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See accompanying notes.

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 1 Basis of Presentation

The consolidated financial statements include the accounts of Matrix Service Company (Matrix Service or the Company) and its subsidiaries, all of which are wholly owned. Intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with Rule 10-01 of Regulation S-X for interim financial statements required to be filed with the Securities and Exchange Commission and do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. However, the information furnished reflects all adjustments, consisting of normal recurring adjustments and other adjustments described herein that are, in the opinion of management, necessary for a fair statement of the results for the interim periods.

The accompanying financial statements should be read in conjunction with the audited financial statements for the year ended May 31, 2007, included in the Company s Annual Report on Form 10-K for the year then ended. Matrix Service s business is cyclical due to the scope and timing of projects released by its customer base. In addition, Matrix Service generates a significant portion of its revenues under a comparatively few major contracts which often do not commence or terminate in the same period from one year to the next. Accordingly, results for any interim period may not necessarily be indicative of future operating results.

Note 2 Recent Accounting Standards

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

Effective June 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 , as amended (FIN No. 48). Upon adoption of FIN No. 48 on June 1, 2007 and as of November 30, 2007, the Company had no material uncertain tax positions and no adjustments to the Company s opening financial position were required.

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

The Company accrues interest and penalties on underpayment of income taxes related to uncertain tax positions as a component of income tax expense in the consolidated statement of income. No amounts were recognized for interest and penalties upon adoption of FIN No. 48 or during the three or six-months ended November 30, 2007.

SFAS No. 157 Fair Value Measurements

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

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS 159), The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 . SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS 159 is effective for the Company s fiscal year beginning on June 1, 2008. The adoption of this statement is not expected to have a material effect on the consolidated financial statements of the Company.

Note 3 - Assets Held for Sale

The Company holds excess land located in Orange, California, for which a sale is pending. The carrying value of the excess land at November 30, 2007 was $0.8 million, which approximates the expected net proceeds from the pending sale. The land is recorded in the Other Current Assets line in the Consolidated Balance Sheets and is reflected in the Company s Other segment in Note 11.

Note 4 - Uncompleted Contracts

Contract terms of the Company s construction contracts generally provide for progress billings based on completion of certain phases of the work. The excess of costs incurred and estimated earnings recognized for construction contracts over amounts billed on uncompleted contracts is reported as a current asset. The excess of amounts billed over costs incurred and estimated earnings recognized for construction contracts on uncompleted contracts is reported as a current liability. Gross and net amounts on uncompleted contracts are as follows:

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

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

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Gulf Coast LNG Project

We recorded a $16.0 million charge on the Gulf Coast LNG project in the second quarter of fiscal 2008. This charge reflects management s best estimate of the total revenues to be realized, including incentives, and total costs at completion. The current forecast includes actual cost and productivity data as of December 31, 2007 when the project was 84% complete and detailed cost projections for all remaining activity. The current forecast also reflects the manpower and costs necessary to achieve our contractual delivery dates for each of the three tanks being constructed by Matrix Service.

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

If we fail to achieve the contractual delivery dates, we would begin to lose incentives and would begin to incur liquidated damages on a daily basis subject to contractual limitations. The current revenue forecast includes $7.8 million in incentive payments, tied to various delivery dates from February through April, 2008. Liquidated damages under the contract are $25,000 per tank per day up to an aggregate total of $6.5 million. In addition to lost incentives and payment of liquidated damages, a delay in the schedule could also result in additional labor and equipment costs, which we are unable to estimate but which could be material.

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 5 Debt

Availability under the senior credit facility is as follows:

	November 30, 2007	May 31, 2007
	(In thousands)	
Senior credit facility - revolver	$ 75,000	$ 75,000
Amounts borrowed	3,250	
Letters of credit	8,395	8,575
Availability under senior credit facility	$ 63,355	$ 66,425

Effective November 30, 2006, the Company entered into the Second Amended and Restated Credit Agreement (Credit Agreement), which provides for a five-year, $75.0 million senior revolving credit facility (Credit Facility). On July 6, 2007 the Company entered into the First Amendment to the Second Amended and Restated Credit Agreement (Amendment) which changed certain terms and extended the Revolving Credit Termination Date from November 30, 2011 to November 30, 2012. The Company is currently seeking an increase in the total capacity to $100.0 million, and is negotiating an option to further expand the revolving credit facility to $125.0 million upon the Company s request and with the consent of the Administrative Agent.

The Credit Agreement is guaranteed by substantially all of the Company s subsidiaries and is secured by a lien on substantially all of the Company s assets. The Credit Facility may be used for working capital, issuance of letters of credit or other lawful corporate purposes. The Credit Agreement contains customary affirmative and negative covenants that place certain restrictions on the Company, including limits on new debt, operating and capital lease obligations, asset sales and certain distributions. Significant financial covenants include the following:

- Senior Leverage Ratio not to exceed 2.50 to 1.00;
- Asset Coverage Ratio to be greater than 1.45 to 1.00;
- Fixed Charge Coverage Ratio to be greater than 1.25 to 1.00; and
- Tangible Net Worth must be greater than the sum of $55.6 million plus 75% of positive net income after August 31, 2006 and net proceeds from the sale of any equity securities.

At the Company s option, amounts borrowed under the Credit Facility bear interest at LIBOR or an Alternate Base Rate, plus in each case, an additional margin based on the Senior Leverage Ratio. The Alternate Base Rate is the greater of the Prime Rate or the Fed Funds Effective Rate, plus 0.50%. The Amendment reduced additional margin ranges from between 0.00% and 0.75% to between 0.00% and 0.25% on the Alternate Base Rate loans and from between 1.50% and 2.25% to between 1.00% and 1.75% on LIBOR-based loans. The Company pays an Unused Revolving Credit Facility Fee of 0.175% to 0.375%. Since the closing date, the Company has been at the lowest rate tier on borrowings and for other fees.

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Convertible Debt

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

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

Note 6 Acquisition Payable

As part of an acquisition in fiscal 2003, the Company entered into an acquisition payable for a portion of the purchase price. The acquisition payable is recorded at $2.8 million at November 30, 2007 and is accreted for the change in its present value each period utilizing a 5.1% effective interest rate. Payments related to the acquisition payable are due annually and the final payment of $2.8 million is due on March 7, 2008.

Pursuant to the purchase agreement, the former shareholders of the acquired entity agreed, jointly and severally, to indemnify Matrix Service for damages it suffers due to breaches of representations and warranties made by the shareholders with respect to, among other things, its employee benefit plans, the ownership, use and condition of its assets and the performance by the acquired company of its contractual obligations and its obligations under applicable laws, including employment and environmental laws. As to these matters, Matrix Service may recover its damages only if its claims for damages are made by March 7, 2008, the amount of damages claimed as to any single event exceeds a de minimus amount of $10,000, and only after the aggregate amount of all such claims excluding de minimus claims exceeds $250,000. In order to better assure the payment to Matrix Service of any claims by it for indemnity, $10.0 million of the purchase price was withheld in the form of a deferred purchase price payable to the former shareholders or their designee. Upon final determination that a claim for indemnity is proper, the amount of the claim can be deducted by Matrix Service from the deferred payments of the purchase price. Since the purchase date on March 7, 2003, claims have not exceeded $250,000, and thus no adjustment to the deferred purchase price has been made related to these provisions as of November 30, 2007.

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 7 Income Taxes

Deferred income taxes are computed using the liability method whereby deferred tax assets and liabilities are recognized based on temporary differences between the financial statement and tax basis of assets and liabilities using presently enacted tax rates. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes.

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

Note 8 Commitments and Contingencies

Insurance Reserves

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

Typically our contracts require us to indemnify our customers for injury, damage or loss arising from the performance of our services and provide for warranties for materials and workmanship. The Company may also be required to name the customer as an additional insured under certain insurance policies up to the limits of insurance available to us, or we may have to purchase special insurance policies or surety bonds for specific customers. Matrix Service generally requires its subcontractors to indemnify the Company and the Company s customer plus name the Company as an additional insured for activities arising out of the subcontractors presence at the customer s location. Certain subcontractors must also provide additional insurance policies, including surety bonds in favor of the Company, to secure the subcontractors work or as required by the subcontract. There can be no assurance that our insurance and the additional insurance coverage provided by our subcontractors will protect us against a valid claim or loss under the contracts with our customers.

Matrix Service maintains a performance and payment bonding line, which was $90.0 million through November 30, 2007. This bonding line was subsequently increased to $140.0 million on December 21, 2007.

Unapproved Change Orders and Claims

As of November 30, 2007 and May 31, 2007, accounts receivable and costs and estimated earnings in excess of billings on uncompleted contracts included revenues, to the extent of costs incurred, for unapproved change orders of $4.6 million and $5.1 million, respectively, and claims of $2.4 million and $1.5 million, respectively. Amounts disclosed for unapproved change orders and claims exclude amounts associated with the contract dispute disclosed elsewhere in this Note. Generally, collection of amounts related to unapproved change orders and claims is expected within twelve months. However, customers generally will not pay these amounts to Matrix Service until final resolution of related claims, and accordingly, collection of these amounts may extend beyond one year.

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Contract Dispute

In March 2000, the Company entered into a joint venture partnership (JV) agreement for the construction of a pulp and paper project for an owner, which was completed late in 2000. The services provided by the JV consisted primarily of a labor contract with the owner supplying the engineering and the majority of the materials to be installed. The claim arises out of a contractual dispute in which the Company believes the JV incurred substantial work because the owner s planning and engineering on the project was not adequate. The owner did not pay amounts owed and claims that the JV was not properly licensed by the Oregon Contractors Licensing Board, and therefore not eligible to file a lawsuit under Oregon law. An Oregon state court ruled in favor of the owner regarding the licensing issue and the Company appealed the decision.

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

Capital Commitments

At November 30, 2007, expected remaining spending on capital projects that have been approved but are not yet completed total $6.8 million.

New Operating Lease

On November 16, 2007, the Company entered into an operating lease on a facility that will be used primarily as the corporate headquarters. The lease term is for 89 months and will begin upon occupancy of the facility, which the Company expects to be in the fourth quarter of fiscal 2008. Total minimum lease payments under this arrangement are $4.6 million and will begin 5 months after occupancy.

Other

The Company and its subsidiaries are named as defendants in various other legal actions and are vigorously defending each of them. It is the opinion of management that none of the known legal actions will have a material adverse impact on the Company s financial position, results of operations or liquidity.

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 9 Other Comprehensive Income

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

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

Note 10 Earnings per Common Share

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

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

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

The computation of basic and diluted EPS is as follows:

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

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 11 Segments

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

The primary turnkey and specialty construction services of our Construction Services segment are aboveground storage tanks for the bulk storage/terminal industry, capital construction for the downstream petroleum industry, specialty construction, and electrical/instrumentation services for various industries. These services including civil/structural, mechanical, piping, electrical/instrumentation, millwrighting, and fabrication are provided for projects of varying complexities, schedule durations, and budgets. Our project experience includes renovations, retrofits, modifications and expansions to existing facilities as well as grassroots construction of new facilities.

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

Other consists of operating activity related to previously disposed of businesses and certain corporate assets.

The Company evaluates performance and allocates resources based on profit or loss from operations before income taxes. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Intersegment sales and transfers are recorded at cost and there is no intercompany profit or loss on intersegment sales or transfers.

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

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Results of Operations

	Construction Services	Repair & Maintenance Services	Other	Combined Total
		(In thousands)		
Three Months Ended November 30, 2007				
Gross revenues	$ 119,443	$ 79,420	$	$ 198,863
Less: Inter-segment revenues	3,170	959		4,129
Consolidated revenues	116,273	78,461		194,734
Gross profit (loss)	(1,839)	13,085		11,246
Operating income (loss)	(9,269)	8,508	166	(595)
Income (loss) before income tax expense	(9,432)	8,460	166	(806)
Net income (loss)	(5,240)	5,350	100	210
Segment assets	163,597	93,030	21,634	278,261
Capital expenditures	2,400	1,870	1,169	5,439
Depreciation and amortization expense	1,178	861		2,039
Three Months Ended November 30, 2006				
Gross revenues	$ 85,871	$ 83,383	$	$ 169,254
Less: Inter-segment revenues	2,568	320		2,888
Consolidated revenues	83,303	83,063		166,366
Gross profit	9,372	12,530		21,902
Operating income (loss)	4,609	8,590	(46)	13,153
Income (loss) before income tax expense	4,487	8,180	(46)	12,621
Net income (loss)	2,945	5,157	(28)	8,074
Segment assets	93,561	82,739	20,014	196,314
Capital expenditures	1,921	1,173	378	3,472
Depreciation and amortization expense	896	677		1,573
Six Months Ended November 30, 2007				
Gross revenues	$ 222,460	$ 143,405	$	$ 365,865
Less: Inter-segment revenues	7,408	2,396		9,804
Consolidated revenues	215,052	141,009		356,061
Gross profit	6,834	23,316		30,150
Operating income (loss)	(5,345)	15,527	81	10,263
Income (loss) before income tax expense	(5,719)	15,392	81	9,754
Net income (loss)	(3,013)	9,510	49	6,546
Segment assets	163,597	93,030	21,634	278,261
Capital expenditures	3,906	2,542	1,879	8,327
Depreciation and amortization expense	2,231	1,582		3,813
Six Months Ended November 30, 2006				
Gross revenues	$ 164,862	$ 133,811	$	$ 298,673
Less: Inter-segment revenues	4,750	698		5,448
Consolidated revenues	160,112	133,113		293,225
Gross Profit	17,819	17,390		35,209

Operating income (loss)	8,900	9,922	(46)	18,776
Income (loss) before income tax expense	8,198	9,479	(46)	17,631
Net income (loss)	5,172	5,938	(28)	11,082
Segment assets	93,561	82,739	20,014	196,314
Capital expenditures	4,193	1,935	649	6,777
Depreciation and amortization expense	1,695	1,336		3,031

Table of Contents

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Segment Revenue from External Customers by Industry Type

	Construction Services	Repair & Maintenance Services (In thousands)	Total
Three Months Ended November 30, 2007			
Aboveground Storage Tanks	$ 58,326	$ 44,504	$ 102,830
Downstream Petroleum	39,499	29,810	69,309
Electrical and Instrumentation	5,239	4,147	9,386
Specialty	13,209		13,209
Total	$ 116,273	$ 78,461	$ 194,734
Three Months Ended November 30, 2006			
Aboveground Storage Tanks	$ 38,147	$ 33,685	$ 71,832
Downstream Petroleum	25,411	42,761	68,172
Electrical and Instrumentation	7,315	6,617	13,932
Specialty	12,430		12,430
Total	$ 83,303	$ 83,063	$ 166,366
Six Months Ended November 30, 2007			
Aboveground Storage Tanks	$ 97,801	$ 86,033	$ 183,834
Downstream Petroleum	73,050	47,347	120,397
Electrical and Instrumentation	7,410	7,629	15,039
Specialty	36,791		36,791
Total	$ 215,052	$ 141,009	$ 356,061
Six Months Ended November 30, 2006			
Aboveground Storage Tanks	$ 76,351	$ 59,893	$ 136,244
Downstream Petroleum	40,087	62,481	102,568
Electrical and Instrumentation	11,774	10,739	22,513
Specialty	31,900		31,900
Total	$ 160,112	$ 133,113	$ 293,225

Table of Contents

ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Critical Accounting Estimates

The following is a discussion of the most critical accounting policies, judgments and uncertainties that are inherent in our application of generally accepted accounting principles (GAAP).

Revenue Recognition

Matrix Service records profits on fixed-price contracts on a percentage-of-completion basis, primarily based on costs incurred to date compared to the total estimated contract cost. Matrix Service records revenue on reimbursable and time and material contracts based on a proportional performance basis as costs are incurred. Contracts in process are valued at cost plus accrued profits less billings on uncompleted contracts. Contracts are generally considered substantially complete when field construction is completed. The elapsed time from award of a contract to completion of performance may be in excess of one year. Matrix Service includes pass-through revenue and costs on cost-plus contracts, which are customer-reimbursable materials, equipment and subcontractor costs, when Matrix Service determines that it is responsible for the procurement and management of such cost components on behalf of the customer.

Matrix Service has numerous contracts that are in various stages of completion which require estimates to determine the appropriate cost and revenue recognition. Matrix Service has a history of making reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs, and accordingly, does not believe significant fluctuations are likely to materialize. However, current estimates may be revised as additional information becomes available. If estimates of costs to complete fixed-price contracts indicate a loss, a provision is made through a contract write-down for the total loss anticipated. A number of our contracts contain various cost and performance incentives and penalties that impact the earnings we realize from our contracts. Adjustments related to these incentives and penalties are recorded in the period on a percentage of completion basis when estimable and probable.

Indirect costs (such as salaries and benefits, supplies and tools, equipment costs and insurance costs) are charged to projects based upon direct labor hours and overhead allocation rates per direct labor hour. Warranty costs are normally incurred prior to project completion and are charged to project costs as they are incurred. Warranty costs incurred subsequent to project completion were not material for the periods presented. Overhead allocation rates are established annually during the budgeting process and evaluated for accuracy throughout the year based upon actual direct labor hours and actual costs incurred.

Claims Recognition

Claims are amounts in excess of the agreed contract price (or amounts not included in the original contract price) that we seek to collect from customers or others for delays, errors in specifications and designs, contract terminations, change orders in dispute or unapproved as to both scope and price or other causes of anticipated additional costs incurred by us. Recognition of amounts as additional contract revenue related to claims is appropriate only if it is probable that the claims will result in additional contract revenue and if the amount can be reliably estimated. We must determine if:

- there is a legal basis for the claim;
- the additional costs were caused by circumstances that were unforeseen by the Company and are not the result of deficiencies in our performance;
- the costs are identifiable or determinable and are reasonable in view of the work performed; and
- the evidence supporting the claim is objective and verifiable.

If all of these requirements are met, revenue from a claim is recorded only to the extent that we have incurred costs relating to the claim.

-19-

Table of Contents

As of November 30, 2007 and May 31, 2007, accounts receivable and costs and estimated earnings in excess of billings on uncompleted contracts included revenues, to the extent of costs incurred, for unapproved change orders of $4.6 million and $5.1 million, respectively, and claims of $2.4 million and $1.5 million, respectively. Historically, our collections for unapproved change orders and other claims have approximated the amount of revenue recognized.

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

	Claims for Unapproved Change Orders	Other Claims	Total
		(In thousands)	
Balance at May 31, 2007	$ 5,129	$ 1,493	$ 6,622
Additions	1,176	897	2,073
Collections	(1,636)		(1,636)
Loss	(34)		(34)
Balance at November 30, 2007	$ 4,635	$ 2,390	$ 7,025
Balance at May 31, 2006	$ 3,845	$ 523	$ 4,368
Additions	401		401
Collections	(3,466)	(492)	(3,958)
Loss	(379)	(31)	(410)
Balance at November 30, 2006	$ 401	$	$ 401

Gulf Coast LNG Project

We recorded a $16.0 million charge on the Gulf Coast LNG project in the second quarter of fiscal 2008. This charge reflects management s best estimate of the total revenues to be realized, including incentives, and total costs at completion. The current forecast includes actual cost and productivity data as of December 31, 2007 when the project was 84% complete and detailed cost projections for all remaining activity. The current forecast also reflects the manpower and costs necessary to achieve our contractual delivery dates for each of the three tanks being constructed by Matrix Service.

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

If we fail to achieve the contractual delivery dates, we would begin to lose incentives and would begin to incur liquidated damages on a daily basis subject to contractual limitations. The current revenue forecast includes $7.8 million in incentive payments, tied to various delivery dates from February through April, 2008. Liquidated damages under the contract are $25,000 per tank per day up to an aggregate total of $6.5 million. In addition to lost incentives and payment of liquidated damages, a delay in the schedule could also result in additional labor and equipment costs, which we are unable to estimate but which could be material.

Table of Contents

Loss Contingencies

Various legal actions, claims, and other contingencies arise in the normal course of our business. Contingencies are recorded in the consolidated financial statements, or are otherwise disclosed, in accordance with SFAS No. 5 Accounting for Contingencies. Specific reserves are provided for loss contingencies to the extent we conclude their occurrence is both probable and estimable. We use a case-by-case basis evaluation of the underlying data and update our evaluation as further information becomes known. We believe that any amounts exceeding our recorded accruals should not materially affect our financial position, results of operations or liquidity. However, the results of litigation are inherently unpredictable and the possibility exists that the ultimate resolution of one or more of these matters could result in a material adverse effect on our financial position, results of operations or liquidity.

Legal costs are expensed as incurred.

Insurance Reserves

We maintain insurance coverage for various aspects of our operations. However, we retain exposure to potential losses through the use of deductibles, coverage limits and self-insured retentions. As of November 30, 2007 and May 31, 2007, insurance reserves totaling $6.4 million are reflected on our balance sheet. These amounts represent our best estimate of our ultimate obligations for asserted claims plus claims incurred but not yet reported at the balance sheet date. We establish specific reserves for claims using a case-by-case evaluation of the underlying claim data and update our evaluations as further information becomes known. Judgments and assumptions are inherent in our reserve accruals; as a result, changes in assumptions or claims experience could result in changes to these estimates in the future. Additionally, the actual results of claim settlements could differ from the amounts estimated.

Goodwill

Goodwill and intangible assets with indefinite useful lives are not amortized and are tested at least annually for impairment. We perform our annual analysis during the fourth quarter of each fiscal year and in any other period in which indicators of impairment warrant an additional analysis. Goodwill represents the excess of the purchase price of acquisitions over the fair value of the net assets acquired. Goodwill is evaluated for impairment by first comparing management s estimate of the fair value of a reporting unit with its carrying value, including goodwill. Reporting units, for purposes of goodwill impairment calculations are our reportable segments.

Management utilizes a discounted cash flow analysis to determine the estimated fair value of our reporting units. Significant judgments and assumptions including the discount rate, anticipated revenue growth and gross margins, estimated operating and interest expense, and capital expenditures are inherent in these fair value estimates which are based on our operating budgets. As a result, actual results may differ from the estimates utilized in our discounted cash flow analysis. The use of alternate judgments and/or assumptions could result in a fair value that differs from our estimate and could result in the recognition of an impairment charge in the financial statements.

As a result of these uncertainties, we utilize multiple scenarios and assign probabilities to each of the scenarios in the discounted cash flow analysis. The results of the discounted cash flow analysis are then compared to the carrying value of the reporting unit. If the carrying value of a reporting unit exceeds its fair value, a computation of the implied fair value of goodwill is compared with its related carrying value. If the carrying value of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in the amount of the excess. If an impairment charge is incurred, it would negatively impact our results of operations and financial position.

We do not currently anticipate a goodwill impairment for either our Construction Services or Repair and Maintenance Services segments. However, certain events may occur that might adversely affect the reported value of goodwill. Such events could include, but are not limited to, strategic decisions made in response to economic or competitive conditions, a significant change in the project plans of our customers, the economic condition of the customers and industries we serve, and a material negative change in the relationships with one or more of our significant customers. If our judgments and assumptions change as a result of the occurrence of any of these events or other events that we do not currently anticipate, our expectations as to future results and our estimate of the implied value of one or more of our reporting units also may change.

Our significant assumptions, including revenue growth, gross margins, operating and interest expense and other factors, have been reasonably accurate in recent years, but are likely to change in light of the dynamic competitive environment in which we operate. However, given the excess of estimated fair value over carrying value of $120.6 million for the Construction Services segment and $35.0 million for the Repair and Maintenance Services segment at May 31, 2007 and the absence of any indicators of impairment at November 30, 2007, we do not currently anticipate recording a goodwill impairment charge for either of our operating units.

Table of Contents

Results of Operations

Overview

The Company has two reportable segments, Construction Services and Repair and Maintenance Services. The majority of the work for both segments is performed in the United States with less than 2.0% of revenues generated in Canada during the current fiscal year. However, the Company does continue to seek opportunities for growth in both the domestic and international markets.

The primary turnkey and specialty construction services of our Construction Services segment are aboveground storage tanks for the bulk storage/terminal industry, capital construction for the downstream petroleum industry, specialty construction, and electrical/instrumentation services for various industries. These services, including civil/structural, mechanical, piping, electrical/instrumentation, millwrighting, and fabrication, are provided for projects of varying complexities, schedule durations, and budgets. Our project experience includes renovations, retrofits, modifications and expansions to existing facilities as well as grassroots construction of new facilities.

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

Significant fluctuations in revenues, gross profits and operating results are discussed below on a consolidated basis and for each segment. Revenues fluctuate from quarter to quarter due to many factors, including the changing product mix and project schedules, which are dependent on the level and timing of customer releases of new business.

Three Months Ended November 30, 2007 Compared to Three Months Ended November 30, 2006

Consolidated

Consolidated revenues were $194.7 million in fiscal 2008, an increase of $28.3 million, or 17.0%, from consolidated revenues of $166.4 million for fiscal 2007. The improvement in consolidated revenues resulted from an increase of $32.9 million in Construction Services revenues partially offset by a decline of $4.6 million in Repair and Maintenance Services revenues.

Consolidated gross profit decreased from $21.9 million in fiscal 2007 to $11.2 million in fiscal 2008. The decline of $10.7 million, or 48.9%, occurred despite 17.0% revenue growth due to reduced gross margins in the Construction Services segment. Consolidated gross margins decreased from 13.2% in fiscal 2007 to 5.8% in fiscal 2008 due to the Construction Services segment s overall gross margin declining from 11.3% in fiscal 2007 to (1.6)% in fiscal 2008. Slightly offsetting this decline was an improvement in gross margins for the Repair and Maintenance Services segment, where the overall gross margin grew to 16.7% in the current fiscal year versus 15.1% in the prior fiscal year.

Consolidated SG&A expenses were $11.8 million in fiscal 2008 compared to $8.7 million for fiscal 2007. This increase of $3.1 million was primarily due to increased employee-related expenses, including higher non-cash SFAS 123(R) expense of $0.6 million and employee severance costs of $0.4 million, and a bad debt charge of $1.0 million caused by the bankruptcy of a customer that is involved in a contract dispute with the Company. SG&A expense as a percentage of revenue increased to 6.1% in fiscal 2008 compared to 5.2% in the prior fiscal year.

Table of Contents

Interest expense decreased to $0.3 million in fiscal 2008 compared to $0.8 million in fiscal 2007. The decline of $0.5 million was primarily due to reduced amortization of prepaid interest on the convertible notes and lower amortization of debt issuance costs. Current year interest expense was primarily related to the amortization of deal fees on the senior revolving credit facility and interest on borrowings under this facility.

Income before income tax expense decreased to a loss of $0.8 million in fiscal 2008 from income of $12.6 million in fiscal 2007. This $13.4 million decline was due to the low gross margins recognized in the Construction Services segment combined with increased SG&A expenses.

During the second quarter of fiscal 2008 the Company recorded a $0.7 million tax benefit resulting from the continuing assessment of the realizability of state investment tax credits. The reduced effective tax rate of 36.0% for fiscal 2007 was attributable to the utilization of losses on disputed contracts, the tax benefits of which had been reserved as a valuation allowance in previous years.

Net income for fiscal 2008 fell to $0.2 million, or $0.01 per fully diluted share, versus net income in fiscal 2007 of $8.1 million, or $0.31 per fully diluted share.

Construction Services

Construction Services revenues for the second quarter 2008 were $116.3 million compared to $83.3 million in the same period a year earlier. The increase was a result of higher construction work in Aboveground Storage Tanks, where second quarter revenues increased 53.0% to $58.3 million, from $38.1 million in the second quarter of fiscal 2007. The increase was also driven by Downstream Petroleum revenues, which gained 55.5% to $39.5 million, from $25.4 million for the year-earlier period, and by Specialty revenues, which increased 6.5% to $13.2 million, from $12.4 million for the year-earlier period. These improvements were partially offset by a decline of $2.1 million in Electrical and Instrumentation revenues.

Gross profit decreased from $9.4 million in fiscal 2007 to a $1.8 million loss in fiscal 2008. The decline of $11.2 million was a result of an additional $16.0 million pre-tax charge for cost overruns in fiscal 2008 related to a LNG construction project in the Gulf Coast Region. The additional cost overruns are primarily attributable to higher craft turnover and continued productivity and construction-related issues on an increasingly compressed schedule for the remaining portions of the project, similar to those previously disclosed. Construction Services gross margins dropped from 11.3% in fiscal 2007 to (1.6)% in fiscal 2008 as a result of this additional charge. Partially offsetting the LNG charge, were our remaining Construction Services projects which are experiencing higher margins than those recognized in the prior fiscal period.

Operating loss and loss before income tax expense were $9.3 million and $9.4 million, respectively, in fiscal 2008 versus operating income and income before income tax expense of $4.6 million and $4.5 million in fiscal 2007.

Repair and Maintenance Services

Repair and Maintenance Services revenues were $78.5 million in the second quarter of 2008 versus $83.1 million in the same quarter in 2007. The decrease was primarily a result of lower Downstream Petroleum revenues, where second quarter revenues were $29.8 million compared to $42.8 million a year earlier, and by Electrical and Instrumentation revenues, which fell to $4.1 million, from $6.6 million for the year-earlier period. These declines were partially offset by Aboveground Storage Tank revenues which rose 32.0% to $44.5 million from $33.7 million in the year-earlier period.

Gross margins were 16.7% in the quarter versus 15.1% in the second quarter a year ago. Repair and Maintenance Services gross margins benefited from continued high levels of callout work, particularly in Aboveground Storage Tank.

Operating income and income before income tax expense were $8.5 million in fiscal 2008 compared to $8.6 million and $8.2 million in fiscal 2007.

Table of Contents

Six Months Ended November 30, 2007 Compared to Six Months Ended November 30, 2006

Consolidated

Consolidated revenues were $356.1 million in fiscal 2008, an increase of $62.9 million, or 21.5%, from consolidated revenues of $293.2 million for fiscal 2007. The improvement in consolidated revenues resulted from an increase of $55.0 million in Construction Services revenues combined with growth of $7.9 million in Repair and Maintenance Services revenues.

Consolidated gross profit decreased from $35.2 million in fiscal 2007 to $30.2 million in fiscal 2008. The decline of $5.0 million, or 14.2%, occurred despite the 21.5% growth in revenues due to the Construction Services segment experiencing low gross margins. Consolidated gross margins decreased from 12.0% in fiscal 2007 to 8.5% in fiscal 2008 due to lower margins in the Construction Services segment, which fell to 3.2% in the current fiscal year versus 11.1% in the prior fiscal year. Partially offsetting this decline was an improvement in the Repair and Maintenance Services segment, where the overall gross margin increased from 13.1% in fiscal 2007 to 16.5% in fiscal 2008.

Consolidated SG&A expenses were $19.9 million in fiscal 2008 compared to $16.4 million for fiscal 2007. The increase of $3.5 million was primarily due to employee-related expenses, including higher non-cash SFAS 123(R) expense of $0.9 million and employee severance costs of $0.4 million, and a bad debt charge of $1.0 million caused by the bankruptcy of a customer that is involved in a contract dispute with the Company. SG&A expense as a percentage of revenue remained consistent at 5.6% in both fiscal periods as the 21.5% growth in revenues offset the increase in SG&A expenses.

Interest expense decreased to $0.6 million in fiscal 2008 compared to $1.5 million in fiscal 2007. This decline of $0.9 million was primarily due to reduced amortization of prepaid interest on the convertible notes and lower amortization of debt issuance costs. Current year interest expense was primarily related to the amortization of deal fees on the senior revolving credit facility and interest on borrowings under this facility.

Income before income tax expense decreased to $9.8 million in fiscal 2008 from $17.6 million in fiscal 2007. The $7.8 million decrease was due to lower gross margins realized in the Construction Services segment combined with increased SG&A expenses partially offset by improved gross profit in the Repair and Maintenance Services segment and a decline in interest expense.

The effective tax rates for fiscal 2008 and fiscal 2007 were 32.9% and 37.1%, respectively. The fiscal 2008 tax rate was reduced due to a $0.7 million tax benefit resulting from the continuing assessment of the realizability of state investment tax credits. The fiscal 2007 reduced rate was impacted by the utilization of losses on disputed contracts, the tax benefits of which had been reserved as a valuation allowance in previous years.

Net income for fiscal 2008 fell to $6.5 million, or $0.24 per fully diluted share, versus net income in fiscal 2007 of $11.1 million, or $0.43 per fully diluted share.

Construction Services

Revenues for the Construction Services segment were $215.1 million, compared with $160.1 million for the six months ending November 30, 2006. The increase was primarily due to higher construction work in Downstream Petroleum, where revenues for the six month period increased 82.3% to $73.1 million versus $40.1 million for the same six month period last year. The increase was also driven by higher Aboveground Storage Tank revenues, which increased 28.0% to $97.8 million in the recent six month period, versus $76.4 million a year earlier, and by higher Specialty revenues, which gained 15.4% to $36.8 million in the recent six month period compared to $31.9 million a year earlier. These increases were partially offset by a decline of $4.4 million in Electrical and Instrumentation revenues.

Gross profit decreased from $17.8 million in fiscal 2007 to $6.8 million in fiscal 2008 while gross margins dropped from 11.1% in fiscal 2007 to 3.2% in fiscal 2008. This decline of $11.0 million was a result of $17.5 million of pre-tax charges for cost overruns related to a LNG construction project in the Gulf Coast Region. The additional cost overruns were primarily attributable to higher craft turnover and continued productivity and construction-related issues on an increasingly compressed schedule for the remaining portions of the project, similar to those previously disclosed. Our remaining Construction Services projects are experiencing higher margins than those recognized in the prior fiscal period.

Table of Contents

Operating loss and loss before income tax expense were $5.3 million and $5.7 million, respectively, in fiscal 2008 versus operating income and income before income tax expense of $8.9 million and $8.2 million in fiscal 2007.

Repair and Maintenance Services

Revenues for Repair and Maintenance Services rose $7.9 million, or 5.9%, to $141.0 million, for the six month period ending November 30, 2007, from $133.1 million for the six month period ending November 30, 2006. The increase was primarily due to significantly higher Aboveground Storage Tank revenues, which rose 43.6% to $86.0 million, versus $59.9 million for the same six month period last year. These increases were partially offset by lower Downstream Petroleum revenues, which fell 24.3% to $47.3 million in the six month period from $62.5 million in the same six month period last year, and by Electrical and Instrumentation revenues, which fell 29.0% to $7.6 million in the six month period from $10.7 million in the same six month period last year.

Gross margins improved to 16.5% in fiscal 2008 as compared to gross margins of 13.1% in fiscal 2007. Repair and Maintenance Services gross margins benefited from continued high levels of callout work, particularly in our Aboveground Storage Tank segment.

Operating income and income before income tax expense climbed to $15.5 million and $15.4 million, respectively, in fiscal 2008 compared to $9.9 million and $9.5 million produced in fiscal 2007. This improvement resulted from higher revenues and improved margins.

Table of Contents

Backlog

We define backlog as the total dollar amount of revenues that we expect to recognize as a result of performing work that has been awarded to us through a signed contract that we consider firm. We have historically included estimated revenues on our fixed price contracts and certain cost plus contracts in backlog; however, we had included only a small portion of our time and material contract expected revenues because we had taken a conservative approach regarding what constituted a firm contract.

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

- fixed-price arrangements;
- minimum customer commitments on cost plus arrangements; and
- certain time and material contracts in which the estimated contract value is firm or can be estimated with a reasonable amount of certainty in both timing and amounts.

The following provides a rollforward of our backlog for the three-months ended November 30, 2007:

	Construction Services	Repair and Maintenance Services (In thousands)	Total
Backlog as of August 31, 2007	$ 384,284	$ 114,959	$ 499,243
New backlog awarded	104,625	77,165	181,790
Revenue recognized on contracts in backlog	(116,273)	(78,461)	(194,734)
Backlog as of November 30, 2007	$ 372,636	$ 113,663	$ 486,299

At November 30, 2007, the Construction Services segment had a backlog of $372.6 million, as compared to $384.3 million as of August 31, 2007. The decrease in backlog of $11.7 million relates to a decrease of $5.2 million in Specialty, a decrease of $4.1 million in Downstream Petroleum, a decrease of $1.9 million in Electrical and Instrumentation and a decrease of $0.5 million in Aboveground Storage Tanks. The backlog at November 30, 2007 and August 31, 2007 for the Repair and Maintenance Services segment was $113.7 million and $115.0 million, respectively. The decrease in backlog of $1.3 million includes a decrease in Aboveground Storage Tanks of $5.7 million partially offset by an increase of $3.7 million in Downstream Petroleum and an increase of $0.7 million in Electrical and Instrumentation.

Table of Contents

The following provides a rollforward of our backlog for the six-months ended November 30, 2007:

	Construction Services	Repair and Maintenance Services	Total
		(In thousands)	
Backlog as of May 31, 2007	$ 313,837	$ 42,566	$ 356,403
Impact of change in method	35,417	68,210	103,627
New backlog awarded	238,434	143,896	382,330
Revenue recognized on contracts in backlog	(215,052)	(141,009)	(356,061)
Backlog as of November 30, 2007	$ 372,636	$ 113,663	$ 486,299

At November 30, 2007, the Construction Services segment had backlog of $372.6 million, as compared to backlog of $349.3 million as of May 31, 2007. The increase in backlog of $23.3 million relates to an increase of $43.7 million in Aboveground Storage Tank, $6.8 million in Downstream Petroleum, and $0.3 million for Electrical and Instrumentation. These increases were partially offset by a decrease of $27.5 million in Specialty. The backlog at November 30, 2007 and May 31, 2007 for the Repair and Maintenance Services segment were $113.7 million and $110.8 million, respectively. The increase in backlog of $2.9 million includes an increase in Downstream Petroleum of $2.3 million, an increase in Electrical and Instrumentation of $0.4 million and an increase of $0.2 million in Aboveground Storage Tanks.

Table of Contents

Non-GAAP Financial Measure

EBITDA is a supplemental, non-GAAP financial measure. EBITDA is defined as earnings before net interest expense, income taxes, depreciation and amortization. We have presented EBITDA because it is used by the financial community as a method of measuring our performance and of evaluating the market value of companies considered to be in similar businesses. We believe that the line item on our consolidated statements of operations entitled "net income" is the most directly comparable GAAP measure to EBITDA. Since EBITDA is not a measure of performance calculated in accordance with GAAP, it should not be considered in isolation of, or as a substitute for, net earnings as an indicator of operating performance. EBITDA, as we calculate it, may not be comparable to similarly titled measures employed by other companies. In addition, this measure is not necessarily a measure of our ability to fund our cash needs. As EBITDA excludes certain financial information compared with net income, the most directly comparable GAAP financial measure, users of this financial information should consider the type of events and transactions that are excluded. Our non-GAAP performance measure, EBITDA, has certain material limitations as follows:

It does not include interest expense. Because we have borrowed money to finance our operations, interest expense is a necessary and ongoing part of our costs and has assisted us in generating revenue. Therefore, any measure that excludes interest expense has material limitations.

It does not include income taxes. Because the payment of income taxes is a necessary and ongoing part of our operations, any measure that excludes income taxes has material limitations.

It does not include depreciation and amortization expense. Because we use capital assets to generate revenue, depreciation and amortization expense is a necessary element of our cost structure. Therefore, any measure that excludes depreciation and amortization expense has material limitations.

EBITDA for the three and six-month periods ended November 30, 2007 was $1.5 million and $14.1 million respectively, compared to EBITDA of $14.9 million and $22.1 million for the three and six-month periods ended November 30, 2006. A reconciliation of EBITDA to net income follows:

	Three Months Ended November 30,		Six Months Ended	
	November 30, 2007	2006	November 30, 2007	November 30, 2006
	(In thousands)		(In thousands)	
Net income	$ 210	$ 8,074	$ 6,546	$ 11,082
Interest expense, net	258	730	546	1,447
Provision (benefit) for income taxes	(1,016)	4,547	3,208	6,549
Depreciation and amortization	2,039	1,573	3,813	3,031
EBITDA	$ 1,491	$ 14,924	$ 14,113	$ 22,109

Table of Contents

Financial Condition & Liquidity

Overview

We define liquidity as the ongoing ability to pay our liabilities as they become due, fund business operations and meet all monetary contractual obligations. Our primary sources of liquidity in the first six months of fiscal 2008 were cash flows from operations and borrowings under our senior revolving credit facility. At November 30, 2007, cash on hand totaled $6.2 million and availability under the senior revolving credit facility totaled $63.4 million resulting in total liquidity of $69.6 million.

Factors that routinely impact our short-term liquidity include, but are not limited to:

- Changes in working capital
- Contract terms that determine the timing of billings to customers and the collection of those billings
  - Some cost plus and fixed price customer contracts are billed based on milestones which may require us to incur significant expenditures prior to collections from our customers.
  - Time and material contracts are normally billed in arrears. Therefore, we are routinely required to carry these costs until they can be billed and collected.
  - Some of our large construction projects require retentions.
- Significant capital expenditures

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

Cash Flows from Operating Activities

Operations generated $2.2 million in cash in the first six months of fiscal 2008. The cash generated from operations was due primarily to profitable operating results partially offset by an unfavorable increase in working capital. The unfavorable change in working capital primarily relates to an increase in receivables of $29.9 million and a decrease in accrued expenses of $5.2 million partially offset by an increase in accounts payable of $9.8 million and an increase in billings in excess of $17.8 million. The fluctuations are primarily due to the following:

- Receivables The increase is primarily due to the timing of billings and increased operating activity. Our receivable aging continues to be favorable and we do not expect significant collection problems.
- Accrued expenses The decrease in the balance was primarily caused by the payment of fiscal 2007 incentives in fiscal 2008.

Accounts payable The increase is primarily due to higher expenditures associated with the increased level of revenue in the first six months of fiscal 2008 as compared to the last six months in fiscal 2007.

Billings in excess The increase is mainly due to increased operating activity and the timing of billings on our projects.

-30-

Table of Contents

Cash Flows from Investing Activities

Investing activities used $8.1 million in cash in the first six months of fiscal 2008. This was due to capital expenditures of $8.3 million partially offset by proceeds from asset sales of $0.2 million. Capital expenditures included $4.5 million for the purchase of construction equipment, $1.4 million for transportation equipment, $1.1 million for furniture and fixtures, and $1.3 million for land and buildings. We also routinely acquire assets utilizing capital leases. Assets acquired through capital leases totaled $0.2 million in the first six months of fiscal 2008 and are reported as non-cash additions to Property, Plant and Equipment.

At November 30, 2007, expected remaining spending on capital projects that have been approved but are not yet completed total $6.8 million.

The fiscal 2008 capital budget of $31.1 million, which was approved at the beginning of fiscal 2008, included $13.4 million of capital to replace equipment, $12.6 million of capital to increase fabrication capacity and to equip additional construction and maintenance crews in targeted growth markets, and $5.1 million of capital to purchase, expand or improve facilities to address the Company s need for additional office and shop space. Although we do not currently anticipate any significant change to our fiscal 2008 capital budget, we are currently monitoring the cash impact of the LNG Construction Project and, if warranted, our fiscal 2008 capital budget will be adjusted downward. Any deferral of capital expenditures is not expected to significantly impact our fiscal 2008 results or limit our future opportunities.

Cash Flows from Financing Activities

Financing activities provided $2.8 million in cash in the first six months of fiscal 2008 primarily due to borrowings of $3.3 million partially offset by capital lease payments of $0.4 million and treasury stock purchases of $0.7 million related to the statutory tax withholding on the net share settlement provisions on deferred share issuances.

Senior Revolving Credit Facility

The senior revolving credit facility is primarily used to fund short-term changes in working capital and issuance of letters of credit. The total capacity of the facility at November 30, 2007 was $75.0 million with borrowings of $3.3 million and $8.4 million outstanding for letters of credit that have been issued to support certain workers compensation insurance programs and to secure the final payment under the acquisition note payable. Availability under our senior credit facility is as follows:

	November 30, 2007	**May 31, 2007**
	(In thousands)	
Senior credit facility - revolver	$ 75,000	$ 75,000
Amounts borrowed	3,250	
Letters of credit	8,395	8,575
Availability under senior credit facility	$ 63,355	$ 66,425

The facility contains customary negative covenants including limits on other indebtedness, operating and capital lease obligations, asset sales, dividends and certain other distributions. The facility also contains financial covenants that require us to maintain certain financial ratios, which could reduce availability under the facility in future periods. We are currently in compliance with all covenants and have full availability under the facility.

Acquisition Payable

As part of an acquisition in fiscal 2003, we deferred a portion of the purchase price to be paid in annual installments over five years. The final payment of $2.8 million is due on March 7, 2008.

New Operating Lease

On November 16, 2007, the Company entered into an operating lease on a facility that will be used primarily as the corporate headquarters. The lease term is for 89 months and will begin upon occupancy of the facility, which the Company expects to be in the fourth quarter of fiscal 2008. Total minimum lease payments under this arrangement are $4.6 million and will begin 5 months after occupancy.

Dividend Policy

We have never paid cash dividends on our Common Stock. We currently intend to retain earnings to finance the growth and development of our business. Any payment of cash dividends in the future will depend upon our financial condition, capital requirements and earnings as well as other factors the Board of Directors may deem relevant. Our credit agreement limits the amount of cash dividends we can pay.

Stock Repurchase Program

In October 2000, the Board of Directors authorized a stock buyback program, which permitted the purchase of up to 20% (i.e., 3,447,506 shares) of our common stock outstanding at that time. To date, Matrix Service has purchased 2,139,992 shares under the program and has authorization to purchase an additional 1,307,514 shares. The Company repurchased 23,192 common shares during the first six months of fiscal 2008 related to the statutory tax withholding on net share settlement provisions on the issuance of deferred shares. In addition to shares repurchased in conjunction with the issuance of deferred shares, Matrix Service intends to repurchase shares in future periods if accretive to earnings per share. The Company currently has 1,218,518 treasury shares as of November 30, 2007 and intends to utilize these treasury shares solely for the satisfaction of stock issuances under the Company s stock plans.

Outlook

Based upon the results of our LNG project, we will not meet our earlier gross margin guidance. We believe gross margins in the remaining six months of the fiscal year should be in the range of 11.5% to 13.5%, which would include approximately $27 million of additional LNG revenues at zero gross profit. While revenues trended higher in the second quarter, we still believe our original range of $700 million to $750 million is appropriate and SG&A expense should still range between 5.0% and 5.5%.

Table of Contents

FORWARD-LOOKING STATEMENTS

This Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical facts, included in this Form 10-Q which address activities, events or developments which we expect, believe or anticipate will or may occur in the future are forward-looking statements. The words believes, intends, expects, anticipates, projects, estimates, predicts and similar expressions are intended to identify forward-looking statements.

These forward-looking statements may include, among others, such things as:

- amounts and nature of future revenues and margins from our Construction Services segment and Repair and Maintenance Services segment;
- our ability to generate sufficient cash from operations, borrow under our senior revolving credit facility or raise cash in order to meet our short and long-term capital requirements;
- our ability to continue to comply with the financial covenants in our Credit Agreement;
- the adequacy of our reserves for contingencies, disputed contracts and insurance losses;
- the likely impact of new or existing regulations on the demand for our services; and
- expansion and other development trends of the industries we serve.

These statements are based on certain assumptions and analyses we made in light of our experience and our perception of historical trends, current conditions and expected future developments as well as other factors we believe are appropriate in the circumstances. However, whether actual results and developments will conform with our expectations and predictions is subject to a number of risks and uncertainties which could cause actual results to differ materially from our expectations, including:

- the risk factors discussed in our Form 10-K for the fiscal year ended May 31, 2007 and listed from time to time in our filings with the Securities and Exchange Commission;
- our ability to achieve project milestones and earn incentive payments or avoid liquidated damages, especially on our larger contracts;
- general economic, market or business conditions;
- changes in laws or regulations; and
- other factors, most of which are beyond our control.

Consequently, all of the forward-looking statements made in this Form 10-Q are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected consequences to or effects on us or our business or operations. We assume no obligation to update publicly any such forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in market risk faced by us from those reported in our Annual Report on Form 10-K for the fiscal year ended May 31, 2007, filed with the Securities and Exchange Commission. For more information on market risk, see Part II, Item 7A in our fiscal 2007 Annual Report on Form 10-K.

Table of Contents

ITEM 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based on the definition of disclosure controls and procedures in Rule 13a-15(e). In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of November 30, 2007. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There have been no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting during the quarter ended November 30, 2007.

Table of Contents

PART II

OTHER INFORMATION

ITEM 1. Legal Proceedings
For information regarding legal proceedings, see Note 8 in Item 1 of Part 1 of this Quarterly Report on Form 10-Q, which information is incorporated by reference into this Part II, Item 1.

ITEM 1A. Risk Factors
There were no material changes in our Risk Factors from those reported in Item IA. of Part I of our Annual Report on Form 10-K for the fiscal year ended May 31, 2007.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds
Issuer Purchases of Equity Securities

In October 2000, the Board of Directors authorized a stock buyback program, which permitted the purchase of up to 20% (i.e., 3,447,506 shares) of the common stock outstanding at that time. To date, Matrix Service has purchased 2,139,992 shares under the program and has authorization to purchase an additional 1,307,514 shares.

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

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Shares That May Yet Be Purchased Under the Plans or Programs
September 1 30, 2007		$	2,116,800	1,330,706
October 1-31, 2007	2,434	$ 28.96	2,119,234	1,328,272
November 1-30, 2007	20,758	$ 30.32	2,139,992	1,307,514
Total	23,192	$ 30.19		

Dividend Policy

We have never paid cash dividends on our Common Stock. We currently intend to retain earnings to finance the growth and development of our business. Any payment of cash dividends in the future will depend upon our financial condition, capital requirements and earnings as well as other factors the Board of Directors may deem relevant. Our credit agreement limits the amount of cash dividends we can pay.

ITEM 3. Defaults Upon Senior Securities
Not applicable

Table of Contents

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

The Company s annual meeting of stockholders was held in Tulsa, Oklahoma at 10:30 a.m. local time on Monday, October 22, 2007. Proxies for the meeting were solicited pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended. There was no solicitation in opposition to the nominees for election as directors as listed in the proxy statement, and all nominees were elected.

Out of a total of 26,600,751 shares of the Company s common stock outstanding and entitled to vote, 24,557,943 shares were present at the meeting in person or by proxy, representing approximately 92.3 percent. Matters voted upon at the meeting were as follows:

Six directors to serve on the Company s Board of Directors. Messers. Bradley, Hall, Hendrix, Lackey, Maxwell and Tippeconnic were elected to serve until the 2008 Annual Meeting. The vote tabulation with respect to each nominee was as follows:

Nominee	For	Authority Withheld
Michael J. Bradley	24,049,630	508,313
Michael J. Hall	23,219,585	1,338,358
I. Edgar (Ed) Hendrix	24,044,382	513,561
Paul K. Lackey	24,032,362	525,581
Tom E. Maxwell	23,084,463	1,473,480
David J. Tippeconnic	24,043,982	513,961

Ratified the appointment of Deloitte & Touche, LLP as the Company s independent registered public accounting firm for fiscal 2008.

Number of Votes Cast			
For	Against	Abstain	Broker Non-Votes
24,478,160	75,917	3,866	

ITEM 5. Other Information

Not applicable

ITEM 6. Exhibits:

Exhibit 3	By-laws, as amended (previously filed as Exhibit 3 to the Company s Current Report on Form 8-K filed on December 4, 2007, and incorporated by reference herein).
Exhibit 31.1:	Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002 CEO.
Exhibit 31.2:	Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002 CFO.
Exhibit 32.1:	Certification Pursuant to 18 U.S.C. 1350 (section 906 of Sarbanes-Oxley Act of 2002) CEO.
Exhibit 32.2:	Certification Pursuant to 18 U.S.C. 1350 (section 906 of Sarbanes-Oxley Act of 2002) CFO.

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MATRIX SERVICE COMPANY

Date: January 11, 2008

By: George L. Austin
George L. Austin Vice President-Finance and Chief Financial Officer signing on behalf of the registrant and as the registrant's chief accounting officer.

Table of Contents

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