MATRIX SERVICE CO
Form 10-Q
February 09, 2017

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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 December 31, 2016

or
o Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the transition period from to

Commission File No. 1-15461

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

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

5100 East Skelly Drive, Suite 500, Tulsa, Oklahoma 74135
(Address of principal executive offices and zip code)
Registrant’s telephone number, including area code: (918) 838-8822
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Inter Active Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “accelerated filer”, “large accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ý
Non-accelerated filer o	Smaller reporting company ¨

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

As of February 7, 2017 there were 27,888,217 shares of the Company’s common stock, $0.01 par value per share, issued and 26,593,791 shares outstanding.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
Matrix Service Company
Condensed Consolidated Statements of Income
(In thousands, except per share data)
(unaudited)

	Three Months Ended		Six Months Ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Revenues	$312,655	$ 323,529	$654,436	$ 642,860
Cost of revenues	284,443	293,524	593,946	578,271
Gross profit	28,212	30,005	60,490	64,589
Selling, general and administrative expenses	19,975	25,070	37,952	44,553
Operating income	8,237	4,935	22,538	20,036
Other income (expense):				
Interest expense	(497)	(252)	(740)	(515)
Interest income	26	60	38	91
Other	47	(148)	54	(202)
Income before income tax expense	7,813	4,595	21,890	19,410
Provision for federal, state and foreign income taxes	2,563	1,477	7,298	6,553
Net income	5,250	3,118	14,592	12,857
Less: Net loss attributable to noncontrolling interest	—	(2,313)	—	(2,515)
Net income attributable to Matrix Service Company	$5,250	$ 5,431	$14,592	$ 15,372
Basic earnings per common share	$0.20	$ 0.20	$0.55	$ 0.58
Diluted earnings per common share	$0.20	$ 0.20	$0.54	$ 0.56
Weighted average common shares outstanding:				
Basic	26,553	26,721	26,470	26,598
Diluted	26,832	27,248	26,842	27,229

See accompanying notes.

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

	Three Months Ended		Six Months Ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Net income	$5,250	$ 3,118	$14,592	$ 12,857
Other comprehensive loss, net of tax:				
Foreign currency translation loss (net of tax of $69 and $106 for the three and six months ended December 31, 2016, respectively, and $204 and $384 for the three and six months ended December 31, 2015, respectively)	(1,718)	(1,366)	(1,997)	(3,815)
Comprehensive income	3,532	1,752	12,595	9,042
Less: Comprehensive loss attributable to noncontrolling interest	—	(2,313)	—	(2,515)
Comprehensive income attributable to Matrix Service Company	$3,532	$ 4,065	$12,595	$ 11,557

See accompanying notes.

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

	December 31, 2016	June 30, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 66,230	$71,656
Accounts receivable, less allowances (December 31, 2016— $8,313 and June 30, 2016—$8,443)	248,712	190,434
Costs and estimated earnings in excess of billings on uncompleted contracts	80,296	104,001
Inventories	4,194	3,935
Income taxes receivable	486	9
Other current assets	8,318	5,411
Total current assets	408,236	375,446
Property, plant and equipment at cost:		
Land and buildings	39,348	39,224
Construction equipment	91,587	90,386
Transportation equipment	48,254	49,046
Office equipment and software	34,946	29,577
Construction in progress	4,563	7,475
Total property, plant and equipment - at cost	218,698	215,708
Accumulated depreciation	(137,414)	(130,977)
Property, plant and equipment - net	81,284	84,731
Goodwill	113,019	78,293
Other intangible assets	29,351	20,999
Deferred income taxes	2,512	3,719
Other assets	1,388	1,779
Total assets	$ 635,790	$564,967

See accompanying notes.

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

	December 31, 2016	June 30, 2016
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$ 108,260	$ 141,445
Billings on uncompleted contracts in excess of costs and estimated earnings	74,858	58,327
Accrued wages and benefits	21,162	27,716
Accrued insurance	9,171	9,246
Income taxes payable	1,293	2,675
Other accrued expenses	15,539	6,621
Total current liabilities	230,283	246,030
Deferred income taxes	2,855	3,198
Borrowings under senior revolving credit facility	72,412	—
Other liabilities	411	173
Total liabilities	305,961	249,401
Commitments and contingencies		
Stockholders’ equity:		
Matrix Service Company stockholders' equity:		
Common stock—$.01 par value; 60,000,000 shares authorized; 27,888,217 shares issued as of December 31, 2016, and June 30, 2016; 26,588,643 and 26,297,145 shares outstanding as of December 31, 2016 and June 30, 2016	279	279
Additional paid-in capital	124,659	127,058
Retained earnings	237,749	223,157
Accumulated other comprehensive loss	(8,842)	(6,845)
	353,845	343,649
Less: Treasury stock, at cost — 1,299,574 shares as of December 31, 2016, and 1,591,072 shares as of June 30, 2016	(22,840)	(26,907)
Total Matrix Service Company stockholders’ equity	331,005	316,742
Noncontrolling interest	(1,176)	(1,176)
Total stockholders' equity	329,829	315,566
Total liabilities and stockholders’ equity	$ 635,790	$ 564,967

See accompanying notes.

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

	Six Months Ended	
	December 31, 2016	December 31, 2015
Operating activities:		
Net income	$14,592	$ 12,857
Adjustments to reconcile net income to net cash used by operating activities, net of effects from acquisitions:		
Depreciation and amortization	9,988	10,720
Deferred income tax	970	1,390
Gain on sale of property, plant and equipment	(131)	(37)
Provision for uncollectible accounts	(34)	5,544
Stock-based compensation expense	3,547	3,509
Other	133	119
Changes in operating assets and liabilities increasing (decreasing) cash, net of effects from acquisitions:		
Accounts receivable	(48,972)	(13,820)
Costs and estimated earnings in excess of billings on uncompleted contracts	24,451	4,328
Inventories	(259)	85
Other assets and liabilities	(3,974)	(8,861)
Accounts payable	(34,276)	(16,743)
Billings on uncompleted contracts in excess of costs and estimated earnings	4,883	17,436
Accrued expenses	(1,826)	(6,840)
Net cash provided (used) by operating activities	(30,908)	9,687
Investing activities:		
Acquisitions (Note 2)	(39,798)	—
Acquisition of property, plant and equipment	(4,208)	(7,516)
Proceeds from asset sales	196	145
Net cash used by investing activities	$(43,810)	$ (7,371)

See accompanying notes.

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

	Six Months Ended	
	December 31, 2016	December 31, 2015
Financing activities:		
Advances under senior revolving credit facility	$102,084	$ 2,753
Repayments of advances under senior revolving credit facility	(29,672)	(4,331)
Payment of debt amendment fees	(168)	—
Issuances of common stock	222	457
Proceeds from issuance of common stock under employee stock purchase plan	169	166
Repurchase of common stock for payment of statutory taxes due on equity-based compensation	(2,270)	(4,488)
Capital contributions from noncontrolling interest	—	8,433
Net cash provided by financing activities	70,365	2,990
Effect of exchange rate changes on cash and cash equivalents	(1,073)	(2,114)
Increase (decrease) in cash and cash equivalents	(5,426)	3,192
Cash and cash equivalents, beginning of period	71,656	79,239
Cash and cash equivalents, end of period	$66,230	$ 82,431
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$8,361	$ 9,112
Interest	$399	$ 521
Non-cash investing and financing activities:		
Purchases of property, plant and equipment on account	$421	$ 726

See accompanying notes.

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

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income(Loss)	Non-Controlling Interest	Total
Balances, July 1, 2016	$ 279	$126,958	$223,257	$(26,907)	$ (6,845)	$ (1,176)	$315,566
Retrospective adjustment upon adoption of ASU 2016-09 (see Note 1)	—	100	(100)	—	—	—	—
Balances, July 1, 2016, as adjusted	279	127,058	223,157	(26,907)	(6,845)	(1,176)	315,566
Net income	—	—	14,592	—	—	—	14,592
Other comprehensive loss	—	—	—	—	(1,997)	—	(1,997)
Treasury shares sold to Employee Stock Purchase Plan (9,577 shares)	—	12	—	157	—	—	169
Exercise of stock options (21,713 shares)	—	(273)	—	495	—	—	222
Issuance of deferred shares (393,530 shares)	—	(5,685)	—	5,685	—	—	—
Treasury shares purchased to satisfy tax withholding obligations (133,322 shares)	—	—	—	(2,270)	—	—	(2,270)
Stock-based compensation expense	—	3,547	—	—	—	—	3,547
Balances, December 31, 2016	$ 279	$124,659	$237,749	$(22,840)	$ (8,842)	$ (1,176)	$329,829
Balances, July 1, 2015	$ 279	$123,038	$194,394	$(18,489)	$ (5,926)	$ (8,742)	$284,554
Capital contributions from noncontrolling interest	—	—	—	—	—	8,433	8,433
Net income (loss)	—	—	15,372	—	—	(2,515)	12,857
Other comprehensive loss	—	—	—	—	(3,815)	—	(3,815)
Treasury shares sold to Employee Stock Purchase Plan (8,382 shares)	—	89	—	77	—	—	166
Exercise of stock options (50,337 shares)	—	(7)	—	464	—	—	457
Issuance of deferred shares (615,395 shares)	—	(5,706)	—	5,706	—	—	—
Treasury shares purchased to satisfy tax withholding obligations (200,019 shares)	—	—	—	(4,488)	—	—	(4,488)
Tax effect of exercised stock options and vesting of deferred	—	3,245	—	—	—	—	3,245

shares							
Stock-based compensation expense	—	3,509	—	—	—	—	3,509
Balances, December 31, 2015	$ 279	$124,168	$209,766	$(16,730)	$ (9,741)	$ (2,824)	$304,918

See accompanying notes.

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

Note 1 – Basis of Presentation and Accounting Policies

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

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with Rule 10-01 of Regulation S-X for interim financial statements required to be filed with the Securities and Exchange Commission and do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. The information furnished reflects all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair statement of the results of operations, cash flows and financial position for the interim periods presented. The accompanying condensed financial statements should be read in conjunction with the audited financial statements for the year ended June 30, 2016, included in the Company’s Annual Report on Form 10-K for the year then ended. The results of operations for the six month period ended December 31, 2016 may not necessarily be indicative of the results of operations for the full year ending June 30, 2017.

Recently Issued Accounting Standards

Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606)

On May 28, 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09. The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that “an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” The ASU also requires entities to disclose both quantitative and qualitative information that enables users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The ASU's disclosure requirements are significantly more comprehensive than those in existing revenue standards. The ASU applies to all contracts with customers except those that are within the scope of other topics in the FASB Accounting Standards Codification ("ASC").

The ASU is effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted on a limited basis. Upon adoption, the Company may elect one of two application methods, a full retrospective application or a modified retrospective application. We expect to adopt this standard on July 1, 2018 and are currently evaluating its expected impact on our financial statements.

Accounting Standards Update 2014-15, Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern

On August 27, 2014, the FASB issued ASU 2014-15, which provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. The new standard requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date of issuance of the entity’s financial statements. Further, an entity must provide certain disclosures if there is “substantial doubt about the entity’s ability to continue as a going concern.” The FASB believes that requiring management to perform the assessment will enhance the timeliness, clarity, and consistency of related disclosures and improve convergence with international financial reporting standards ("IFRSs") (which emphasize management’s responsibility for performing the going-concern assessment). However, the time horizon for the assessment (look-forward period) and the disclosure thresholds under U.S. GAAP and IFRSs will continue to differ. The ASU is effective for annual periods ending after December 15, 2016, and interim periods thereafter; early adoption is

permitted.
The ASU was adopted during the Company's first fiscal quarter ending September 30, 2016. In connection with the adoption of the ASU, the Company now performs an assessment of its ability to continue as a going concern on a quarterly basis. Disclosure regarding the status of the Company's ability to continue as a going concern is required when there are conditions or events that raise substantial doubt about its ability to continue as a going concern within one year after the date that the financial statements are issued.

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

Accounting Standards Update 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments

On September 25, 2015, the FASB issued ASU 2015-16 to simplify the accounting for measurement-period adjustments. The ASU was issued in response to stakeholder feedback that restatements of prior periods to reflect adjustments made to provisional amounts recognized in a business combination increase the cost and complexity of financial reporting but do not significantly improve the usefulness of the information. Under the ASU, an acquirer must recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The ASU also requires acquirers to present separately on the face of the income statement, or disclose in the notes, the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. For public business entities, the ASU is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. We adopted this standard on July 1, 2016 with no material impact to the Company's financial statements.

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

On February 25, 2016, the FASB issued ASU 2016-02. The amendments in this update require, among other things, that lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Lessees and lessors must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. For public business entities, the ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We are currently evaluating the ASU's expected impact on our financial statements.

Accounting Standards Update 2016-09, Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting

On March 30, 2016, the FASB issued ASU 2016-09, which simplified several aspects of accounting for stock-based compensation transactions, including the accounting for income taxes and forfeitures and statutory tax withholding requirements. The ASU is effective for the Company on July 1, 2017 and early adoption is permitted. The Company adopted the ASU during its first fiscal quarter ending September 30, 2016. The following is a description of the key provisions of the ASU and their impacts to the Company's financial statements:

Accounting for Income Taxes: The amendments require the Company to recognize excess tax benefits or tax deficiencies in its provision for income taxes in its consolidated statements of income during the period of vesting or exercise of its nonvested deferred share awards and stock options, respectively, for which it expects to receive an income tax deduction. Previously, the Company recognized any excess tax benefits in additional paid-in capital ("APIC") in the balance sheet and any tax deficiencies were recognized as a reduction of APIC to the extent the Company has accumulated excess tax benefits. Any tax deficiencies in excess of accumulated excess tax benefits in APIC were recognized in the provision for income taxes. The amendments also require the Company to only present excess tax benefits and tax deficiencies in the operating section of its statements of cash flows as a component of deferred tax activity. Previously, the Company was required to present such items in both the financing section and operating section of its statements of cash flows. Amendments related to the recognition of excess tax benefits and tax deficiencies in income are required to be applied prospectively, and amendments related to the cash flow statement presentation of excess tax benefits and tax deficiencies may be applied either retrospectively or prospectively.

The Company applied the amendments requiring the recognition of excess tax benefits and tax deficiencies in income prospectively. As a result, the Company recognized $0.1 million and $0.5 million of excess tax benefits in its

provision for income taxes during the three and six months ended December 31, 2016, respectively, which increased basic and diluted earnings per share by $0.01 and $0.02, respectively. Under the prior accounting standard, the Company would have recognized the excess tax benefits in equity as additional paid-in capital. The amendments relating to the presentation of excess tax benefits and tax deficiencies in the statement of cash flows were applied retrospectively. The effect of the retrospective adjustment was to eliminate the presentation of an operating cash outflow and a financing cash inflow for excess tax benefits on exercised stock options and vesting of deferred shares. These eliminations increased net cash provided by operating activities by $3.2 million and decreased net cash provided by financing activities by $3.2 million for the six months ended December 31, 2015. Net cash flows did not change as a result of the retrospective adjustment.

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

Accounting for Forfeitures: The amendments in this ASU allow the Company to elect, as a company-wide accounting policy, either to continue to estimate the amount of forfeitures to exclude from compensation expense or to exclude forfeitures from compensation expense as they occur. Upon the adoption of the ASU during the first quarter of fiscal 2017, the Company elected to account for forfeitures as they occur. The Company is required to apply these amendments on a modified retrospective basis with a cumulative adjustment to retained earnings as of the beginning of the fiscal year. The Company recorded a modified retrospective adjustment to reduce the June 30, 2016 retained earnings balance and increase the additional paid-in capital balance by $0.1 million each.

Statutory Tax Withholding Requirements: Under the prior accounting standard, an entire award must be classified as a liability if the fair value of the shares withheld exceeds the Company's minimum statutory withholding obligation. Under the ASU, the Company is allowed to withhold shares with a fair value up to the amount of tax owed using the maximum statutory tax rate in the employee's applicable jurisdictions. The Company is allowed to determine one maximum rate for all employees in each jurisdiction, rather than a rate for each employee in the jurisdiction. Also, the ASU requires that cash outflows to reacquire shares withheld for taxes to be classified in the financing section of the statement of cash flows.

The Company adopted the ASU during the first quarter of fiscal 2017. Since the Company did not have any awards classified as liabilities due to statutory tax withholding requirements as of December 31, 2016, and since the Company already presented its cash outflows for reacquiring shares withheld for taxes as a financing activity in its statements of cash flows, these amendments did not have any impact on its financial statements upon adoption. The Company does not expect changes to employee withholdings for stock compensation to have a material impact to the financial statements.

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

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

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

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

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Note 2 – Acquisitions

Purchase of Houston Interests, LLC

On December 12, 2016, the Company completed the acquisition of Houston Interests, LLC ("Houston Interests"), a premier global solutions company that provides consulting, engineering, design, construction services and systems integration. Houston Interests brings expertise to the Company in natural gas processing; sulfur recovery, processing and handling; liquid terminals, silos and other bulk storage; process plant design; power generation environmental controls and material handling; industrial power distribution; electrical, instrumentation and controls; marine structures; material handling systems and terminals for cement, sulfur, fertilizer, coal and grain; and process heaters. The business has been included in our Matrix PDM Engineering, Inc. subsidiary, and its operating results have been allocated between the Oil Gas & Chemical and Industrial segments.

The Company purchased all of the equity interests of Houston Interests for $39.8 million in cash, net of working capital adjustments and cash acquired. The consideration paid is as follows (in thousands):

Cash paid for equity interest	$46,000
Cash paid for working capital	4,129
Less: cash acquired	(10,331)
Net purchase price	$39,798

The Company funded the equity interest portion of the consideration paid from borrowings under the Company's senior secured revolving credit facility (See Note 5). The remaining consideration was paid with cash on hand.

The net purchase price was allocated to the major categories of assets and liabilities based on their estimated fair value at the acquisition date.

The following table summarizes the preliminary net purchase price allocation (in thousands):

Current assets	$20,803
Property, plant and equipment	942
Goodwill	35,028
Other intangible assets	10,220
Total assets acquired	66,993
Current liabilities	16,674
Other liabilities	190
Net assets acquired	50,129
Cash	10,331
Net purchase price	$39,798

The goodwill recognized from the acquisition is primarily attributable to the technical expertise of the acquired workforce and the complementary nature of Houston Interests' operations, which the Company believes will enable the combined entity to expand its service offerings and enter new markets. All of the goodwill recognized is deductible for income tax purposes. The fair value of the net assets acquired is preliminary pending the final valuation of those assets. As a result, goodwill is also preliminary since it has been recorded as the excess of the purchase price over the estimated fair value of the net assets acquired.

The Company has agreed to pay the previous owners up to $2.6 million for any unused portion of acquired warranty obligations outstanding as of June 30, 2017. In addition, the sellers have agreed to reimburse the Company for any warranty costs incurred in connection with the acquired warranties in excess of $2.6 million. All acquired warranties will expire by June 30, 2017. Any amounts paid to or received from the seller will be accounted for as a working capital adjustment, which will be reflected as a change to the net purchase price. None of the acquired warranties have expired as of December 31, 2016.

The Company incurred $0.4 million of expenses related to closing the acquisition during the three and six months ended December 31, 2016, which were included within selling, general and administrative expenses in the consolidated statements of income. The acquired business contributed revenues of $2.3 million and an operating loss

of $0.2 million during the three and six months ended December 31, 2016.

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The unaudited financial information in the table below summarizes the combined results of operations of Matrix Service Company and Houston Interests for the three and six months ended December 31, 2016 and 2015, on a pro forma basis, as though the companies had been combined as of July 1, 2015. The pro forma financial information presented in the table below is for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at July 1, 2015 nor should it be taken as indicative of future consolidated results of operations.

	Three Months Ended		Six Months Ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
	(In thousands, except per share data)			
Revenues	$329,523	$ 357,975	$690,485	$ 712,158
Net income attributable to Matrix Service Company	$7,884	$ 9,445	$18,763	$ 17,928
Basic earnings per common share	$0.30	$ 0.35	$0.71	$ 0.68
Diluted earnings per common share	$0.29	$ 0.35	$0.70	$ 0.67

The pro forma financial information presented in the table above includes the following adjustments to the combined entities' historical financial statements:

- The combined entities recorded approximately $3.0 million of acquisition and integration expenses during the three and six months ended December 31, 2016, which were transferred in the pro forma earnings to the six months ended December 31, 2015 in order to report them as if they were incurred on July 1, 2015. Pro forma earnings were adjusted to include integration expenses that would have been recognized had the acquisition occurred on July 1, 2015 of $0.4 million and $0.8 million during the three and six months ended December 31, 2016, respectively, and $0.3 million and $0.5 million during the three and six months ended December 31, 2015, respectively.
- Interest expense for the combined entities was increased by $0.3 million and $0.7 million during each of the three and six months ended December 31, 2016 and 2015, respectively. The increase was attributable to the assumption that the Company's borrowings of $46.0 million used to fund a portion of the net purchase price had been outstanding as of July 1, 2015. This increase was partially offset by the assumption that Houston Interests' former debt was extinguished as of July 1, 2015.
- Depreciation and intangible asset amortization expense for the combined entities was reduced by $0.2 million and $0.3 million during the three and six months ended December 31, 2016, respectively, and was increased by $0.5 million and $0.9 million during the three and six months ended December 31, 2015, respectively. These adjustments are primarily due to the recognition of amortizable intangible assets as part of the acquisition and the effect of fair value adjustments to acquired property, plant and equipment.
- Pro forma earnings were adjusted to include additional income tax expense of $1.9 million and $3.3 million during the three and six months ended December 31, 2016, respectively, and $2.5 million and $2.1 million during the three and six months ended December 31, 2015, respectively. Houston Interests was previously an exempt entity and income taxes were not assessed in its historical financial information.

Purchase of Baillie Tank Equipment, Ltd.

On February 1, 2016, the Company completed the acquisition of all outstanding stock of Baillie Tank Equipment, Ltd. (“BTE”), an internationally-based company with nearly 20 years of experience in the design and manufacture of products for use on aboveground storage tanks. Founded in 1998, BTE is a provider of tank products including geodesic domes, aluminum internal floating roofs, floating suction and skimmer systems, roof drain systems, and seals. BTE is headquartered in Sydney, Australia with a manufacturing facility in Seoul, South Korea. The Company acquired BTE to expand its service offerings of certain technical solutions for aboveground storage tanks. The business is now known as Matrix Applied Technologies, and its operating results are included in the Storage Solutions segment.

The Company purchased BTE with cash on-hand for a net purchase price of $13.0 million. The Company paid $15.4 million when including the subsequent repayment of long-term debt acquired and the settlement of certain other liabilities acquired, and excluding the cash acquired and certain amounts owed to the former owners for working capital adjustments. The net purchase price was allocated to the major categories of assets and liabilities based on their estimated fair value at the acquisition date.

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The following table summarizes the final purchase price allocation (in thousands):

Current assets	$5,574
Property, plant and equipment	4,347
Goodwill	7,030
Other intangible assets	720
Other assets	233
Total assets acquired	17,904
Current liabilities	1,669
Deferred income taxes	329
Long-term debt	1,858
Other liabilities	407
Net assets acquired	13,641
Cash acquired	592
Net purchase price	$13,049

The goodwill recognized from the acquisition is attributable to the synergies of combining our operations and the technical expertise of the acquired workforce. None of the goodwill recognized is deductible for income tax purposes. The Company incurred $0.8 million of expenses related to the acquisition during fiscal 2016, which were included within selling, general and administrative expenses in the consolidated statements of income. The acquired business contributed revenues of $1.8 million and $2.8 million during the three and six months ended December 31, 2016, respectively, and contributed operating income of $0.7 million and $0.3 million during the three and six months ended December 31, 2016.

Note 3 – Uncompleted Contracts

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

	December 31, 2016	June 30, 2016
	(in thousands)	
Costs incurred and estimated earnings recognized on uncompleted contracts	$1,983,345	$1,875,014
Billings on uncompleted contracts	1,977,907	1,829,340
	$5,438	$45,674
Shown in balance sheet as:		
Costs and estimated earnings in excess of billings on uncompleted contracts	$80,296	$104,001
Billings on uncompleted contracts in excess of costs and estimated earnings	74,858	58,327
	$5,438	$45,674

Progress billings in accounts receivable at December 31, 2016 and June 30, 2016 included retentions to be collected within one year of $51.4 million and $29.7 million, respectively. Contract retentions collectible beyond one year are included in other assets in the condensed consolidated balance sheet and totaled $0.3 million as of June 30, 2016. There were no retentions collectible beyond one year as of December 31, 2016.

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Other
Under percentage of completion accounting for fixed-priced contracts, contract revenues and earnings are recognized ratably over the contract term based on the proportion of actual costs incurred to total estimated costs. As of December 31, 2016, the Company is performing work on two previously announced significant multi-year projects that are contracted on a fixed price basis. The first project is expected to complete in fiscal 2017 and revenue will continue to decline as this project nears completion. The second project is expected to be completed in fiscal 2018. On the project that is expected to be completed in fiscal 2018, the Company executed a change order in the second quarter that settled the claims outstanding on the effective date of the change order, updated the project schedule, and increased the contract value to allow for the recovery of increased costs. The settlement resulted in a second quarter reduction in earnings related to adjusting the gross profit margin and the percent complete on the project due to the increased project size. In addition, the change order contained provisions that require the achievement of defined schedule milestones to earn a portion of the additional contract value. At December 31, 2016, the Company's schedule assessment indicates that it is probable that these schedule milestones will be achieved. Although this change order reduced the financial risk inherent in this project, it is possible that future changes in contract estimates, including those related to project costs, project timeline, and future change orders or claims, could occur and have a material positive or negative impact to our results of operations and financial position in subsequent accounting periods.

Note 4 – Intangible Assets Including Goodwill

Goodwill

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

	Electrical Infrastructure	Oil Gas & Chemical	Storage Solutions	Industrial	Total
	(In thousands)				
Net balance at June 30, 2016	$42,170	$14,008	$16,681	$5,434	$78,293
Purchase of Houston Interests (Note 2)	—	28,723	—	6,305	35,028
Purchase price adjustment for BTE (Note 2)	—	—	88	—	88
Translation adjustment (1)	(227)	—	(121)	(42)	(390)
Net balance at December 31, 2016	$41,943	$42,731	$16,648	$11,697	$113,019

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

The Company performed its annual goodwill impairment test as of May 31, 2016, which did not indicate the existence of any impairment at that time. While the operating results for the Oil Gas & Chemical and Industrial segments indicated a loss for the three and six months ended December 31, 2016, the Company does not consider these results to be a triggering event requiring the performance of an interim goodwill impairment test since the fundamentals of the industries driving these segments has not significantly deteriorated since the annual test was performed. The Company continues to consider these segments as core to its business and believes current operating results are not indicative of future performance. The Company will continue to monitor its operating results for indicators of impairment and perform additional tests as necessary.

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Other Intangible Assets

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

	At December 31, 2016			
	Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
		(In thousands)		
Intellectual property	9 to 15	$2,579	$ (1,336)	$ 1,243
Customer-based	1 to 15	38,057	(10,914)	27,143
Non-compete agreements	4 to 5	1,453	(1,192)	261
Trade names	1 to 5	1,795	(1,091)	704
Total amortizing intangible assets		$43,884	$ (14,533)	$ 29,351

	At June 30, 2016			
	Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
		(In thousands)		
Intellectual property	9 to 15	$2,579	$ (1,246)	$ 1,333
Customer-based	1.5 to 15	28,179	(9,655)	18,524
Non-compete agreements	4 to 5	1,453	(1,102)	351
Trade names	3 to 5	1,615	(824)	791
Total amortizing intangible assets		$33,826	$ (12,827)	$ 20,999

The increase in the gross carrying amount of other intangible assets at December 31, 2016 compared to June 30, 2016 is primarily due to the December 12, 2016 acquisition of Houston Interests (See Note 2). The specifically identifiable intangible assets recognized in the Houston Interests acquisition consist of:

- customer-based intangibles with a fair value of $10.0 million and useful life of between 1 and 9 years; and
- trade name with a fair value of $0.2 million and useful life of 1 year.

Amortization expense totaled $1.0 million and $1.8 million during the three and six months ended December 31, 2016, respectively, and $0.8 million and $1.6 million during the three and six months ended December 31, 2015, respectively. The Company recognized $0.1 million of amortization expense during the three and six months ended December 31, 2016 for intangible assets recorded as part of the Houston Interests acquisition.

We estimate that the remaining amortization expense at December 31, 2016 will be as follows (in thousands):

Period ending:	
Remainder of Fiscal 2017	$3,100
Fiscal 2018	4,757
Fiscal 2019	3,482
Fiscal 2020	3,472
Fiscal 2021	3,454
Fiscal 2022	2,615
Thereafter	8,471
Total estimated remaining amortization expense at December 31, 2016	$29,351

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Note 5 – Debt

On December 12, 2016, the Company amended its credit agreement, under which it has a senior secured revolving credit facility (the "Credit Agreement"). The amendments are as follows:

- The aggregate revolving loan capacity increased from $200.0 million to $250.0 million.
- The maximum aggregate amount, or sublimit, for Canadian Dollar loans was increased from U.S. $40.0 million to U.S. $50.0 million.
- During any "Acquisition Adjustment Period", as defined in the amended credit agreement, the Company's Senior Leverage Ratio, as defined in the amended credit agreement, may not exceed 3.00 to 1.00. At all other times, the Senior Leverage Ratio may not exceed 2.50 to 1.00.

The Credit Agreement includes a Senior Leverage Ratio covenant - which provides that Consolidated Funded Indebtedness, as of the end of any fiscal quarter, may not exceed 3.0 times Consolidated EBITDA, as defined in the Credit Agreement, during any Acquisition Adjustment Period and may not exceed 2.5 times Consolidated EBITDA at all other times, over the previous four quarters. For the four quarters ended December 31, 2016, Consolidated EBITDA was $84.0 million. Consolidated Funded Indebtedness at December 31, 2016 was $80.0 million.

Availability under the senior revolving credit facility at December 31, 2016 was as follows:

	December 31, 2016	June 30, 2016
	(In thousands)	
Senior revolving credit facility	$250,000	$200,000
Capacity constraint due to the Senior Leverage Ratio	—	20,138
Capacity under the credit facility	250,000	179,862
Borrowings outstanding	72,412	—
Letters of credit	15,378	20,755
Availability under the senior revolving credit facility	$162,210	$159,107

Outstanding borrowings at December 31, 2016 under our Credit Agreement were primarily used to fund the acquisition of Houston Interests (See Note 2) and working capital needs in our Canadian business due to the timing of collections and disbursements on the previously announced power generating project.

At December 31, 2016, the Company was in compliance with all affirmative, negative, and financial covenants under the Credit Agreement.

Subsequent Event

On February 8, 2017, the Company entered into the Fourth Amended and Restated Credit Agreement (the "New Credit Agreement"), by and among the Company and certain foreign subsidiaries, as Borrowers, various subsidiaries of the Company, as Guarantors, JPMorgan Chase Bank, N.A., as Administrative Agent, Sole Lead Arranger and Sole Bookrunner, and the other Lenders party thereto, which replaced the Third Amended and Restated Credit Agreement dated as of November 7, 2011, as previously amended (the "Prior Credit Agreement").

The New Credit Agreement provides for a five-year senior secured revolving credit facility of $300.0 million that expires February 8, 2022, which replaces the $250.0 million senior secured revolving credit facility under the Prior Credit Agreement. The new credit facility may be used for working capital, acquisitions, capital expenditures, issuances of letters of credit and other lawful purposes.

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The New Credit Agreement includes the following covenants and borrowing limitations:

- Our Leverage Ratio, determined as of the end of each fiscal quarter, may not exceed 3.00 to 1.00.
- As with the Prior Credit Agreement, we are required to maintain a Fixed Charge Coverage Ratio, determined as of the end of each fiscal quarter, greater than or equal to 1.25 to 1.00.
- Asset dispositions (other than dispositions in which 100% of the net cash proceeds therefrom are reinvested into the Company and dispositions of inventory and obsolete or unneeded equipment in the ordinary course of business) are limited to $20.0 million per 12-month period.

The new credit facility will include a sub-facility for revolving loans denominated in Australian Dollars, Canadian Dollars, Euros and Pounds Sterling in an aggregate amount not to exceed the U.S. Dollar equivalent of $75.0 million and a $200.0 million sublimit for letters of credit. Each revolving borrowing under the New Credit Agreement will bear interest at a rate per annum equal to:

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

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

The unused credit facility fee is between 0.20% and 0.45% based on the Leverage Ratio.

Note 6 – Income Taxes

We use the asset and liability approach for financial accounting and reporting for income taxes. Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances based on our judgments and estimates are established when necessary to reduce deferred tax assets to the amount expected to be realized in future operating results. Company management believes that realization of deferred tax assets in excess of the valuation allowance is more likely than not. Our estimates are based on facts and circumstances in existence as well as interpretations of existing tax regulations and laws applied to the facts and circumstances.

The Company provides for income taxes regardless of whether it has received a tax assessment. Taxes are provided when it is considered probable that additional taxes will be due in excess of amounts included in the tax return. The Company regularly reviews exposure to additional income taxes due, and as further information is known or events occur, adjustments may be recorded.

Our effective tax rate for the three and six months ended December 31, 2016 was 32.8% and 33.3%, respectively, compared to 32.1% and 33.8% in the same periods a year earlier. The Company recorded discrete benefits of $0.3 million and $0.5 million during the three and six months ended December 31, 2016, respectively, and recorded $0.9 million and $1.4 million of discrete benefits during the three and six months ended December 31, 2015, respectively. The fiscal 2017 discrete benefits primarily relate to the application of ASU 2016-09 (See Note 1) and the fiscal 2016 tax rate was positively impacted by a discrete item related to the retroactive application of the R&D tax credit and a foreign currency item related to our Canadian operations.

Note 7 – Commitments and Contingencies

Insurance Reserves

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

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Typically our contracts require us to indemnify our customers for injury, damage or loss arising from the performance of our services and provide warranties for materials and workmanship. The Company may also be required to name the customer as an additional insured up to the limits of insurance available, or we may be required to purchase special insurance policies or surety bonds for specific customers or provide letters of credit in lieu of bonds to satisfy performance and financial guarantees on some projects. Matrix maintains a performance and payment bonding line sufficient to support the business. The Company generally requires its subcontractors to indemnify the Company and the Company's customer and name the Company as an additional insured for activities arising out of the subcontractors' work. We also require certain subcontractors to provide additional insurance policies, including surety bonds in favor of the Company, to secure the subcontractors' work or as required by the subcontract.
There can be no assurance that our insurance and the additional insurance coverage provided by our subcontractors will fully protect us against a valid claim or loss under the contracts with our customers.

Unapproved Change Orders and Claims

Costs and estimated earnings in excess of billings on uncompleted contracts included revenues for unapproved change orders and claims of $14.4 million at December 31, 2016 and $10.3 million at June 30, 2016. Generally, collection of amounts related to unapproved change orders and claims is expected within twelve months. However, since customers may not pay these amounts until final resolution of related claims, collection of these amounts may extend beyond one year.

Other

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

Note 8 – Earnings per Common Share

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

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

	Three Months Ended		Six Months Ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
	(In thousands, except per share data)			
Basic EPS:				
Net income attributable to Matrix Service Company	$ 5,250	$ 5,431	$ 14,592	$ 15,372
Weighted average shares outstanding	26,553	26,721	26,470	26,598
Basic earnings per share	$ 0.20	$ 0.20	$ 0.55	$ 0.58
Diluted EPS:				
Weighted average shares outstanding – basic	26,553	26,721	26,470	26,598
Dilutive stock options	55	76	53	81
Dilutive nonvested deferred shares	224	451	319	550
Diluted weighted average shares	26,832	27,248	26,842	27,229
Diluted earnings per share	$ 0.20	$ 0.20	$ 0.54	$ 0.56

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

Three Months Ended	Six Months Ended

	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
	(In thousands)			
Nonvested deferred shares	64	86	137	105

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