UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended February 28, 2007

or

¨ Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the transition period from ______ to ______

Commission File number 001-15461

MATRIX SERVICE COMPANY

(Exact name of registrant as specified in its charter)

DELAWARE	**73-1352174**
(State of incorporation)	**(I.R.S. Employer Identification No.)**

10701 E. Ute St., Tulsa, Oklahoma 74116-1517

(Address of principal executive offices and zip code)

Registrant s telephone number, including area code: (918) 838-8822

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

As of April 4, 2007, there were 25,751,059 shares of the Company s common stock, $0.01 par value per share, issued and 24,266,473 shares outstanding.

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PART I

FINANCIAL INFORMATION

ITEM 1. Financial Statements

Matrix Service Company

Consolidated Statements of Operations

(In thousands, except share and per share data)

	Three Months Ended February 28, 2007	Three Months Ended February 28, 2006	Nine Months Ended February 28, 2007	Nine Months Ended February 28, 2006
	(unaudited)		(unaudited)	
Revenues	$ 168,700	$ 119,575	$ 461,925	$ 355,349
Cost of revenues	149,776	107,910	407,792	320,542
Gross profit	18,924	11,665	54,133	34,807
Selling, general and administrative expenses	8,253	7,048	24,640	21,742
Impairment and abandonment costs				70
Restructuring		236	46	603
Operating income	10,671	4,381	29,447	12,392
Other income (expense):				
Interest expense	(475)	(1,537)	(1,980)	(6,952)
Interest income	79	46	137	55
Other	(24)	4	278	1,572
Income before income taxes	10,251	2,894	27,882	7,067
Provision for federal, state and foreign income taxes	4,101	1,123	10,650	2,753
Net income	$ 6,150	$ 1,771	$ 17,232	$ 4,314
Basic earnings per common share	$ 0.27	$ 0.09	$ 0.76	$ 0.22
Diluted earnings per common share	$ 0.24	$ 0.08	$ 0.67	$ 0.21
Weighted average common shares outstanding:				
Basic	23,103,367	20,805,535	22,532,996	19,245,130
Diluted	26,787,536	26,560,079	26,622,944	25,442,564

See accompanying notes.

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Matrix Service Company

Consolidated Balance Sheets

(In thousands)

	February 28, 2007 (unaudited)	May 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 7,002	$ 8,585
Receivables, less allowances (February 28, 2007 $217 and May 31, 2006 $190)	89,522	64,061
Contract disputes receivable	975	11,668
Costs and estimated earnings in excess of billings on uncompleted contracts	38,992	24,538
Prepaid expenses	3,496	5,581
Inventories	5,980	4,738
Income tax receivable		104
Deferred income taxes	783	2,831
Assets held for sale	809	809
Total current assets	147,559	122,915
Property, plant and equipment at cost:		
Land and buildings	23,205	23,100
Construction equipment	37,009	31,081
Transportation equipment	12,939	10,921
Furniture and fixtures	9,400	8,658
Construction in progress	2,854	2,392
	85,407	76,152
Accumulated depreciation	(42,319)	(38,712)
	43,088	37,440
Goodwill	23,302	23,442
Other assets	7,303	4,479
Total assets	$ 221,252	$ 188,276

See accompanying notes.

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Matrix Service Company

Consolidated Balance Sheets

(In thousands, except share data)

	February 28, 2007 (unaudited)	May 31, 2006
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 44,307	$ 47,123
Billings on uncompleted contracts in excess of costs and estimated earnings	23,115	12,078
Accrued insurance	5,372	6,408
Other accrued expenses	17,457	12,436
Income tax payable	1,432	
Current capital lease obligation	499	406
Current portion of acquisition payable	1,878	1,808
Total current liabilities	94,060	80,259
Deferred income taxes	3,451	3,502
Long-term capital lease obligation	435	538
Long-term acquisition payable	2,678	2,578
Convertible notes	15,000	25,000
Stockholders equity:		
Common stock $.01 par value; 60,000,000 shares authorized; 24,686,782 and 22,595,243 shares issued as of February 28, 2007 and May 31, 2006	247	226
Additional paid-in capital	87,532	75,855
Retained earnings	21,512	4,316
Accumulated other comprehensive income	403	814
	109,694	81,211
Less: Treasury stock, at cost 1,486,586 and 1,731,386 shares as of February 28, 2007 and May 31, 2006	(4,066)	(4,812)
Total stockholders equity	105,628	76,399
Total liabilities and stockholders equity	$ 221,252	$ 188,276

See accompanying notes.

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Matrix Service Company

Consolidated Statements of Cash Flows

(In thousands)

	Nine Months Ended February 28, 2007	Nine Months Ended February 28, 2006
	(unaudited)	
Operating activities:		
Net income	$ 17,232	$ 4,314
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	4,695	4,292
Impairment loss		70
Deferred income tax	1,997	1,888
Gain on sale of property, plant and equipment	(139)	(1,570)
Allowance for uncollectible accounts	39	470
Stock-based compensation expense	947	
Accretion on acquisition payable	170	213
Amortization of debt issuance costs	303	2,572
Amortization of prepaid interest	910	1,454
Changes in operating assets and liabilities increasing (decreasing) cash		
Receivables	(14,807)	12,439
Costs and estimated earnings in excess of billings on uncompleted contracts	(14,454)	1,762
Inventories	(1,242)	(554)
Prepaid expenses and other assets	(2,702)	328
Accounts payable	(3,415)	(6,679)
Billings on uncompleted contracts in excess of costs and estimated earnings	11,037	5,689
Accrued expenses	3,985	(2,123)
Income tax receivable/payable	1,536	1,469
Other		(3)
Net cash provided by operating activities	6,092	26,031
Investing activities:		
Acquisition of property, plant and equipment	(9,436)	(3,291)
Proceeds from asset sales	217	6,956
Net cash provided (used) by investing activities	$ (9,219)	$ 3,665

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Matrix Service Company

Consolidated Statements of Cash Flows (continued)

(In thousands)

	Nine Months Ended February 28, 2007 (unaudited)	Nine Months Ended February 28, 2006 (unaudited)
Financing activities:		
Advances under bank credit facility	$ 98,345	$ 102,586
Repayments of bank credit facility	(98,345)	(145,265)
Payment of credit facility refinancing fees	(145)	(930)
Capital lease payments	(408)	(301)
Issuances of common stock	1,210	15,282
Repayment of acquisition payable		(382)
Tax benefit of exercised stock options	1,131	
Net cash provided (used) by financing activities	1,788	(29,010)
Effect of exchange rate changes on cash	(244)	253
Net increase (decrease) in cash and cash equivalents	(1,583)	939
Cash and cash equivalents, beginning of period	8,585	1,496
Cash and cash equivalents, end of period	$ 7,002	$ 2,435
Supplemental disclosure of cash flow information:		
Net cash (paid) received during the period for:		
Income taxes	$ (5,982)	$ 623
Interest	$ (613)	$ (2,879)
Non-cash investing and financing activities:		
Equipment acquired through capital leases	$ 397	$
Purchases of property, plant and equipment on account	$ 1,310	$
Conversion of convertible notes	$ 10,000	$ 5,000

See accompanying notes.

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Matrix Service Company

Consolidated Statements of Changes in Stockholders Equity

(In thousands, except share data)

(unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Treasury Stock	Accumulated Other Comprehensive Income (Loss) Translation	Accumulated Other Comprehensive Income (Loss) Derivative	Total
Balances, May 31, 2006	$ 226	$ 75,855	$ 4,316	$ (4,812)	$ 814	$	$ 76,399
Net income			17,232				17,232
Other comprehensive income							
Translation adjustment					(411)		(411)
Comprehensive income							16,821
Conversion of convertible notes (2,091,539 shares)	21	9,099					9,120
Exercise of stock options (244,800 shares)		500	(36)	746			1,210
Stock based compensation expense		947					947
Tax benefit of exercised stock options		1,131					1,131
Balances, February 28, 2007	$ 247	$ 87,532	$ 21,512	$ (4,066)	$ 403	$	$ 105,628
Balances, May 31, 2005	$ 193	$ 56,322	$ (3,307)	$ (5,201)	$ 44	$ (66)	$ 47,985
Net income			4,314				4,314
Other comprehensive income							
Translation adjustment					568		568
Derivative activity						46	46
Comprehensive income							4,928
Conversion of convertible notes (1,002,275 shares)	10	4,291					4,301
Issuance of additional common stock (2,307,692 shares)	23	14,859					14,882
Exercise of stock options (129,164 shares)		74	(27)	353			400
Tax benefit of exercised stock options		263					263
Balances, February 28, 2006	$ 226	$ 75,809	$ 980	$ (4,848)	$ 612	$ (20)	$ 72,759

See accompanying notes.

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, 2006, 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.

New Accounting Standards

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements in accordance with FAS 109, Accounting for Income Taxes . FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The requirements of FIN 48 are effective for our fiscal year beginning June 1, 2007. We are in the process of evaluating this guidance and therefore have not yet determined the impact that FIN 48 will have on our financial statements upon adoption.

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, providing guidance on the methods used to estimate fair value and expanding disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and is generally applied prospectively. We have not yet assessed the impact of SFAS No. 157 on our financial statements.

Note 2 Stock Based Compensation

Accounting for Stock Based Compensation

Prior to June 1, 2006, the Company accounted for stock options granted under its stock-based compensation plans (Plans) pursuant to the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, as permitted by FASB Statement No. 123, Accounting for Stock-Based Compensation (SFAS No. 123). Therefore, compensation cost for stock options was not recognized in the Consolidated Statements of Operations for the three and nine months ended February 28, 2006, as all options granted under the Plans had an exercise price equal to the market value of the underlying common stock on the date of the grant. Effective June 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), using the modified-prospective method. Under this method, compensation cost is recognized for all share-based awards over the requisite service period. Results for prior periods have not been restated. Total stock-based compensation expense for the three and nine months ended February 28, 2007 was $0.5 million and $0.9 million, respectively. Measured but unrecognized stock-based compensation expense at February 28, 2007 was $5.1 million, which is expected to be recognized as expense over a weighted average period of 2.3 years.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

As a result of adopting SFAS No. 123(R), the Company s net income for the three and nine months ended February 28, 2007 was $0.3 million and $0.7 million, respectively, lower than if the Company had continued to account for share-based compensation under APB No. 25. Basic and diluted earnings per share were $0.01 and $0.03 per share lower for the three and nine months ended February 28, 2007, respectively, due to implementation of SFAS No. 123(R).

The following table illustrates the pro forma effect on net income and earnings per share for the three and nine months ended February 28, 2006 as if the Company had applied the fair value provisions of SFAS No. 123:

	Three Months Ended		Nine Months Ended	
	February 28, 2006		February 28, 2006	
	(In thousands, except per share amounts)			
Net Income as reported	$	1,771	$	4,314
Pro forma compensation expense from stock options, net of tax effects		(145)		(388)
Pro forma net income	$	1,626	$	3,926
Earnings per common share as reported:				
Basic	$	0.09	$	0.22
Diluted	$	0.08	$	0.21
Pro Forma Earnings per common share:				
Basic	$	0.08	$	0.20
Diluted	$	0.07	$	0.19

Plan Information

The Company s 1990 Incentive Stock Option Plan (the 1990 Plan), 1991 Incentive Stock Option Plan (the 1991 Plan), and 2004 Stock Incentive Plan (the 2004 Plan) provide incentives for officers and other key employees of the Company. The Company also had a 1995 Nonemployee Directors Stock Option Plan (the 1995 Plan). Under the 2004 Plan, incentive and non-qualified stock options may be granted to the Company s key employees and non-qualified stock options may be granted to nonemployees who are elected for the first time as directors of the Company after January 1, 1991. Shareholders have authorized an aggregate of 1,800,000 options, 2,640,000 options, 500,000 options and 1,200,000 options to be granted under the 1990, 1991, 1995 and 2004 Plans, respectively.

On October 23, 2006, the stockholders of the company approved an amendment to the 2004 Plan that expanded the type of awards that can be issued to include restricted stock, restricted stock units, stock appreciation rights and performance shares. The Company also terminated the 1995 Plan. The termination of the 1995 Plan did not effect options outstanding at the time of termination. At February 28, 2007, there were approximately 784,000 shares available for grant under the 2004 Plan. There were no shares available for grant under either the 1990 or 1991 Plans.

Stock Options

Stock options are valued at the date of award and compensation cost is recognized on a straight-line basis, net of estimated forfeitures, over the requisite service period. Employee stock options generally vest annually, in equal increments, over a five-year period beginning one year after the grant date. Options previously granted to non-employee directors generally vest annually, in equal installments, over a two-year period beginning one year after the grant date. Under all stock option plans, options cannot be granted for periods in excess of ten years. The option price per share may not be less than the fair market value of the common stock at the time the option is granted. The Company s policy is to issue shares upon the exercise of stock options from its treasury shares, if available.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

The following summary reflects stock option activity and related information for the nine-month period ended February 28, 2007:

Stock Options	Options	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Aggregate Intrinsic Value (In thousands)
Outstanding at May 31, 2006	1,111,800		$ 6.66	
Granted				
Exercised	(244,800)		$ 4.94	$ 2,790
Cancelled	(8,000)		$ 7.24	
Outstanding at February 28, 2007	859,000	6.8	$ 7.14	$ 9,269
Vested or expected to vest at February 28, 2007	815,249	6.7	$ 7.10	$ 8,833
Exercisable at February 28, 2007	446,260	5.8	$ 6.38	$ 5,154

The Company uses the Black-Scholes option pricing model to estimate grant date fair value for each stock option granted. Expected volatility is based on the historic volatility of the Company s stock. The risk-free rate is based on the applicable U.S. Treasury Note rate. The expected life of the option is based on historical and expected future exercise behavior.

The fair value of shares which became fully vested during the nine month period ended February 28, 2007 was approximately $1.4 million. There were no shares that vested for the three months ended February 28, 2007.

The following summary provides additional information about stock options that are outstanding and exercisable at February 28, 2007:

Range of Exercise Prices	Stock Options Outstanding Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Stock Options Exercisable Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)
$ 2.13 - $ 2.41	113,300	$ 2.24	2.7	113,300	$ 2.24	2.7
3.03 - 3.70	96,700	3.45	5.3	77,300	3.39	5.2
4.08 - 5.49	244,600	4.66	7.8	86,500	4.46	7.8

8.93 - 12.20	404,400	10.90	7.6	169,160	11.50	7.1
$ 2.13 - $ 12.20	859,000	$ 7.14	6.8	446,260	$ 6.38	5.8

Nonvested Deferred Shares

Subsequent to the approval of amendments to the 2004 Plan, the Company issued 263,130 nonvested deferred shares. A portion of the shares awarded to employees vest after three years if certain performance conditions are satisfied and the remaining shares generally vest in five equal annual installments beginning one year after the grant. All shares awarded to non-employee directors vest after three years if certain performance conditions are satisfied. Based on the actual performance as measured against the performance criteria, the performance-based portion of the actual award can range from zero to one hundred percent of the original award grant.

Deferred shares are valued at market value on the grant date. Deferred share expense, net of estimated forfeitures, is generally recognized over the vesting period on a straight-line basis.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

The following summary reflects nonvested deferred share activity and related information for the nine months ended February 28, 2007:

Deferred Shares	Shares	Weighted Average Grant Date Fair Value
Nonvested shares at May 31, 2006		$
Granted	263,130	14.79
Vested		
Nonvested shares at February 28, 2007	263,130	$ 14.79

Note 3 Restructuring and Management Plans

On March 28, 2005, the Company initiated a restructuring program focused on reducing the cost structure, improving operating results, and improving liquidity. The Company refocused on its core strengths and eliminated unprofitable and marginal work in under-performing areas. As a result of this effort, the Company identified certain assets for disposition including selected transportation and rigging assets, the aluminum floating roof business as well as excess facilities and/or land in Tulsa, Oklahoma; Orange, California; and Holmes, Pennsylvania. The details of asset dispositions are further discussed in Note 4. Matrix Service also ceased work on a number of large routine maintenance contracts that were utilizing valuable resources while providing minimal returns. The Company has substantially completed its restructuring program including the issuance of convertible notes (discussed in Note 5), completion of a private placement of common stock (discussed in Note 6) and refinancing of its senior credit facility (discussed in Note 5).

Restructuring activities other than asset sales and debt refinancing of the Company for the nine months ended February 28, 2007 and February 28, 2006 consisted of the following:

	Employee Severance Benefits	Consulting Fees	Other Costs	Total
		(In thousands)		
Liability balance at May 31, 2006	$	$	$ 559	$ 559
Charge to income			46	46
Payments			(338)	(338)
Liability balance at February 28, 2007	$	$	$ 267	$ 267
Liability balance at May 31, 2005	$ 892	$ 425	$ 542	$ 1,859
Charge (credit) to income	(20)	237	386	603
Payments	(865)	(662)	(291)	(1,818)

Liability balance at February 28, 2006	$ 7	$	$ 637	$ 644

For the nine months ended February 28, 2007, the Company charged less than $0.1 million of restructuring related costs against earnings and made payments of $0.3 million. The payments relate primarily to workers compensation claims paid in connection with businesses previously disposed of and the final payment due to a former CEO. There were no charges to earnings or payments for the three months ended February 28, 2007.

During fiscal 2006, the Company charged $0.2 million of restructuring related costs against earnings in the third quarter and charged $0.6 million in the nine month period. These restructuring charges were primarily related to additional professional fees incurred in connection with the restructuring activities, restructuring incentives and costs incurred to shut down a fabrication facility. Restructuring charges related to specific operating activities are reflected in the applicable segment in Note 12. Other restructuring charges are allocated based on percentage of revenue. Payments of approximately $0.6 million were made during the three months ended February 28, 2006 and payments for the nine months ended February 28, 2006 totaled $1.8 million.

Restructuring liabilities are included in other accrued expenses in the Company s Consolidated Balance Sheets.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 4 Property Sales and Assets Held for Sale

As part of the Company s restructuring efforts discussed in Note 3, certain assets have been sold or identified for sale.

Asset Sales

In the first quarter of fiscal 2006, the Company sold a fabrication facility in Tulsa, Oklahoma which was no longer being utilized, for $0.7 million, which was equal to the book value of the asset. The asset was previously classified as held for sale.

In addition, in the first quarter of fiscal 2006 the Company sold excess construction equipment for net proceeds of $1.7 million, including $0.2 million for services subsequently provided.

In the second quarter of fiscal 2006, the Company sold a fabrication facility and land in Holmes, Pennsylvania for $0.7 million. The asset was previously classified as held for sale and the sale resulted in a gain of approximately $0.4 million.

Also, in the second quarter of fiscal 2006, the Company completed the sale of the net assets of its Bethlehem, Pennsylvania fabrication facility for $3.5 million, of which $0.5 million was in the form of a 12% promissory note. This sale resulted in a gain of $0.4 million. Principal and interest on the note was payable in equal monthly installments over 60 months beginning in January 2006. In November 2006, the buyer prepaid the remaining deferred obligation of $0.5 million.

In the third quarter of fiscal 2006, the Company sold and subsequently leased-back its corporate facility. The net proceeds from the sale were $0.7 million. No gain or loss was recognized on the sale, as the facility was previously impaired $0.1 million in the second quarter of fiscal 2006 to adjust the carrying value of the facility to the estimated sale proceeds.

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 February 28, 2007 was $0.8 million, which approximates the expected net proceeds from the pending sale. The land is classified as a current asset held for sale in the Consolidated Balance Sheets and is reflected in the Company s Other segment in Note 12.

Note 5 Debt

At February 28, 2007 and May 31, 2006, debt consisted of the following:

	February 28, 2007	May 31, 2006
	(In thousands)	
Debt outstanding:		
Senior credit facility revolver	$	$
Convertible notes	15,000	25,000
Total debt	$ 15,000	$ 25,000

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Senior Credit Facility

Effective November 30, 2006, the Company entered into a Second Amended and Restated Credit Agreement (Credit Agreement), which provides for a five-year, $75 million senior revolving credit facility (New Credit Facility). The Company may elect to increase the total capacity under the Credit Agreement up to $100 million, with approval 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 New Credit Facility replaced a $50 million senior revolving credit facility that would have expired in December 2008.

The New 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 and operating and capital lease obligations and restrictions on capital expenditures, 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 the net proceeds from the sale of any equity securities.

At the Company s option, amounts borrowed under the New 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 0.5%. The additional margin ranges from 0.00% to 0.75% on the Alternate Base Rate loans and 1.50% to 2.25% on LIBOR-based loans. Since the closing date, the Company has been at the lowest interest rate tier for LIBOR and Alternate Base Rate loans.

On February 28, 2007, no loans were outstanding under the New Credit Facility; however, the Company had utilized $10.6 million for letters of credit. The remaining $64.4 million is available and subject to an unused fee of 0.25%.

Convertible Debt

In connection with the private placement of $30 million of five-year convertible notes, on April 25, 2005, we entered into a registration rights agreement with the investors in the convertible notes. The registration rights agreement requires us to use our best efforts to keep our registration statement, covering the resale of the shares of our common stock issuable upon conversion of the convertible notes, continuously effective until the earlier of (a) the date on which all of our common stock covered by such registration statement has been sold or may be sold without volume restrictions pursuant to Rule 144(k) under the Securities Act of 1933, as amended, or (b) the fifth anniversary of the closing date. If we fail to satisfy our obligations under the registration rights agreement, we will owe the holders of the convertible notes as partial liquidated damages an amount in cash equal to 1% of the aggregate amount paid for the convertible notes for each such event, and thereafter on each monthly anniversary of each such event (if the applicable failure shall not have been cured by such date) until the applicable failure is cured, we will owe the note holders an amount in cash equal to an additional 1% of the aggregate amount paid for the convertible notes. We believe the likelihood of any payment obligation under the registration rights agreement is remote; therefore, we have not recorded a liability for this potential obligation. In the event we would be required to make payments under this provision, the initial payment and each subsequent monthly payment would be $100,000.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

The convertible notes were issued under a securities purchase agreement among the Company and certain investors, and bear 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. Subsequent to April 25, 2007, the convertible notes will bear interest at a rate of 5% per year if certain conditions defined in the convertible notes are met. Interest is payable in arrears on each March 31, June 30, September 30 and December 31, beginning on June 30, 2007, through the date of maturity. Prepaid interest of $0.2 million is included in prepaid assets at February 28, 2007.

The securities purchase agreement requires us to maintain certain financial ratios. It also limits the amount of senior obligations permitted under the senior credit facility or the refinancing or replacement thereof, including new and replacement letters of credit, to $90 million; limits capital lease obligations to $12.5 million, limits operating leases to $15 million, limits purchase money financing to $1 million and limits debt under the Company s performance and bonding line to $150 million. The Company is currently in compliance with all terms and covenants of the securities purchase agreement.

The notes are 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 and in fiscal 2007, an additional $10.0 million of the convertible notes were converted into 2,091,539 shares. As of February 28, 2007, $15.0 million of the convertible notes remained outstanding. In March 2007, $5.0 million of the remaining $15.0 million of convertible notes were converted into 1,064,277 shares.

Note 6 Private Placement of Common Stock

On October 3, 2005, the Company completed a private placement of approximately 2.3 million shares of common stock. The common stock was priced at $6.50 per share. The net proceeds from the issuance were $14.9 million. The Company used the proceeds to repay a portion of its outstanding balance on the Company s revolving line of credit in order to provide additional liquidity for working capital needs.

In connection with the private placement of common stock, on October 3, 2005, the Company entered into a registration rights agreement with the purchasers of the common stock. The registration rights agreement required us to file a registration statement with respect to the resale of the shares of the common stock issued in the private placement. The registration statement was filed with the SEC on October 20, 2005 and was declared effective by the SEC on October 28, 2005. The registration rights agreement also requires us to use our best efforts to keep the registration statement continuously effective until the earlier of (a) the date on which all of the common stock covered by such registration statement has been sold or may be sold without volume restrictions pursuant to Rule 144(k) under the Securities Act of 1933, as amended, or (b) the fifth anniversary of the date the registration statement is declared effective by the SEC. If we fail to satisfy our obligations under the registration rights agreement, we will owe the holders of the common stock as partial liquidated damages an amount in cash equal to 1% of the aggregate amount paid for the common stock for each such event, and thereafter on each monthly anniversary of each such event (if the applicable failure shall not have been cured by such date) until the applicable failure is cured. We believe the likelihood of any payment obligation under the registration rights agreement is remote; therefore, we have not recorded a liability for this potential obligation. In the event we would be required to make payments under this provision, the initial payment and each subsequent payment would be approximately $150,000 per month and would continue until the failure is cured.

Note 7 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 $4.6 million at February 28, 2007 and is accreted for the change in its present value each period utilizing a 5.1% effective interest rate. In March 2007, the Company made the annual payment due of $1.9 million; the final annual payment of $2.8 million is due in March 2008.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

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 February 28, 2007.

Note 8 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.

Note 9 Contingencies

Insurance Reserves

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

Typically the Company s contracts require an indemnification to 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 the Company and 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 also have to provide additional insurance policies, including surety bonds in favor of the Company, to secure the subcontractors work or as required by the subcontract. Matrix Service maintains performance and payment bonding lines of $90.0 million in aggregate, of which $12.6 million was utilized at February 28, 2007.

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

Legion Insurance Dispute

Matrix Service, as plaintiff, has been in litigation with Mutual Indemnity and Mutual Risk Management Ltd. (Mutual) in the Tulsa County District Court in the State of Oklahoma over matters arising out of a workers compensation program with a former insurance provider, Legion Insurance Company (Legion). These matters involve disputes over a letter of credit (LC) for $2.2 million, a bond for $2.1 million and a deposit of $1.0 million pledged to secure Matrix Service s obligations under this program. As a part of its insurance program, Legion used an offshore insurance company, Mutual. Matrix Service purchased preferred stock in Mutual, which then reinsured part of the workers compensation exposure that was underwritten by Legion.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

On April 1, 2002, the Insurance Commissioner for the State of Pennsylvania placed Legion into rehabilitation. Matrix Service was concerned that the security held by Mutual would be commingled with other shareholder assets and not used exclusively to pay Matrix Service claims. Matrix Service filed suit in the Tulsa County District Court to require a full accounting of all funds held by Mutual and restrain Mutual from drawing on the LC or surety bond. The court granted a temporary restraining order prohibiting the use of such assets for the payment of claims other than Matrix Service claims.

On July 25, 2003, a Pennsylvania court placed Legion into liquidation. At that time, all open workers compensation claims were sent to the various state guaranty funds for handling. Many of the states have denied responsibility with respect to Matrix Service claims because Matrix Service s net worth exceeded the statutory maximum as of December 31, 2002, the year preceding the Legion liquidation, under which claims would be handled by the individual state guaranty funds. Those states returned the claims back to Matrix Service for direct handling. In other states where Matrix Service has exposure, the state guaranty funds took over the claims.

In November 2006, the Company settled and paid its outstanding obligations to Legion resulting from workers compensation claim payments made on Matrix Service s behalf by Legion itself, and by the various state guaranty funds that sought reimbursement from Legion. Since these obligations have been satisfied, Matrix Service will work with Mutual to dismiss the lawsuit, and limit Mutual s security interests. The Company recognized a gain of less than $0.1 million as a result of the settlement with Legion. The Company believes it is adequately reserved for any additional claim payments or settlements with the state guaranty funds.

Refinery Accident

On November 6, 2005, two employees of the Company were fatally injured in an accident that occurred at a customer jobsite in Delaware City, Delaware. The estates of both families have filed liability claims against the property owner. These claims have been tendered by the property owner to the Company for defense. The Company believes that it is adequately reserved or insured for this incident.

Contract Disputes

At May 31, 2006, the Company had recorded net receivables of approximately $11.7 million under four contracts which were in dispute. In fiscal 2007, the Company settled three of the four disputes, comprising $10.7 million of the recorded net receivables, and collected $10.9 million under the settlements resulting in a $0.2 million pre-tax net gain.

At February 28, 2007, the Company has one remaining contract dispute, which has a recorded value of $1.0 million. 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. The Company will proceed with arbitration and expects a full resolution of this matter to occur within the next twelve months. The Company believes it has a valid claim for the amount owed.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Unapproved Change Orders and Claims

As of February 28, 2007, revenue recognized on unapproved change orders was $0.7 million while there was no revenue recognized on claims. At May 31, 2006, 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 $3.8 million and claims of $0.5 million.

Amounts disclosed for unapproved change orders and claims exclude amounts associated with contract disputes discussed previously. 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.

The following table provides a rollforward of revenue recognized on claims and unapproved change orders.

	Claims for Unapproved Change Orders	Other Claims	Total
		(In thousands)	
Balance at May 31, 2006	$ 3,845	$ 523	$ 4,368
Additions	1,014		1,014
Collections	(3,757)	(492)	(4,249)
Loss	(379)	(31)	(410)
Balance at February 28, 2007	$ 723	$	$ 723
Balance at May 31, 2005	$ 208	$ 383	$ 591
Additions	2,968	337	3,305
Collections	(333)	(141)	(474)
Loss	(25)		(25)
Balance at February 28, 2006	$ 2,818	$ 579	$ 3,397

Other

The Company and its subsidiaries are named as defendants in various other legal actions and are vigorously defending against each of them. In the opinion of management, none of such legal actions will have a material effect on the Company s financial position, results of operations or liquidity.

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Notes to Consolidated Financial Statements (continued)

Note 10 Accumulated Other Comprehensive Income

At February 28, 2007, other comprehensive income and accumulated other comprehensive income consists of foreign currency translation adjustments related to operations in Canada. In fiscal 2006, other comprehensive income and accumulated other comprehensive income also included fair value adjustments of derivative instruments.

	Three Months Ended February 28, 2007	Three Months Ended February 28, 2006	Nine Months Ended February 28, 2007	Nine Months Ended February 28, 2006
	(In thousands)		(In thousands)	
Net income	$ 6,150	$ 1,771	$ 17,232	$ 4,314
Other comprehensive income (loss)	(136)	171	(411)	614
Comprehensive income	$ 6,014	$ 1,942	$ 16,821	$ 4,928

Note 11 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, nonvested deferred shares and 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. 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. Stock options, nonvested deferred shares, and convertible debt are considered antidilutive in the event of a net loss.

Nonvested deferred shares that vest based on performance conditions are included in diluted EPS at the beginning of the reporting period in which the performance conditions are satisfied. The treasury stock method is applied to determine the dilutive impact of nonvested deferred shares that vest based on the duration of service periods.

There were 33,092 antidilutive options for the nine month period ending February 28, 2007 and there were no antidilutive options for the three month period ending February 28, 2007. Antidilutive options for the three and nine month periods ending February 28, 2006 were 253,307 and 336,990, respectively. These options were not included in the calculation of diluted earnings per share.

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

The computation of basic and diluted EPS is as follows:

	Three Months Ended February 28, 2007	Three Months Ended February 28, 2006	Nine Months Ended February 28, 2007	Nine Months Ended February 28, 2006
	(In thousands, except share and per share data)			
Basic EPS:				
Net income	$ 6,150	$ 1,771	$ 17,232	$ 4,314
Weighted average shares Outstanding	23,103,367	20,805,535	22,532,996	19,245,130
Basic EPS	$ 0.27	$ 0.09	$ 0.76	$ 0.22
Diluted EPS:				
Net income	$ 6,150	$ 1,771	$ 17,232	$ 4,314
Convertible notes interest expense (net of tax)	179	297	621	993
Adjusted net income	$ 6,329	$ 2,068	$ 17,853	$ 5,307
Weighted average shares outstanding basic	23,103,367	20,805,535	22,532,996	19,245,130
Dilutive stock options	445,832	424,054	386,836	376,867
Dilutive nonvested deferred shares	40,043		4,962	
Dilutive convertible note shares	3,198,294	5,330,490	3,698,150	5,820,567
Dilutive weighted average shares	26,787,536	26,560,079	26,622,944	25,442,564
Diluted EPS	$ 0.24	$ 0.08	$ 0.67	$ 0.21

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Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 12 Segment Information

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

The Construction Services segment provides turnkey construction, civil construction, structural steel erection, mechanical installation, process piping, electrical and instrumentation, fabrication, vessel and boiler erection, millwrighting, plant modifications, centerline turbine erection, and startup and commissioning. In addition, design, engineering, fabrication and construction of aboveground storage tanks are offered.

The Repair and Maintenance Services segment provides outage and turnaround services, plant maintenance, electrical and instrumentation maintenance, tank inspection, repair and maintenance, industrial cleaning, and American Society of Mechanical Engineers (ASME) code repairs.

Other consists of items related to previously disposed of businesses and unallocated 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 included in the Company s Annual Report on Form 10-K for the year ended May 31, 2006. Intersegment sales and transfers are recorded at cost and there is no intercompany profit or loss on intersegment sales or transfers.

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

Restructuring charges are reflected in the applicable segment. Other restructuring, impairment and abandonment charges are allocated to the Construction Services and Repair and Maintenance Services segments based on each segment s percentage of total revenue.

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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 February 28, 2007				
Gross revenues	$ 106,174	$ 65,730	$	$ 171,904
Less: Inter-segment revenues	2,853	351		3,204
Consolidated revenues	103,321	65,379		168,700
Gross profit	10,752	8,172		18,924
Operating income	6,221	4,450		10,671
Income before income tax expense	5,987	4,264		10,251
Net income	3,595	2,555		6,150
Segment assets	121,022	78,762	21,468	221,252
Capital expenditures	1,121	988	550	2,659
Depreciation and amortization expense	981	683		1,664
Three Months ended February 28, 2006				
Gross revenues	$ 56,995	$ 65,375	$	$ 122,370
Less: Inter-segment revenues	2,746	49		2,795
Consolidated revenues	54,249	65,326		119,575
Gross profit	3,882	7,783		11,665
Operating income (loss)	1,223	3,258	(100)	4,381
Income (loss) before income tax expense	261	2,733	(100)	2,894
Net income (loss)	163	1,670	(62)	1,771
Segment assets	84,982	62,311	28,204	175,497
Capital expenditures	1,294	306	467	2,067
Depreciation and amortization expense	705	723		1,428
Nine Months ended February 28, 2007				
Gross revenues	$ 271,036	$ 199,541	$	$ 470,577
Less: Inter-segment revenues	7,603	1,049		8,652
Consolidated revenues	263,433	198,492		