

INTEGRATED ELECTRICAL SERVICES INC
Form 10-Q
August 11, 2008
Table of Contents

UNITED STATES 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 June 30, 2008
OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission File Number 1-1183

Integrated Electrical Services, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

76-0542208
(I.R.S. Employer
Identification No.)

1800 West Loop South, Suite 500, Houston, Texas 77027
(Address of principal executive offices and ZIP code)

Registrant's telephone number, including area code: **(713) 860-1500**

Edgar Filing: INTEGRATED ELECTRICAL SERVICES INC - Form 10-Q

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

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

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

The number of shares outstanding as of August 4, 2008 of the issuer's common stock was 14,839,716.

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES

INDEX

	Page
PART I. FINANCIAL INFORMATION	
<u>Item 1.</u>	
	<u>Condensed Consolidated Financial Statements</u>
	<u>Condensed Consolidated Balance Sheets as of June 30, 2008 and September 30, 2007</u> 5
	<u>Condensed Consolidated Statements of Operations for the Three Months ended June 30, 2008 and 2007</u> 6
	<u>Condensed Consolidated Statements of Operations for the Nine Months Ended June 30, 2008 and 2007</u> 7
	<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended June 30, 2008 and 2007</u> 8
	<u>Notes to Condensed Consolidated Financial Statements</u> 9
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 23
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 36
<u>Item 4.</u>	<u>Controls and Procedures</u> 36
PART II. OTHER INFORMATION	
<u>Item 1.</u>	<u>Legal Proceedings</u> 39
<u>Item 1A.</u>	<u>Risk Factors</u> 39
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 39
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u> 39
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u> 39
<u>Item 5.</u>	<u>Other Information</u> 39
<u>Item 6.</u>	<u>Exhibits</u> 40
<u>Signatures</u>	41

Table of Contents

DEFINITIONS

In this quarterly report on Form 10-Q, the words "IES", "the Company", "we", "our", "ours", and "us" refer to Integrated Electrical Services, Inc. and its subsidiaries, except as otherwise specified herein.

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q includes certain statements that may be deemed "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, all of which are based upon various estimates and assumptions that we believe to be reasonable as of the date hereof. These statements involve risks and uncertainties that could cause our actual future outcomes to differ materially from those set forth in such statements. Such risks and uncertainties include, but are not limited to:

- general economic and capital markets conditions, including changes in interest rates that affect the cost of construction financing and mortgages, and the availability of such capital to our customers;
- potential difficulty in fulfilling the covenant terms of our credit facilities;
- limitations on the availability of sufficient credit or cash flow to fund our working capital needs;
- increased cost of surety bonds affecting margins on work and the ability to obtain additional bonding;
- fluctuations in operating activity due to downturns in levels of construction, seasonality, and differing regional economic conditions;
- inaccurate estimates used when entering into fixed-priced contracts;
- potential errors when estimating revenue and progress to date on percentage-of-completion contracts;

Edgar Filing: INTEGRATED ELECTRICAL SERVICES INC - Form 10-Q

- difficulty in managing the operation of existing entities;
- fluctuations in the cost of commodities used in our business, in particular copper, aluminum, steel, and certain plastics;
- rising fuel costs for our operating vehicle fleet;
- competition in the construction industry, both from third parties and former employees, which could result in the loss of one or more customers or lead to lower margins on new contracts;
- fluctuations in financial results due to assumptions made regarding future events used to value our stock options and performance-based stock awards;
- increase in cost of, or limitations on availability of, qualified labor, especially electricians and construction supervisors;
- accidents resulting from the physical hazards associated with our work and potential for vehicle accidents;
- loss of key personnel or transition of new senior management;
- challenges integrating new types of work or new processes into business units;
- uncertainties inherent to estimating future operating results, including revenues, operating income, or cash flow;
- difficulty incorporating new accounting, control and operating procedures;
- difficulty addressing the material weakness identified by us and our independent auditors;

- disagreements with taxing authorities with regard to tax positions we have adopted;

Table of Contents

- unexpected liabilities, losses from warranties, or liabilities of business units of which we have sold substantially all of the assets;
- the residual effect with customers and vendors from our reorganization, resulting in higher costs, lower administrative performance, less work or less favorable delivery or credit terms;
- reduced productivity, either at the corporate office or operating level;
- difficulty in transferring all of our electrical and construction licenses after our recent consolidation of business units;
- growth in latent defect litigation in the residential market in California and the expansion of such litigation into other states where we provide residential electrical work for home builders not otherwise covered by insurance; and
- the possibility that our restructuring program will not be successfully executed.

You should understand that the foregoing, as well as other risk factors discussed in our annual report on Form 10-K for the year ended September 30, 2007, could cause future outcomes to differ materially from those expressed in this and our aforementioned 10-K. We undertake no obligation to publicly update or revise information concerning our restructuring efforts, borrowing availability, or cash position or any forward-looking statements to reflect events or circumstances that may arise after the date of this report. Forward-looking statements are provided in this Form 10-Q pursuant to the safe harbor established under the Private Securities Litigation Reform Act of 1995 and should be evaluated in the context of the estimates, assumptions, uncertainties, and risks described herein.

General information about us can be found at www.ies-co.com under Investor Relations. Our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments to those reports, are available free of charge through our website as soon as reasonably practicable after we file them with, or furnish them to, the Securities and Exchange Commission. You may also contact our Investor Relations department, and they will provide you with copies of our public reports.

Table of Contents**ITEM 1. FINANCIAL STATEMENTS****INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(IN THOUSANDS, EXCEPT SHARE INFORMATION)**

	June 30, 2008 (Unaudited)	September 30, 2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 56,818	\$ 69,676
Restricted cash		20,000
Accounts receivable:		
Trade, net of allowance of \$4,063 and \$2,608, respectively	147,717	131,767
Retainage	30,133	29,536
Costs and estimated earnings in excess of billings on uncompleted contracts	10,747	16,121
Inventories	16,838	15,268
Prepaid expenses and other current assets	5,761	4,618
Assets from discontinued operations	1,589	6,431
Total current assets	269,603	293,417
PROPERTY AND EQUIPMENT, net	23,700	22,095
GOODWILL	5,713	14,574
OTHER NON-CURRENT ASSETS, net	22,232	23,336
Total assets	\$ 321,248	\$ 353,422
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 150	\$ 78
Accounts payable and accrued expenses	93,358	98,452
Billings in excess of costs and estimated earnings on uncompleted contracts	40,334	35,277
Liabilities from discontinued operations	589	1,920
Total current liabilities	134,431	135,727
LONG-TERM DEBT, net of current maturities	25,127	45,698
OTHER NON-CURRENT LIABILITIES	10,155	18,072
Total liabilities	169,713	199,497
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY:		
Preferred stock, \$0.01 par value, 10,000,000 shares authorized, none issued and outstanding		
Common stock, \$0.01 par value, 100,000,000 shares authorized; 15,407,802 and 15,418,357 shares issued and 15,002,724 and 15,339,086 outstanding, respectively	154	154
Treasury stock, at cost, 405,078 and 79,271 shares, respectively	(7,206)	(1,716)
Additional paid-in capital	169,470	168,070
Retained deficit	(10,883)	(12,583)

Edgar Filing: INTEGRATED ELECTRICAL SERVICES INC - Form 10-Q

Total stockholders' equity		151,535		153,925
Total liabilities and stockholders' equity	\$	321,248	\$	353,422

The accompanying Notes to condensed consolidated financial statements are an integral part of these financial statements.

Table of Contents**INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(IN THOUSANDS, EXCEPT SHARE AND PER SHARE INFORMATION)**

	Three Months Ended June 30, 2008 (Unaudited)	Three Months Ended June 30, 2007 (Unaudited)
Revenues	\$ 214,485	\$ 222,631
Cost of services	180,587	184,322
Gross profit	33,898	38,309
Selling, general and administrative expenses	28,052	34,113
(Gain) on sale of assets	(115)	(91)
Restructuring charges	1,038	
Income from operations	4,923	4,287
Other (income) expense:		
Interest expense	1,356	2,846
Interest income	(284)	(1,076)
Other (income) expense, net	67	(209)
Interest and other expense, net	1,139	1,561
Income from continuing operations before income taxes	3,784	2,726
Provision for income taxes	1,758	1,693
Net income from continuing operations	2,026	1,033
Discontinued operations (Note 2):		
Income (loss) from discontinued operations, including gain (loss) on disposal of assets of \$0 and \$(12), respectively	49	(29)
Provision (benefit) for income taxes	37	(203)
Net income from discontinued operations	12	174
Net income	\$ 2,038	\$ 1,207
Basic earnings per share:		
Continuing operations	\$ 0.14	\$ 0.07
Discontinued operations	\$ 0.00	\$ 0.01
Total	\$ 0.14	\$ 0.08
Diluted earnings per share:		
Continuing operations	\$ 0.14	\$ 0.07
Discontinued operations	\$ 0.00	\$ 0.01
Total	\$ 0.14	\$ 0.08
Shares used in the computation of earnings per share (Note 4):		
Basic	14,969,008	15,086,156
Diluted	15,003,131	15,163,387

The accompanying Notes to condensed consolidated financial statements are an integral part of these financial statements.

Edgar Filing: INTEGRATED ELECTRICAL SERVICES INC - Form 10-Q

Table of Contents

	Nine Months Ended June 30, 2008 (Unaudited)		Nine Months Ended June 30, 2007 (Unaudited)	
Revenues	\$	608,957	\$	665,977
Cost of services		511,297		553,969
Gross profit		97,660		112,008
Selling, general and administrative expenses		86,283		104,774
(Gain) on sale of assets		(139)		(117)
Restructuring charges		4,431		
Income from operations		7,085		7,351
Other (income) expense:				
Interest expense		7,507		7,884
Interest income		(1,829)		(3,028)
Other (income) expense, net		(1,256)		(113)
Interest and other expense, net		4,422		4,743
Income from continuing operations before income taxes		2,663		2,608
Provision for income taxes		1,572		2,077
Net income from continuing operations		1,091		531
Discontinued operations (Note 2):				
Income (loss) from discontinued operations, including gain on disposal of assets of \$7 and \$1, respectively		387		(2,204)
Provision (benefit) for income taxes		198		(1,340)
Net income (loss) from discontinued operations		189		(864)
Net income (loss)	\$	1,280	\$	(333)
Basic earnings (loss) per share:				
Continuing operations	\$	0.07	\$	0.04
Discontinued operations	\$	0.01	\$	(0.06)
Total	\$	0.09	\$	(0.02)
Diluted earnings (loss) per share:				
Continuing operations	\$	0.07	\$	0.04
Discontinued operations	\$	0.01	\$	(0.06)
Total	\$	0.08	\$	(0.02)
Shares used in the computation of earnings (loss) per share (Note 4):				
Basic		15,026,675		15,047,956
Diluted		15,109,335		15,063,922

The accompanying Notes to condensed consolidated financial statements are an integral part of these financial statements.

Table of Contents**INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(IN THOUSANDS)**

	Nine Months Ended June 30, 2008 (Unaudited)	Nine Months Ended June 30, 2007 (Unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 1,280	\$ (333)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Net (income) loss from discontinued operations	(189)	864
Bad debt expense	2,179	735
Deferred financing cost amortization	1,714	937
Depreciation and amortization	6,434	7,507
(Gain) on sale of property and equipment	(139)	(117)
Non-cash paid-in-kind interest added to term loan		5,012
Non-cash compensation expense	2,702	3,364
Non-cash restructuring write-offs	131	
Equity in gains of investment	(424)	(58)
Goodwill adjustment-utilization of deferred tax assets under SOP 90-7	1,057	
Changes in operating assets and liabilities, net of effect of discontinued operations:		
Accounts receivable	(18,831)	17,398
Inventories	(1,570)	3,580
Costs and estimated earnings in excess of billings on uncompleted contracts	5,374	1,251
Prepaid expenses and other current assets	1,487	5,840
Other non-current assets	(1,262)	4,433
Accounts payable and accrued expenses	(6,091)	(8,308)
Billings in excess of costs and estimated earnings on uncompleted contracts	5,053	7,075
Other non-current liabilities	258	288
Net cash provided by (used in) continuing operations	(837)	49,468
Net cash provided by discontinued operations	3,892	7,172
Net cash provided by operating activities	3,055	56,640
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(9,613)	(1,626)
Proceeds from sales of property and equipment	335	516
Distribution from unconsolidated affiliate	488	240
Change in restricted cash	20,000	
Net cash provided by (used in) continuing operations	11,210	(870)
Net cash provided by (used in) discontinued operations	7	(25)
Net cash provided by (used in) investing activities	11,217	(895)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings of debt	25,193	72
Repayments of debt	(45,692)	(15,040)
Payments for debt issuance costs	(575)	
Acquisition of treasury stock	(6,056)	
Net cash used in financing activities	(27,130)	(14,968)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(12,858)	40,777
CASH AND CASH EQUIVALENTS, beginning of period	69,676	28,166
CASH AND CASH EQUIVALENTS, end of period	\$ 56,818	\$ 68,943

Edgar Filing: INTEGRATED ELECTRICAL SERVICES INC - Form 10-Q

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid for interest	\$	3,690	\$	2,081
Cash paid for income taxes	\$	663	\$	1,282

Non-cash activities: During the nine months ended June 30, 2008, we financed \$2.0 million of prepaid insurance through an account payable to the insurance provider, paid a \$2.1 million account payable for property and equipment that was purchased and accrued during the year ended September 30, 2007, recorded a \$0.1 million accrued liability for the purchase of property and equipment that was unpaid as of June 30, 2008, and acquired \$0.7 million of treasury stock through a payable to our broker.

The accompanying Notes to condensed consolidated finance statements are an integral part of these financial statements.

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008

(UNAUDITED)

1. BUSINESS

Integrated Electrical Services, Inc. (the Company or IES), a Delaware corporation, was founded in June 1997 to create a leading national provider of electrical contracting services, focusing primarily on the commercial, industrial, residential, low voltage and service and maintenance markets.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These unaudited condensed consolidated financial statements reflect, in the opinion of management, all adjustments necessary to present fairly the financial position as of, and the results of operations for, the periods presented. All adjustments are considered to be normal and recurring. Interim period results are not necessarily indicative of results of operations or cash flows for the full year. During interim periods, we follow the same accounting policies disclosed in our Annual Report on Form 10-K for the year ended September 30, 2007, with the exception of the adoption of Financial Accounting Standards Board (FASB) Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* and *Interpretation of FASB 109* as described in the paragraph that follows. Please refer to the Notes of our 2007 Form 10-K when reviewing interim financial results.

On October 1, 2007, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement 109* (FIN 48). FIN 48 created a single model to address accounting for uncertain income tax positions and established a minimum recognition threshold a tax position must meet before being recognized in the financial statements.

The evaluation of a tax position under FIN 48 is a two-step process. The first step is the recognition process to determine if it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authority, based on the technical merits of the position. The second step is a measurement process whereby a tax position that meets the more likely than not recognition threshold is calculated to determine the amount of benefit/expense to recognize in the financial statements. The tax position is measured at the largest amount of benefit/expense that is more likely than not of being realized upon ultimate settlement.

As the result of the adoption of FIN 48 and recognition of the cumulative effect of the adoption of the new accounting principal, we recorded an \$8.2 million decrease in contingent tax liabilities. The reduction of the contingent tax liabilities resulted in a \$7.8 million decrease in goodwill

Edgar Filing: INTEGRATED ELECTRICAL SERVICES INC - Form 10-Q

as prescribed by Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code* (SOP 90-7) and a \$0.4 million increase in retained earnings. Upon the adoption of FIN 48, the total liability for unrecognized tax benefits was \$6.2 million, excluding accrued interest and penalties, which are discussed below. The liabilities for unrecognized tax benefits are a component of Other non-current liabilities in our consolidated balance sheet. The reversal of the liabilities for unrecognized tax benefits would result in a \$6.1 million adjustment that would first go to reduce goodwill, then intangible assets and then additional paid-in capital as prescribed by SOP 90-7. The remaining \$0.1 million would result in a decrease in the provision for income tax expense.

We recognize interest and penalties related to unrecognized tax benefits as part of the provision for income taxes. Upon the adoption of FIN 48, we had approximately \$0.4 million in accrued interest and penalties included in liabilities for unrecognized tax benefits. The accrued interest and penalties are a component of Other non-current liabilities in our consolidated balance sheet. The reversal of the accrued interest and penalties would result in a \$0.2 million adjustment that would first go to reduce goodwill, then intangible assets and then additional paid-in capital as prescribed by SOP 90-7. The remaining \$0.2 million would result in a decrease in the provision for income tax expense.

We are currently not under federal audit by the Internal Revenue Service. The tax years ended September 30, 2004 and forward are subject to audit as are tax years prior to September 30, 2004, to the extent of unutilized net operating losses generated in those years. Currently, one of our business units is under a state audit for the tax years ended September 30, 2002 and 2003.

Table of Contents

We anticipate that approximately \$0.3 million of liabilities for unrecognized tax benefits, including accrued interest, may be reversed in the next twelve months. This reversal is predominately due to the expiration of the statutes of limitation for unrecognized tax benefits and the settlement of a state audit.

RECLASSIFICATIONS

Certain prior period balances have been reclassified to conform to current year presentation, including the income statement line items interest expense and interest income, which were previously shown as a single net amount.

USE OF ESTIMATES AND ASSUMPTIONS

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions by management in determining the reported amounts of assets and liabilities, disclosures of contingent liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates are primarily used in our revenue recognition for construction in progress. Other estimates consist of allowances for doubtful accounts receivable, inventory obsolescence reserves, fair value assumptions in analyzing goodwill and long-lived asset impairments and adjustments from fresh-start accounting, realizability of deferred tax assets, self-insured claims liabilities, and estimated forfeiture rates and projected earnings used to measure stock-based compensation awards.

SEASONALITY AND QUARTERLY FLUCTUATIONS

Our results of operations are seasonal, depending on weather trends, with higher revenues typically generated during spring and summer months and lower revenues typically generated during fall and winter months. In addition, the construction industry has historically been highly cyclical. Our volume of business may be adversely affected by declines in construction projects resulting from adverse regional or national economic conditions. Quarterly results may also be materially affected by the timing of new construction projects. Accordingly, operating results for any fiscal period are not necessarily indicative of results that may be achieved for any subsequent fiscal period.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 enhances the guidance for using fair value to measure assets and liabilities. In addition, SFAS 157 expands information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value and the effect of fair value measurements on earnings. This statement applies whenever other standards require (or permit) assets or liabilities to be measured at fair value, but it does not expand the use of fair value in any new circumstances. We are currently evaluating the potential impact, if any, SFAS 157 will have on our financial results for our fiscal year beginning on October 1, 2008.

Edgar Filing: INTEGRATED ELECTRICAL SERVICES INC - Form 10-Q

SFAS 157 was originally to be effective for fiscal years beginning after November 15, 2007. However, on February 12, 2008, the FASB issued FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2) which amends SFAS 157 to delay the effective date for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (that is, at least annually) to fiscal years beginning after November 15, 2008. We currently do not have any assets that are measured at fair value. We are currently evaluating the potential impact, if any, FSP 157-2 will have on our financial results for our fiscal year beginning on October 1, 2009. We believe we will likely be required to provide additional disclosures in future financial statements beginning after the effective date of the new standard.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159) which permits companies to measure certain financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing companies the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the potential impact, if any, SFAS 159 will have on our financial results for our fiscal year beginning on October 1, 2008; however, as we do not intend to elect fair value for any of our assets and liabilities, there should be no impact.

In December 2007, the FASB issued Statement No. 141 (revised 2007), *Business Combinations* (SFAS 141(R)) which changes the accounting for acquisitions. SFAS 141(R) requires an acquiring entity to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS 141(R) eliminates the step acquisition model, changes the

Table of Contents

recognition of contingent consideration from being recognized when it is probable to being recognized at the time of acquisition, disallows the capitalization of transaction costs, and changes when restructuring charges related to acquisitions can be recognized. The standard is effective for fiscal years beginning on or after December 15, 2008 and will only impact the accounting for acquisitions that are made after adoption.

STOCK-BASED COMPENSATION

Stock-based compensation consists of expenses related to employee stock option awards, restricted stock grants and performance-based restricted stock grants (see Note 6). We recognize stock-based compensation expense in a pro-rata manner based on the value of stock-based payment awards that are expected to vest, reduced for estimated forfeitures. SFAS 123(R), *Share-Based Payment* (SFAS 123(R)) requires forfeitures to be estimated at the time of grant and revised in subsequent periods if actual forfeitures differ from those estimates. We used the modified prospective application method at the time SFAS 123(R) was adopted.

SFAS 123(R) does not require a specific valuation model to measure the value of stock options, and either a binomial or the Black-Scholes model may be used. We used a binomial option pricing model to measure the fair value of stock options awarded in our 2007 and 2008 fiscal years. We believe the binomial pricing model is a more precise measure of the value of our stock options; however, the difference in the values between the two methods was not material for the options that we granted.

The assumptions used in the binomial pricing model calculation for the nine months ended June 30, 2008 and 2007 are as follows:

	Nine Months Ended June 30, 2008	
	2008	2007
Weighted average value per option granted during the period (1)	\$ 8.49	\$ 13.34
Assumptions:		
Stock price volatility	51.6%	43.6%
Risk free rate of return	3.3%	4.8%
Future forfeiture rate (2)	0.0%	0.0%
Expected term	6.0 years	6.0 years

(1) We do not pay dividends on our common stock.

(2) The forfeiture rate is assumed to be zero based on the limited number of employees who have been awarded stock options.

2. STRATEGIC ACTIONS*Restructuring Program*

We have restructured our operations from our previous geographic structure into three major lines of business: Industrial, Commercial and Residential. This operational restructuring is part of our long-term strategic plan to reduce our cost structure, reposition our business to better serve our customers, strengthen financial controls and, as a result, position the Company to implement a market-based growth strategy in the future. The restructuring program has consolidated administrative support functions, eliminating redundant functions that were previously performed at our 27 business units. We expect to incur pre-tax restructuring charges, including severance benefits and consulting charges, of approximately \$5 million to \$10 million over the course of the restructuring process, which will be substantially complete by September 30, 2008.

The first component of our restructuring program was initiated in our Industrial segment in June 2007. Under this portion of the planned restructuring, 5 of our business units were integrated under the IES Industrial segment, and the support and administrative functions of those businesses were combined at an operating location in Houston, Texas. In connection with this realignment, we approved a transition and severance benefits program for 25 employees who were separated from the Company on or before June 30, 2008 through the elimination of redundant positions. During the nine months ended June 30, 2008, we have recognized approximately \$0.3 million in severance charges for the value of cash compensation and payroll taxes that will be paid out through November 2008 in the form of salary continuation. Since the inception of this program, we have recorded \$0.5 million in severance charges for our Industrial segment. These charges have been included in the caption Restructuring Charges in the consolidated statement of operations, and we have a remaining liability of \$0.1 million included as an accrued expense.

Table of Contents

The second component of our restructuring program was initiated in our Commercial segment in September 2007. Under this portion of the restructuring, 17 of our business units were integrated under the IES Commercial segment, and the support and administrative functions of those businesses were combined at an operating location in Tempe, Arizona. In connection with this realignment, we approved a transition and severance benefits plan for approximately 100 employees who have been or will be separated through the elimination of redundant positions. The affected employees will continue to work for the Company for up to six months. During the nine months ended June 30, 2008, we recognized approximately \$1.9 million in severance charges for cash compensation and payroll taxes that will be paid out through December 2008 in the form of salary continuation. Since the inception of this program, we have recorded \$2.0 million in severance charges for our Commercial segment. These charges have been identified within the Restructuring Charges caption in the consolidated statement of operations, and we have a remaining liability of \$0.7 million included in accrued expenses. We expect to recognize an additional \$0.1 million in severance liabilities for the value of cash compensation for Commercial employees who have already been included in the transition and severance program, which we expect to incur in the fourth quarter of our 2008 fiscal year.

The third component of our restructuring program was initiated in our Residential segment in September 2007. Under this portion of the restructuring, 5 of our business units were integrated under the IES Residential segment during our 2008 fiscal year, and the support and administrative functions of those businesses has been combined at an operating location near Houston, Texas. In connection with this realignment, we approved a transition and severance benefits plan for 17 employees who have been separated through the elimination of redundant positions. During the nine months ended June 30, 2008, we recognized approximately \$0.2 million in severance liabilities for cash compensation and payroll taxes. These charges have been identified within the Restructuring Charges caption in the consolidated statement of operations.

In addition to the severance costs described above, we incurred charges of approximately \$0.4 million and \$2.0 million, respectively, for consulting services associated with our restructuring program during the three months and nine months ended June 30, 2008. During the nine months ended June 30, 2008, we also wrote off \$0.1 million of leasehold improvements at a location we closed. Since we began the program in June 2007, we have recorded a total of \$5.3 million of restructuring charges.

The following table summarizes the activities related to our restructuring activities by component (in thousands):

	Severance Charges	Consulting / Other Charges	Total
Restructuring liability at September 30, 2007	\$ 208	\$ 180	\$ 388
Restructuring charges incurred during the nine months ended June 30, 2008	2,434	1,997	4,431
Less - cash payments during the nine months ended June 30, 2008	(1,759)	(1,993)	(3,752)
Less - non-cash expenses / write-offs		(131)	(131)
Restructuring liability at June 30, 2008	\$ 883	\$ 53	\$ 936

Exit or Disposal Activities

In March 2006, based on the recommendation of our Board of Directors, we committed to an exit plan with respect to certain underperforming business units in our Commercial and Industrial segments. The exit plan committed to a shut-down or consolidation of the operations of these business units, or the sale or other disposition of the business units, whichever came sooner. In our assessment of the estimated net realizable value of the accounts receivable at these business units, we increased our general allowance for doubtful accounts having considered various factors, including the risk of collection and the age of the receivables.

Edgar Filing: INTEGRATED ELECTRICAL SERVICES INC - Form 10-Q

In June 2007, we shut down our Mid-States Electric business unit, located in Jackson, Tennessee. Mid-States' operating equipment was either transferred to other IES business units or sold to third parties. All project work was completed prior to the business unit being closed, and legacy projects were completed by other IES business units. Mid-States' assets, liabilities and operating results for both the current and prior periods have been reclassified to discontinued operations. Mid-States was part of our Commercial segment prior to being classified as discontinued.

Remaining net working capital related to these business units was \$0.8 million and \$4.3 million at June 30, 2008 and September 30, 2007, respectively. As a result of inherent uncertainty in the exit plan and the monetization of these business units' working capital, we could experience additional losses of working capital. As of June 30, 2008, we believe we have recorded adequate reserves to reflect the net realizable value of the working capital; however, subsequent events may impact our ability to collect these receivables.

The exit plan is substantially complete for the business units that we selected to exit in March 2006, with the operations of these business units having substantially ceased as of September 30, 2006. Mid-States' operations were shut down as of June 30, 2007.

Edgar Filing: INTEGRATED ELECTRICAL SERVICES INC - Form 10-Q

Table of Contents

We have included the results of operations related to these business units in discontinued operations for the three months and nine months ended June 30, 2008, and all prior periods presented have been reclassified accordingly.

Summarized financial data for all discontinued operations are outlined below (in thousands):

	Three Months Ended June 30,	
	2008	2007
Revenues	\$ 92	\$ 1,660
Gross profit	\$ 68	\$ 13
Pre-tax income (loss)	\$ 48	\$ (29)

	Nine Months Ended June 30,	
	2008	2007
Revenues	\$ 1,025	\$ 7,885
Gross profit (loss)	\$ 464	\$ (1,635)
Pre-tax income (loss)	\$ 386	\$ (2,204)

	June 30, 2008	September 30, 2007
Accounts receivable, net	\$ 1,374	\$ 6,184
Costs and estimated earnings in excess of billings on uncompleted contracts	5	8
Property and equipment, net	210	239
Total assets	\$ 1,589	\$ 6,431
Accounts payable	\$ 167	\$ 600
Accrued liabilities	336	522
Billings in excess of costs and estimated earnings on uncompleted contracts	86	798
Total liabilities	589	1,920
Net assets	\$ 1,000	\$ 4,511

3. DEBT AND LIQUIDITY

Debt consists of the following (in thousands):

	June 30, 2008	September 30, 2007
Term Loan, due May 15, 2013, bearing interest at 11.0%	\$ 25,000	\$ 45,598
Term Loan, due May 12, 2013, bearing interest at an adjusted rate of 10.75%		45,598
Capital lease and other	277	178
Total debt	25,277	45,776
Less Short-term debt and current maturities of long-term debt	(150)	(78)
Total long-term debt	\$ 25,127	\$ 45,698

Edgar Filing: INTEGRATED ELECTRICAL SERVICES INC - Form 10-Q

Future payments on debt at June 30, 2008 are as follows (in thousands):

2008	40
2009	140
2010	90
2011	7
2012	
Thereafter	25,000
Total	\$ 25,277

For the three months ended June 30, 2008 and 2007, we incurred interest expense of \$1.3 million and \$2.8 million, respectively. These interest expenses include amortization of deferred financing charges of \$0.3 million and \$0.4 million for the three months ended June 30, 2008 and 2007, respectively. For the nine months ended June 30, 2008 and 2007, we incurred interest expense of \$7.6 million and \$7.9 million, respectively. These interest expenses include deferred financing charges of \$1.7 million and \$0.9 million,

Table of Contents

for the nine months ended June 30, 2008 and 2007, respectively, and prepayment penalties of \$2.1 million and \$0.7 million incurred during December 2007 and May 2007, respectively.

The Tontine Capital Partners Term Loan

On December 12, 2007, we entered into a \$25.0 million senior subordinated loan agreement (the Tontine Term Loan) with Tontine Capital Partners, L.P., a related party. The proceeds of the Tontine Term Loan, together with cash on hand, were used to fund the repayment of the Eton Park Term Loan (discussed below).

The Tontine Term Loan bears interest at 11.0% per annum and is due on May 15, 2013. Interest is payable quarterly, beginning on December 31, 2007, in cash or in-kind at our option. Any interest paid in-kind will bear interest at the same rate (11.0%) as the Tontine Term Loan. We may repay the Tontine Term Loan at any time prior to the maturity date at par, plus accrued interest without penalty. The Tontine Term Loan is subordinated to our existing Revolving Credit Facility (as defined below). The Tontine Term Loan is an unsecured obligation of the Company and its subsidiary borrowers. The Tontine Term Loan contains no financial covenants or restrictions on dividends or distributions to stockholders.

The Revolving Credit Facility

On May 12, 2006, we entered into an agreement (the Loan and Security Agreement) for a revolving credit facility (the Revolving Credit Facility) with Bank of America and certain other lenders. On May 9, 2008, we renegotiated the terms of our Revolving Credit Facility and entered into an amended agreement with the same financial institutions.

The Revolving Credit Facility provides access to revolving borrowings in the aggregate amount of up to \$60.0 million. At June 30, 2008, we had \$37.6 million in letters of credit issued against the Revolving Credit Facility and \$14.4 million available under the Revolving Credit Facility.

The Revolving Credit Facility is guaranteed by our subsidiaries and secured by first priority liens on substantially all of our and our subsidiaries existing and future acquired assets, exclusive of collateral provided to sureties. The Revolving Credit Facility contains customary affirmative, negative and financial covenants that were modified in conjunction with its renewal and amendment on May 9, 2008. The financial covenants are described below in the section titled Financial Covenants . The Revolving Credit Facility also restricts us from paying cash dividends and places limitations on our ability to repurchase our common stock. The maturity date of the Revolving Credit Facility is May 12, 2010.

Under the renegotiated terms of our Revolving Credit Facility interest is calculated at LIBOR plus 3.0%, or the lender's prime rate (the Base Rate) plus 1.0% through September 30, 2008. Thereafter, interest is based on our total liquidity, which is calculated as cash on hand plus availability under the revolving credit facility, as shown in the following table.

Edgar Filing: INTEGRATED ELECTRICAL SERVICES INC - Form 10-Q

Total Liquidity	Interest Rate
Greater than \$60 million	LIBOR plus 2.75% or Base Rate plus 0.75%
From \$40 million to \$60 million	LIBOR plus 3.00% or Base Rate plus 1.00%
Less than \$40 million	LIBOR plus 3.25% or Base Rate plus 1.25%

The letter of credit fee under the revised agreement is 3.25% through September 30, 2008, after which the letter of credit fee will be based on the same factor as loans outstanding.

In addition, we will be charged monthly in arrears (1) an unused line fee of either 0.5% or 0.375%, depending on the utilization of the credit line, and (2) certain other fees and charges as specified in the revolving credit agreement. Finally, the Revolving Credit Facility is subject to a prepayment fee of 0.5% until May 2009 and 0.25% until May 2010. We incurred a \$275,000 charge from Bank of America as a result of the amendment, of which \$200,000 is classified as a prepaid expense and is being amortized over 12 months and \$75,000 is classified as a deferred financing fee and is being amortized over 24 months.

Through May 9, 2008, loans under the Revolving Credit Facility bore interest at LIBOR plus 3.5% or the base rate plus 1.5% on the terms set in the credit agreement. In addition, we were charged monthly in arrears (1) an unused line fee of either 0.5% or 0.375%, depending on the utilization of the credit line, (2) a letter of credit fee equal to the applicable per annum LIBOR margin times the amount of all outstanding letters of credit, and (3) certain other fees and charges as specified in the revolving credit agreement.

Table of Contents

Financial Covenants

The financial covenants for the Revolving Credit Facility as in effect on June 30, 2008, are described in the table that follows. As of June 30, 2008, we are in compliance with each of the following amended financial covenants under the Revolving Credit Facility:

Covenant	Requirement	Actual
Shutdown Subsidiaries Earnings Before Interest and Taxes	Cumulative loss not to exceed \$2.0 million	Cumulative loss of \$1.0 million
Fixed Charge Coverage Ratio	Minimum of 1.25:1.00	N/A (1)