KEITH COMPANIES INC
Form 10-Q
November 05, 2004

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2004
Commission File Number 0-26561

THE KEITH COMPANIES, INC.

(Exact name of registrant as specified in its charter)

California	33-0203193
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

19 TECHNOLOGY DRIVE, IRVINE, CALIFORNIA 92618

(Address of principal executive offices and zip code)

Registrant s telephone number, including area code: (949) 923-6001

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
Yes X No

The number of outstanding shares of the registrant s common stock as of October 26, 2004 was 7,889,758.

THE KEITH COMPANIES, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

THE KEITH COMPANIES, INC. AND SUBSIDIARIES
Consolidated Balance Sheets

	September 30, 2004	December 31, 2003
Assets	**(Unaudited)**	
Current assets:		
Cash and cash equivalents	$34,399,000	$24,277,000
Securities held-to-maturity	3,400,000	4,600,000
Contracts and trade receivables, net of allowance for doubtful accounts of $1,232,000 and $1,328,000 at September 30, 2004 and December 31, 2003, respectively	16,621,000	19,844,000
Costs and estimated earnings in excess of billings.	12,309,000	9,997,000
Prepaid expenses and other current assets	1,382,000	1,468,000
Total current assets	68,111,000	60,186,000
Equipment and leasehold improvements, net	4,524,000	4,067,000
Goodwill, net of accumulated amortization of $761,000 at September 30, 2004 and December 31, 2003	23,059,000	23,059,000
Other assets	301,000	224,000
Total assets	$95,995,000	$87,536,000
Liabilities and Shareholders Equity		
Current liabilities:		
Trade accounts payable	$ 1,184,000	$ 1,640,000
Accrued employee compensation	5,643,000	4,037,000
Current portion of deferred tax liabilities	2,444,000	2,444,000
Other accrued liabilities	3,493,000	3,078,000
Billings in excess of costs and estimated earnings.	1,756,000	1,571,000
Total current liabilities	14,520,000	12,770,000
Issuable common stock		792,000
Deferred tax liabilities	1,560,000	1,560,000
Accrued rent	423,000	452,000

Total liabilities	16,503,000	15,574,000
Shareholders equity:		
Preferred stock, $0.001 par value. Authorized 5,000,000 shares; no shares issued or outstanding		
Common stock, $0.001 par value. Authorized 100,000,000 shares; issued and outstanding 7,888,158 and 7,653,935 shares at September 30, 2004 and December 31, 2003, respectively	8,000	8,000
Additional paid-in capital	47,806,000	45,464,000
Deferred stock compensation	(979,000)	(169,000)
Retained earnings	32,657,000	26,659,000
Total shareholders equity	79,492,000	71,962,000
Total liabilities and shareholders equity	$95,995,000	$87,536,000

See accompanying notes to the consolidated financial statements.

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THE KEITH COMPANIES, INC. AND SUBSIDIARIES
Consolidated Statements of Income
(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Gross revenue	$27,599,000	$25,175,000	$78,935,000	$74,919,000
Subcontractor costs	2,022,000	2,321,000	6,384,000	6,942,000
Net revenue	25,577,000	22,854,000	72,551,000	67,977,000
Costs of revenue	15,617,000	14,234,000	45,386,000	43,949,000
Gross profit	9,960,000	8,620,000	27,165,000	24,028,000
Selling, general and administrative expenses	6,118,000	5,041,000	17,610,000	15,672,000
Income from operations	3,842,000	3,579,000	9,555,000	8,356,000
Interest income, net	113,000	65,000	257,000	195,000
Other expenses (income), net	4,000	32,000	(20,000)	(188,000)
Income before provision for income taxes	3,951,000	3,612,000	9,832,000	8,739,000
Provision for income taxes	1,541,000	1,409,000	3,834,000	3,408,000
Net income	$ 2,410,000	$ 2,203,000	$ 5,998,000	$ 5,331,000
Earnings per share:				
Basic	$ 0.31	$ 0.29	$ 0.77	$ 0.70
Diluted	$ 0.30	$ 0.28	$ 0.75	$ 0.67
Weighted average number of shares outstanding:				
Basic	7,804,274	7,626,534	7,763,480	7,607,642
Diluted	8,038,295	7,975,890	8,021,497	7,955,167

See accompanying notes to the consolidated financial statements.

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THE KEITH COMPANIES, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(Unaudited)

	For the Nine Months Ended September 30,	
	2004	**2003**
Cash flows from operating activities:		
Net income	$ 5,998,000	$ 5,331,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,486,000	1,705,000
Loss on sale/impairment of equipment	48,000	37,000
Tax benefit from stock options and restricted shares	200,000	36,000
Deferred stock compensation expense	180,000	20,000
Changes in operating assets and liabilities:		
Contracts and trade receivables, net	3,262,000	1,277,000
Costs and estimated earnings in excess of billings	(2,312,000)	(1,085,000)
Prepaid expenses and other assets	(5,000)	(57,000)
Trade accounts payable and accrued liabilities	1,485,000	(687,000)
Billings in excess of costs and estimated earnings	185,000	(262,000)
Net cash provided by operating activities	10,527,000	6,315,000
Cash flows from investing activities:		
Net cash expended for acquisitions		(722,000)
Additions to equipment and leasehold improvements	(2,018,000)	(1,066,000)
Proceeds from (purchases of) securities held-to-maturity	1,200,000	(1,938,000)
Proceeds from sales of equipment	26,000	46,000
Net cash used in investing activities	(792,000)	(3,680,000)
Cash flows from financing activities:		
Principal payments on capital lease obligations		(53,000)
Net proceeds from stock options and restricted shares	387,000	215,000
Net cash provided by financing activities	387,000	162,000
Net increase in cash and cash equivalents	10,122,000	2,797,000
Cash and cash equivalents, beginning of period	24,277,000	20,333,000

Cash and cash equivalents, end of period	$34,399,000	$23,130,000

See supplemental cash flow information at Note 7.

See accompanying notes to the consolidated financial statements.

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THE KEITH COMPANIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

The accompanying consolidated balance sheet as of September 30, 2004, the consolidated statements of income for the three and nine months ended September 30, 2004 and 2003, and the consolidated statements of cash flows for the nine months ended September 30, 2004 and 2003 are unaudited and in the opinion of management include all adjustments necessary to present fairly the information set forth therein, which consist solely of normal recurring adjustments. All significant intercompany transactions have been eliminated and certain reclassifications have been made to prior periods consolidated financial statements to conform to the current period presentation. The results of operations for these interim periods are not necessarily indicative of results for the full year. The consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report on Form 10-K of The Keith Companies, Inc. (together with its subsidiaries, the Company or TKCI) for the year ended December 31, 2003 as certain disclosures which would substantially duplicate those contained in such audited financial statements have been omitted from this report.

2. Accounting for Stock Options

The Company accounts for its stock options and restricted shares in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. The Company has not recorded any compensation expense related to the granting of options. Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock Based Compensation, permits entities to recognize the fair value of all stock-based awards on the date of grant as an expense over the vesting period. Alternatively, SFAS No. 123 allows entities to continue to apply the provisions of APB Opinion No. 25; however, SFAS No. 148, Accounting for Stock Based Compensation Transition and Disclosure, requires pro forma net income disclosures as if the fair-value-based method defined in SFAS No. 123 had been applied. The Company has elected to continue to apply the provisions of APB Opinion No. 25 and to provide the pro forma disclosure specified by SFAS No. 148. The Company, however, has recorded approximately $54,000 and $110,000, net of taxes, of compensation expense related to restricted shares for the three and nine months ended September 30, 2004, respectively, and $12,000 for each of the three and nine months ended September 30, 2003.

Had the Company determined compensation cost based on the fair value at the grant date for its stock options (using the Black-Scholes method) and restricted shares under SFAS No. 123, the Company s net income would have been adjusted to the pro forma amounts indicated below:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income:				
Net income, as reported	$2,410,000	$2,203,000	$5,998,000	$5,331,000
Add: Employee compensation expense related to restricted shares included in net income, net of taxes	54,000	12,000	110,000	12,000
Deduct: Stock-based employee compensation expense determined	(156,000)	(135,000)	(442,000)	(354,000)

under the fair-value based method, net of taxes				
Pro forma net income	$2,308,000	$2,080,000	$5,666,000	$4,989,000
Basic earnings per share:				
As reported	$ 0.31	$ 0.29	$ 0.77	$ 0.70
Pro forma	$ 0.30	$ 0.27	$ 0.73	$ 0.66
Diluted earnings per share:				
As reported	$ 0.30	$ 0.28	$ 0.75	$ 0.67
Pro forma	$ 0.29	$ 0.26	$ 0.71	$ 0.63

THE KEITH COMPANIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements
(Unaudited)

3. Earnings Per Share

Basic earnings per share (EPS) is computed by dividing net income during the period by the weighted average number of common shares outstanding during each period, excluding unvested restricted shares outstanding. Diluted EPS is computed by dividing net income during the period by the weighted average number of shares that would have been outstanding assuming the issuance of dilutive potential common shares as if outstanding during the reporting period including unvested restricted shares, net of shares assumed to be repurchased using the treasury stock method.

The following is a reconciliation of the denominator for the basic EPS computation to the denominator of the diluted EPS computation:

	For the Three Months Ended September 30,		**For the Nine Months Ended September 30,**	
	2004	**2003**	**2004**	**2003**
Weighted average shares used for the basic EPS computation	7,804,274	7,626,534	7,763,480	7,607,642
Incremental shares from the assumed exercise of dilutive stock options, unvested restricted shares and contingently issuable shares	234,021	349,356	258,017	347,525
Weighted average shares used for the diluted EPS computation	8,038,295	7,975,890	8,021,497	7,955,167

In conjunction with certain acquisitions, the Company agreed to pay consideration consisting of shares of its common stock. As a result, the Company estimated and included 20,151 weighted average contingently issuable shares in its weighted average shares used for the diluted EPS computation for the nine months ended September 30, 2004, and 142,816 for both the three and nine months ended September 30, 2003. There were no weighted average contingently issuable shares included in the calculation of diluted EPS for the three months ended September 30, 2004, since such shares were issued in May of 2004.

There were 75,857 and 146,221 anti-dilutive weighted stock options excluded from the above calculations for the three and nine months ended September 30, 2004, respectively, and 167,391 and 169,013 for the three and nine months ended September 30, 2003, respectively.

4. Segment and Related Information

The Company evaluates performance and makes resource allocation decisions based on the overall type of services provided to customers. Prior to January 1, 2004, the Company had grouped its operations, for financial reporting purposes, into two primary segments: Real Estate Development and Public Works/Infrastructure (REPWI) and Energy/Industrial (EI). Effective January 1, 2004, the Company groups its operations into three primary reportable segments: Real Estate Development (RE), Public Works/Infrastructure (PWI) and Energy/Industrial (EI). All prior period segment information has been adjusted to conform to the current period presentation. The RE segment primarily provides engineering and consulting services for the development of private projects, such as residential communities, commercial and industrial properties, and recreational facilities. The PWI segment primarily provides services for the development of public works/infrastructure projects, such as water/sewage facilities and transportation systems, and institutional projects, such as schools, hospitals and other public facilities. The EI segment primarily provides the technical expertise and management to design and test manufacturing facilities and processes, design mechanical and electrical systems solutions, and design, test and start-up primary and alternate electrical power systems for power generators and large scale power consumers.

THE KEITH COMPANIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements
(Unaudited)

The following tables set forth certain information regarding the Company s reportable segments as of and for the three and nine months ended September 30, 2004 and 2003:

As of and for the Three Months Ended September 30, 2004

	RE	PWI	EI	Corporate	Consolidated
Net revenue	$19,586,000	$ 3,816,000	$2,175,000	$	$25,577,000
Income (loss) from operations	$ 6,159,000	$ 720,000	$ (277,000)	$ (2,760,000)	$ 3,842,000
Identifiable assets.	$35,896,000	$13,314,000	$9,805,000	$36,980,000	$95,995,000

As of and for the Three Months Ended September 30, 2003

	RE	PWI	EI	Corporate	Consolidated
Net revenue	$16,411,000	$ 3,896,000	$2,547,000	$	$22,854,000
Income (loss) from operations	$ 4,870,000	$ 600,000	$ 200,000	$ (2,091,000)	$ 3,579,000
Identifiable assets.	$34,248,000	$15,490,000	$9,184,000	$27,202,000	$86,124,000

As of and for the Nine Months Ended September 30, 2004

	RE	PWI	EI	Corporate	Consolidated
Net revenue	$55,374,000	$10,752,000	$6,425,000	$	$72,551,000
Income (loss) from operations	$16,494,000	$ 1,395,000	$ (658,000)	$(7,676,000)	$ 9,555,000

As of and for the Nine Months Ended September 30, 2003

	RE	PWI	EI	Corporate	Consolidated
Net revenue	$47,347,000	$11,090,000	$9,540,000	$	$67,977,000
Income (loss) from operations	$12,535,000	$ 1,457,000	$ 785,000	$(6,421,000)	$ 8,356,000

5. Goodwill

The changes in the carrying amount of goodwill as reported by each reportable segment as of and for the three and nine months ended September 30, 2004 are as follows:

As of and for the Three Months Ended September 30, 2004

	RE	PWI	EI	Total
Balance as of July 1, 2004	$8,828,000	$9,329,000	$4,902,000	$23,059,000
Purchase price adjustments				
Balance as of September 30, 2004	$8,828,000	$9,329,000	$4,902,000	$23,059,000

As of and for the Nine Months Ended September 30, 2004

	RE	PWI	EI	Total
Balance as of January 1, 2004	$8,828,000	$9,329,000	$4,902,000	$23,059,000
Purchase price adjustments				
Balance as of September 30, 2004	$8,828,000	$9,329,000	$4,902,000	$23,059,000

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THE KEITH COMPANIES, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements
(Unaudited)

6. Indebtedness

The Company has available a $10.0 million unsecured line of credit consisting of four components: (i) an acquisition component, (ii) an equipment and vehicle financing component, (iii) a standby letter of credit component, and (iv) a working capital component. The line provides up to a maximum of $5.0 million to finance acquisitions, up to a maximum of $3.0 million to finance equipment and vehicle purchases, up to a maximum of $1.0 million for standby letters of credit, and up to a maximum of $10.0 million less the aggregate outstanding principal balance of the acquisition, equipment and vehicle, and standby letter of credit components for working capital. The line bears interest at either a range of 0.25% below prime to prime, or a range of 1.25% to 1.75% over LIBOR depending on the Company s ability to meet certain financial covenants. As of September 30, 2004, the Company was in compliance with the financial covenants under this line of credit agreement. All components of the line of credit mature in June 2005. This line of credit agreement restricts the payment of dividends without the bank s consent. There were no amounts outstanding under this line of credit agreement as of September 30, 2004. As of December 31, 2003, the Company had utilized the letter of credit component to issue a $229,000 stand-by letter of credit, which expired in February 2004.

7. Supplemental Cash Flow Information

	For the Nine Months Ended September 30,	
	2004	**2003**
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 10,000	$ 12,000
Cash paid for income taxes	$2,826,000	$4,384,000
Non-cash financing and investing activities:		
Issuable common stock issued	$ 779,000	$ 715,000
Restricted shares granted	$ 990,000	$
Purchase price adjustment to goodwill	$	$ 154,000

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The following discussion should be read in conjunction with the consolidated financial statements of the Company and the related notes included elsewhere in this Form 10-Q and the Annual Report on Form 10-K for the fiscal year ended December 31, 2003 filed by the Company. This Quarterly Report on Form 10-Q contains certain forward-looking statements, including among others:

- forecasts of earnings, revenue or other financial items;
- anticipated activity in the real estate development, public works/infrastructure and the energy/industrial industries;
- our business strategy for expanding our presence in these industries;
- anticipated growth and economic expansion in the Western and Midwestern United States;
- anticipated trends in our financial condition and results of operations;
- anticipated growth in the pace and size of our acquisitions;
- anticipated impact of future acquisitions and/or new divisions on the condition of our business by industry and geographic location;
- the long-term nature of some of our projects;
- our ability to attract and retain employees;
- our business strategy for integrating businesses that we acquire and/or internally create;
- our ability to sustain our growth and profitability; and
- our ability to distinguish ourselves from our current and future competitors.

We generally identify forward-looking statements in this Report using words like believe, expect, estimate, may, should plan, project, contemplate, anticipate, predict or similar expressions. You may find some of these stateme under Management s Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere is this Report. These statements involve known and unknown risks, uncertainties and other factors, including those described in the Risk Factors section, that may cause our or our industry s actual results, levels of activity, performance or achievements to differ from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Except as required by applicable laws, rules or regulations, including the securities laws of the United States, and the rules and regulations of the Securities and Exchange Commission, we do not plan to publicly update or revise any forward-looking statements after we file this Report, whether as a result of any new information, future events or otherwise.

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

You should read the following discussion and analysis together with our consolidated financial statements and related notes included elsewhere in this Report. Some of the information contained in this discussion and analysis or set forth elsewhere in this Report, including information with respect to our plans and strategies for our business, includes forward-looking statements that involve risks and uncertainties. You should review the Risk Factors section of this Report for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in this Report.

Overview

Business

We are a full service engineering and consulting services firm providing professional services on a wide range of projects to the real estate development, public works/infrastructure, and energy/industrial industries and in this report, we refer to these industries as the RE, PWI, and EI industries, respectively. For the nine months ended September 30, 2004, our net revenue generated from services related to our RE, PWI, and EI groups was approximately 76%, 15%, and 9%, respectively. Excluding corporate overhead/expenses, our RE group contributed over 95% of our total income from operations for the nine months ended September 30, 2004. In an effort to diversify our business, we intend to expand our presence in the PWI and EI industries. See *Diversification Strategy* section below for additional information.

We currently have approximately 830 employees/project workers and provide our engineering and consulting services from 16 primary divisions located in seven states: Arizona, California, Michigan, Nevada, Oregon, Texas and Utah. In addition to these 16 primary divisions, we also have a small energy operation in Brazil and in the second quarter of 2004, we contributed $0.2 million to a non-public entity in the energy sector with respect to which we received a controlling interest. For the nine months ended September 30, 2004, approximately 77% of our net revenue was generated from services rendered in California.

Services Provided

We provide a broad range of services. In the RE and PWI industries, our primary services include civil engineering, surveying and mapping, land planning, environmental services, cultural resources services, construction management, site acquisition, and water resource engineering. The services we provide to the EI industry primarily include instrumentation and controls systems engineering, fire protection engineering, electrical engineering, mechanical engineering, chemical process engineering, start-up and testing, and operations and maintenance.

For a more detailed discussion of the services we provide, please refer to our Annual Report on Form 10-K.

Industries Served

As mentioned above, we provide a wide range of engineering and consulting services to the RE, PWI and EI industries. The following is a brief description of the nature of the work associated with each industry that we serve:

Real Estate Development

Our RE group primarily provides engineering and consulting services for the development of private projects, such as residential communities, commercial and industrial properties, and recreational facilities.

Residential, commercial, golf, and other recreational developers use professional and technical consultants to provide planning and environmental services to create land use plans, write the supporting planning and environmental documents and process entitlements and permits through governmental authorities. Consultants also assist clients with obtaining approvals and permits from federal, state and local agencies. After projects are approved by governmental agencies, developers need surveying, mapping, and civil engineering services to survey development sites, create accurate boundary and base maps, and provide engineering designs for grading, streets, sewer and water pipelines and facilities, utilities and drainage facilities. Upon completion of the design phase, surveyors provide construction staking services to identify the precise locations of streets, utilities, pipelines, and other facilities to be constructed. In culturally sensitive areas, developers may also require environmental and archaeology services for planning and assistance with environmental approvals as well as construction and post-construction phase monitoring services.

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Residential development includes large-scale communities, senior citizen and retirement communities, single family homes, condominiums and apartments. Commercial development includes the development and construction of retail, office, hotel and industrial facilities. Golf and recreational facility development includes golf courses, driving ranges, parks, clubhouses, theme parks, resorts and lakes.

There are generally two types of real estate development clients: the land developer and the builder. Some take on characteristics of both. Developers generally must look long-term, utilize longer-term investment financing and evaluate the performance of projects across multiple business cycles. The developer pursues land development rights and implements the process of designing and constructing infrastructure utility, roadway and landform grading improvements. A developer s projects often span several years or even decades. The builder, on the other hand, generally provides an end-user product, including homes, retail stores, restaurants or clubhouses. The builder s approach is generally based upon current and relatively short-term economic conditions. Financing for a builder s work is often construction-oriented and anticipates short-term returns. The builder often buys property that has already been zoned, graded and otherwise improved by the land developer.

Public Works/Infrastructure

Our PWI group primarily provides services in the support of the development of public works/infrastructure projects, such as water and sewer facilities, transportation systems, and institutional projects, such as schools, hospitals and other public facilities.

Water resource services encompass the study and analysis of rainfall, water collection and distribution, use of water for cleanliness, nourishment and irrigation and the treatment and disposal of used or contaminated water. Due to the multiple demands for municipal, environmental and agricultural uses, water is a resource requiring extensive management throughout the United States. As populations continue to grow and higher standards are placed on protecting the environment without sacrificing the supply and quality of water, water districts, public agencies, agricultural users and municipalities are faced with the challenge of managing their water supplies more efficiently. Protecting communities from natural disasters such as floods and mudflows, cleaning natural waterways, eliminating pollution from storm runoff flowing into the ocean and protecting and enhancing natural riparian resources are among the missions of public water-managing agencies. Private developers also address these issues as part of their land development.

Highly experienced transportation planners, engineers, and designers provide an entire spectrum of resources necessary to effectively engineer and design state-of-the-art transportation infrastructure. Engineers develop street, major arterial and highway designs in cooperation with federal, state and local agencies to improve transportation networks. Highway and interchange projects require engineering designs for the roadways and interchanges and for the placement or relocation of sewer and water pipelines and utility lines and for rainfall run-off management. Surveying services are also required for the establishment of proper rights of way of these facilities and for the layout for construction.

Public and quasi-public facilities including schools and hospitals require services very much like those we provide to commercial developers in the RE industry.

Historically, during periods of unfavorable private sector economic conditions, public works projects have provided ongoing and more reliable sources of revenue for engineering firms and consultants than private real estate development and other private projects. Public projects are often long-term and have generally provided more determinable and consistent revenue streams than non-publicly funded projects.

Energy/Industrial

Our EI group primarily provides the technical expertise and management to design and test manufacturing facilities and processes, design mechanical and electrical systems solutions, and design, test and start-up primary and alternative energy power systems for power generators and large scale power consumers.

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The energy/industrial industry consists of manufacturing facilities, processing facilities, power generation and distribution, and production/refining methods and systems. Power plants, machines, assembly lines, factories and refineries require mechanical, electrical and process engineering services to enable utilization of new processes and to improve efficiency and reliability of their production effort. Comprehensive engineering services that are required include**:**

- Design or redesign of electrical, heating, ventilation and air conditioning systems;
- Mechanical equipment design;
- Equipment selection and purchasing;
- Design of integrated computer and monitoring device systems to control manufacturing and process equipment;
- Chemical/process engineering;
- Energy generation and usage consulting;
- Fire protection engineering;
- Material handling and process flow planning;
- Automation and robotics design;
- Construction management and installation supervision;
- Plant testing during construction and start-up;
- Plant operations and maintenance;
- Project management; and
- Computer programming.

Projects that utilize mechanical, electrical and process engineering and consulting services include:

- Energy/Power Generation and Management: power plants, natural gas/electrical systems and distribution systems;
- High Tech Facilities: biotechnology, pharmaceutical and laboratory facilities, computer centers, control rooms and research and development facilities;
- Heavy Manufacturing: automotive assembly, and pulp and paper processing;

Consumer Products: beverage, household products, packaging, and food processing;

Educational Facilities: school and university buildings and campuses; and

Public Facilities: medical buildings, hospitals, and publicly owned or occupied buildings.

Factors Affecting Our Business

On a macroeconomic basis, the economic and industry-wide factors that most significantly affect our business include: changes in economic growth in the United States (especially in California), changes in interest rates, the demand for real estate, the availability of qualified professionals, the ongoing financing of public works and infrastructure enhancements and refurbishments, the demand for power generation, capital spending in the energy/industrial industry, and increasing competition by domestic and foreign companies.

We continue to experience a high level of demand for our services in the residential real estate industry, which in part, has been positively impacted by the continued low interest rate environment along with an out of balance supply/demand relationship which is most notable in California. The demand for services in this area has made the hiring and retaining of qualified professionals a challenge for us. The reduced funding of public works projects has not only reduced the number of contracts available to propose on, but it has also increased the amount of competition for that work. The energy/industrial industry is still negatively impacted by the low demand for new power plants and/or alternative power solutions, coupled with an overall decrease in capital spending in that industry We are, however, seeing an indication that demand and work in this area may increase as a result of the recent extension of the production tax credit and industrial project starts.

There are a number of opportunities, challenges and risks that we face. The main opportunities that we are currently focusing on are acquisitions in the pubic works/infrastructure industry, opening new offices focusing mainly in the real estate development industry, and proposing on contracts/opportunities in the energy/industrial industry. Challenges that we currently face include, but are not limited to, identifying accretive acquisition candidates, attracting and retaining qualified professionals, servicing our clients on a timely basis, estimating and managing our costs on fixed-price contracts and/or

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contracts with not-to-exceed provisions, maintaining our profit margins, and the costs and time involved with implementing and complying with the requirements of the Sarbanes-Oxley Act of 2002. For a detailed discussion of risks that may impact us, please refer to the Risk Factors section included in this filing. We believe that we have the appropriate staff and procedures in place to take the steps that are necessary and feasible to address our main opportunities, challenges and risks.

Diversification Strategy

To help reduce our susceptibility to economic cycles affecting the RE industry, we intend to expand our work in the PWI and the EI industries as feasible, based upon such items as economic and market conditions. We believe that among other business initiatives, our acquisition strategy may play a significant role in contributing to this objective. We currently are focusing our acquisition efforts on companies which are mainly in the public works/infrastructure sector. Expanding our presence in the PWI and EI industries may have a significant impact on our future net revenue mix. As a result of this diversification strategy, our operating margins may be negatively affected by the decreased business concentration from the RE industry which has historically yielded higher operating margins than services provided to the PWI and EI industries.

General

Revenue

We derive most of our revenue from professional service activities. The majority of these activities are billed under various types of contracts with our clients, including fixed price and time-and-materials contracts. Most of our time-and-material contracts have not-to-exceed provisions. For contracts with either a fixed price or a not-to-exceed provision, revenue is recognized under the percentage of completion method of accounting based on the proportion of actual direct contract costs incurred in relation to total estimated direct contract costs. We believe that cost incurred is the best available measure of progress towards completion on these contracts. In the course of providing services, we sometimes subcontract for various services. These costs are included in billings to clients and are included in our gross revenue. Because subcontractor services can change significantly from project to project, changes in gross revenue may not be indicative of business trends. Accordingly, we also report net revenue, which is gross revenue less reimbursable subcontractor costs. Our revenue is generated from a large number of relatively small contracts.

Costs of Revenue

Costs of revenue include labor, non-reimbursable costs, materials and various direct and indirect overhead costs including rent, utilities and depreciation. Direct labor employees work predominantly at our offices and client job sites. The number of direct labor employees assigned to a contract will vary according to the size, complexity, duration and demands of the project. Contract terminations, completions, scheduling delays and contract proposal activity may result in periods when direct labor employees are not fully utilized. As we grow, we anticipate that we will add professional and administrative staff to support our growth. These professionals are in great demand and are likely to remain a limited resource for the foreseeable future. The significant competition for employees with the skills we require creates wage pressures on professional compensation. We attempt to increase our billing rates to customers to compensate for wage increases. There can be, however, a lag before wage increases can be incorporated into our existing contracts. Some expenses, primarily long-term leases, are fixed and cannot be adjusted in reaction to an economic downturn.

Selling, General and Administrative Expenses

Selling, general and administrative expenses (SG&A) primarily consist of corporate costs related to finance and accounting, information technology, business development and marketing, contract proposals, executive salaries, provisions for doubtful accounts and other indirect overhead costs.

Critical Accounting Policies and Significant Estimates

The accounting policies that are most important to the portrayal of our financial condition and results of operations, and require management s most difficult, subjective or complex judgments, are considered to be our critical accounting policies. Because of the uncertainties inherent in making assumptions and estimates regarding unknown future outcomes, future events may result in significant differences between estimates and actual results. We believe that each of the assumptions and estimates are appropriate in the circumstances, and represent the most likely future outcome. The following are what we believe are the accounting policies most affected by management estimates and judgments.

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Revenue Recognition and Cost Estimates on Contracts. We use estimates in recognizing revenue related to our contracts with fixed price or not-to-exceed provisions. For these contracts, revenue is recognized under the percentage of completion method of accounting based on the proportion of actual direct contract costs incurred to total estimated direct contract costs. We believe that costs incurred is the best available measure of progress towards completion on these contracts. Estimating the total estimated direct contract cost is a subjective process and requires the use of our best estimates based upon the current information known by us at that point in time. Our estimates of total direct contract cost have a direct impact on the revenue recognized by us. If our current estimates of total direct contract costs turn out to be higher than our previous estimates of total direct contract cost, then we would have over-recognized revenue for that previous period. Conversely, if our current estimates of total direct contract costs turn out to be lower than our previous estimates of total direct contract costs, we would have under-recognized revenue for that previous period. In both cases, a job-to-date adjustment would be made to true-up revenue as a change in estimate applied prospectively.

Goodwill. We use estimates in order to determine if goodwill has been impaired. An impairment loss may be recognized if the carrying amount of a reporting unit s net book value exceeds the estimated fair value of the reporting unit. We arrive at the estimated fair value of a reporting unit by using a variety of customary valuation methods, such as discounted cash flow analysis and multiples of net revenue and earnings before interest and taxes. These valuation methods use a variety of assumptions such as future billable employee headcount, net revenue per billable employee, operating income, cash flow, discount rates and multiples. Estimating fair value of a reporting unit is a subjective process and requires the use of our best estimates. We will perform our valuation analysis at least annually or if an event occurs or circumstances change that would indicate the carrying amount of goodwill may be impaired. If our estimates or assumptions change from those used in our current valuation, we may be required to recognize an impairment loss in future periods.

Provision for Doubtful Accounts. We use estimates in arriving at our allowance for doubtful accounts related to our contracts and trade receivables. These estimates are based on our best assessment as to the collectibility of the related receivable balance. Each quarter, we re-evaluate our estimates to assess the adequacy of our allowance for doubtful accounts and adjust the allowance for doubtful accounts as necessary. Factors considered in arriving at our allowance for doubtful accounts, include among other things, historical and anticipated client default rates at the various aging categories of contract and trade receivables and the overall business environment/economy. Future collections of receivables that are different from our current estimates will affect results of operations in future periods.

Discretionary Bonus Plan. We currently have a discretionary bonus plan under which we may award an annual cash performance bonus to our employees provided that our annual actual results meet or exceed pre-established annual targets. We review the need for a bonus accrual on a quarterly basis by comparing our actual quarterly results and our estimated results for the remainder of the year to our annual pre-established targets. Furthermore, the estimated bonus amount may be subject to a discretionary adjustment. Estimating our future results is a subjective process and requires the use of our best estimates based upon the current information known to us at that point in time. As a result of potential changes to our estimates and/or discretionary adjustments, our quarterly results may be significantly affected by adjustments to the bonus accrual. Any annual bonus award under this plan is at the discretion of the Compensation Committee of the Board of Directors.

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Results of Operations

The following table sets forth the Company s unaudited consolidated statements of income for each of the periods presented as a percentage of net revenue:

	For the Three Months Ended September 30,		For the Nine Month Ended September 30,	
	2004	**2003**	**2004**	**2003**
Gross revenue	107.9%	110.2%	108.8%	110.2%
Subcontractor costs	7.9	10.2	8.8	10.2
Net revenue	100.0	100.0	100.0	100.0
Costs of revenue	61.1	62.3	62.6	64.7
Gross profit	38.9	37.7	37.4	35.3
SG&A expenses	23.9	22.1	24.2	23.1
Income from operations	15.0	15.6	13.2	12.2
Interest income, net	0.4	0.3	0.4	0.3
Other expense (income), net	0.0	0.1	0.0	(0.3)
Income before provision for income taxes	15.4	15.8	13.6	12.8
Provision for income taxes	6.0	6.2	5.3	5.0
Net income	9.4%	9.6%	8.3%	7.8%

The following table sets forth certain components of the Company s unaudited consolidated statements of income for the three and nine months ended September 30, 2004 and includes the dollar and percentage change compared to the prior year period:

	For the Three Months Ended September 30,	For the Nine Months Ended September 30,
	(dollars in thousands) Change	(dollars in thousands) Change

	2004	2003	$	%	2004	2003	$	%
Gross revenue	$27,599	$25,175	$2,424	9.6%	$78,935	$74,919	$4,016	5.4%
Subcontractor costs	2,022	2,321	(299)	(12.9)	6,384	6,942	(558)	(8.0)
Net revenue	25,577	22,854	2,723	11.9	72,551	67,977	4,574	6.7
Costs of revenue	15,617	14,234	1,383	9.7	45,386	43,949	1,437	3.3
Gross profit	9,960	8,620	1,340	15.5	27,165	24,028	3,137	13.1
SG&A expenses	6,118	5,041	1,077	21.4	17,610	15,672	1,938	12.4
Income from operations	3,842	3,579	263	7.3	9,555	8,356	1,199	14.3
Interest income, net	113	65	48	73.8	257	195	62	31.8
Other expense (income), net	4	32	(28)	(87.5)	(20)	(188)	(168)	89.4
Income before provision for income taxes	3,951	3,612	339	9.4	9,832	8,739	1,093	12.5
Provision for income taxes.	1,541	1,409	132	9.4	3,834	3,408	426	12.5
Net income	$ 2,410	$ 2,203	$ 207	9.4%	$ 5,998	$ 5,331	$ 667	12.5%

The following tables set forth certain unaudited financial information regarding the Company s reportable segments for the three months ended September 30, 2004 and 2003:

	For the Three Months Ended September 30, 2004 (dollars in thousands)				
	RE	PWI	EI	Corporate	Consolidated
Net revenue	$19,586	$3,816	$2,175	$	$25,577
Gross profit	8,209	1,361	390		9,960
SG&A expenses	2,050	641	667	2,760	6,118
Income (loss) from operations	$ 6,159	$ 720	$ (277)	$(2,760)	$ 3,842

	For the Three Months Ended September 30, 2003 (dollars in thousands)				
	RE	PWI	EI	Corporate	Consolidated
Net revenue	$16,411	$3,896	$2,547	$	$22,854
Gross profit	6,625	1,292	703		8,620
SG&A expenses	1,755	692	503	2,091	5,041
Income (loss) from operations	$ 4,870	$ 600	$ 200	$(2,091)	$ 3,579

The following tables set forth certain unaudited financial information regarding the Company s reportable segments for the nine months ended September 30, 2004 and 2003:

	For the Nine Months Ended September 30, 2004 (dollars in thousands)				
	RE	PWI	EI	Corporate	Consolidated
Net revenue	$55,374	$10,752	$6,425	$	$72,551
Gross profit	22,306	3,500	1,359		27,165
SG&A expenses	5,812	2,105	2,017	7,676	17,610

Income (loss) from operations	$16,494	$ 1,395	$ (658)	$(7,676)	$ 9,555

For the Nine Months Ended September 30, 2003 (dollars in thousands)					
	RE	PWI	EI	Corporate	Consolidated
Net revenue	$47,347	$11,090	$9,540	$	$67,977
Gross profit	18,049	3,588	2,391		24,028
SG&A expenses	5,514	2,131	1,606	6,421	15,672
Income (loss) from operations	$12,535	$ 1,457	$ 785	$(6,421)	$ 8,356

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Three and Nine Months Ended September 30, 2004 and September 30, 2003

Net Revenue. Net revenue for the three months ended September 30, 2004 increased $2.7 million, or 11.9%, to $25.6 million compared to $22.9 million for the three months ended September 30, 2003. Net revenue for the nine months ended September 30, 2004 increased $4.6 million, or 6.7%, to $72.6 million compared to $68.0 million for the nine months ended September 30, 2003. The increase in net revenue for both the three and nine months ended September 30, 2004 was primarily due to increased net revenue generated from our real estate development segment, partially offset by lower net revenue from our energy/industrial segment.

Net revenue from our real estate development segment increased $3.2 million, or 19.3%, to $19.6 million for the three months ended September 30, 2004 compared to $16.4 million for same period in 2003. For the nine months ended September 30, 2004, net revenue from our real estate development segment increased $8.1 million, or 17.0%, to $55.4 million compared to $47.3 million for the nine months ended September 30, 2003. The increase for both periods was primarily due to a strong California residential real estate market, which was partially fueled by the continued low interest rate environment along with an out of balance supply/demand relationship which is most notable in California. The demand for our services related to the residential real estate market component of our real estate development segment resulted in an increase in our billable employee headcount, improvement of our billable employee utilization rate and a higher direct labor multiplier from this segment for both the three and nine months ended September 30, 2004 as compared to the same periods in 2003. The billable employee utilization rate is a measure of employee billability. The direct labor multiplier shows the amount of net revenue generated for each dollar of direct labor costs incurred on contracts.

As noted above, we continue to experience strong results from our real estate development segment, which has benefited from the low interest rate environment along with an out of balance supply/demand relationship which is most notable in California. Certain events, including the Federal Reserve s decision to increase the federal funds rate, lead us to believe that there may be further interest rate hikes. If interest rates continue to rise, this may impact the demand for real estate, and therefore may have a negative impact on our net revenue and profitability. Additionally, there have been geographic areas that showed a reduction in the pace of home sales in recent months where we provide large portions of our real estate development services. If home sales slow to a point where demand does not out pace supply by a large enough margin, our clients may slow down or cancel work which may have a negative impact on our net revenue and profitability.

Net revenue from our energy/industrial segment decreased $0.3 million, or 14.6%, to $2.2 million for the three months ended September 30, 2004 compared to $2.5 million for the same period in 2003. For the nine months ended September 30, 2004, net revenue from our energy/industrial segment decreased $3.1 million, or 32.7%, to $6.4 million compared to $9.5 million for the nine months ended September 30, 2003. The decrease for both the three and nine months ended September 30, 2004 was primarily due to a slowdown in the pace of construction of new power plants and/or alternative power solutions along with a general decrease in capital spending in the energy/industrial industry. This slowdown resulted in a significant decrease in the number of our billable employees/project workers for both the three and nine months ended September 30, 2004 as compared to the same period in 2003. In addition, we experienced a decrease in our billable employee/project worker utilization rates in this segment, as employees became less billable for both the three and nine months ended September 30, 2004 as compared to the same periods in 2003. For the nine months ended September 30, 2004, these decreases were partially offset by an increase in the direct labor multiplier compared to the same period in 2003.

Market uncertainties in the power generation portion of the energy/industrial industry have caused a decline in the pace of construction of new power plants and/or alternative power solutions and a general decrease in capital spending in the energy/industrial industry. As a result and as mentioned above, our energy/industrial segment continued to experience a reduction in net revenue during the first nine months of 2004 as compared to the same period in 2003.

However, we continue to be encouraged by the level of proposal activity in the energy/industrial segment. If proposals are not awarded as contracts and/or the market uncertainty continues, there may be further reductions in net revenue which would continue to negatively impact profitability from our energy/industrial segment.

Net revenue from our public works/infrastructure segment decreased $0.1 million, or 2.1%, to $3.8 million for the three months ended September 30, 2004 compared to $3.9 million for the same period in 2003. For the nine months ended September 30, 2004 net revenue from our public works/infrastructure segment decreased $0.3 million, or 3.0%, to $10.8 million compared to $11.1 million for the nine months ended September 30, 2003. Although these decreases are not significant in comparison to our overall company-wide net revenue, certain current conditions, including a weak economy in the public works/infrastructure industry and reduced funding of public works projects, lead us to believe that we could experience a further reduction to net revenue and profitability related to this segment, which may result in an adverse impact to our overall company-wide net revenue and profitability.

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Gross Profit. Gross profit for the three months ended September 30, 2004 increased $1.4 million, or 15.5%, to $10.0 million compared to $8.6 million for the three months ended September 30, 2003. For the nine months ended September 30, 2004, gross profit increased $3.2 million, or 13.1%, to $27.2 million compared to $24.0 million for the nine months ended September 30, 2003. The increase in gross profit for the three and nine months ended September 30, 2004 was primarily attributable to higher gross profit generated by our real estate development segment partially offset by lower gross profit from our energy/industrial segment.

Gross profit from our real estate development segment increased $1.6 million, or 23.9%, to $8.2 million for the three months ended September 30, 2004 compared to $6.6 million for the three months ended September 30, 2003. For the nine months ended September 30, 2004, gross profit from our real estate development segment increased $4.3 million, or 23.6%, to $22.3 million compared to $18.0 million for the nine months ended September 30, 2003. This increase in gross profit for both the three and nine months ended September 30, 2004 was primarily attributable to a strong California residential real estate market which resulted in an increase in our billable employee headcount, an improvement in our billable employee utilization rate and a higher direct labor multiplier, as mentioned above.

Gross profit from our energy/industrial segment decreased $0.3 million, or 44.5%, to $0.4 million for the three months ended September 30, 2004 compared to $0.7 million for the three months ended September 30, 2003. For the nine months ended September 30, 2004, gross profit from our energy/industrial segment decreased $1.0 million, or 43.2%, to $1.4 million compared to $2.4 million for the nine months ended September 30, 2003. The decrease in gross profit for both the three and nine months ended September 30, 2004 was primarily due to a continuing decline in the pace of construction of new power plants and/or alternative power solutions and a general decrease in capital spending in the energy/industrial industry which contributed to a significant reduction in our workforce and lower employee/project worker utilization, as mentioned above.

As a percentage of net revenue, gross profit increased to 38.9% during the third quarter of 2004 compared to 37.7% during the same period of 2003. For the nine months ended September 30, 2004, gross profit as a percentage of net revenue increased to 37.4% compared to 35.3% during the same period of 2003. The percentage increase for both periods was primarily related to higher gross profit contributed from our real estate development segment, partially offset by lower gross profit contributed from our energy/industrial segment (due primarily to the items noted above).

As noted above under the Net Revenue section, certain economic events/trends may have a negative impact on the gross profit and profitability of our real estate development, energy/industrial, and/or our public works/infrastructure segments in the future.

Selling, General and Administrative Expenses. SG&A for the three months ended September 30, 2004 increased $1.1 million, or 21.4%, to $6.1 million compared to $5.0 million for the same period in 2003. The dollar increase was primarily related to higher SG&A from our corporate operations, real estate development segment, and energy/industrial segment. SG&A related to our corporate operations, real estate development segment and energy/industrial segment increased by approximately $0.7 million, $0.3 million and $0.2 million, respectively. These increases were primarily due to, among other things, an increase in our discretionary bonus accrual of $0.4 million, and $0.1 million related to our real estate development segment and corporate operations, respectively. The bonus amount was lower in 2003 primarily due to a partial reversal of the bonus accrual during the third quarter of 2003. SG&A related to our corporate operations also increased by an additional $0.6 million, which was primarily attributable to increased compensation cost, an increase in headcount, including the creation of two new corporate executive positions (President of Real Estate Development Services and President of Energy/Industrial Services), and costs related to implementing and complying with the requirements of the Sarbanes-Oxley Act of 2002. Our real estate development segment also incurred higher compensation costs which were offset by lower proposal activity. SG&A related to our energy/industrial segment increased by $0.2 million, which was primarily attributable to costs associated with a business development agreement. For the three months ended September 30, 2004, SG&A as a percentage of net revenue increased to 23.9% compared to 22.1% for the corresponding prior year period. The percentage increase was primarily due to our discretionary bonus accrual, corporate operations, and our energy/industrial segment mainly due to the items discussed above and due to lower net revenue in our energy/industrial segment. The percentage increase was partially offset primarily by lower proposal activity in our real estate development segment.

SG&A for the nine months ended September 30, 2004 increased $1.9 million, or 12.4%, to $17.6 million compared to $15.7 million for the same period in 2003. The dollar increase was primarily related to higher SG&A from our corporate operations, energy/industrial segment and real estate development segment. SG&A related to our corporate operations, energy/industrial segment and real estate development segment increased by approximately $1.3 million, $0.4 million and $0.3 million, respectively. These increases were primarily due to, among other things, an increase in our discretionary bonus accrual of $0.3 million, and $0.1 million related to our real estate development segment and corporate operations, respectively. SG&A related to our corporate operations also increased by an additional $1.2 million, which was primarily attributable to increased compensation cost, an increase in headcount, including the creation of two new corporate executive positions (President of Real Estate Development Services and President of Energy/Industrial Services), and increased costs associated with implementing and complying with the requirements of the Sarbanes-Oxley Act of 2002. SG&A related to our energy/industrial segment also increased by $0.4 million, which was primarily attributable to costs associated with a business development agreement. Our real estate development segment also incurred higher compensation costs which were offset by lower proposal activity. For the nine months ended September 30, 2004, SG&A as a percentage of net revenue increased to 24.2% compared to 23.1% for the corresponding prior year period. The percentage increase was primarily due to our corporate operations, discretionary bonus accrual, and our energy/industrial segment mainly due to the items discussed above and due to lower net revenue in our energy/industrial segment. The percentage increase was partially offset primarily by lower proposal activity in our real estate development segment.

Other Expense (Income), net. For the nine months ended September 30, 2004, other income decreased by $0.2 million as compared to the corresponding prior year period. This decrease for the nine months ended September 30, 2004 was primarily attributable to a net $0.2 million sublease termination fee recognized by us in the first quarter of 2003 related to one of our facilities which we had subleased.

Income Taxes. For the three months ended September 30, 2004, the provision for income taxes was $1.5 million compared to $1.4 million for the three months ended September 30, 2003. For the nine months ended September 30, 2004, the provision for income taxes was $3.8 million compared to $3.4 million for the nine months ended September 30, 2003. The increase in provision for income taxes during both periods resulted from a higher taxable base as our effective tax rate remained at 39% for both 2004 and 2003.

Related Party

In March 2001, we entered into change in control agreements with Aram H. Keith, our chief executive officer and chairman of the board, Eric C. Nielsen, our president and chief operating officer, and Gary C. Campanaro, our chief financial officer and secretary, and a director of our company. These agreements provide that if the executive officer s employment with us terminates as a result of an involuntary or constructive termination (as these terms are defined in the agreements) at any time within two years following a change in control, then, in addition to other benefits, the executive officer will receive a one-time payment, equal to two times the executive officer s highest annual level of total cash compensation (including any and all bonus amounts) paid by us to that executive officer during any one of the three consecutive calendar years (inclusive of the year of termination) immediately prior to termination. The executive officer also is entitled to receive a payment by us to offset any excise tax under the Internal Revenue Code of 1986, as amended, that has been levied against the executive officer for payments that we have made to him. In addition, any grants of stock options or restricted shares made to the executive officer will immediately vest and, in the case of stock options will become exercisable as of the date of termination, and remain exercisable until their respective expiration dates.

We have not entered into any material related party transactions during 2004.

Liquidity and Capital Resources

Cash and cash equivalents combined with securities held-to-maturity totaled $37.8 million as of September 30, 2004, compared to $28.9 million as of December 31, 2003, an increase of $8.9 million. Working capital as of September 30, 2004 was $53.6 million compared to $47.4 million as of December 31, 2003, an increase of $6.2 million. Our debt to equity ratio (excluding the effect of issuable common stock at December 31, 2003) at both September 30, 2004 and December 31, 2003 was 0.00 to 1.

Cash Flows From Operating Activities. Net cash provided by operating activities increased by $4.2 million, to $10.5 million for the nine months ended September 30, 2004 compared to $6.3 million for the nine months ended September 30, 2003. The increase in net cash provided by operating activities was primarily due to collections on contract and trade accounts receivable, which resulted in a $5.4 million increase in cash coupled with a $1.6 million decrease in income taxes paid due to the timing of estimated tax payments as compared to the prior year period. This increase was partially offset by a $2.2 million increase in cash payments related to employee compensation and the timing of payments to vendors as compared to the prior year period.

Cash Flows From Investing Activities. Net cash used in investing activities totaled $0.8 million for the nine months ended September 30, 2004 compared to $3.7 million for the corresponding prior year period, a decrease of $2.9 million. This decrease in net cash used by investing activities was primarily due to proceeds from the sale of $1.2 million in securities held-to-maturity during the nine months ended September 30, 2004 as compared to purchases of $1.9 million of securities held-to-maturity during the corresponding prior year period coupled with approximately $0.7 million in cash expended for acquisitions in the prior year period. These decreases in cash used in investing activities were partially offset by a $1.0 million increase in capital expenditures associated with equipment purchases during 2004. This increase in capital expenditures was partially due to $0.5 million of equipment purchased by an entity in the energy sector to which we contributed $0.2 million in the second quarter of 2004 for which we received a controlling interest. Accordingly, we have consolidated this entity s financial results with those of ours.

Cash Flows From Financing Activities. Net cash provided by financing activities increased by $225,000 to $387,000 for the nine months ended September 30, 2004 compared to $162,000 for the nine months ended September 30, 2003. This increase in net cash provided by financing activities resulted primarily from an increase in net proceeds from stock options and restricted shares during the first nine months of 2004.

The Company has available a $10.0 million unsecured line of credit consisting of four components: (i) an acquisition component, (ii) an equipment and vehicle financing component, (iii) a standby letter of credit component, and (iv) a working capital component. The line provides up to a maximum of $5.0 million to finance acquisitions, up to a maximum of $3.0 million to finance equipment and vehicle purchases, up to a maximum of $1.0 million for standby letters of credit, and up to a maximum of $10.0 million less the aggregate outstanding principal balance of the acquisition, equipment and vehicle, and standby letter of credit components for working capital. The line bears interest at either a range of 0.25% below prime to prime, or a range of 1.25% to 1.75% over LIBOR depending on the Company s ability to meet certain financial covenants. As of September 30, 2004, the Company was in compliance with the financial covenants under this line of credit agreement. All components of the line of credit mature in June 2005. This line of credit agreement restricts the payment of dividends without the bank s consent. The Company did not have any outstanding balances under this line of credit agreement as of September 30, 2004.

On occasion, we will enter into purchase agreements related to acquisitions which provide for future purchase price payments or earn-outs as a result of achieving certain operating results by the acquired companies. As a result of these earn-out provisions, we may be obligated to pay additional consideration in future periods. Current accounting principles require that these earn-outs be accrued on our balance sheet only at the point at which the earn-out period has elapsed and the performance targets have been met. As of September 30, 2004, we have three months remaining on an earn-out for which we may be obligated to pay a maximum of $7.4 million in additional purchase price related to an acquisition in the energy/industrial segment, of which approximately 50% will be paid in cash with the remaining 50% to be paid out in our common stock. This potential earn-out is not currently reflected on our balance sheet as the earn-out period has not elapsed and, therefore, the achievement of the performance target is currently unknown. However, based on current market conditions and our expectations, we do not anticipate that it is likely that a substantial portion of this earn-out amount will be paid.

There have been no significant changes to our contractual obligations or commitments from those disclosed in our most recently filed Form 10-K.

We do not hold any derivative financial instruments for trading purposes or otherwise. In addition, we presently do not enter into any hedging type activities to manage our exposure to foreign currency risk associated with our Brazilian operation which is part of our energy/industrial segment and generated approximately $0.5 million in net revenue for the nine months ended September 30, 2004. Furthermore, we have not engaged in energy or commodity trading activities and do not anticipate doing so in the future, nor do we have any transactions involving unconsolidated entities, special purpose entities, or variable interest entities.

Future Cash Requirements

We expect to fund our future liquidity needs primarily from (i) operating cash flows, (ii) existing balances of cash and cash equivalents and securities held-to-maturity, and (iii) borrowings under our $10.0 million unsecured revolving line of credit which had no outstanding balance as of September 30, 2004. We believe these sources of funds will be sufficient to provide for our operations and planned capital expenditures, and satisfy our lease obligations over the next twelve months. We expect our capital expenditures for the next twelve months to be approximately $2.0 million to $3.5 million.

We also intend to use available liquidity to continue our acquisition strategy. We continue to examine acquisitions of complementary businesses and anticipate that our liquidity will be sufficient to provide for potential acquisitions for the next twelve months. However, the pace and size of acquisitions are difficult to predict. We may complete more or fewer acquisitions than we currently contemplate depending on the opportunities that present themselves, and our cash requirements may change accordingly.

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Effect of Recent Accounting Pronouncements

In March 2004, the EITF reached a consensus on Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. This consensus applies to investments in marketable debt and equity securities, as well as investments in equity securities accounted for under the cost method. It provides guidance for determining when an investment is considered impaired, whether the impairment is other than temporary, and the measurement of an impairment loss. The guidance also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The provisions of EITF Issue No. 03-1 are effective at the beginning of the first interim period beginning after June 15, 2004, with exception of debt securities that are impaired because of interest rate and/or sector spread increases, for which the effective date is delayed as a result of proposed FSP EITF Issue 03-1-b, Effective Date of Paragraph 16 of EITF Issue No. 3-1 . The adoption of EITF Issue No. 03-1 did not have a material impact on our financial condition, results of operations, or cash flows.

Inflation

Although our operations can be influenced by general economic trends, we do not believe that inflation had a significant impact on our results of operations for the periods presented. Due to the short-term nature of most of our contracts, if costs of revenue increase, we will attempt to pass these increases on to our clients; however, there can be a lag before these increases in costs can be incorporated into our existing contracts.

The following discussion summarizes material risks which you should carefully consider before you decide to invest in our common stock or to maintain or increase your investment. Any of the following risks, if they actually occur, would likely harm our business. The trading price of our common stock could then decline, and you may lose all or part of the money you paid to buy our common stock.

Risk Factors Risks Related To Our Industries

Our business could suffer if there is a downturn in the real estate market

We estimate that during the first nine months of 2004, approximately 76% of our net revenue and 96% of our income from operations, excluding corporate overhead/expenses, was related to services in connection with residential and commercial real estate development projects. Reduced demand in the real estate market would likely decrease the demand for our services. A decrease in the demand for our services could result in cash flow difficulties and potential operating losses for our company.

The real estate market and, therefore, our business, may be impacted by a number of factors, which may include:

- changes in employment levels and other national and local economic conditions;
- changes in interest rates and in the availability, cost and terms of financing;
- the impact of present or future environmental, zoning or other laws and regulations;
- changes in real estate tax rates and assessments and other operating expenses;
- changes in levels of government spending and fiscal policies; and
- earthquakes and other natural or manmade disasters and other factors which are beyond our control.

We derive revenue from contracts with government agencies. Any disruption in government funding or in our relationship with those agencies could adversely affect our business

The demand for our services is related to the level of government program funding that is allocated to rebuild, improve and expand the nation s infrastructure. We believe that the success and further development of our business depends, in part, upon the continued funding of these government programs and upon our ability to participate in these government programs. We cannot assure you that governments will have the available resources to fund these programs, that these programs will continue to be funded even if governments have available financial resources or that we will continue to win government contracts.

Some of these government contracts are subject to renewal or extensions annually, so we cannot be assured of our continued work under these contracts in the future. Unsuccessful bidders may protest or challenge the award of these contracts. In addition, government agencies can terminate these contracts at their convenience. As a result, we may incur costs in connection with the termination of these contracts and suffer a loss of business. Also, contracts with government agencies are subject to substantial regulation and an audit of actual costs incurred. Consequently, there may be a downward adjustment to our revenue if billed recoverable costs exceed actual recoverable costs.

We derive revenue from engineering services provided to the energy industry. Continued delay and reduction in the pace of construction for new power plants, cogeneration facilities, and electrical distribution facilities has had, and may continue to have an adverse affect on our business

The demand for our services is related to the level and pace of construction of energy related solutions. We believe that the success and further development of this aspect of our business depends, in part, upon the need for and funding of these projects. High energy prices, power shortages, and pressure at state and federal levels for increased supply resulted in increased demand for energy related solutions with an unprecedented number of new power plants, cogeneration facilities, and electrical distribution facilities announced in 2001. However, weakening demand and a softening economy combined with a decline in energy prices have caused builders of such energy related solutions to reconsider planned projects. Many have announced downsizings or cancellations of new power plants and/or alternative power solutions. The decline in the pace of construction of new power plants and/or alternative power solutions has had, and may continue to have, an adverse affect on our energy/industrial segment.

We may have difficulty in attracting and retaining qualified professionals, which may harm our reputation in the marketplace and restrict our ability to implement our business strategy

We derive our revenue almost exclusively from services performed by our professionals. We may not be able to attract and retain the desired number of professionals over the short or long-term. There is significant competition for professionals with the skills necessary for providing our services from major and boutique consulting, engineering, research and other professional service firms. We believe our existing relationships between our clients and our employees is one of our greatest business development assets. Our inability to attract and retain qualified professionals could impede our ability to secure and complete engagements, in which event, we may lose market share and our revenue and profit may decline.

Increased competition in the industries we serve may adversely affect our business

We may decide to reduce fees for our services in order to compete effectively. If so, our revenue and margins may decline. The market for engineering, consulting and technical services is highly competitive and is based primarily on quality of service, relative experience, staffing capabilities, reputation, geographic presence, stability and price. Many of our competitors have more personnel and greater financial, technical and marketing resources than us. Historically, clients have chosen among competing firms based on the quality and timeliness of the firm s service in addition to fees. We believe, however, that fees have and may continue to become a more important factor, especially in our public works/infrastructure services segment. If competitive pressures force us to make fee concessions or otherwise reduce fees for our services, then our revenue and margins may be negatively impacted.

Terrorism and related conflicts may have a material adverse effect on our operating results

The terrorist attacks that took place in the United States on September 11, 2001, along with the United States military campaign against terrorism in Afghanistan, Iraq and elsewhere, and ongoing violence in the Middle East have created many economic and political uncertainties, some of which may continue to materially affect the markets in which we operate, and our operations and profitability. The short-term and long-term effects of these developments on our customers, the markets for our services and the U.S. economy are uncertain. The consequences of any terrorist attacks, or any armed conflicts, are unpredictable, and we may not be able to foresee events that could have an adverse effect on our markets or our business.

Risk Factors Risks Related To Our Business

Our revenue, income and cash flow could decline if there is a downturn in the California economy or real estate market

We estimate that during the first nine months of 2004, approximately 77% of our net revenue was derived from services rendered in California. Poor economic conditions in California may significantly reduce the demand for our services and decrease our revenue and profits. From 1991 to 1996, our business was negatively impacted during the real estate market downturn in Southern California, and we experienced cash flow difficulties and substantial operating losses.

If we are unable to effectively manage our growth, we may experience a decline in our revenue and profitability

We have grown rapidly and intend to pursue further growth, through acquisitions and otherwise, as part of our business strategy but we may not be able to manage our growth effectively and efficiently. Our inability to manage our growth effectively and efficiently could cause us to incur unforeseen costs, time delays or other negative impacts, any of which could cause a decline in our revenue and profitability. Our rapid growth has presented and will continue to present numerous administrative and operational challenges, including the management of an expanding array of engineering and consulting services, the assimilation of financial reporting systems, increased pressure on our senior management and increased demand on our systems and internal controls.

If we are unable to successfully implement our acquisition strategy, we may not meet our current expectations of growth and/or operating results

Our growth strategy includes the strategic acquisition of companies that expand our service offerings and geographic presence, including acquisitions that may be larger than our historic acquisitions. If we are unsuccessful in implementing our acquisition strategy, it may be more difficult to implement our diversification strategy and we could fail to achieve the overall

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revenue and profitability growth that we currently expect. We may not be successful in implementing our acquisition strategy for a number of reasons, including the following:

We may fail to consummate an acquisition even if an announcement had been made to acquire a target company;

As the engineering industry consolidates, suitable acquisition candidates are expected to become more difficult to locate and may only be available at an increased price or under terms that are less favorable than in the past;

We may not be able to arrange suitable financing to consummate an acquisition;

We may not be successful in integrating an acquired company s professionals, clientele and culture into ours;

We may not be successful in generating the same level of operating performance that an acquired company experienced prior to the acquisition;

As we expand our service offerings and geographic presence, we may not be able to maintain the current level of quality of services;

We may not be able to maintain our reputation in an acquired entity s geographic area or service offerings and as a consequence our ability to attract and retain clients in those or other areas may be negatively impacted;

An acquired company may be less profitable than us, resulting in reduced profit margins; and

The acquisition, subsequent integration, and ongoing operations of an acquired company may require a significant amount of management s time, diverting their attention from our existing operations and clients.

We recently opened new offices in Southern California, and may open additional offices. We have incurred, and will continue to incur, start-up expenses and these offices may not be profitable soon, or at all.

If we do not generate additional business through new or existing clients to sustain our new offices and retain qualified management and staff to operate these offices, our margins and profitability may decline. In October 2004, we opened two new offices in Southern California to service existing business in our real estate development sector and in an effort to generate new business. We may open additional offices in California to capitalize on growth or other strategic opportunities. Opening new offices involves start up expenses as well as multi-year capital commitments, and requires substantial management time which may create a distraction from the day to day operations of our business. Critical to the success of an office is having the right management and staff. If the office does not have the right management and staff, it can have low margins or not be profitable. Also, as we open new offices in California and if these offices grow, we increase the risks associated with our significant concentration of business in California and in the real estate development sector.

From time to time, we have and may continue to pursue and invest in business opportunities that are not directly within our core competencies. If these business opportunities are not profitable, our results of operations may be materially adversely affected.

We may not always control all aspects of new business opportunities outside of our core competency and we may depend in part upon the knowledge and expertise of other professional service providers and management teams in order to make these business opportunities profitable. New business opportunities can also require substantial management time which may create a distraction from our day to day business operations. If these business opportunities do not perform as anticipated or are not profitable, our earnings in those periods may be materially adversely affected and we may experience a partial or complete loss of our investment.

Our diversification strategy could decrease our operating margins

To help reduce our susceptibility to economic cycles affecting the real estate development industry, we intend to expand our work in the public works/infrastructure and the energy/industrial industries, as feasible. As a result of this diversification strategy, our operating margins may be negatively affected by the decreased business concentration from the real estate development industry which has historically yielded higher operating margins than services provided to the public works/infrastructure and energy/industrial industries.

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If our estimates or assumptions used in arriving at the fair value of acquired entities change from those used in our current valuations, we may be required to recognize a goodwill impairment loss

We use estimates in order to determine if goodwill has been impaired. An impairment loss may be required to be recognized if the carrying amount of a reporting unit s net book value exceeds the estimated fair value of the reporting unit. We arrive at the estimated fair value of a reporting unit by using a variety of customary valuation methods, such as discounted cash flow analysis and multiples of net revenue and earnings before interest and taxes. These valuation methods use a variety of assumptions such as future billable employee headcount, net revenue per billable employee, operating income, cash flow, discount rates and multiples. Estimating fair value of a reporting unit is a subjective process and requires the use of our best estimates. If our estimates or assumptions change from those used in our current valuation, we may be required to recognize an impairment loss. As of September 30, 2004, our goodwill balance, net of accumulated amortization was $23.1 million. We no longer amortize goodwill due to our adoption of SFAS No. 142 Goodwill and Other Intangible Assets.

We could lose money if we fail to accurately estimate our costs on fixed-price contracts and/or contracts with not-to-exceed provisions

We expect to perform services under contracts that may limit our profitability. Under fixed-price contracts we perform services at a stipulated price. Under time-and-materials contracts with not-to-exceed provisions, we are reimbursed for the number of labor hours expended at an established hourly rate plus the cost of materials incurred, subject, however, to a stated maximum dollar amount for the services to be provided under the contract. In both of these types of contracts, we agree to provide our services based on our estimate of the costs a particular project will involve. Our estimates are not always accurate. Underestimation of costs for these types of contracts may cause us to incur losses or result in a project not being as profitable as we expected. We may fail to estimate costs accurately for a number of reasons, including:

- weakness in the management of our projects;
- loss of efficiency resulting from cross-utilization of office staff from various locations;
- changes in the costs of goods and services that may occur during the contract period;
- problems with new technologies; and
- delays beyond our control.

Our backlog is an uncertain indicator of future financial performance and is subject to adjustment or cancellation

Our gross revenue backlog for fixed-price contracts and time-and-material contracts with not-to-exceed provisions as of September 30, 2004 was approximately $68.4 million. We cannot assure you that the entire balance of our backlog will convert into revenue since our contracts are subject to scope adjustments and/or cancellations. Scope adjustments or cancellations may result in a reduction in our backlog, which could adversely affect our revenue and profitability.

The loss of Mr. Keith could adversely affect our business, including our ability to secure and complete engagements and attract and retain employees

We do not have an employment agreement with, or maintain key man life insurance on Aram H. Keith, our chief executive officer. If we lose the services of Mr. Keith, we may be less likely to secure or complete contracts and to attract and retain additional employees. The efforts, abilities, business generation capabilities and name recognition of Mr. Keith are important to our success in those activities.

If our employees leave our company and join a competitor, we may lose business

Our employees might leave our company and become competitors of ours. If this happens, we may lose additional employees and some of our existing clients that have formed relationships with our former employees. In addition, we may lose future clients to a former employee as a new competitor. In either event, we could lose clients and revenue, and our profitability could decline.

Adverse weather conditions or acts of God may cause a delay or elimination of our net revenue otherwise recognized and adversely affect our profitability

Field activities are generally performed outdoors and may include surveying, archeology, plant start-up and testing, and plant operations. Certain weather conditions or acts of God (such as fire, floods, and similar events) may cause postponements in the initiation and/or completion of our field activities and/or may hinder the ability of our office employees to arrive at work, which may result in a delay or elimination of revenue that otherwise would have been recognized, while certain costs will continue to be incurred. Adverse weather conditions or acts of God may also delay or eliminate our initiation and/or completion of the various phases of work relating to our other engineering services that commence concurrent with or subsequent to field activities. Any delay in completion of the field, office and/or other activities may require us to incur additional costs attributable to overtime work necessary to meet the client s required schedule. Due to various factors, a delay in the commencement or completion of a project may also result in a cancellation of the contract. As a result, our net revenue and profitability may be adversely affected.

Our business may expose us to liability in excess of our current insurance coverage

We are exposed to potential liabilities to clients for errors or omissions in the services we perform. These liabilities could exceed our current insurance coverage and the fees we derive from those services. We cannot always predict the magnitude of these potential liabilities but claims could be significant. A partially or completely uninsured claim, if successful and of significant magnitude, could result in substantial losses.

We currently maintain general liability, umbrella, professional liability, directors and officers liability, and various types of other insurance policies. Claims may be made against us which exceed the limits of these policies, in which case we would be liable to pay these claims from our assets. Our professional liability and directors and officers liability policies are claims made policies and only claims made during the term of the policy are covered. If we terminate our policies and do not obtain retroactive coverage, we would be uninsured for claims made after termination even if these claims are based on events or acts that occurred during the term of the policy. Our insurance policies typically have various exceptions to the claims covered and also require us to assume some costs of the claim even though a portion of the claim may be covered, resulting in potential liability to us. Further, our expansion into new services or geographic areas could result in our failure to obtain coverage for these services or areas, or the coverage being offered may be at a higher cost than our current coverage. Due to the current insurance environment, we have experienced and may continue to experience an increase in our insurance premiums. We may not be able to pass these increases on to our clients in increased billing rates.

If we are unable to engage qualified subcontractors, we may lose projects, revenue and clients

We often contract with outside companies to perform designated portions of the services we perform for our clients. If we are unable to engage subcontractors, our ability to perform under some of our contracts may be impeded and the quality of our service may decline. As a consequence, we may lose projects, revenue and clients. For the nine months of 2004, subcontractor costs accounted for approximately 8.8% of our net revenue.

We derive revenue from contracts for work performed in foreign countries which are subject to a number of risks that could adversely affect the results from these contracts

International business is subject to the customary risks associated with international transactions, including political risks, local laws and taxes, difficulty in enforcing contracts, the potential imposition of trade or currency exchange restrictions, tariff increases and difficulties or delays in collecting accounts receivables. Weak foreign economies and/or a weakening of foreign currencies against the U.S. dollar could have a material adverse effect on our business, financial condition and results of operations. We presently do not enter into any hedging type activities to manage our exposure to foreign currency risk associated with our Brazilian operations.

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Risk Factors   Risks Related To Ownership of Our Stock

Our stock price may decrease, which could result in significant losses for investors or adversely affect our business

The following factors could cause the market price of our common stock to decrease, perhaps substantially:

- the failure of our quarterly operating results to meet expectations;
- adverse developments in the worldwide economy, the financial markets, the engineering and consulting services market, the real estate market, the public works/infrastructure market, and/or the energy/industrial market;
- changes in interest rates;
- our failure to meet securities analysts expectations;
- changes in accounting principles;
- sales of common stock by our senior management, members of our board, existing shareholders, or holders of options/restricted shares;
- announcements of key developments by our competitors;
- the reaction of markets and securities analysts to announcements and developments involving our company; and
- resolution of threatened or pending litigation.

In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. We may in the future be the target of similar litigation. Securities litigation could result in substantial costs and divert management s attention and resources.

Insiders have substantial control over us, which could limit your ability to influence the outcome of key transactions

Our executive officers and directors, in the aggregate, hold approximately 17% of our outstanding common stock, of which our chairman of the board and chief executive officer holds approximately 16%. Accordingly, our chairman of the board and chief executive officer can have significant influence over most matters requiring approval by our shareholders, including the election of directors and the approval of mergers or other business combination transactions.

If we need to sell or issue additional shares of common stock and/or incur additional debt to finance future acquisitions, your stock ownership could be diluted and our results of operations could be adversely affected

Our business strategy is to expand into new markets and enhance our position in existing markets through the acquisitions of complementary businesses. In order to successfully complete targeted acquisitions or to fund our other activities, we may issue additional equity securities that could dilute your stock ownership. We may also incur additional debt if we acquire another company, and this could negatively impact our results of operations.

Our board of directors has the ability to discourage takeover attempts, which may reduce or eliminate your ability to sell your shares for a premium in a change of control transaction

Our amended and restated articles of incorporation provide us with the ability to issue blank check preferred stock without consulting our shareholders. As a result, our board of directors may frustrate a takeover attempt by issuing shares to a friendly shareholder or acquirer, implementing a poison pill or otherwise creating features of newly issued preferred stock.

Shares of our common stock eligible for public sale could cause the market price of our stock to drop, even if our business is doing well

We currently have approximately 7.9 million shares of common stock outstanding. Sales of a substantial number of shares of our common stock in the public market, or the perception that these sales could occur, could adversely affect the market price for our common stock. Certain shareholders hold large numbers of shares which they are able to sell in the public market.

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Significant sales of these shares could cause the market price of our common stock to decline regardless of the performance of our business. These sales also might make it difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

Our common stock is thinly traded. Consequently, it may be difficult for shareholders to sell our common stock, which may result in losses for investors

The average daily trading volume, excluding block trades, for our common stock on the Nasdaq National Market was approximately 9,000 shares for the trailing twelve months ended September 30, 2004. Accordingly, the market price of our common stock is subject to significant fluctuations that may have been, and may continue to be, exaggerated due to the lack of an active trading market for our common stock. This negative factor may make it difficult for shareholders to sell our common stock, which may result in losses for investors.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to interest rate changes primarily as a result of our cash and cash equivalents (Cash), securities held-to-maturity (Securities) and line of credit, which are used to maintain liquidity and to fund capital expenditures and our expansion. Due to our large balance of Cash and Securities, our earnings and cash flows may be materially impacted by changes in interest rates. We have the intent and believe we have the ability to hold all of our Securities until maturity, and therefore, we should not bear any interest rate risk due to early disposition. Due to our having no outstanding debt as of September 30, 2004, our earnings and cash flows should not be materially impacted by changes in interest rates on our debt. Our bank line of credit is based on variable interest rates and is therefore affected by changes in market rates. We do not enter into derivative or interest rate hedging transactions.

The table below presents the principal amounts of Securities, along with the weighted average interest rates, fair values and expected maturity by year to evaluate the expected cash flows and sensitivity to interest rate changes as of September 30, 2004.

	2005	Total	Fair Value(1)
Securities (non-trading)	$3,400,000	$3,400,000	$3,400,000
Weighted average interest rate (2)	1.07%	1.07%	1.07%

(1) The fair value for Securities was based on the quoted market price of such securities as of September 30, 2004.

(2) Our Securities are invested in federally tax-exempt bonds.

As the table incorporates only those exposures that existed as of September 30, 2004, it does not consider those exposures or positions which could arise after that date. Moreover, because firm commitments are not presented in the table above, the information presented in the table has limited predictive value. Our ultimate realized gain or loss with respect to interest rate fluctuations will depend on those exposures or positions that arise during the period and interest rates.

ITEM 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the

SEC s rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic reports with the SEC.

In accordance with SEC requirements, our chief executive officer and chief financial officer note that, since the date of the most recent evaluation of our disclosure controls and procedures to the date of our Quarterly Report on Form 10-Q, there

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have been no significant changes in our internal controls or in other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

Our management, including the chief executive officer and our chief financial officer, does not expect that our disclosure controls or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company 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 errors or mistakes. 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 control. The design of any system of controls also is based in part upon 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; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Number	
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 Dated November 4, 2004
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 Dated November 4, 2004
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Dated November 4, 2004
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Dated November 4, 2004

(b) Reports on Form 8-K

On August 5, 2004, we filed a Current Report on Form 8-K, Items 5 and 12, relating to a press release announcing 2004 Second Quarter Results and Earnings Guidance.

On November 4, 2004, we filed a Current Report on Form 8-K, Items 2.02 and 7.01, relating to a press release announcing 2004 Third Quarter Results and Earnings Guidance.

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.

Dated: November 4, 2004	THE KEITH COMPANIES, INC.
	By: /s/ Aram H. Keith Aram H. Keith Chairman of the Board of Directors and Chief Executive Officer
	By: /s/ Gary C. Campanaro Gary C. Campanaro Chief Financial Officer and Secretary

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Exhibit Index

Exhibit Number	Description
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