The error was the result of a reconciling difference between the inventory general ledger account and inventory sub-ledger at one of the Company s subsidiaries. This error resulted in an overstatement of inventory, an understatement of vendor rebate receivable, an overstatement of selling, general and administrative expenses and an understatement of cost of services. The previous reported results have been revised for discontinued operations. In addition, during the financial statement reporting process for the restatement of these quarterly financial statements and subsequent to the filing of the Company s Form 10-K for the year ended September 30, 2006, the Company determined there were items that required reclassification between continuing and discontinued operations related to the three months ended December 31, 2004 and 2005. Those adjustments have been reflected in these financial statements. There was no impact to the overall financial results of the Company. As a result, the Company has reclassified these adjustments out of continuing operations and into discontinued operations. The tables below show the effects of all revisions to reported results on the Consolidated Balance Sheet as of December 31, 2005 and the Consolidated Statement of Operations for the three months ended December 31, 2005 (in thousands). The restatement also impacted the Consolidated Statement of Stockholders Equity (Deficit) and the Consolidated Statement of Cash Flows.

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	Three Months Ended December 31, 2005 (Unaudited)		
	As Reported	Inventory Adjustments	As Restated
Consolidated Statement of Operations Data:			
Revenues	$ 226,666	$	$ 226,666
Cost of services	191,932	240	192,172
Gross profit	34,734	(240)	34,494
Selling, general and administrative expenses	29,761	(21)	29,740
Income (loss) from operations	4,973	(219)	4,754
Interest and other expense, net	5,829		5,829
Loss from continuing operations before income taxes	(856)	(219)	(1,075)
Provision for income taxes	699		699
Net loss from continuing operations	(1,555)	(219)	(1,774)
Discontinued operations:			
Loss from discontinued operations	(910)		(910)
Benefit for income taxes	(289)		(289)
Net loss from discontinued operations	(621)		(621)
Net loss	$ (2,176)	$ (219)	$ (2,395)
Basic loss per share:			
Continuing operations	$ (0.10)	$ (0.01)	$ (0.12)
Discontinued operations	$ (0.04)	$	$ (0.04)
Total	$ (0.15)	$ (0.01)	$ (0.16)
Diluted loss per share:			
Continuing operations	$ (0.10)	$ (0.01)	$ (0.12)
Discontinued operations	$ (0.04)	$	$ (0.04)
Total	$ (0.15)	$ (0.01)	$ (0.16)

	As of December 31, 2005 (Unaudited)		
Consolidated Balance Sheet	As Reported	Inventory Adjustments	As Restated
Assets:			
Cash and cash equivalents	$ 24,879	$	$ 24,879
Restricted cash	19,090		19,090

Accounts receivable (net)	141,432	102	141,534
Retainage	31,487		31,487
Cost and estimated earnings in excess of billings on uncompleted contracts	15,837		15,837
Inventories	22,314	(342)	21,972
Prepaid expenses and other current assets	23,856		23,856
Assets held for sale discontinued operations	55,548		55,548
Total current assets	334,443	(240)	334,203
Property and equipment, net	23,510		23,510
Goodwill	24,343		24,343
Other non-current assets, net	14,389		14,389
Total assets	$ 396,685	$ (240)	$ 396,445
Liabilities:			
Current maturities of long-term debt	$ 26	$	$ 26
Accounts payable and accrued expenses	99,324	(21)	99,303
Billings in excess of cost and estimated earnings on uncompleted contracts	26,705		26,705
Liabilities held for sale discontinued operations	18,268		18,268
Senior convertible notes, net	50,711		50,711
Senior subordinated notes, net	173,115		173,115
Total current liabilities	368,149	(21)	368,128
Long-term debt, net of current maturities	139		139
Other non-current liabilities	14,273		14,273
Total liabilities	382,561	(21)	382,540
Stockholders equity	14,124	(219)	13,905
Total liabilities and stockholders equity	$ 396,685	$ (240)	$ 396,445

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3. BUSINESS DIVESTITURES

Costs Associated with Exit or Disposal Activities

As a result of disappointing operating results, the Board of Directors directed us to develop alternatives with respect to certain underperforming subsidiaries. These subsidiaries were included in our commercial and industrial segment. On March 28, 2006, the Company committed to an exit plan with respect to those underperforming subsidiaries. The exit plan committed to a shut-down or consolidation of the operations of these subsidiaries or the sale or other disposition of the subsidiaries, whichever came earlier.

Net working capital related to these subsidiaries was $25.7 million at December 31, 2005. As a result of inherent uncertainty in the exit plan and in monetizing net working capital related to these subsidiaries, the Company could experience additional losses of working capital. At December 31, 2005, the Company has recorded adequate reserves to reflect the net realizable value of the working capital; however, subsequent events such as loss of specific customer knowledge may impact our ability to collect.

The Company has included the results of operations related to these subsidiaries in discontinued operations for the three months ended December 31, 2005 and all prior periods presented have been reclassified accordingly. Revenue for these shutdown subsidiaries was $59.7 million and $32.4 million for the three months ended December 31, 2004 and 2005, respectively. Operating losses for these subsidiaries were $2.4 million and $1.4 million for the three months ended December 31, 2004 and 2005, respectively.

Divestitures

During October 2004, the Company announced plans to begin a strategic realignment including the planned divestiture of certain subsidiaries within our commercial and industrial segment. As of December 31, 2005, the planned divestitures had been completed.

During the year ended September 30, 2005, we completed the sale of all the net assets of thirteen of our operating subsidiaries for $54.1 million in total consideration. During the three months ended December 31, 2005, the Company completed the sale of one additional operating subsidiary for $7.3 million in total consideration. Including goodwill impairments, if any, these divestitures generated a pre-tax net loss of $7.7 million and a pre-tax net income of $0.5 million for the three months ended December 31, 2004 and 2005, respectively, and have been recognized as discontinued operations in the consolidated statements of operations for all periods presented.

The discontinued operations disclosures include only those identified subsidiaries qualifying for discontinued operations treatment for the periods presented. Depreciation expense associated with discontinued operations for the three months ended December 31, 2004 and 2005 was $0.9 million and $ million, respectively.

Summarized financial data for discontinued operations are outlined below (in thousands):

	Three Months Ended December 31,	
	2004	**2005**
Revenues	$117,856	$37,852
Gross profit	5,706	2,038
Pretax loss	$ (10,160)	$ (910)

	Balance as of	
	September 30, 2005	**December 31, 2005**
Accounts receivable, net	$ 64,622	$ 46,470
Inventory	1,455	986
Costs and estimated earnings in excess of billings on uncompleted contracts	7,879	7,645
Other current assets	341	241
Property and equipment, net	928	198
Other noncurrent assets	8	8

Total assets	$ 75,233	$ 55,548
Accounts payable and accrued liabilities	$ 21,384	$ 12,920
Billings in excess of costs and estimated earnings on uncompleted contracts	10,307	5,348
Total liabilities	$ 31,691	$ 18,268
Net assets	$ 43,542	$ 37,280

Goodwill Impairment Associated with Discontinued Operations

During the fiscal first quarter ended December 31, 2004, the Company recorded a goodwill impairment charge of $5.6 million related to the identification of certain subsidiaries for disposal by sale prior to the end of the fiscal second quarter ended March 31, 2005. This impairment charge is included in the net loss from discontinued operations caption in the statement of operations. The impairment charge was calculated based on the assessed fair value ascribed to the subsidiaries identified for disposal less the net book value of the assets related to those subsidiaries. The fair value utilized in this calculation was the same as that discussed in the preceding paragraph addressing the impairment of discontinued operations. Where the fair value did not exceed the net book value of a subsidiary including goodwill, the goodwill balance was impaired as appropriate. This impairment of goodwill was determined prior to the disclosed calculation of any additional impairment of the identified subsidiary disposal group as required pursuant to Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* There was no goodwill impairment during the quarter ended December 31, 2005 related to discontinued operations.

Impairment Associated with Discontinued Operations

In accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* during the fiscal first quarter ended December 31, 2004, the Company recorded an impairment charge of $0.7 million related to the identification of certain subsidiaries for disposal by sale prior to the end of the fiscal 2005. The impairment was calculated as the difference between the fair values, less costs to sell, assessed at the date the companies individually were selected for sale and their respective net book values after all other adjustments had been recorded. In determining the fair value for the disposed assets and liabilities, the Company evaluated past performance, expected future performance, management issues, bonding requirements, market forecasts and the carrying value of such assets and liabilities and received a fairness opinion from an independent consulting and investment banking firm in support of this determination for certain of the subsidiaries included in the assessment. The impairment charge was related to subsidiaries included in the commercial and industrial segment of the Company s operations (see Note 6). There was no impairment charge for long-lived assets during the quarter ended December 31, 2005 related to discontinued operations.

4. DEBT

Credit Facility

On August 1, 2005, the Company entered into a three-year $80 million asset-based revolving credit facility (the Credit Facility) with Bank of America, N.A., as administrative agent (BofA). The new Credit Facility replaced the Company s existing revolving credit facility with JPMorgan Chase Bank, N.A., which was scheduled to mature on August 31, 2005. The Company and each of its operating subsidiaries are co-borrowers and are jointly and severally liable for all obligations under the Credit Facility. The Company s other subsidiaries have guaranteed all of the obligations under the Credit Facility. The obligations of the borrowers and the guarantors are secured by a pledge of substantially all of the assets of the Company and its subsidiaries, excluding any assets pledged to secure surety bonds procured by the Company and its subsidiaries in connection with their operations.

The Credit Facility allows the Company and the other borrowers to obtain revolving credit loans and provides for the issuance of letters of credit. The amount available at any time under the Credit Facility for revolving credit loans or the issuance of letters of credit is determined by a borrowing base calculated as a percentage of accounts receivable, inventory and equipment. The borrowing base is limited to $80 million, reduced by a fixed reserve which is currently $27.9 million. The Company has also deposited $19.1 million in an account pledged to Bank of America destined to collateralize letters of credit. The amount in the collateral account can be used to increase borrowing capacity.

The Company amended the Credit Facility to provide relief for the fixed charge covenant for the months of August and September 2005, and eliminated the requirement for a fixed charge covenant test to be performed in September and October 2005. The second amendment obtained limited availability under the facility by requiring the Company to have at least $12.0 million in excess funds availability at all times.

On January 3, 2006, the Company entered into a further amendment, effective December 30, 2005, to the Credit Facility. The amendment eliminated the Fixed Charge Coverage Ratio test for the period ended November 30, 2005 and provided that the test for the period ended December 31, 2005 would not be made until the delivery on or before January 16, 2006 of financial statements covering such period. The amendment further provided a limited waiver of any Event of Default that would otherwise exist with respect to the audited annual financial statements for the period ended September 30, 2005. Subsequent amendments further extended the delivery date for financial statements covering the periods ended December 31, 2005 to January 26, 2006. These amendments required the payments of fees upon their execution. These fees are capitalized as deferred financing costs and amortized over the life of the facility.

As of January 26, 2006, the Company failed to meet the Fixed Charge Coverage Ratio for the period ended December 31, 2005, constituting an event of default under the Credit Facility. Additionally, the Company was in default with respect to the pledge of its ownership interest in EnerTech Capital Partners II L.P. to BofA as Collateral under the Credit Facility. By reason of the existence of these defaults, BofA did not have any obligation to make additional extensions of credit under the Credit Facility and had full legal right to exercise its rights and remedies under the Credit Facility and related agreements.

On January 27, 2006, IES entered into a Forbearance Agreement (Forbearance Agreement) with BofA in connection with the Credit Facility. The Forbearance Agreement provided for BofA s forbearance from exercising its rights and remedies under the Credit Facility and related agreements from January 27, 2006 through the earliest to occur of (i) 5:00 p.m. (Dallas, Texas time) on February 28, 2006 or (ii) the date that any Forbearance Default (as defined in the Forbearance Agreement) occurs. Notwithstanding the forbearance, on January 26, 2006, BofA sent a blockage notice to the Senior Subordinated Notes indenture trustee preventing any payments from being made on such notes. Lastly, under the Forbearance Agreement, BofA had no obligation to make any loans or otherwise extend any credit to the Company under the Credit Facility. Any agreement by BofA to make any loans or otherwise extend any further credit was in the sole discretion of BofA.

Capitalized terms used but not defined under this heading have the meaning set forth in the Loan and Security Agreement, dated as of August 1, 2005, and filed as exhibit 10.1 to the Form 8-K dated August 4, 2005.

Senior Convertible Notes

On November 24, 2004, the Company entered into a purchase agreement for a private placement of $36.0 million aggregate principal amount of Senior Convertible Notes. Investors in the notes agreed to a purchase price equal to 100% of the principal amount of the notes. The notes require payment of interest semi-annually in arrears at an annual rate of 6.5%, have a stated maturity of November 1, 2014, constitute senior unsecured obligations, are guaranteed on a senior unsecured basis by our significant domestic subsidiaries, and are convertible at the option of the holder under certain circumstances into shares of our common stock at an initial conversion price of $3.25 per share, subject to adjustment. On November 1, 2008, the Company has the option to redeem the Senior Convertible Notes, subject to certain conditions. The net proceeds from the sale of the notes were used to prepay a portion of our senior secured Credit Facility and for general corporate purposes. The notes, the guarantees and the shares of common stock issuable upon conversion of the notes to be offered have not been registered under the Securities Act of 1933, as amended, or any state securities laws and, unless so registered, the securities may not be offered or sold in the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. A default under the Credit Facility or the Senior Subordinated Notes resulting in acceleration that is not cured within 30 days is also a cross default under the Senior Convertible Notes. In addition, other events of default under the Senior Convertible Notes indenture include, but are not limited to, a change of control, the de-listing of the Company s stock from a national exchange or the commencement of a bankruptcy proceeding.

On February 24, 2004 and following shareholder approval, the Company sold $14 million in principal of its Series B 6.5% Senior Convertible Notes due 2014, pursuant to separate option exercises by the holders of the aforementioned $36 million aggregate principal amount of Senior Convertible Notes issued by the Company in an initial private placement on November 24, 2004. The Senior Convertible Notes are a hybrid instrument comprised of two components: (1) a debt instrument and (2) certain embedded derivatives. The embedded derivatives include a redemption premium and a make-whole provision. In accordance with the guidance that Statement of Financial Accounting Standards No. 133, as amended, *Accounting for Derivative Instruments and Hedging Activities* , (SFAS 133) and Emerging Issues Task Force Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock* (EITF 00-19) provide, the embedded derivatives must be removed from the debt host and accounted for separately as a derivative instrument. These derivative instruments will be marked-to-market each reporting period. During the three months ended December 31, 2004, the Company was required to also value the portion of the Senior Convertible Notes that would settle in cash because of shareholder approval of the Senior Convertible Notes had not yet been obtained. The initial value of this derivative was $1.4 million and the value at December 31, 2004 was $4.0 million, and consequently, a $2.6 million mark to market loss was recorded. The value of this derivative immediately prior to the affirmative shareholder vote was $2.0 million, and accordingly, the Company recorded a mark to market gain of $2.0 million during the three months ended March 31, 2005. There was no mark to market gain or loss during the three months ended June 30, 2005. During the quarter ended September 30, 2005, there was a mark to market loss of $0.1 million recorded. There was no mark to market gain or loss during the three months ended December 31, 2005. The calculation of the fair value of the conversion option was performed utilizing the Black-Scholes option pricing model with the following assumptions effective at the three months ended December 31, 2005: expected dividend yield of 0.00%, expected stock price volatility of 40.00%, weighted average risk free interest rate ranging from 3.67% to 4.15% for four to ten years, respectively, and an expected term of four to ten years. The valuation of the other embedded derivatives was derived by other valuation methods, including present value measures and binomial models. At December 31, 2005, the fair value of the two remaining derivatives was $1.5 million. Additionally, at March 31, 2005 the Company recorded a net discount of $0.8 million which is being amortized over the remaining term of the Senior Convertible Notes. The Company did not cause a registration statement to become effective on or before November 23, 2005, to register the underlying shares for the notes and liquidated damages began to accrue at the rate of 0.25% per annum.

On January 19, 2006, the holders of the outstanding Series A and Series B Senior Convertible Notes, delivered written notice (the Notices) to the Company alleging that a Termination of Trading constituting a Fundamental Change, each as defined under the Indenture dated as of November 24, 2004 (the Indenture) by and among the Company, the guarantors party thereto and the Bank of New York, as trustee, had occurred with respect to the Senior Convertible Notes and that, as a result, the Company is required to repurchase the Senior Convertible Notes on the terms and conditions specified in the Indenture. Pursuant to the Indenture, a Termination of Trading is deemed to have occurred if the common stock of the Company into which the Senior Convertible Notes are convertible is neither listed for trading on the New York Stock Exchange (the NYSE) or the American Stock Exchange nor approved for listing on the NASDAQ National Market or the NASDAQ SmallCap Market, and no American Depositary Shares or similar instruments for such common stock are so listed or approved for listing in the United States. The Notices allege that a Termination of Trading occurred with respect to the Senior Convertible Notes when the Company was orally notified on December 15, 2005 that its common stock had been suspended from trading on the NYSE. As further described below, the Company does not believe that a Termination of Trading has occurred and disputes any assertion to the contrary.

As previously disclosed by the Company in Current Reports on Form 8-K filed with the Securities and Exchange Commission (SEC), on December 15, 2005 the NYSE suspended trading of the Company s common stock and informed the Company of the NYSE s intent to submit an application to the SEC to de-list the Company s common stock after completion of applicable procedures, including any appeal by IES of the NYSE s staff s decision. On December 30, 2005, in accordance with Rule 804.00 of the NYSE Listed Company Manual, the Company appealed the NYSE s staff s decision by requesting a review by the designated committee of the Board of Directors of the NYSE (the Committee) of the staff s determination to suspend the trading of the Company s common stock and an oral presentation before the Committee. The Company believes that, until its common stock is de-listed by the NYSE after application to the SEC, which is not expected to occur prior to completion of the Company s appeal to the Committee, the Company s common stock has not ceased to be listed on the NYSE for purposes of determining whether a Termination of Trading has occurred under the Indenture. The Company s shares now trade over-the-counter on the pink sheets under the symbol IESR.

The Notices state that the Company was required to provide the holders of the Notes with notice of the occurrence of a Termination of Trading within 15 business days after December 15, 2005 and that the Company failed to do so. If a Termination of Trading occurred on December 15, 2005, the Company s failure to provide notice to the holders of the Senior Convertible Notes on or about, or prior to, January 9, 2006 would constitute an Event of Default under the Indenture.

If a Termination of Trading occurred on December 15, 2005, then pursuant to the Notices, the Company would have been required to repurchase the Senior Convertible Notes in cash at a purchase price equal to 100% of the principal amount of the Senior Convertible Notes held by such holders plus accrued and unpaid interest and Liquidated Damages (as defined in the Indenture) thereon on or about, or prior to, February 7, 2006. If an Event of Default occurred as a result of the Company s failure to deliver notice to the holders of the Senior Convertible Notes of the occurrence of a Termination of Trading, the holders of at least 25% in aggregate principal amount of the Senior Convertible Notes have the right to declare the principal amount plus accrued and unpaid interest and Liquidated

Damages thereon immediately due and payable in cash.

In either case, the amount due under the Senior Convertible Notes, including the principal amount plus accrued and unpaid interest and Liquidated Damages thereon, would be approximately $51 million, and the Company would not be able to make such payment when due. Pursuant to the Notices, the holders have elected to exercise their repurchase rights following a Termination of Trading and have not accelerated the obligations under the Senior Convertible Notes pursuant to an Event of Default; however, the Notices expressly reserve the holders rights to accelerate the Senior Convertible Notes under the terms of the Indenture. Nevertheless, the Company s contemplated restructuring provides that the Senior Convertible Notes would be reinstated or the holders otherwise provided the full value of their Senior Convertible Note claims. See Part I, Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations Update on Financial Restructuring . The Company does not believe that the delivery of the Notices is likely to have any impact upon the recovery of the holders of the Senior Convertible Notes in a Chapter 11 proceeding. There is no assurance that the Company will successfully complete their contemplated restructuring, or any other restructuring. See Item 1A. Risk Factors.

Senior Subordinated Notes

The Company has outstanding two different series of senior subordinated notes with similar terms. The notes bear interest at 9 3/8% and will mature on February 1, 2009. Interest is paid on the notes on February 1 and August 1 of each year. The notes are unsecured senior subordinated obligations and are subordinated to all other existing and future senior indebtedness. The notes are guaranteed on a senior subordinated basis by all the Company s subsidiaries. Under the terms of the notes, the Company is required to comply with various affirmative and negative covenants including (1) restrictions on additional indebtedness, and (2) restrictions on liens, guarantees and dividends. At December 31, 2005, the Company had $172.9 million in outstanding senior subordinated notes. An interest payment of approximately $8.1 million on the Senior Subordinated Notes was due on February 1, 2006. The Company did not make this interest payment. Under the indenture for the Senior Subordinated Notes, this non-payment does not become an Event of Default until 30 days after the due date for such payment.

Our debt instruments and agreements, including the Credit Facility, the Senior Subordinated Notes, the Senior Convertible Notes and our agreement with our primary surety bonding company, contain cross-default provisions whereby an uncured and unwaived event of default under one will result in an event of default under each of the others. In accordance with Emerging Issues Task Force (EITF) 86-30, Classifications of Obligations When a Violation is Waived by the Creditor, the Company has classified the long-term portion of Senior Convertible Notes and Senior Subordinated Notes as current liabilities on the balance sheet due to the defaults under the Credit Facility and the potential for cross-defaults described above.

Debt consists of the following (in thousands):

	September 30, 2005	December 31, 2005
Senior Subordinated Notes, due February 1, 2009, bearing interest at 9.375% with an effective interest rate of 15.8%	$ 62,885	$ 62,885
Senior Subordinated Notes, due February 1, 2009, bearing interest at 9.375% with an effective interest rate of 15.8%	110,000	110,000
Senior Convertible Notes, due November 1, 2014, bearing interest at 6.5% with an effective interest rate of 6.5%	50,000	50,000
Other	59	165
Total debt	222,944	223,050
Less Short-term debt and current maturities of long-term debt	(32)	(26)
Less Senior Convertible Notes	(50,000)	(50,000)
Less Senior Subordinated Notes	(172,885)	(172,885)
Total long-term debt	$ 27	$ 139

5. EARNINGS PER SHARE

The following table reconciles the numerators and denominators of the basic and diluted earnings per share for the three months ended December 31, 2004 and 2005 (in thousands, except share data):

	Three Months Ended December 31,	
	2004	2005 (Restated)

Numerator:		
Net loss	$ (17,608)	$ (2,395)
Denominator:		
Weighted average shares outstanding basic	14,970,502	14,970,502
Effect of dilutive stock options		
Weighted average shares outstanding diluted	14,970,502	14,970,502
Earnings (loss) per share:		
Basic	$ (1.18)	$ (0.16)
Diluted	$ (1.18)	$ (0.16)

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For the three months ended December 31, 2004 and 2005, stock options of 3.2 million and 3.2 million representing common stock shares, respectively, were excluded from the computation of diluted earnings per share because the options exercise prices were greater than the average market price of the Company s common stock.

6. OPERATING SEGMENTS

The Company follows SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131). Certain information is disclosed, per SFAS 131, based on the way management organizes financial information for making operating decisions and assessing performance.

The Company s reportable segments are strategic business units that offer products and services to two distinct customer groups. They are managed separately because each business requires different operating and marketing strategies. These segments, which contain different economic characteristics, are managed through geographical regions.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on income from operations of the respective business units prior to home office expenses. Management allocates costs between segments for selling, general and administrative expenses, goodwill impairment, depreciation expense, capital expenditures and total assets.

Segment information for continuing operations for the three months ended December 31, 2004 and 2005 is as follows (in thousands):

	Three Months Ended December 31, 2004			
	Commercial and Industrial	**Residential**	**Corporate**	**Total**
Revenues	$ 132,273	$ 73,405	$	$ 205,678
Cost of services	115,153	59,035		174,188
Gross profit	17,120	14,370		31,490
Selling, general and administrative	11,567	9,929	8,026	29,522
Income (loss) from operations	$ 5,553	$ 4,441	$ (8,026)	$ 1,968
Other data:				
Depreciation and amortization expense	$ 1,212	$ 264	$ 639	$ 2,115
Capital expenditures	293	221	379	893
Total assets	222,525	86,842	77,738	387,105

	Three Months Ended December 31, 2005 (Restated)			
	Commercial and Industrial	**Residential**	**Corporate**	**Total**
Revenues	$ 136,394	$ 90,272	$	$ 226,666
Cost of services	118,202	73,970		192,172
Gross profit	18,192	16,302		34,494
Selling, general and administrative	11,616	9,944	8,180	29,740
Income (loss) from operations	$ 6,576	$ 6,358	$ (8,180)	$ 4,754

Other data:				
Depreciation and amortization expense	$ 876	$ 276	$ 514	$ 1,666
Capital expenditures	368	296	159	823
Total assets	150,424	89,391	101,082	340,897

The Company does not have operations or long-lived assets in countries outside of the United States.

Total assets as of December 31, 2004 and 2005 exclude assets held for sale and from discontinued operations of $176,084 and $55,548, respectively.

During fiscal 2006, we modified our methodology for allocating selling, general and administrative costs between operating segments. As a result, all periods presented have been reclassified to conform to current year presentation.

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7. 1999 INCENTIVE COMPENSATION PLAN

In November 1999, the Board of Directors adopted the 1999 Incentive Compensation Plan (the 1999 Plan). The 1999 Plan authorizes the Compensation Committee of the Board of Directors or the Board of Directors to grant employees of the Company awards in the form of options, stock appreciation rights, restricted stock or other stock based awards. The Company has up to 5.5 million shares of common stock authorized for issuance under the 1999 Plan.

In December 2003, the Company granted a restricted stock award of 242,295 shares under its 1999 Plan to certain employees. This award vests in equal installments on December 1, 2004 and 2005, provided the recipient is still employed by the Company. The market value of the stock on the date of grant for this award was $2.0 million, which is recognized as compensation expense over the related two year vesting period. On December 1, 2004, 113,248 restricted shares vested under this award. During the period December 1, 2003 through November 30, 2004, 15,746 shares of those originally awarded were forfeited. From December 1, 2004 through December 31, 2005, an additional 34,984 shares have been forfeited. On December 1, 2005, the remaining 78,317 restricted shares vested under this award.

In January 2005, the Company granted a restricted stock award of 365,564 shares under its 1999 Plan to certain employees. This award vests in equal installments on January 3, 2006 and 2007, provided the recipient is still employed by the Company. The market value of the stock on the date of grant for this award was $1.7 million, which is recognized as compensation expense over the related two year vesting period. Through December 31, 2005, 20,437 shares were forfeited under this grant.

During the three months ended December 31, 2004, the Company amortized $0.2 million to expense in connection with these awards. Effective October 1, 2005, the Company adopted Statement of Financial Accounting Standards 123 (revised 2004), Stock Based Payments (SFAS 123(R) (See Note 2). During the three months ended December 31, 2005, the Company recognized $0.3 million in compensation expense related to these awards in accordance with the provisions of SFAS 123 (R).

8. EMPLOYEE STOCK PURCHASE PLAN

The Company has an Employee Stock Purchase Plan (the ESPP), which provides for the sale of common stock to participants as defined at a price equal to the lower of 85% of the Company s closing stock price at the beginning or end of the option period, as defined. The ESPP is intended to qualify as an Employee Stock Purchase Plan under Section 423 of the Internal Revenue Code of 1986, as amended. In the three months ended December 31, 2004 and 2005, no shares were issued under the ESPP, respectively. The Company suspended contributions to the Plan for the period January 1, 2005 through December 31, 2005 and may elect to do so in the future.

9. COMMITMENTS AND CONTINGENCIES

Legal Matters

The Company and its subsidiaries are involved in various legal proceedings that have arisen in the ordinary course of business. While it is not possible to predict the outcome of such proceedings with certainty and it is possible that the results of legal proceedings may materially adversely affect us, in the opinion of the Company, all such proceedings are either adequately covered by insurance or, if not so covered, should not ultimately result in any liability which would have a material adverse effect on the financial position, liquidity or results of operations of the Company. The Company expenses routine legal costs related to such proceedings as incurred.

The following is a discussion of certain significant legal matters the Company is currently involved in:

A. In re Integrated Electrical Services, Inc. Securities Litigation, No. 4:04-CV-3342; in the United States District Court for the Southern District of Texas, Houston Division: Between August 20 and October 4, 2004, five putative securities fraud class actions were filed against IES and certain of its officers and directors in the United States District Court for the Southern District of Texas. The five lawsuits were consolidated under the caption In re Integrated Electrical Services, Inc. Securities Litigation, No. 4:04-CV-3342. On March 23, 2005, the Court appointed Central Laborer Pension Fund as lead plaintiff and appointed lead counsel. Pursuant to the parties agreed scheduling order, lead plaintiff filed its amended complaint on June 6, 2005. The amended complaint alleges that defendants violated Section 10(b) and 20(a) of the Securities Exchange Act of 1934 by making materially false and misleading statements during the proposed class period of November 10, 2003 to August 13, 2004. Specifically, the amended complaint alleges that defendants misrepresented the Company s financial condition in 2003 and 2004 as evidenced by the restatement, violated generally accepted accounting principles, and misrepresented the sufficiency of the Company s internal controls so that they could engage in insider trading at artificially-inflated prices, retain their positions at the Company, and obtain a $175 million credit facility for the Company.

On August 5, 2005, the defendants moved to dismiss the amended complaint for failure to state a claim. The defendants argued, among other things, that the amended complaint fails to allege fraud with particularity as required by Rule 9(b) of the Federal Rules of Civil Procedure and fails to satisfy the heightened pleading requirements for securities fraud class actions under the Private Securities Litigation Reform Act of 1995. Specifically, defendants argue that the amended complaint does not allege fraud with particularity as to numerous GAAP violations and opinion statements about internal controls, fails to raise a strong inference that defendants acted knowingly or with severe recklessness, and includes vague and conclusory allegations from confidential witnesses without a proper factual basis. Lead plaintiff filed its opposition to the motion to dismiss on September 28, 2005, and defendants filed their reply in support of the motion to dismiss on November 14, 2005.

On December 21, 2005, the Court held a telephonic hearing relating to the motion to dismiss. On January 10, the Court issued a memorandum and order dismissing with prejudice all claims filed against the Defendants. The Plaintiff in the securities class action filed its notice of appeal on February 2, 2006. No dates for briefing the appeal have been set or determined.

B. SEC Investigation   On August 31, 2004, the Fort Worth Regional Office of the SEC sent a request for information concerning IES s inability to file its 10-Q in a timely fashion, the internal investigation conducted by counsel to the Audit Committee of the company s Board of Directors, and the material weaknesses identified by IES s auditors in August 2004. In December 2004, the Commission issued a formal order authorizing the staff to conduct a private investigation into these and related matters. The investigation is still ongoing, and the Company is cooperating with the SEC. An adverse outcome in this matter could have a material adverse effect on our business, consolidated financial condition, results of operations or cash flows.

C. Radek v. Allen, et al., No. 2004-48577; in the 113th Judicial District Court, Harris County, Texas: On September 3, 2004, Chris Radek filed a shareholder derivative action in the District Court of Harris County, Texas naming Herbert R. Allen, Richard L. China, William W. Reynolds, Britt Rice, David A. Miller, Ronald P. Badie, Donald P. Hodel, Alan R. Sielbeck, C. Byron Snyder, Donald C. Trauscht, and James D. Woods as individual defendants and IES as nominal defendant. On July 15, 2005, plaintiff filed an amended shareholder derivative petition alleging substantially similar factual claims to those made in the putative class action, and making common law claims against the individual defendants for breach of fiduciary duties, misappropriation of information, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment. On September 16, 2005, defendants filed special exceptions or, alternatively, a motion to stay the derivative action. On November 11, 2005, Plaintiff filed a response to defendants special exceptions and motion to stay. A hearing on defendants special exceptions and motion to stay took place on January 9, 2006. Following that hearing, the parties submitted supplemental briefing relating to the standard for finding director self-interest in a derivative case. Defendants also advised the Court that the class action had been dismissed with prejudice. The Court has not yet ruled on the special exceptions.

D. Cynthia People v. Primo Electric Company, Inc., Robert Wilson, Ray Hopkins, and Darcia Perini; In the United States District Court for the District of Maryland; C.A. No. 24-C-05-002152: On March 10, 2005, one of IES wholly-owned subsidiaries was served with a lawsuit filed by an ex-employee alleging thirteen causes of action including employment, race and sex discrimination as well as claims for fraud, intentional infliction of emotional distress, negligence and conversion. On each claim plaintiff is demanding $5-10 million in compensatory and $10-20 million in punitive damages; attorney s fees and costs. This action was filed after the local office of the EEOC terminated their process and issued plaintiff a right-to -sue letter per her request. IES will vigorously contest any claim of wrongdoing in this matter and does not believe the claimed damages bear any likelihood of being found in this case. However, if such damages were to be found, it would have a material adverse effect on consolidated financial condition and cash flows. The Company intends to vigorously contest these actions. An adverse outcome in these actions could have a material adverse effect on our business, consolidated financial condition, results of operations or cash flows.

E. Florida Power & Light Company vs. Qualified Contractors, Davis Electrical Contractors, Inc., et al. Case No. 04-80505, United States District Court for the Southern District of Florida, Miami Division: This is a property damage claim arising out of installation of electrical and pipe fitting work performed on a turbine construction project at a power plant. After the Company subsidiary completed the project there was a failure at one of the turbines resulting in damage to the turbines alleged to be approximately $9.2 million. A bench trial began on January 19 and is expected to conclude early February. The company does not believe it is liable for any of the damages and that even if held liable is insured for amounts in excess of any potential verdict.

The Company intends to vigorously contest all of these actions. An adverse outcome in any of these actions could have a material adverse effect on our business, consolidated financial condition, results of operations or cash flows.

We are involved in various other legal proceedings that have arisen in the ordinary course of business. While it is not possible to predict the outcome of any of these proceedings with certainty and it is possible that the results of legal proceedings may materially adversely affect us, in our opinion, these proceedings are either adequately covered by insurance or, if not so covered, should not ultimately result in any liability which would have a material adverse effect on our financial position, liquidity or results of operations. The Company intends to vigorously contest these actions. An adverse outcome in these actions could have a material adverse effect on our business, consolidated financial condition, results of operations or cash flows.

Other Commitments and Contingencies

Some of the Company s customers and vendors require the Company to post letters of credit as a means of guaranteeing performance under its contracts and ensuring payment by the Company to subcontractors and vendors. If the customer has reasonable cause to effect payment under a letter of credit, the Company would be required to reimburse its creditor for the letter of credit. Depending on the circumstances surrounding a reimbursement to its creditor, the Company may have a charge to earnings in that period. To date the Company has not had a situation where a customer or vendor has had reasonable cause to effect payment under a letter of credit. At December 31, 2005, $2.6 million of the Company s outstanding letters of credit were to collateralize its customers and vendors.

Some of the underwriters of the Company s casualty insurance program require it to post letters of credit as collateral. This is common in the insurance industry. To date the Company has not had a situation where an underwriter has had reasonable cause to effect payment under a letter of credit. At December 31, 2005, $34.0 million of the Company s outstanding letters of credit were to collateralize its insurance program.

Many of the Company s customers require us to post performance and payment bonds issued by a surety. Those bonds guarantee the customer that the Company will perform under the terms of a contract and that it will pay its subcontractors and vendors. In the event that the Company fails to perform under a contract or pay subcontractors and vendors, the customer may demand the surety to pay or perform under the Company s bond. The Company s relationship with its sureties is such that it will indemnify the sureties for any expenses they incur in connection with any of the bonds they issue on the Company s behalf. To date, the Company has not incurred significant expenses to indemnify its sureties for expenses they incurred on the Company s behalf. As of December 31, 2005, the Company s cost to complete projects covered by surety bonds was approximately $59.6 million and utilized a combination of cash and letters of credit totaling $30.9 million to collateralize the Company s bonding program.

The Company has committed to invest up to $5.0 million in EnerTech Capital Partners II L.P. (EnerTech). EnerTech is a private equity firm specializing in investment opportunities emerging from the deregulation and resulting convergence of the energy, utility and telecommunications industries. Through December 31, 2005, the Company had invested $4.3 million under its commitment to EnerTech.

On September 30, 2005, we and Bank of America entered into a letter agreement whereby we would make ratable monthly payments to increase the amount of cash collateral held by the lender as security for our obligations under the credit facility to $17.6 million by January 31, 2006. The balance in the account as of December 31, 2005 was $19.1 million and