

Mistras Group, Inc.  
Form 10-Q  
October 14, 2010

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended August 31, 2010

Or

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

For the transition period to

Commission file number 001- 34481

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Mistras Group, Inc.  
(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

22-3341267  
(I.R.S. Employer  
Identification No.)

195 Clarksville Road  
Princeton Junction, New Jersey  
(Address of principal executive offices)

08550  
(Zip Code)

(609) 716-4000  
(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required

to submit and post such files).

Yes  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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a 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

As of October 8, 2010, the registrant had 26,664,254 shares of common stock outstanding.

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## PART I—FINANCIAL INFORMATION

## ITEM 1. Financial Statements (unaudited)

Mistras Group, Inc. and Subsidiaries  
 Unaudited Consolidated Balance Sheets  
 (in thousands, except share and per share data)

	August 31, 2010	May 31, 2010
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 13,855	\$ 16,037
Accounts receivable, net	51,877	54,721
Inventories, net	8,982	8,736
Deferred income taxes	2,272	2,189
Prepaid expenses and other current assets	5,334	5,292
Total current assets	82,320	86,975
Property, plant and equipment, net	40,469	39,981
Intangible assets, net	17,695	16,088
Goodwill	47,622	44,315
Other assets	204	1,273
Total assets	\$ 188,310	\$ 188,632
<b>LIABILITIES, PREFERRED STOCK AND EQUITY</b>		
Current liabilities		
Current portion of long-term debt	\$ 6,579	\$ 6,303
Current portion of capital lease obligations	5,219	5,370
Accounts payable	4,553	4,640
Accrued expenses and other current liabilities	19,263	20,090
Income taxes payable	2,332	3,281
Total current liabilities	37,946	39,684
Long-term debt, net of current portion	6,441	5,691
Obligations under capital leases, net of current portion	8,467	9,199
Deferred income taxes	2,032	2,087
Other long-term liabilities	662	1,417
Total liabilities	55,548	58,078
Commitments and contingencies		
Preferred stock, 10,000,000 shares authorized	—	—
Equity		
Common stock, \$0.01 par value, 200,000,000 shares authorized, 26,664,254 and 26,663,528 shares issued and outstanding as of August 31, 2010 and May 31, 2010, respectively	267	267
Additional paid-in capital	162,783	162,054
Accumulated deficit	(28,856 )	(30,448 )
Accumulated other comprehensive loss	(1,797 )	(1,587 )
Total Mistras Group, Inc. stockholders' equity	132,397	130,286
Noncontrolling interest	365	268
Total equity	132,762	130,554

Total liabilities, preferred stock and equity	\$	188,310	\$	188,632
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The accompanying notes are an integral part of these consolidated financial statements.

Mistras Group, Inc. and Subsidiaries  
 Unaudited Consolidated Statements of Operations  
 (in thousands, except per share data)

	For the three months ended August 31,	
	2010	2009
<b>Revenues:</b>		
Services	\$ 61,252	\$ 51,656
Products	7,158	4,433
Total revenues	68,410	56,089
<b>Cost of Revenues:</b>		
Cost of services	41,391	34,369
Cost of goods sold	3,277	2,099
Depreciation of services	2,809	2,280
Depreciation of products	155	191
Total cost of revenues	47,632	38,939
Gross profit	20,778	17,150
Selling, general and administrative expenses	15,479	13,133
Research and engineering	555	483
Depreciation and amortization	1,178	1,045
Legal reserve	250	(297 )
Income from operations	3,316	2,786
<b>Other expenses</b>		
Interest expense	690	1,064
Loss on extinguishment of long-term debt	—	169
Income before provision for income taxes and noncontrolling interest	2,626	1,553
Provision for income taxes	1,054	694
Net income	1,572	859
Net loss (income) attributable to noncontrolling interests, net of taxes	20	(44 )
Net income attributable to common stockholders	\$ 1,592	\$ 815
<b>Earnings per common share:</b>		
Basic	\$ 0.06	\$ 0.06
Diluted	\$ 0.06	\$ 0.04
<b>Weighted average common shares outstanding:</b>		
Basic	26,664	13,000
Diluted	26,778	20,435

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

Mistras Group, Inc. and Subsidiaries  
 Unaudited Consolidated Statement of Stockholders' Equity  
 (in thousands)

	Common Stock		Additional paid-in capital	Retained earnings (accumulated deficit)	Accumulated other comprehensive loss	Noncontrolling Interest	Total	Comprehensive income (loss)
	Shares	Amount						
Balance at May 31, 2010	26,664	\$ 267	\$ 162,054	\$ (30,448 )	\$ (1,587 )	\$ 268	\$ 130,554	\$
Net income (loss)	—	—	—	1,592	—	(20 )	1,572	1,572
Foreign currency translation adjustment	—	—	—	—	(210 )	—	(210 )	(210 )
Stock compensation	—	—	729	—	—	—	729	—
Noncontrolling interest in subsidiary	—	—	—	—	—	117	117	—
Balance at August 31, 2010	26,664	\$ 267	\$ 162,783	\$ (28,856 )	\$ (1,797 )	\$ 365	\$ 132,762	\$ 1,362

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

Mistras Group, Inc. and Subsidiaries  
 Unaudited Consolidated Statements of Cash Flows  
 (in thousands)

	For the three months ended August 31,	
	2010	2009
Cash flows from operating activities		
Net income attributable to common stockholders	\$ 1,592	\$ 815
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	4,142	3,516
Deferred income taxes	(24 )	—
Provision for doubtful accounts	105	897
Loss on extinguishment of long-term debt	—	169
Gain on sale of assets	(9 )	(29 )
Amortization of deferred financing costs	42	69
Stock compensation expense	729	250
Noncash interest rate swap	89	124
Net (loss) income attributable to noncontrolling interests	(20 )	44
Foreign currency (gain) loss	(17 )	210
Changes in operating assets and liabilities, net of effect of acquisitions		
Accounts receivable	3,140	214
Inventories	(189 )	965
Prepaid expenses and other current assets	(18 )	(436 )
Other assets	937	(575 )
Accounts payable	281	1,154
Income taxes payable	(938 )	452
Accrued expenses and other current liabilities	(1,561 )	(2,356 )
Net cash provided by operating activities	8,281	5,483
Cash flows from investing activities		
Purchase of property, plant and equipment	(1,877 )	(1,375 )
Purchase of intangible assets	(86 )	(85 )
Acquisition of businesses, net of cash acquired	(5,301 )	(14,000 )
Proceeds from sale of equipment	24	102
Net cash used in investing activities	(7,240 )	(15,358 )
Cash flows from financing activities		
Repayment of capital lease obligations	(1,459 )	(1,425 )
Repayments of long-term debt	(1,642 )	(38,009 )
Net borrowings from revolver	—	25,335
Proceeds from borrowings of long-term debt	—	25,000
Debt issuance costs	—	(500 )
Net cash (used in) provided by financing activities	(3,101 )	10,401
Effect of exchange rate changes on cash and cash equivalents		
	(122 )	(159 )
Net change in cash and cash equivalents	(2,182 )	367
Cash and cash equivalents		
Beginning of period	16,037	5,668
End of period	\$ 13,855	\$ 6,035

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Supplemental disclosure of cash paid

Interest	\$ 750	\$ 1,035
Income taxes	\$ 3,530	\$ 185
Noncash investing and financing		
Equipment acquired through capital lease obligations	\$ 583	\$ 1,598
Issuance of notes payable and other debt obligations primarily related to acquisitions	\$ 1,637	\$ 4,412

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

Mistras Group, Inc. and Subsidiaries  
Notes to Unaudited Consolidated Financial Statements  
(tabular dollars in thousands, except per share data)

1. Description of Business & Basis of Presentation

Description of Business

Mistras Group, Inc. and subsidiaries (the “Company”) is a leading “one source” global provider of technology-enabled asset protection solutions used to evaluate the structural integrity of critical energy, industrial and public infrastructure. The Company combines industry-leading products and technologies, expertise in mechanical integrity (MI) and non-destructive testing (NDT) services and proprietary data analysis software to deliver a comprehensive portfolio of customized solutions, ranging from routine inspections to complex, plant-wide asset integrity assessments and management. These mission critical solutions enhance customers’ ability to extend the useful life of their assets, increase productivity, minimize repair costs, comply with governmental safety and environmental regulations, manage risk and avoid catastrophic disasters. Given the role the Company services play in ensuring the safe and efficient operation of infrastructure, the Company has historically provided a majority of its services to its customers on a regular, recurring basis. The Company serves a global customer base of companies with asset-intensive infrastructure, including companies in the oil and gas, fossil and nuclear power, public infrastructure, chemicals, aerospace and defense, transportation, primary metals and metalworking, pharmaceuticals and food processing industry.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended August 31, 2010 are not necessarily indicative of the results that may be expected for the year ending May 31, 2011. The balance sheet at May 31, 2010 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. You should read these unaudited consolidated financial statements together with the historical consolidated financial statements of the Company as filed with the Securities and Exchange Commission.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Mistras Group, Inc. and its wholly or majority-owned subsidiaries: Quality Service Laboratories, Inc., Cismis Springfield Corp., Mistras Group, S.A. (formerly Euro Physical Acoustics, S.A.) and its majority-owned subsidiary, IPS S.A.R.L. (“IPS”), Nippon Physical Acoustics Ltd., Physical Acoustics South America, Diapac Company, Mistras Canada, Inc. and Physical Acoustics Ltd. and its wholly or majority-owned subsidiaries, Physical Acoustics India Private Ltd., Physical Acoustics B.V. and Envirocoustics A.B.E.E. (“Envac”). Where the Company’s ownership interest is less than 100%, the noncontrolling interests are reported in stockholders’ equity in the accompanying consolidated balance sheets. The noncontrolling interest in net income, net of tax, is classified separately in the accompanying consolidated statements of operations.

All significant intercompany accounts and transactions have been eliminated in consolidation. All foreign subsidiaries’ reporting year ends are April 30, while Mistras Group, Inc. and the domestic subsidiaries year ends are May 31. The effect of this difference in timing of reporting foreign operations on the consolidated results of operations and consolidated financial position is not significant.

Reclassification

Certain amounts previously reported in prior periods have been reclassified to conform to the current year presentation. Such reclassifications did not have a material effect on the Company's financial condition or results of operations as previously reported.

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Mistras Group, Inc. and Subsidiaries  
Notes to Unaudited Consolidated Financial Statements  
(tabular dollars in thousands, except per share data)

2. Summary of Significant Accounting Policies

Revenue recognition

Revenue recognition policies for the various sources of revenues are as follows:

Services

The Company predominantly derives revenues by providing its services on a time and material basis and recognizes revenues when services are rendered. At the end of any reporting period, there may be earned but unbilled revenues that are accrued. Payments received in advance of revenue recognition are reflected as deferred revenues.

Software

Revenues from the sale of perpetual licenses are recognized upon the delivery and acceptance of the software. Revenues from term licenses are recognized ratably over the period of the license. Revenues from maintenance, unspecified upgrades and technical support are recognized ratably over the period such items are delivered. For multiple-element arrangement software contracts that include non-software elements, and where the software is essential to the functionality of the non-software elements (collectively referred to as software multiple-element arrangements), the Company applies the rules as noted below.

Products

Revenues from product sales are recognized when risk of loss and title passes to the customer, which is generally upon product delivery. The exceptions to this accounting treatment would be for multiple-element arrangements (described below) or those situations where specialized installation or customer acceptance is required. Payments received in advance of revenue recognition are reflected as deferred revenues.

Percentage of completion

A portion of the Company's revenues are generated from engineering and manufacturing of custom products under long-term contracts that may last from several months to several years, depending on the contract. Revenues from long-term contracts are recognized on the percentage-of-completion method of accounting. Under the percentage-of-completion method of accounting revenues are recognized as work is performed. The percentage of completion at any point in time is based on total costs or total labor dollars incurred to date in relation to the total estimated costs or total labor dollars estimated at completion. The percentage of completion is then applied to the total contract revenue to determine the amount of revenue to be recognized in the period. Application of the percentage-of-completion method of accounting requires the use of estimates of costs to be incurred for the performance of the contract. Contract costs include all direct materials, direct labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and all costs associated with operation of equipment. The cost estimation process is based upon the professional knowledge and experience of the Company's engineers, project managers and financial professionals. Factors that are considered in estimating the work to be completed include the availability and productivity of labor, the nature and complexity of the work to be performed, the effect of change orders, the availability of materials, the effect of any delays in our project performance and the recoverability of any claims. Whenever revisions of estimated contract costs and contract values indicate that the

contract costs will exceed estimated revenues, thus creating a loss, a provision for the total estimated loss is recorded in that period.

#### Multiple-element arrangements

The Company occasionally enters into transactions that represent multiple-element arrangements, which may include any combination of services, software, and hardware. Vendor-specific objective evidence is utilized to determine whether they can be separated into more than one unit of accounting. A multiple-element arrangement is separated into more than one unit of accounting if: (1) the delivered item has value on a standalone basis; and (2) there is objective and reliable evidence of the fair value of the undelivered items if the delivery or performance of the undelivered items is probable and in the control of the Company.

Mistras Group, Inc. and Subsidiaries  
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If these criteria are not met, then revenues are deferred until such criteria are met or until the period(s) over which the last undelivered element is delivered. If there is objective and reliable evidence of fair value for all units of accounting in an arrangement, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative fair value.

#### Use of Estimates

These unaudited consolidated financial statements have been prepared in conformity with GAAP, which requires management to make estimates and assumptions about future events that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The more significant estimates include valuation of goodwill and intangible assets, useful lives of long-lived assets, allowances for doubtful accounts, inventory valuation, reserves for self-insured workers compensation and health benefits and provision for income taxes.

#### Earnings per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the sum of (1) the weighted-average number of shares of common stock outstanding during the period, and (2) the dilutive effect of the assumed exercise of stock options using the treasury stock method. With respect to the number of weighted-average shares outstanding (denominator), diluted shares reflects only the exercise of options to acquire common stock to the extent that the options' exercise prices are less than the average market price of common shares during the period and the pro forma vesting of restricted stock units.

#### Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair market value of net assets of the acquired business at the date of acquisition. The Company tests for impairment annually, in its fiscal fourth quarter, using a two-step process. The first step identifies potential impairment by comparing the fair value of the Company's reporting units to its carrying value. If the fair value is less than the carrying value, the second step measures the amount of impairment, if any. The impairment loss is the amount by which the carrying amount of goodwill exceeds the implied fair value of that goodwill. The most recent annual test for impairment performed for fiscal 2010 did not identify any instances of impairment and there were no events through August 31, 2010 that warranted a reconsideration of our impairment test results.

Intangible assets are recorded at cost. Intangible assets with finite lives are amortized on a straight-line basis over their estimated useful lives.

#### Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. At times, cash deposits may exceed the limits insured by the Federal Deposit Insurance Corporation. The Company believes it is not exposed to any significant credit risk or the risk of nonperformance of the financial institutions.

The Company sells primarily to large companies, extends reasonably short collection terms, performs credit evaluations and does not require collateral. The Company maintains reserves for potential credit losses.

The Company has one major customer with multiple business units that accounted for 18% and 22% of revenues for the three months ended August 31, 2010 and 2009, respectively. Accounts receivable from this customer was approximately 15% and 10% of total accounts receivable, net as of August 31, 2010 and May 31, 2010, respectively.

#### Stock-based compensation

The Company measures the cost of employee services received in exchange for an award of equity instruments based upon the grant-date fair value of the award. The Company uses the “straight-line” attribution method for allocating compensation costs and recognizes the fair value of each stock option on a straight-line basis over the vesting period of the related awards.

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The Company uses the Black-Scholes option-pricing model to estimate the fair value of the stock option awards as of the grant date. The Black-Scholes model, by its design, is highly complex and dependent upon key data inputs estimated by management. The primary data inputs with the greatest degree of judgment are the expected term of stock-based awards and the estimated volatility of the Company's common stock price. The Black-Scholes model is sensitive to changes in these two variables. Since the Company's initial public offering ("IPO"), the expected term of the Company's stock options is generally determined using the mid-point between the vesting period and the end of the contractual term. Expected stock price volatility is typically based on the daily historical trading data for a period equal to the expected term. Because the Company's historical trading data only dates back to October 8, 2009, the first trading date after its IPO, the Company has estimated expected volatility using an analysis of the stock price volatility of comparable peer companies. Prior to the Company's IPO, the exercise price equaled the estimated fair market value of the Company's common stock, as determined by its board of directors. Since the Company's IPO, the exercise price of stock option grants is determined using the closing market price of the Company's common stock on the date of grant.

#### Recent Accounting Pronouncements

In October 2009, the FASB issued guidance on revenue recognition related to multiple-element arrangements. The new guidance requires companies to allocate revenue in multiple-element arrangements based on an element's estimated selling price if vendor-specific or other first party evidence of value is not available. This guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted retrospectively from the beginning of an entity's fiscal year. The Company does not expect a significant impact on the financial statements of the Company when the guidance is adopted in fiscal 2012.

### 3. Capitalization

#### Common Stock

In October 2009, the Company completed its initial public offering of 10,000,000 shares of common stock at a price of \$12.50 per share. The Company sold 6,700,000 shares. The Company received net proceeds of approximately \$74.0 million from the offering. The Company used approximately \$68.0 million of the net proceeds to repay the outstanding principal balance of the term loan (\$25.0 million), outstanding balance of the revolver (\$41.4 million) and accrued interest thereon (\$0.1 million), as well as approximately \$1.5 million to pay costs and expenses related to the offering. The remaining proceeds (approximately \$6.0 million) were used for acquisitions and working capital purposes.

Dividends on common stock will be paid when, and if declared by the board of directors. Each holder of common stock is entitled to vote on all matters and is entitled to one vote for each share held.

#### Preferred stock

Prior to its IPO in October 2009, the Company completed several private placements of its Class A and Class B preferred stock. These preferred shares included various redemption and conversion features and were reported outside the equity section and adjusted to fair value, which represented their redemption value at each reporting date. All of the preferred shares outstanding as of the offering converted to common stock and all accretion recorded

through the redemption price formula were credited to additional paid-in capital.

Stock options

In September 2009, the Company's Board of Directors and shareholders adopted and approved the 2009 Long-Term Incentive Plan (the "2009 Plan"), which became effective upon the closing of the IPO. Awards may be in the form of stock options, restricted stock units and other forms of stock-based incentives, including stock appreciation rights and deferred stock rights. The term of each incentive and non-qualified stock option is ten years. Vesting generally occurs over a period of four years, the expense for which is recorded on a straight-line basis over the requisite service period. The Plan allows for the grant of awards of up to approximately 2,286,000 shares, of which approximately 1,997,000 shares were available as of August 31, 2010 for future grants under the 2009 Plan.

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Mistras Group, Inc. and Subsidiaries  
Notes to Unaudited Consolidated Financial Statements  
(tabular dollars in thousands, except per share data)

Prior to the Company's IPO in October 2009, the Company had two stock option plans: (i) the 1995 Incentive Stock Option and Restricted Stock Purchase Plan (the "1995 Plan"), and (ii) the 2007 Stock Option Plan (the "2007 Plan"). No additional awards may be granted from these two plans.

Under the 2009 Plan, the 2007 Plan and the 1995 Plan, collectively, there were a total of approximately 2,911,000 stock options and 219,000 restricted stock units outstanding as of August 31, 2010.

The fair value of the Company's stock option awards was estimated at the date of grant using the Black-Scholes option-pricing model with the following range of assumptions:

	For the three months ended August 31,			
	2010		2009	
Dividend yield	0.0	%	0.0	%
Expected volatility	44	%	44	%
Risk-free interest rate	2.6	%	1.9-3.0	%
Expected term (years)	6.3		4.0-6.3	

The Company recognized stock-based compensation expense related to stock option awards of approximately \$710 thousand, and \$250 thousand for the three months ended August 31, 2010, and 2009, respectively. As of August 31, 2010, there was approximately \$9.4 million of unrecognized compensation costs, net of estimated forfeitures, related to stock option awards which are expected to be recognized over a remaining weighted average period of 2.9 years. There were no stock option exercises during the three months ended August 31, 2010 and 2009.

The Company also recognized \$19 thousand in stock-based compensation expense related to restricted stock unit awards during the three months ended August 31, 2010. There was no such expense incurred during the three months ended August 31, 2009. As of August 31, 2010, there was approximately \$2.1 million of unrecognized compensation costs, net of estimated forfeitures, related to restricted stock unit awards, which are expected to be recognized over a remaining weighted average period of 4.0 years.

#### 4. Acquisitions

Assets and liabilities of the acquired businesses were included in the Consolidated Balance Sheet as of August 31, 2010 based on their estimated fair value on the date of acquisition as determined in a purchase price allocation, using available information and making assumptions management believes are reasonable. Results of operations for the period from acquisition date are reported in each respective operating segment's statement of operations.

The Company made two acquisitions during the quarter ended August 31, 2010 for strategic market expansion. The first acquisition was an asset purchase that met the definition of a "business" as defined by the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 805-10-20. In the second acquisition, we acquired 80% of the common stock of the acquiree. The remaining 20% of the acquiree's common stock is recorded as noncontrolling interest in stockholders' equity. Revenues included in the Consolidated Statement of Operations for the three months ended August 31, 2010 from these acquisitions for the period subsequent to the closing of each respective transaction was approximately \$1.1 million. On a pro forma basis from the beginning of fiscal 2010, revenues from these acquisitions would have been approximately \$2.1 million. Operating income or other financial

measures for these acquisitions both from the date of closing of each respective transaction and on a pro forma basis is impractical to estimate due to the integration of these entities post-acquisition.

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Mistras Group, Inc. and Subsidiaries  
Notes to Unaudited Consolidated Financial Statements  
(tabular dollars in thousands, except per share data)

The table below summarizes the preliminary purchase price allocation for all acquisitions:

Number of entities	2
Total cost:	
Cash paid	\$5,301
Subordinated notes issued	1,637
Debt assumed	98
	\$7,036
Current assets acquired	59
Property, plant and equipment	1,067
Deferred tax asset	6
Intangibles, primarily customer lists	2,655
Goodwill	3,366
Less: noncontrolling interest	(117 )
	\$7,036

The amortization period of intangible assets acquired range from one to seven years. Goodwill of approximately \$3.4 million resulting from these acquisitions arises largely from the synergies expected from combining the operations of the acquisitions with our existing services operations, as well as from the benefits derived from the assembled workforce of the acquired companies. The goodwill recognized is expected to be deductible for tax purposes.

#### 5. Property, plant and equipment, net

Property, plant and equipment consist of the following:

	Useful Life (Years)	August 31, 2010	May 31, 2010
Land		\$ 2,186	\$ 1,304
Building and improvements	30-40	10,677	10,240
Office furniture and equipment	5-8	3,543	1,479
Machinery and equipment	5-7	68,499	68,238
		84,905	81,261
Accumulated depreciation and amortization		44,436	41,280
		\$ 40,469	\$ 39,981

Depreciation expense for the three months ended August 31, 2010 and 2009 was \$3.0 million and \$2.5 million, respectively.

Mistras Group, Inc. and Subsidiaries  
Notes to Unaudited Consolidated Financial Statements  
(tabular dollars in thousands, except per share data)

## 6. Accounts Receivable and Allowance for Doubtful Accounts

An allowance for doubtful accounts is provided against accounts receivable for amounts management believes may be uncollectible. Changes in the allowance for doubtful accounts are represented by the following:

Balance, May 31, 2010	\$ 1,661
Provision for doubtful accounts	105
Write-offs, net of recoveries	(19 )
Foreign exchange valuation	7
Balance, August 31, 2010	\$ 1,754

## 7. Inventories

Inventories consist of the following:

	As of August 31, 2010	As of May 31, 2010
Raw materials	\$ 2,595	\$ 2,564
Work in process	2,373	2,252
Finished goods	2,746	2,655
Supplies	1,268	1,265
	\$ 8,982	\$ 8,736

Inventories are net of reserves for slow-moving and obsolete inventory of approximately \$0.9 million as of August 31, 2010 and May 31, 2010, respectively.

## 8. Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consist of the following:

	As of August 31, 2010	As of May 31, 2010
Accrued salaries, wages and related employee benefits	\$ 8,511	\$ 8,158
Other accrued expenses	2,675	2,740
Accrued worker compensation and health benefits	6,809	8,041
Deferred revenues	1,268	1,151
Total	\$ 19,263	\$ 20,090

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## 9. Long-Term Debt

Long-term debt consists of the following:

	As of August 31, 2010	As of May 31, 2010
Senior credit facility:		
Revolver	\$ —	\$ —
Term loans	—	—
Notes payable	12,149	11,023
Other	871	971
	13,020	11,994
Less: Current maturities	6,579	6,303
Long-term debt, net of current maturities	\$ 6,441	\$ 5,691

### Senior Credit Facility

In July 2009, the Company entered into its current credit agreement with Bank of America, N.A., JPMorgan Chase Bank, N.A., TD Bank, N.A. and Capital One, N.A., which provided for a \$25.0 million term loan and a \$55.0 million secured revolving credit facility. As of August 31, 2010, there were no current borrowings under the revolving credit facility.

In December 2009, the Company signed an amendment to its current credit agreement that, among other things, adjusted certain affirmative and negative covenants including delivery of financial statements, the minimum consolidated debt service coverage ratio, the procedures for obtaining lender approval for acquisitions and the removal of the minimum EBITDA requirement.

Under the amended agreement, borrowings under the credit agreement bear interest at the LIBOR or base rate, at the Company's option, plus an applicable LIBOR margin ranging from 1.75% to 3.25%, or base rate margin ranging from -0.50% to 0.50%, and a market disruption increase of between 0% and 1.0%, if the lenders determine its applicable.

The credit agreement also contains financial and other covenants limiting our ability to, among other things, create liens, make investments and certain capital expenditures, incur more indebtedness, merge or consolidate, acquire other companies, make dispositions of property, pay dividends and make distributions to stockholders, enter into a new line of business, enter into transactions with affiliates and enter into burdensome agreements. The agreement's financial covenants require us to maintain a minimum debt service coverage ratio, and a funded debt leverage ratio, all as defined in the credit agreement. There is a provision in the credit facility that requires us to repay 25% of the immediately preceding fiscal year's "free cash flow" if our ratio of "funded debt" to EBITDA, as defined in the credit agreement, is greater than a specified amount on or before October 1 each year.

As of August 31, 2010, we were in compliance with the terms of the credit agreement.

In the three months ended August 31, 2009, the Company capitalized approximately \$0.5 million of costs related to the new credit agreement and expensed approximately \$0.2 million of deferred financing costs related to its former credit facility. In connection with the repayment and extinguishment of the term loan portion of this new facility in

October 2009, the Company expensed approximately \$0.2 million of financing costs incurred in the three months ended August 31, 2009. The unamortized balance of these costs is included in net intangible assets in the Consolidated Balance Sheet. The accelerated amounts expensed are classified as loss on extinguishment of debt in the Consolidated Statement of Operations.

#### Notes Payable and Other

In connection with its acquisitions through the first quarter of fiscal 2011, the Company issued subordinated notes payable to the sellers and assumed certain other notes payable. These notes generally mature three years from the date of acquisition with interest rates ranging from 0% to 7%. The Company has discounted these obligations to reflect a 5.5% to 10.0% imputed interest rate. Unamortized discount on these notes totaled approximately \$0.3 million as of August 31, 2010 and May 31, 2010. Amortization is recorded as interest expense in the Consolidated Statement of Operations.

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## 10. Fair Value Measurements

In fiscal 2007, the Company hedged a portion of the variable rate interest payments on debt using interest rate swap contracts to convert variable payments into fixed payments. The Company does not apply hedge accounting to its interest rate swap contracts. Changes in the fair value of these instruments are reported as a component of interest expense. The Company repaid all of its variable rate debt in October 2009. The Company has an interest rate swap that remains outstanding with a notional amount of \$8.0 million and a fair value of approximately \$0.1 million which is recorded in accrued expenses and other current liabilities in the Consolidated Balance Sheet as of August 31, 2010. The following outlines the significant terms of the contracts at August 31, 2010 and May 31, 2010, respectively:

Contract date	Term	Notional Amount	Variable interest rate	Fixed interest rate	As of August 31, 2010	As of May 31, 2010
November 20, 2006	4 years	\$ 8,000	LIBOR	5.17 %	\$ (121 )	\$ (210 )
		\$ 8,000			\$ (121 )	\$ (210 )

The Company classifies its interest rate swaps at fair value in the following categories:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs other than quoted market prices in active markets that are observable for the asset or liability, either directly or indirectly, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data by correlation or other means.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The fair value of the Company's interest rate swap liability, approximately \$0.1 million at August 31, 2010, was determined using quoted prices in an active market and was classified as a Level 1 liability within the fair value hierarchy.

## 11. Commitments and Contingencies

The Company is subject to periodic lawsuits, investigations and claims that arise in the ordinary course of business. Although the Company cannot predict with certainty the ultimate resolution of lawsuits, investigations and claims asserted against it, the Company does not believe that any currently pending legal proceeding to which the Company is a party will have a material adverse effect on its business, results of operations, cash flows or financial condition, except as disclosed below. The costs of defense and amounts that may be recovered in such matters may be covered by insurance.

The Company is a defendant in two related purported class action lawsuits in California, based upon alleged violations of California labor and employment law. The first case, Quiroz v. Mistras Group, Inc., et al, U.S. District Court, Central District of California (Case No. CV09-7146 PSG), was originally filed in California State court in September

2009, and was removed to Federal Court. This matter was a purported class action case on behalf of existing and former California employees of the Company and its subsidiaries for violation of various labor and employment laws, primarily for failure to pay wages timely and for having defective wage statements, as well as other claims, and is seeking penalties under the California Private Attorneys General Act. In March 2010, the plaintiff's request to certify the case as a class action suit was denied. The Plaintiffs sought to remand the case back to California State Court, but the Federal Court has retained jurisdiction.

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The second case is *Ballard v. Mistras Group, Inc., et al*, U.S. District Court, Central District of California (Case No. 2:10-cv-03186 (PSG)), filed in late March 2010 in California State Court and removed to Federal court. This matter is also a purported class action case, based on substantially identical claims as the *Quiroz* case, and was filed by the same attorney representing the plaintiff in the *Quiroz* case, approximately two weeks after class action certification was denied in *Quiroz*. The plaintiff is attempting to remand this case back to California State Court and is seeking class action certification.

In September 2010, the Company participated in non-binding mediation for the *Quiroz* and *Ballard* cases together, but was unable reach a settlement. As such, the case has moved forward with the trial currently scheduled for February 2011.

During the three months ended August 31, 2010, the Company recorded a reserve of approximately \$0.3 million in connection with the *Quiroz* and *Ballard* cases, which represents its estimate of potential liability related to these cases.

#### 12. Subsequent Event

In October 2010, the Company acquired the assets of an asset protection business to continue its strategic efforts in market expansion. The Company is in the process of completing the preliminary purchase price allocation. This acquisition was not individually significant and no pro forma information has been included.

#### 13. Segment Disclosure

The Company's three segments are:

**Services.** This segment provides asset protection solutions in North and Central America with the largest concentration in the United States.

**Products and Systems.** This segment designs, manufactures, sells, installs and services the Company's asset protection products and systems, including equipment and instrumentation, predominantly in the United States.

**International.** This segment offers services, products and systems similar to those of our other segments to global markets, principally in Europe, the Middle East, Africa, Asia and South America, but not to customers in China and South Korea, which are served by our Products and Systems segment.

General corporate services, including accounting, audit, and contract management, are provided to the segments which are reported as intersegment transactions within corporate and eliminations. Sales to the International segment from the Products and Systems segment and subsequent sales by the International segment of the same items are recorded and reflected in the operating performance of both segments. Additionally, engineering charges and royalty fees charged to the services and international segments by the products and systems segment are reflected in the operating performance of each segment. All such intersegment transactions are eliminated in corporate and eliminations.

Segment income from operations is determined based on internal performance measures used by the Chief Executive Officer, who is the chief operating decision maker, to assess the performance of each business in a given period and to make decisions as to resource allocations. In connection with that assessment, the Chief Executive Officer may exclude matters such as charges for stock-based compensation and certain other acquisition-related charges and

balances, technology and product development costs, certain gains and losses from dispositions, and litigation settlements or other charges. Certain general and administrative costs such as human resources, information technology and training are allocated to the segments. Segment income from operations also excludes interest and other financial charges and income taxes. Corporate and other assets are comprised principally of cash, deposits, property, plant and equipment, domestic deferred taxes, deferred charges and other assets. Corporate loss from operations consists of depreciation on the corporate office facilities and equipment, administrative charges related to corporate personnel and other charges that cannot be readily identified for allocation to a particular segment.

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Revenues by operating segment include intercompany transactions, which are eliminated in corporate and eliminations.

Selected consolidated financial information by segment for the periods shown was as follows:

	Three months ended August 31,	
	2010	2009
<b>Revenues</b>		
Services	\$ 55,282	\$ 45,702
Products and Systems	5,310	3,625
International	9,040	7,751
Corporate and eliminations	(1,222 )	(989 )
	\$ 68,410	\$ 56,089

The Services segment had sales to other operating segments of \$0.3 million for the three months ended August 31, 2010. Sales to other operating segments for the three months ended August 31, 2009 were de minimus.

The Products and Systems segment had sales to other operating segments of \$0.8 million and \$0.9 million for the three months ended August 31, 2010 and 2009, respectively.

The International segment had sales to other operating segments of \$0.2 million for the three months ended August 31, 2010. Sales to other operating segments for the three months ended August 31, 2009 were de minimus.

	Three months ended August 31,	
	2010	2009
<b>Gross profit</b>		
Services	\$ 15,001	\$ 12,528
Products and Systems	2,569	1,688
International	3,271	3,046
Corporate and eliminations	(63 )	(112 )
	\$ 20,778	\$ 17,150

	Three months ended August 31,	
	2010	2009
<b>Income from operations</b>		
Services	\$ 3,848	\$ 3,232
Products and Systems	791	(70 )
International	1,028	1,262
Corporate and eliminations	(2,351 )	(1,638 )

\$ 3,316                      \$ 2,786

Operating income by operating segment includes intercompany transactions, which are eliminated in corporate and eliminations.

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	Three months ended August 31,	
	2010	2009
<b>Depreciation and amortization</b>		
Services	\$ 3,584	\$ 2,874
Products and Systems	206	246
International	320	365
Corporate and eliminations	32	31
	\$ 4,142	\$ 3,516
	As of August 31, 2010	As of May 31, 2010
<b>Intangible assets, net</b>		
Services	\$ 15,207	\$ 14,042
Products and Systems	1,048	1,016
International	930	504
Corporate and eliminations	510	526
	\$ 17,695	\$ 16,088
	As of August 31, 2010	As of May 31, 2010
<b>Goodwill</b>		
Services	\$ 46,010	\$ 42,804
Products and Systems	—	—
International	1,612	1,511
Corporate and eliminations	—	—
	\$ 47,622	\$ 44,315
	As of August 31, 2010	As of May 31, 2010
<b>Long-lived assets</b>		
Services	\$ 95,115	\$ 91,040
Products and Systems	3,724	3,837
International	5,548	4,957
Corporate and eliminations	1,399	550
	\$ 105,786	\$ 100,384

Mistras Group, Inc. and Subsidiaries  
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	For the three months ended August 31,	
	2010	2009
Revenues by geographic region		
United States	\$ 54,767	\$ 45,237
Europe	6,440	6,387
Other Americas	4,853	2,926
Asia-Pacific	2,350	1,539
	\$ 68,410	\$ 56,089

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended ("Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended ("Exchange Act"). Forward-looking statements reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, our competitive position and the effects of competition, the projected growth of the industries in which we operate, the benefits and synergies to be obtained from our completed and any future acquisitions, and statements of management's goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as "may," "should," "could," "would," "predicts," "potential," "continue," "expects," "anticipates," "future," "believes," "estimates," "appears," "projects" and similar expressions, as well as statements in the future tense, identify forward-looking statements. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and management's good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Important factors that could cause such differences include, but are not limited to the factors discussed under the "Risk Factors" section.

The following is a discussion and analysis of our financial condition and results of operations and should be read together with our condensed consolidated financial statements and related notes to the condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q and our audited consolidated financial statements and related notes to the audited consolidated financial statements included in our Annual Report on Form 10-K. In this quarterly report, our fiscal years, which end on May 31, are identified according to the calendar year in which they end (e.g., the fiscal year ended May 31, 2010 is referred to as "fiscal 2010"), and unless otherwise specified or the context otherwise requires, "Mistras," "the Company," "we," "us" and "our" refer to Mistras Group, Inc. and consolidated subsidiaries.

### Overview

We are a leading "one source" global provider of technology-enabled asset protection solutions used to evaluate the structural integrity of critical energy, industrial and public infrastructure. We combine industry-leading products and technologies, expertise in mechanical integrity (MI) and non-destructive testing (NDT) services and proprietary data analysis software to deliver a comprehensive portfolio of customized solutions, ranging from routine inspections to complex, plant-wide asset integrity assessments and management. These mission critical solutions enhance our customers' ability to extend the useful life of their assets, increase productivity, minimize repair costs, comply with governmental safety and environmental regulations, manage risk and avoid catastrophic disasters. Given the role our services play in ensuring the safe and efficient operation of infrastructure, we have historically provided a majority of our services to our customers on a regular, recurring basis. We serve a global customer base of companies with asset-intensive infrastructure, including companies in the oil and gas, fossil and nuclear power, public infrastructure, chemicals, aerospace and defense, transportation, primary metals and metalworking, pharmaceuticals and food processing industries. During fiscal 2010, we provided our asset protection solutions to approximately 4,800 customers. As of August 31, 2010, we had approximately 2,400 employees, including 32 Ph.D.'s and more than 100 other degreed engineers and highly-skilled, certified technicians, in 74 offices across 15 countries. We have established long-term relationships as a critical solutions provider to many leading companies in our target markets. Our current principal market is the oil and gas industry, which accounted for approximately 61% and 63% of our revenues for the first quarter of fiscal 2011 and 2010, respectively.

For the last several years, we have focused on introducing our advanced asset protection solutions to our customers using proprietary, technology-enabled software and testing instruments, including those developed by our Products and Systems segment. During this period, the demand for outsourced asset protection solutions has, in general, increased, creating demand from which our entire industry has benefited. We have experienced compounded annual growth rate (CAGR) for revenue of 31% over the last three fiscal years, including the impact of acquisitions and currency fluctuations. During the same period, revenues from our customers in the oil and gas market, historically our largest target market, had a CAGR of 40%. All of our other target markets, collectively, had a CAGR of 19%. We believe further growth can be realized in all of our target markets. Concurrent with this growth, we have worked to build our infrastructure to profitably absorb additional growth and have made a number of small acquisitions in an effort to leverage our fixed costs, grow our base of experienced personnel, expand our technical capabilities and increase our geographical reach.

We have increased our capabilities and the size of our customer base through the development of applied technologies and managed support services, organic growth and the successful and seamless integration of acquired companies. These acquisitions have provided us with additional products, technologies, resources and customers that have enhanced our sustainable competitive advantages over our competition.

The global economy continues to be fragile. Global financial markets continue to experience uncertainty, including severely diminished liquidity and credit availability, low consumer confidence, slow economic growth, persistently high unemployment rates, volatile currency exchange rates and continued uncertainty about economic stability. There may be further deterioration and volatility in the global economy, the global financial markets, and consumer confidence. However, we believe it also has allowed us to capitalize on this opportunity to selectively hire new talented individuals that otherwise might not have been available to us, to acquire and develop new technology in order to aggressively expand our proprietary portfolio of customized solutions, and to make acquisitions of complementary businesses at reasonable valuations. We believe we will be able to derive additional revenues from these strategic investments with favorable gross margins in future periods, which we believe would at least in part offset any further negative revenue impact we incur from the economic downturn during those periods.

### Consolidated Results of Operations

First quarter of fiscal 2011 compared to first quarter of fiscal 2010

Our consolidated results of operations for the first quarter of fiscal 2011 and fiscal 2010 were as follows:

	For the three months ended August 31,	
	2010	2009
	(in thousands )	
Statement of Operations Data		
Revenues	\$ 68,410	\$ 56,089
Cost of revenues	44,668	36,468
Depreciation	2,964	2,471
Gross profit	20,778	17,150
Selling, general and administrative expenses	15,479	13,133
Research and engineering	555	483
Depreciation and amortization	1,178	1,045
Legal reserve	250	(297 )
Income from operations	3,316	2,786
Interest expense	690	1,064
Loss on extinguishment of long-term debt	—	169
Income before provision for income taxes and noncontrolling interest	2,626	1,553
Provision for income taxes	1,054	694
Net income	1,572	859
Net loss (income) attributable to noncontrolling interests, net of taxes	20	(44 )
Net income attributable to common stockholders	\$ 1,592	\$ 815

Our EBITDA1 and Adjusted EBITDA1, non-GAAP measures explained below, for the first quarter of fiscal 2011 and fiscal 2010 were as follows:



EBITDA and Adjusted EBITDA data	For the three months ended August 31,	
	2010	2009
	(in thousands)	
Net income	\$ 1,592	\$ 815
Interest expense	690	1,064
Provision for income taxes	1,054	694
Depreciation and amortization	4,142	3,516
EBITDA	\$ 7,478	\$ 6,089
Legal reserve	250	(297)
Large customer bankruptcy	—	767
Stock compensation expense	729	250
Loss on extinguishment of debt	—	169
Adjusted EBITDA	\$ 8,457	\$ 6,978

1 EBITDA and Adjusted EBITDA are performance measures used by management that are not calculated in accordance with U.S. generally accepted accounting principles (GAAP). EBITDA is defined in this Quarterly Report as net income plus: interest expense, provision for income taxes and depreciation and amortization. Adjusted EBITDA is defined in this Quarterly Report as net income plus: interest expense, provision for income taxes, depreciation and amortization, stock-based compensation expense, certain acquisition related costs and certain one-time and generally non-recurring items (which items are described in the next paragraph and the reconciliation table below).

Our management uses Adjusted EBITDA as a measure of operating performance to assist in comparing performance from period to period on a consistent basis, as a measure for planning and forecasting overall expectations and for evaluating actual results against such expectations. Adjusted EBITDA is also used as a performance evaluation metric off which to base executive and employee incentive compensation programs.

We believe investors and other users of our financial statements benefit from the presentation of adjusted EBITDA in evaluating our operating performance because it provides an additional tool to compare our operating performance on a consistent basis and measure underlying trends and results in our business. Adjusted EBITDA removes the impact of certain items that management believes do not directly reflect our core operations. For instance, Adjusted EBITDA generally excludes interest expense, taxes and depreciation, amortization, each of which can vary substantially from company to company depending upon accounting methods and the book value and age of assets, capital structure, capital investment cycles and the method by which assets were acquired. It also eliminates stock-based compensation, which is generally a non-cash expense and is excluded by management when evaluating the underlying performance of our business operations.

While Adjusted EBITDA is a term and financial measurement commonly used by investors and securities analysts, it has limitations. As a non-GAAP measurement, Adjusted EBITDA has no standard meaning and, therefore, may not be comparable with similar measurements for other companies. Adjusted EBITDA is generally limited as an analytical tool because it excludes charges and expenses we do incur as part of our operations. For example, Adjusted EBITDA excludes taxes, but we generally incur significant U.S. federal, state and foreign income taxes each year and the provision for income taxes is a necessary cost. Adjusted EBITDA should not be considered in isolation or as a substitute for analyzing our results as reported under U.S. generally accepted accounting principles.

Revenues. Revenues were \$68.4 million for the first quarter of fiscal 2011 compared to \$56.1 million for the first quarter of fiscal 2010.

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	Three months ended August 31,	
	2010	2009
	(in thousands)	
Revenues		
Services	\$ 55,282	\$ 45,702
Products and Systems	5,310	3,625
International	9,040	7,751
Corporate and eliminations	(1,222 )	(989 )
	\$ 68,410	\$ 56,089

We estimate our growth rates for our first quarter of fiscal 2011 and 2010 are as follows:

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	For the three months ended				
	2010		August 31,		2009
Revenue growth	\$	12,321		\$	9,092
% Growth over prior year		22.0	%		19.3 %
Comprised of:					
% of organic growth		14.5	%		10.9 %
% of acquisition growth		7.9	%		12.2 %
% foreign exchange decrease		(0.4	%)		(3.8 %)
		22.0	%		19.3 %

Revenues increased \$12.3 million, or 22%, for the first quarter of fiscal 2011 compared to the first quarter of fiscal 2010 as a result of growth in all our segments. For the first quarter of fiscal 2011 and the first quarter of fiscal 2010, we estimate that our organic growth rate, as compared to growth driven by acquisitions, was approximately 15% and 11%, respectively. This organic growth was the result of continued demand for our asset protection solutions, including growth from new and existing customers. In the first quarter of fiscal 2011, we estimate that growth from acquisitions was approximately \$4.4 million, or approximately 8%, compared to approximately \$5.7 million, or approximately 12%, in the first quarter of fiscal 2010. We completed two acquisitions in the first quarter of fiscal 2011 and two acquisitions in the first quarter of fiscal 2010, further increasing our capabilities and adding to our base of qualified technicians.

Despite the prolonged downturn in the global economy, we continued to experience growth in many of our target markets in the first quarter of fiscal 2011 as compared to the first quarter of fiscal 2010. The largest dollar increase was attributable to customers in the oil and gas market which was achieved globally on several new and existing projects, including an increase in our portfolio of “run and maintain” outsourced contracts and new work, some of which were obtained through our acquisitions. Overall the oil and gas market provided approximately 61% and 63% of our total revenues for the first quarter of fiscal 2011 and 2010, respectively. We also experienced high growth in several of our other target markets, including chemical, fossil and nuclear power. These increases were partially offset by declines in aerospace and infrastructure markets. Our largest customer accounted for approximately 18% and 22% of our revenues in the first quarter of fiscal 2011 and 2010, respectively. No other customer accounted for more than 8% of our revenues in the first quarter of fiscal 2011.

Gross profit. Our gross profit was \$20.8 million and increased \$3.6 million, or 21% in the first quarter of fiscal 2011 compared to \$17.2 million in the first quarter of fiscal 2010. As a percentage of revenues, our gross profit and its components are as follows:

	For the three months ended				
	2010		August 31,		2009
					(in thousand)
Gross profit	\$	20,778		\$	17,150
Gross profit % comprised of:					
Revenues		100.0	%		100.0 %
Cost of revenues		65.3	%		65.0 %
Depreciation		4.3	%		4.4 %
Total		30.4	%		30.6 %

Gross profit % decrease from prior year quarter	(0.2	%)	(4.7	%)
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Our gross profit by segment for the first quarter of fiscal 2011 and 2010, was as follows:

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	Three months ended August 31,	
	2010	2009
	(in thousands)	
<b>Gross profit</b>		
Services	\$ 15,001	\$ 12,528
Products and Systems	2,569	1,688
International	3,271	3,046
Corporate and eliminations	(63 )	(112 )
	\$ 20,778	\$ 17,150

As a percentage of revenues, our gross profit was approximately 30% for each of the first quarter of fiscal 2011 and the first quarter of fiscal 2010. Cost of revenues, excluding depreciation, as a percentage of revenues was approximately 65% in each of the first quarter of fiscal 2011 and the first quarter of fiscal 2010. Depreciation expense included in the determination of gross profit for the first quarter of fiscal years 2011 and 2010 was \$3.0 million, or 4% of revenues, and \$2.5 million, or 4% of revenues, respectively.

With our increase in revenues for the first quarter of fiscal 2011, our gross profit as a percentage of revenues remained fairly consistent at approximately 30% as compared to the first quarter of fiscal 2010. While overall gross profit as a percentage of segment revenues remained fairly consistent, we incurred a slight decrease in gross profit percentage in the Services segment that was primarily attributable to sales derived from several new contracts, which drove market share growth but were competitive from a pricing perspective in the short term. Historically, by introducing more advanced NDT tools to new customers, margin enhancement follows. This slight decrease was offset by improved efficiencies in our utilization rates when compared to the first quarter of fiscal 2010. In addition, our Products and Systems segment's gross profit percentage increased slightly as a result of an increase in sales volume of its products, which generally yield higher margins.

Income from operations. Our income from operations by segment for the first quarter of fiscal 2011 and 2010, was as follows:

	Three months ended August 31,	
	2010	2009
	(in thousands)	
<b>Income from operations</b>		
Services	\$ 3,848	\$ 3,232
Products and Systems	791	(70 )
International	1,028	1,262
Corporate and eliminations	(2,351 )	(1,638 )
	\$ 3,316	\$ 2,786

Our income from operations of \$3.3 million for the first quarter of fiscal 2011 increased \$0.5 million, or 19%, compared to the first quarter of fiscal 2010. As a percentage of revenues, our income from operations was 5% in the first quarter of fiscal 2011 and fiscal 2010.

As a percentage of revenues, selling, general and administrative expenses for the first quarter of fiscal 2011 were 23%, consistent with the first quarter of fiscal 2010. Our selling, general and administrative expenses for the first quarter of fiscal 2011 increased approximately \$2.3 million, or 18%, over the first quarter of fiscal 2010, primarily due to the cost of additional infrastructure to support our growth, including new locations obtained through our acquisitions. Our

recent acquisitions accounted for approximately \$0.5 million of this increase. Stock compensation costs increased approximately \$0.5 million in the first quarter of fiscal 2011 over the first quarter of fiscal 2010. Other increases in our selling, general and administrative expenses included higher compensation and benefit expenses over the previous year attributed to normal salary increases, as well as our investment in additional management and corporate staff. A significant portion of these increases (as well as other increases in cost of revenues) supported our development of new and existing centers of excellence. Our professional fees increased in the first quarter of fiscal 2011, which related primarily to increased costs associated with operating as a publicly traded company, including Sarbanes-Oxley Act compliance. These increases were offset by decreases in professional fees related to our IPO in 2009 and our provision for bad debts. Income from operations was also impacted by a legal provision of \$0.3 million in the quarter as compared to a reversal of a legal provision in the first quarter of 2010. Depreciation and amortization included in the determination of income from operations for the first quarter of fiscal 2011 and the first quarter of fiscal 2010 was \$1.2 million, or 2% of revenues, and \$1.0 million, or 2% of revenues, respectively.

Interest expense. Interest expense was \$0.7 million and \$1.1 million for the first quarter of fiscal 2011 and the first quarter of fiscal 2010, respectively. The decrease in the first quarter of fiscal 2011 interest expense related directly to our repayment of approximately \$66.4 million in borrowings in October 2009, which was the primary use of the net proceeds we received from our initial public offering. In each of the three months ended August 31, 2010 and 2009, we incurred additional expense related to the market rate adjustments to our interest rate swaps, as the fixed rate on these swaps was higher than market rates during both annual periods. The total interest expense adjustments for these swap arrangements in each of the first quarter of fiscal 2011 and the first quarter of fiscal 2010 was approximately \$0.1 million.

Net loss (income) attributable to noncontrolling interests, net of taxes. The decrease in net income attributable to noncontrolling interests relates primarily to a decrease in net income from Diapac, our subsidiary in Russia, and the net loss incurred by IPS, our recently acquired subsidiary in France, offset by an increase in net income of our Brazilian subsidiary, PASA.

Income taxes. Our effective income tax rate was approximately 40% for the first quarter of fiscal 2011 compared to approximately 45% for fiscal 2010. The decrease was primarily due to the impact of permanent tax differences and an adjustment to our liabilities related to uncertain tax provisions offset by higher state taxes and U.S. federal taxes on our foreign profits.

Net income attributable to common shareholders Net income attributable to common shareholders for the first quarter of fiscal 2011 was \$1.6 million, or 2% of our revenues, which is greater than our net income attributable to common shareholders for the first quarter of fiscal 2010, which was \$0.8 million, or 1% of revenues. This increase in net income was primarily the result of our revenue growth and lower interest expense, offset by higher selling, general and administrative expense and research and engineering expenses.

#### Cash Flows Table

Our cash flows are summarized in the table below:

	For the three months ended August 31,	
	2010	2009
	(in thousands)	
Net cash provided by (used in):		
Operating Activities	\$ 8,281	\$ 5,483
Investing Activities	(7,240 )	(15,358 )
Financing Activities	(3,101 )	10,401
Effect of exchange rate changes on cash and cash equivalents	(122 )	(159 )
Net change in cash and cash equivalents	\$ (2,182 )	\$ 367

#### Cash Flows from Operating Activities

During the three months ended August 31, 2010, cash provided by our operating activities was \$8.3 million, an increase of \$2.8 million from the comparable period of fiscal 2010. Positive operating cash flow was primarily attributable to net income of \$1.6 million and \$1.7 million of cash provided by a decrease in our working capital, which primarily related to collections of our trade accounts receivable.



#### Cash Flows from Investing Activities

During the three months ended August 31, 2010, cash used in investing activities was \$7.2 million compared to \$15.4 million from the comparable period of fiscal 2010. Cash purchases of property, plant and equipment were \$1.9 million and were primarily related to equipment used by our technicians. Cash used in investing activities also included our acquisition of two asset protection businesses for cash payments aggregating \$5.3 million.

During the three months ended August 31, 2009, cash used in investing activities was \$15.4 million and included cash purchases of property, plant and equipment of \$1.4 million and our acquisition of two asset protection businesses for cash payments aggregating \$14.0 million.

#### Cash Flows from Financing Activities

Net cash used in financing activities was \$3.1 million for the three months ended August 31, 2010, and related primarily to repayments of capital lease obligations and long-term debt. For the three months ended August 31, 2009 net cash provided by financing activities of \$10.4 million resulted from the refinancing of our former credit facility in July 2009.

#### Effect of Exchange Rate on Changes on Cash and Cash Equivalents

In each of the three months ended August 31, 2010 and 2009, the effect of exchange rate changes on our cash and cash equivalents was \$0.1 million and \$0.2 million, respectively.

#### Cash balance and credit facility borrowings

As of August 31, 2010, we had cash and cash equivalents totaling \$13.9 million and \$55.0 million available to us under our revolving credit facility. We finance our operations primarily through our net income, bank borrowings and capital lease financing. We believe these sources are sufficient to fund our capital expenditures, debt maturities and other business needs.

On July 22, 2009, we entered into our current credit agreement with Bank of America, N.A., JPMorgan Chase Bank, N.A., TD Bank, N.A. and Capital One, N.A., which provided for a \$25.0 million term loan and a \$55.0 million secured revolving credit facility. The proceeds from this transaction were used to repay the outstanding indebtedness from our former credit facility and to fund acquisitions.

In October 2009, we repaid the outstanding principal balance of the term loan and the outstanding balance of the revolving credit facility using the proceeds from our initial public offering. Credit extended under the term loan may not be re-borrowed under the current credit agreement. Credit extended under the revolving credit facility may be re-borrowed at any time. Borrowings made under the revolving credit facility are payable on July 21, 2012. In December 2009, we signed an amendment to our current credit agreement that, among other things, adjusted certain affirmative and negative covenants including delivery of financial statements, the minimum consolidated debt service coverage ratio, the procedures for obtaining lender approval in acquisitions and the removal of the minimum EBITDA requirement.

Under the amended agreement, borrowings under the credit agreement bear interest at the LIBOR or base rate, at our option, plus an applicable LIBOR margin ranging from 1.75% to 3.25%, or base rate margin ranging from -0.50% to 0.50%, and a market disruption increase of between 0.0% and 1.0%, if the lenders determine it to be applicable.

The credit agreement also contains financial and other covenants limiting our ability to, among other things, create liens, make investments and certain capital expenditures, incur more indebtedness, merge or consolidate, acquire other companies, make dispositions of property, pay dividends and make distributions to stockholders, enter into a new line of business, enter into transactions with affiliates and enter into burdensome agreements. The agreement's financial covenants require us to maintain a minimum debt service coverage ratio, and a funded debt leverage ratio, all as defined in the credit agreement. There is a provision in the credit facility that requires us to repay 25% of the immediately preceding fiscal year's "free cash flow" if our ratio of "funded debt" to EBITDA, as defined in the credit agreement, is greater than a specified amount on or before October 1 each year.

At August 31, 2010, we were in compliance with the terms of the credit agreement.

## Liquidity and capital resources outlook

### Future sources of cash

We expect our future sources of cash to include cash flow from operations, cash borrowed under our revolving credit facility and cash borrowed from leasing companies to purchase equipment and fleet service vehicles. Our revolving credit facility is available for cash advances required for working capital and for letters of credit to support our operations. To meet our short-and long-term liquidity requirements, we expect primarily to rely on cash generated from our operating activities. We are currently funding our acquisitions through our available cash, borrowings under our revolving credit facility when necessary, and seller notes. We may also obtain capital through the issuance of debt or equity securities, or a combination of both.

### Future uses of cash

We expect our future uses of cash will primarily be for acquisitions, international expansion, purchases or manufacture of field testing equipment to support growth, additional investments in technology and software products and the replacement of existing assets and equipment used in our operations. We often make purchases to support new sources of revenues, particularly in our Services segment, but generally only do so with a high degree of certainty about related customer orders and pricing. In addition, we have a certain amount of replacement equipment, including our fleet vehicles. We historically spend approximately 4% to 5% of our total revenues on capital expenditures, excluding acquisitions, and expect to fund these expenditures through a combination of cash and lease financing.

Our anticipated acquisitions may also require capital. For example, we have completed three acquisitions in fiscal 2011 with an initial cash outlay of approximately \$16.8 million, of which approximately \$5.0 million was funded by our credit facility. This includes one acquisition completed in October 2010. In some cases, additional equipment will be needed to upgrade the capabilities of these acquired companies. In addition, our future acquisition and capital spending may increase as we aggressively pursue growth opportunities. Other investments in infrastructure, training and software may also be required to match our growth, but we plan to continue using a disciplined approach to building our business. In addition, we will use cash to fund our operating leases, capital leases and long-term debt repayment and various other obligations, including the commitments discussed in the table below, as they arise.

We will also use cash to support our working capital requirements for our operations, particularly in the event of further growth and due to the impacts of seasonality on our business. Our future working capital requirements will depend on many factors, including the rate of our revenue growth, our introduction of new solutions and enhancements to existing solutions and our expansion of sales and marketing and product development activities. To the extent that our cash and cash equivalents and future cash flows from operating activities are insufficient to fund our future activities, we may need to raise additional funds through bank credit arrangements or public or private equity or debt financings. We also may need to raise additional funds in the event we determine in the future to effect one or more acquisitions of businesses, technologies or products that will complement our existing operations. In the event additional funding is required, we may not be able to obtain bank credit arrangements or effect an equity or debt financing on terms acceptable to us or at all.

### Off-balance sheet arrangements

During the first quarter of fiscal 2011, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Risk

We have foreign currency exposure related to our operations in foreign locations where the functional currency is not the U.S. dollar. This foreign currency exposure, particularly the Euro, British Pound Sterling (GBP), Brazilian Real, Russian Ruble, Japanese Yen and the Indian Rupee, arises primarily from the translation of our foreign subsidiaries' financial statements into U.S. dollars. For example, a portion of our annual sales and operating costs are denominated in GBP and we have exposure related to sales and operating costs increasing or decreasing based on changes in currency exchange rates. If the U.S. dollar increases in value against these foreign currencies, the value in U.S. dollars of the assets and liabilities originally recorded in these foreign currencies will decrease. Conversely, if the U.S. dollar decreases in value against these foreign currencies, the value in U.S. dollars of the assets and liabilities originally recorded in these foreign currencies will increase. Thus, increases and decreases in the value of the U.S. dollar relative to these foreign currencies have a direct impact on the value in U.S. dollars of our foreign currency denominated assets and liabilities, even if the value of these items has not changed in their original currency. For our foreign subsidiaries, assets and liabilities are translated at period ending rates of exchange. Translation adjustments for the assets and liability accounts are included in accumulated other comprehensive income in stockholders' equity (deficit). We had approximately \$0.2 million of foreign currency translation losses in other comprehensive income for the first three months of fiscal 2011. We do not currently enter into forward exchange contracts to hedge exposures denominated in foreign currencies. We may consider entering into hedging or forward exchange contracts in the future.

### Interest Rate Sensitivity

The interest rate on our revolving credit facility is variable. Accordingly, to the extent that we borrow under this facility, we are exposed to the risks associated with increases in interest rates under the facility.

From time to time, we enter into two interest rate swap contracts whereby we would receive or pay an amount equal to the difference between a fixed rate and LIBOR on a quarterly basis in order to reduce our exposure to interest rate fluctuations. All gains and losses are recognized as an adjustment to interest expense and the combined fair values are recorded in other liabilities on the consolidated balance sheet. At August 31, 2010, we had one interest rate swap contract outstanding with a notional amount of \$8.0 million.

We had cash and cash equivalents of \$13.9 million at August 31, 2010. These amounts are held for working capital purposes and were invested primarily in short-term interest-bearing accounts. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Declines in interest rates, however, will reduce future investment income.

### Fair Value of Financial Instruments

We do not have material exposure to market risk with respect to investments, as our investments consist primarily of highly liquid investments purchased with a remaining maturity of three months or less. We do not use derivative financial instruments for speculative or trading purposes; however, this does not preclude our adoption of specific hedging strategies in the future.

## ITEM 4. Controls and Procedures

### Limitations on Effectiveness of Control.

Our management, including the principal executive and financial officers, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The design of our control system reflects the fact that there are resource constraints and the benefits of such controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control failures and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is also based in part on certain assumptions about the likelihood of future events and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of management's assessments of the current effectiveness of our disclosure controls and procedures and its internal control over financial reporting are subject to risks. However, our disclosure controls and procedures are designed to provide reasonable assurance that the objectives of our control system are met.

Evaluation of Disclosure Controls and Procedures.

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer (“CEO”) and our Chief Financial Officer (“CFO”), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). This evaluation included consideration of the various processes carried out under the direction of our disclosure committee in an effort to ensure that information required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the time periods specified by the SEC. This evaluation also considered the work completed relating to our compliance efforts with regards to the requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

Based on this evaluation, our CEO and CFO concluded that, as of August 31, 2010, our disclosure controls and procedures were operating effectively to ensure that the information required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the requisite time periods and that such information is accumulated and communicated to management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

We intend to regularly review and evaluate the design and effectiveness of our disclosure controls and procedures and internal controls over financial reporting on an ongoing basis and to improve these controls and procedures over time.

Changes in Internal Control Over Financial Reporting.

There were no changes in our internal control over financial reporting (as defined in Rules 13a-13(f) and 15d-15(f) of the Exchange Act) that have materially affected or are reasonably likely to materially affect our internal control over financial reporting during the first quarter of fiscal 2011.

PART II—OTHER INFORMATION

ITEM 1. Legal Proceedings

See Note 11 to the financial statements included in this report for a description of legal proceedings involving us.

ITEM 1.A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the risk factors discussed under the “Risk Factors” section included in our Annual Report on Form 10-K, filed with the SEC on August 17, 2010. There have been no material changes to the risk factors previously disclosed in the Annual Report.

ITEM 2. Unregistered Sale of Equity Securities and Use of Proceeds

(a) Sales of Unregistered Securities

None.

(b) Use of Proceeds from Public Offering of Common Stock

None

(c) Repurchases of Our Equity Securities

None.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

See Exhibit Index on Page 31 of this report, and incorporated herein by reference.

Signatures

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

MISTRAS GROUP, INC.

By: /s/ Francis T. Joyce  
Francis T. Joyce  
Chief Financial Officer  
(Principal financial officer and duly  
authorized officer)

Date: October 13, 2010

EXHIBIT INDEX

Exhibit No.	Description
10.1	Amendment to Employment Agreement, dated July 14, 2010 between Sotirios J. Vahaviolos and Mistras Group, Inc.
10.2	Compensation Plan for Non-Employee Directors (July 2010)
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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