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PRESENTATION

Operator

Rich Dietz ***SBC Communications - VP IR***

Good afternoon, everyone, and thanks for joining us here today. I m Rich Dietz, Vice President of Investor Relations for SBC. On behalf of everyone here both at SBC and AT&T, welcome. We are really thrilled to be here, and we really appreciate your time and attention this afternoon.

Yesterday, we announced our agreement to acquire AT&T. We followed that with a conference call. We are here today to follow up, provide you some additional background, and to give you a chance to hear in person from the key executives, those who will be executing on this deal, this exciting new platform that the combined Company will be able to create.

Today we have Ed Whitacre, SBC s Chairman and CEO, Dave Dorman, Chairman and CEO of AT&T; both will have opening comments. Then you will hear from Randall Stephenson, SBC s Chief Operating Officer, along with 2 key operational personnel and executives of SBC.

First, John Stankey, Senior Executive Vice President and Chief Technology Officer. John is responsible for a number of the areas including network planning, IT, enterprise product platforms, data services, sales operation support, and procurement. After John you will hear from Mark Keiffer, SBC s Senior Vice President for Business Marketing. After that Rick Lindner, SBC s CFO will provide the financial wrapup and a summary of our deal. Then, finally, of course we will conclude with Qs and As.

Also with us today for the Q&A session are several additional key executives including Bill Hannigan, AT&T s President and Chief Operating Officer, and Tom Horton, AT&T s Vice Chairman and Financial Officer.

Before we get started, for those who are taking part via the Web or by phone today, let me remind you that the presentation slides for this event are available on the investor relations page of SBC s website, SBC.com.

Also I want to mention a word about the Q&A session. We will hold all the questions until the speakers are finished and have a full Q&A session; and at all times the speakers and other executives will be available on stage for that Q&A session. Today s meeting is for analysts, so ask that the analysts are the ones who ask the questions during the Q&A session. To help those who are listening

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SBC - SBC Communications and AT&T Analyst Meeting Webcast

via the Web, we ask that you identify yourself and the firm that you re representing.

Of course I need to cover our Safe Harbor statement. Information set forth in this presentation contains financial estimates and other forward-looking statements that are subject to risks and uncertainties, and actual results might differ materially. Information about the factors that may affect future results are contained in the slides accompanying this speech. They have been posted to SBC s website and are contained in SBC s filings with the Securities and Exchange Commission, which are available also at SBC s website, wwwdSEC.gov.

SBC disclaims any obligation to update and revise statements contained in this presentation based on new information or otherwise.

This presentation may contain certain non-GAAP financial measures. Reconciliations between the non-GAAP financial measures and the GAAP financial measures are available on SBC s website, SBC.com investor relations. I also want to call your attention to the information regarding SEC filings that can be found on slide 5 in your booklet.

Okay. At this point, with no further delay, it is my great honor to introduce Ed Whitacre, SBC s CEO. Ed?

Ed Whitacre ***SBC Communications - Chairman & CEO***

Thank you, Rich, and good afternoon to all of you. On behalf of everyone at SBC and AT&T, let me start by saying how excited we are to be here today to present you the details of a transaction that we believe will truly transform our business.

Our agreement to acquire AT&T is a positive step forward for SBC and our stockholders. We are creating the prototype communications company for the 21st century, opening a new era of innovation and competition for customers everywhere. If you know me, and some of you do, you know I would not say that lightly.

Over the years we have been involved in a lot of deals at SBC. We have done mergers that carried a bigger price tag than this one. We have made acquisitions that gave us a larger customer base than this one. We have done those which doubled our employee count. But we have never made an acquisition that was more important to our Company s future, to our nation s role in the global communications marketplace.

The combination of SBC and AT&T puts together a terrific set of network assets, assets that complement one another very well. It adds product sets and service capabilities that will speed our development in key areas. As a result, the new Company can deliver the advanced data and IP-based services that are the future of communications, and do it much faster and more efficiently than either Company could have done it alone.

It accelerates our expansion in the enterprise space. It gives us nationwide presence and global reach. All this comes with huge synergy opportunities that start right after closing and ramp fast. We have said that we expect to gain approvals and close the transaction early next year. I expect us to beat that.

Today you will hear from operating executives responsible for delivering on the great opportunities we have. We are leaving a lot of time for questions. We will spend as much time as you want answering your questions today.

This transaction is about change. Big changes are taking place in our industry, changes that are forcing companies to confront their future. We are leading that change; we are not waiting for it to happen to us. This is a great combination. Customers will benefit. It will create value for stockholders, and the Company we are creating through this transaction and through our Cingular Wireless deal last year will be built for tremendous success in the years ahead.

It is the right products, it is the right networks, it is the right cost structure at the right time and at the right price. We have a great story to tell about the terrific opportunities ahead for our stockholders, employees, and customers. Again I want to thank you for joining us today. At this point I will ask Dave Dorman to add a couple of comments. Dave?

Dave Dorman ***AT&T - Chairman & CEO***

Thank you, Ed. I would like to echo Ed s enthusiasm for this transaction. We are truly very excited about the opportunity to combine forces with SBC, and we do believe we are creating the industry s premier communications and networking company with this transaction.

This deal allows AT&T to continue to play a significant role in building the defining entity for telecom in the 21st century. By combining with SBC now we create a Company capable of delivering advanced network technologies and a full suite of integrated communications services throughout America and around the world.

I m asked the question, why did AT&T agree to this merger, and why now? Clearly, we have moved through a period of prolonged challenge and instability in the telecom industry in the recent few years. We have had dynamic and dramatic advances in technology. We have had an ever-shifting regulatory environment. We have had intense and increased competition; and we have had fraud on the part of several of our competitors.

The combined impact of these factors has forever altered the telecom landscape and forced us to make more than our share of strategic shifts. Most recently, regulatory reversals led us to redefine our business model, stepping back from actively marketing traditional consumer services to focus our full energies on the enterprise market and the emerging technologies and product sets that we refer to as SoIP, or services over IP.

Given the continued challenges and competitive forces we re sure to face, we understand that operational scale and scope will be critically important in defining the winners and losers in this industry over the next several years and in fact the next decade.

In recent months, AT&T has sought to insure our long-term viability by building on our existing technology and scale advantages, as well as our significant financial strength and our global reach. We have made great progress in positioning this Company for the long-term and winning the opportunity to fight on and compete for the future at a time when many had written us off. I m proud of that.

Through this deal, we now have the opportunity to accelerate our growth and transformation by combining our operational and financial advantages with those of SBC. SBC has a growing and significant consumer and small-business presence, which we don t; a demonstrated commitment to broadband deployment, which we don t; a vibrant local and regional market set for voice data, DSL, wireless and the new frontier of video, which we don t.

So why now? The fact is both of us are at a point where we re fundamentally redefining ourselves, in our case moving away from traditional consumer services and towards a deeper penetration in the enterprise market, and VoIP and Wireless offerings through others and our own efforts. SBC in contrast is not a major player in the enterprise space and is instead focused on expanding their current suite of bundled service offerings to consumers and small business while beginning to play at the enterprise.

Also, from a regulatory perspective, you could not expect me not to get a chance to say it is no longer unthinkable. Going forward, this combination will allow us to continue to providing high-quality services to our customers, which they have comes to rely on, and while assuring, as Ed said earlier, that a U.S.-based firm will serve as a global leader in networking and telecommunications.

It provides AT&T with additional financial strength and stability to accelerate the innovating and investing we have been doing to change our networks and to change our business processes. AT&T brings to SBC more than just its global network, services customers, into a combined company. It also brings the people of AT&T and their unique skills and experience in competing and serving customers on a national and global basis, particularly in the business market.

I know that Ed Whitacre has enormous respect for the history and significance of AT&T as a corporate icon, and he has welcomed AT&T s people with a great statement yesterday welcome home. I know that he fully values their knowledge, their expertise, and the excellence that we bring to the table and they bring to the table. And that is a big part of the reason I believe Ed pursued this deal, taking this step which is a bold one, to reinvent this industry.

While it is certainly ironic, and many people will write and opine in the coming days, that a Baby Bell and SBC is no baby is acquiring its former parent some 20 years after the divestiture. It is the right move at the right time for both Companies, and is an exciting opportunity to reshape the future of the industry in a positive direction.

We are committing to delivering the potential synergies and efficiencies of the combined Company, and we re confident that they are achievable. The fact is this combination is good for our shareowners, it is good for our customers, and it s good for employees who now have the opportunity to play a role in building that defining entity of telecom for the 21st century.

With that, let me turn it back over to Ed or Randall. Sorry.

Randall Stephenson ***SBC Communications - COO***

Thanks, Dave. It s good to be here this afternoon. You heard from me at length yesterday, so I am going to be brief here this afternoon. What I want to do is put before you a couple of our operating guys who worked extensively with Bill Hannigan and his organization in AT&T to pull together the data that gave us the conference to do this transaction, and that we can pull these synergies together that we have talked about.

I want to accomplish just a couple of things. The first is just give you a little bit of an appreciation for the kind of company we have created your here by putting these 2 companies together. Second, I want you to walk out of here with a real strong appreciation and comfort level for what it will take to bring these synergies to pass.

When you step back from this, and you have heard Dave and Ed both talk about this, the set of assets, network assets that we re bringing together is impressive. It is very impressive. You start with AT&T, they have a it is truly a state-of-the-art IP backbone that as big as just about any backbone in the world. It s got incredible capacity on it.

It s got the capacity to more than accommodate what SBC will put on this network, and we will be putting a lot on it. We have a lot of broadband customers, business customers, and we have Lightspeed, Project Lightspeed coming, where we will begin deploying IP video and carrying video over the IP backbone. So having this kind of capacity is very, very important to us.

Add to that the national network that they have. This is a state-of-the-art national long distance network. This thing has MPLS at the core; it has it at the edge; it is as good as you are going to find in the United States. Then you extend from that national network a global presence and global network assets, and you have a network that we just think is second to none. This is a hard to duplicate network.

But now if you step back and you combine to that SBC s network assets, which are also very, very impressive, and you start with our local network, we have a very, very dense local network that covers one-third of the United States. If you think about this thing, it goes from New Haven, Connecticut, to Chicago to Dallas to San Francisco and L.A.

On top of that local dense network, we have a broadband network that is covering 80 percent of that network. On top of that we have 5.1 million broadband customers, one of the largest broadband customer bases in the United States, growing faster than anybody else s broadband customer base in the United States.

Now combine that with the largest and I would say densest, most spectrum rich wireless network in the United States that is soon-to-be fully IP capable; and you put those together, and you have what I believe is a very, very impressive set of assets.

Bring to that what AT&T is bringing to this Company, and that is a product set that is really impressive. When you talk about their IP product set, a consumer Voice over IP product we re working hard to develop something like this. It s done. They have a VoIP product set. IP VPN; unified communications. A very, very rich product set that we believe we can leverage very quickly.

If you look at just the functionality, I would tell you one of the things that impressed us the most when we looked at this organization is what this Company has done in terms of streamlining its operations on the high-end business side. Everything from ordering to provisioning to billing it is something you re not going to find in another asset in the United States.

So if you can take those critical network assets, the functionality and the product set we have talked about here, and you integrate those two, what you get are synergies that are quite frankly unlike anything that I have seen before.

We have done a lot of transactions as you know over the past, and we have done transactions where we combined Southwestern Bell and Pacific Bell. If you think about that transaction, the synergies came from overheads and IT procurement costs and then best practices between the two companies. We did the same exact thing with Ameritech. We have not done a large-scale transaction like this, where there is such an overlap of capability, where we have redundancy in some of our network assets; and as a result what we see are synergies that are quite frankly unlike anything that we have done or anything we have experienced or seen before.

If you add it up, what John Stankey and Mark Keiffer are going to show you the details of is a transaction that yields $15 billion in synergies, about the same value as the transaction itself. The great part about these synergies again because of the redundancy of the cost structures and such is that these synergies begin immediately.

This is not something that will take 3 years of IT development to create. We can begin to realize these synergies very quickly. In fact if this transaction closes in 2006, by the year 2008 we think we can take our run rate cost down by about $2 billion a year, and that that will ramp to somewhere around $3 billion by 2011. So it s a very exciting opportunity.

If $2 billion seems daunting to you, I said this yesterday and I will repeat it. Consider that in our area we re trying to ramp in the enterprise space. We have just begun and we re trying to create scale. We are spending in sales, network, operating support, customer care, somewhere at about a $1.6 billion run rate today. So am I optimistic we can get 2 billion? Yes. You throw in the procurement opportunity, IT, the corporate overheads, I think a $2 billion a year run rate savings is very, very achievable.

If you could just for a moment consider fast forwarding this tape about 3 years, and this integration has been completed, the approvals are done, and we have a company that I truly believe in 3 years has a cost lecture that is best in class. When you are computing in the environment of telecom, which is a highly competitive industry, having a cost structure that is best in class is very, very critical. It s a good position to be in, and it s an advantageous position to be in.

You add to that a service set that we have talked about already, we think you have a Company that fundamentally changes the U.S. telecom position, and it changes SBC and America AT&T s position as well. So we re very excited about this. We re very anxious to get this transaction moving. What I want to do is introduce Mark Keiffer to you, and he is going to talk to you a little bit more about the marketing and sales side of this.

Mark Keiffer ***SBC Communications - SVP Business Marketing***

Good afternoon. I think I have the opportunity to talk with you about probably the most exciting thing that is going on. Bill Hannigan and his team, along with Ray Wilkins, Bob Ferguson, and several people at SBC have had a lot of opportunity to talk with our customers since the deal has been announced.

I want to take just a minute to step back and share with you both, from a customer perspective and what our perception has been, about what the key things that we re going to be able to deliver,

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SBC - SBC Communications and AT&T Analyst Meeting Webcast

again, from a customer perspective going forward. After all, they are the ones that pay our bill, and we have got to make sure that as we work through this process we re going to deliver the things that they need in order for their business to be successful going forward.

It really boils down to 3 things. What we have heard is reach, solution set, and people. What I am going to do is quickly walk you through how that comes together. Kind of tying things that Randall alluded to, as he went through his presentation, and the things that Dave and Ed talked about, what that means to customer and what we are going to be able to do with that in the marketplace.

From a reach perspective, this ties to what Randall was talking about on a dense network from an SBC perspective. The local network, not surprisingly when you look at the Southwest, the Midwest and the West, SBC brings to bear a density of our network that allows us to deliver on a regional perspective wherever our customers footprint needs us to go. Again from a customer s perspective, delivering to their footprint.

Now what you see on that map is the East Coast looks a little barren, doesn t it ? We have been working to build that out but we re not there yet.

Let me show you the next map. This is a map of AT&T s POPs. What do you see along the Eastern corridor there? A lot of density. So take the assets that SBC has, combine those with the assets that AT&T brings to bear, from a national perspective we will be able to deliver, from a customer s perspective their locations, where their branch offices are, what they need to be successful going forward.

Now lay on top of that the global network. At the high-end when a customer is global we will be able to leverage the national assets with that global network for their footprint. In the discussions that we have had with our customers this is one of the biggest things they re excited about, because no matter where their location is from the A location to the Z location we re going to be able to provide the products and services that they need to be successful. So reach, a very key element.

The second piece that comes to bear is solution set. If we take a look at the products and services that SBC brings, with the products and services that AT&T brings to the table from their perspective, what you see is a very broad and deep portfolio. But that is kind of a broad and deep portfolio of products. What customers are so excited about when they look at this is now the solutions that we will be able to deliver will be tailored to where they are in the business segment.

This is a real key point. We as a combined entity will be able to take a customer wherever they are in the technology continuum, and take them to where they need to be to enable their success.

So what does that mean? There are customers that will be on a voice network for quite awhile. They have made some investments; they have not depreciated those totally; they have got to stay with those assets until they depreciate. They may not be ready yet. That is fine.

We will be able to work with them to deliver solution sets that will enable them to be successful. They want to move up market, data perhaps; we will have the solution sets for that. The key is, wherever they are in the continuum we will be able to deliver a solution that is going to allow them to be successful from their definition of success.

The other thing that is really neat about this when you are bringing these assets together Randall alluded to this is the wireless piece. Not only will we be able to deliver this kind of the definition of technology today, but when you look at the assets as they come together sometimes I think even I get confuse on this sometimes but really it is about optics and the edge of network.

When these assets come together, we will have the ability no matter wherever technology goes, and whatever the applications may be we will be able to deliver against that.

I started with Southwestern Bell in 1982 as an engineer. The edge of the network when I started in this business was 4 walls and a central office for a switch. That was the edge of the network. Over time what we have seen happen is the edge continued to get more blurred and more blurred and more blurred.

At some point in time, this will become the edge of the network. Wherever you are, the device that you are carrying, that will be the edge of the network. We will be able to take that product suite and wrap managed services around it for those who want us to, and be able to manage that for them.

But again a competitive lever that we will have if customers want to manage that themselves that will absolutely be able to. If they want us to take care of it for them, we will be able to do you that. That flexibility has come back loud and clear to us as one of the key things that customers are excited about in bringing these Companies together.

So reach and solution set were two. The third one I talked about was people. Certainly if you look at things like certifications, formal training, things like that, from an SBC and an AT&T perspective we bring best in class human assets to the table when we talk about delivering those kinds of things.

But the other thing that we bring, and this came across loud and clear with some of the customers I was talking about yesterday, is that we can talk about we can give examples of successes that we have had, and how we can leverage those successes in that company s business. It is not a trial. It is not a first time out of the

FINAL TRANSCRIPT

SBC - SBC Communications and AT&T Analyst Meeting Webcast

box try for us. So we will bring a history of performance and able to deliver in the marketplace, something that we re finding to be very, very important as we move forward.

This last point has to do specifically with the accounting (ph). We are going to start very briefly talk about some of the synergies. When you look at these numbers, and I am just going to talk about the sales marketing and sales operation numbers, if you look at that you see a 17 percent reduction and a 14 percent reduction. You might say, well, those are fairly conservative, Mark. And from just a pure numbers perspective those would be.

But one of the key things for us is the account relationship that we have with our customers. As we go through the next year, getting this deal done, after the deal is closed, we are not going to allow ourselves to forget how important the relationship that we have with our customers is. That is absolutely critical.

So we will be very careful as we move through the synergies that we have from the sales force perspective because there are obviously overlaps when we bring this together we will be very careful to make sure that we do nothing to jeopardize the position that we have with our customer base.

So when you kind of step back from this and look at it from a customers perspective, loud and clear, the reach absolutely love it. The solution set that that we re going to be able to bring to the market, it is something that will enable them to be successful as they define it. And we will absolutely have the people, best in class people to deliver that solution as we go forward.

We have got a lot of synergies and opportunities that we re going to be talking about. At this time I want to ask John Stankey to come up, and he will walk us through those.

John Stankey ***SBC Communications - SEVP & CTO***

Good afternoon. Nice to be with all of you today. They don t let me out much, but they promised me a free lunch for coming up here, so I got out from my office and agreed to come. Before I jump into kind of the meat of what I would like to discuss today, I would like to just offer some observations. Some of these reinforce what Randall had to say, but a few of them I think give you kind of an operating perspective on additional things that we think might bring to the future benefits of this great combination.

Randall talked about the dense local broadband access that SBC has and marrying that with the IP infrastructure and the backbone that AT&T has. I would also say that there is an operational opportunity there in terms of SBS is real strong on Layer 1 transport and how to operate those networks on a local basis. Maybe the best in the country when you look at operational metrics. Marry that with what I m about to show you, which is clearly by far and away the best entity in managing Layer 2 and 3 networks, which is the AT&T Company.

I would also point out that we have great opportunities when we think about things like security. AT&T has done a tremendous amount of work in their labs on security offerings and how to manage these new IP networks that are evolving, that is really frame breaking in a lot of ways. SBC has market reach down to the lower segments of the market that AT&T normally could not get at, that are going to be in need of these kind of solutions and an opportunity to spread this.

IP is a wonderful technology as you think about moving that out; but it also brings with it a tremendous amount of complexity and new intellectual property that is necessary to effectively manage it. I think there is great opportunity there.

When I think about combining the technology base from a software and IT practice perspective, SBC is strong in care and billing operations; and I look at AT&T and have been incredibly impressed with what they can do around the network elements, and what they do with network element configuration and the marriage of those two strength together.

The growth in IP traffic that we are generating at the local level, they can help fill the backbone. I also think about the work we have begun to do inside of SBC around, how do we take costs out of our rural and less dense operating areas? We have been looking at wireless local loop possibilities as a way to do that, and how to use some of our spectrum position with Cingular to possibly change that paradigm. AT&T brings out of the lab some fabulous research that we believe will help jump start that paradigm, and look for an opportunity for us to alter cost structure in other parts of our local access business.

We have a world-class procurement operation inside SBC, and now we get to be unleashed on a new spend over at AT&T that we believe will net some benefit; and I will talk a little bit about that as well.

And then spent a lot of time as we were going through this looking at issues like switched access, special access, rates, and pricing, and what is going to go on there. I don t know where you come out on that, but after I have fully examined it what I have concluded is it is kind of hard to predict the future. But what I do see is a tremendous hedge on some major shifts that are going to occur in regulation over time as we look at carrier access reform, for example. This allows this combined Company to really benefit on all sides of the equation as that comes out.

So with that, let me kind of jump in to some of the key points. First of all let me talk to you about 4 execution imperatives. The first one is going to be operational cost reduction. As Randall indicated to you earlier, this is not a best practices exercise. This is a forklift of how AT&T runs their enterprise business segment, and using

those practices to take to SBC s customers. I am going to talk to you about why we think this is an achievable exercise, and why it has got great potential for us.

The second thing I want to talk to you about is scale, and Randall alluded to this as well. It is no secret to any of you in this room that transport is approaching commodity levels. If you re going to be in a commodity business, we all know what is critical to compete, which is the best cost structure around. The marriage of these two Companies takes a very dense local provider with a lot of traffic, with the largest backbone player, and brings the 2 together to aggregate an incredible amount of traffic to start out.

Now none of us are just interested in playing in the commodity business, but we believe having the lowest marginal cost structure is critical as the ticket that gets you to the dance, to be able to continue to play in the managed services space and to be able to move up the continue in IP applications that are beginning to emerge. We believe strongly that this ll put us in a cost position that will be second to none, to ensure that we maintain a position in this key commodity aspect of our business.

Third, I would tell you is capital efficiency. As IP becomes a more dominant transport architecture, there is a far more efficient way to build these flat nonhierarchical networks than how the transitional TDMA or TDM IXC ILEC networks grew up over time. We believe that in getting an opportunity to start looking at these flatter networks and engineering them as a network should be engineered and built, as one, that they re going to be tremendous opportunities that are unlocked in this process.

Further, when you think about the buying power that is brought together as you are out in the market purchasing the equipment to do this transformation to IP, we are not only going to be buying at the lowest possible price for equipment but we will have enough clout to move the vendors in the direction that we need them to move to meet our product set.

Fourth, operations integration. As I said earlier, we want to start looking at this as 1 network, not the marry of the longhaul and the local network. So finally with the combination of the merger, technology, and where regulation is going, the opportunity to begin running and operating the network as one unleashes some opportunities.

So let s dive a little bit deeper on where we think some of those immediate opportunities are going to come out of this. As it was mentioned before, SBC s been pushing real hard to get into the enterprise space. We have made a lot of progress in area, but now we have kind of taken a step back and said, it s the right time to do something different. That right time is really driven from the fact that AT&T has done an exceptional job over the last several years of streamlining and operating a very mature and very capable enterprise data business.

I put a couple of numbers up there on the board. We have been over a lot of different things, order volumes, air rates, and a lot of different things to look at. But when you kind of step back from it and want to understand the difference in scale between these two businesses in this space, AT&T is driving an order of magnitude difference of traffic in their IP backbone compared to what we have on the SBC backbone. When you get into that marginal cost issue, that is a pretty critical issue for us.

I would tell you that they re 3 times more productive on a per-employee basis to support frame and ATM services than what SBC is able to do within our internal operation. Even in the mature business of voice minutes of use, they re also over 3 times more productive a pure labor perspective than what we are at SBC.

When you look at these foundational differences, this is what begins to show the difference and the power of putting the two operations together. So let s look at what some of these points are. This is kind of the nickel tour of where we are going to be putting our time and energy.

Before I go into this, I want to point out a key difference in this particular set of operational imperatives than maybe what we have experienced in the past. You heard Randall talk about previous ILEC integration merger work that we had to do, where maybe it was more best practice focus. What is unique about this particular exercise is it is largely focused on a very contained set of operations within our business. It is focused on the enterprise data and long distance space.

We re not talking about operational evolution and change and best practice adoption in 160,000 employees at SBC. We re talking about a contained operation, and we re talk about an operation that is largely done within the 4 walls of work centers, not as much as what is done out in the dispersed field arrangement. Why that is important is because process change in those environments is usually more manageable and it s a lot easier to operate and measure over time. So this is a little bit different than what we have done in the past, and in some respects probably more straightforward.

So first let s look at engineering. There s redundant operations basically here. We have looked at our data engineering operations, where we have similar functions occurring as we engineer data networks for customers. Clearly SBC no longer needs to maintain an engineering work force out of region because we now have the assets of AT&T outside of our immediate footprint to take care of those things.

We have common legacy switching platforms, like Tandem switching on the voice side, that can be easily combined and engineered in conjunction with one another, and planning activities that will naturally overlap. In total you can say we ve got about 2,800 people involved in those activities. We expect about a 19 percent reduction overall in those activities.

Now let s look at enterprise data ordering, processing data orders for our large business customers. The bottom line here is when you look at what AT&T has been able to achieve with some excellent engineering work in their operations organization. They re able to take orders and generate orders on a much more effective and mechanized fashion than we are able to do today within SBC. We believe that we can take our volumes, traffic we have not only in our embedded base but the new customer base, and use the same operating infrastructure to achieve those same objectives within SBC.

We know we can make this kind of a transformation. We have been doing it in the past, as we have had to migrate things like different ordering platforms for DSL services between the regional companies that we have acquired in the past; as we have had to standardize frame and ATM product sets from the different regional companies that we have acquired. We think we have the tools and techniques to very quickly and rapidly move our customer base into this kind of an operating infrastructure and take the benefit of the same kind of flowthrough rate that AT&T has been able to achieve here.

Same thing on the provisioning side. Most impressive is what AT&T has been able to do to get an order to actually provision all the way through the network and configure routers. You can see the base here of about 3,600 employees. We expect we are going to take about a third out of that work group by simply taking the existing practices and the existing flowthrough rate that AT&T has been able to achieve, and overlaying them on top of work activity that occurs within the SBC Companies today.

Enterprise care functions, largely trouble management, testing a circuit, reporting something that is out of service. There has been a fabulous progress in AT&T on using Web portal capabilities for customers to use the Web to test circuits, to get information about their ticket, to report it. Again this is no rocket science; looking at what they been able to do to extract work content out of their centers, overlaying these on top of volumes that we have within the SBC Companies, and then taking the benefits out of there.

Network management, this is the exercise of basically watching network elements to make sure they are performing properly, answering alarms, responding to fix those things. We all have of similar elements in our network. We all built centers and infrastructure to watch them. The irony is we are all watching very similar routers, very similar switches, and very similar fiber facilities.

When you look at the architecture between how SBC is engineered to do this and how AT&T is engineered to do this, there is a high degree of commonality in our approach, which makes the migration of bringing these things together in a unified network management approach much easier. This is simply a matter of getting in a position where highly automated tools are watching more network elements.

Then finally, on the access management side, I can speak from personal opinion when I used to run the access business, the local wholesale support business for SBC, there is probably no finer access management organization in the industry than what AT&T has done. Not only in how they approach it, but in the costs that they re able to achieve.

Our belief is simply, why would we carry a redundant operation like this inside of SBC, when have an opportunity to leverage the best in the industry and have all of our access that we purchase go through one operation. As you can see, there s opportunities there.

So the net of this is that we feel pretty strongly about these operational changes that can occur. We believe they are very contained in what can happen; and we also believe that they re very achievable given what is already on the ground and working within AT&T today.

Now let me switch gears and talk about another labor related issue on the IT side of the house. SBC, again, has had history in integrating information technology organizations from past acquisitions. On the screen I have given you some background around historically what we have been able to achieve in that realm. We have looked at this particular transaction and we think there are similar opportunities here as well.

They are a little bit different in nature because we re not combining 2 local companies. It s a local company and an interexchange carrier. Nonetheless we think there is great opportunity. For example, corporate overheads really are not much different. Standardizing and financial application reporting, looking at human resource and payroll systems, these are all things that naturally will fall out as part of the process that we have had opportunities to look at.

Infrastructure is another place we ve typically had great success at pulling costs out. We think there s naturally going to be some additional opportunities that fall out of here. But what I want to stress to you in terms of as we ve done the financials and looked at the models around this, is that early on we actually expect incremental investment in the combined IT organizations to be able to effect some of the changes I ve talked about before.

Don t expect to start seeing run rate savings in now we have modeled this transaction until the 2009 time frame. Ultimately when those achieve full ramp we expect about an 8 percent reduction in the combined workforce in our IT organizations when we get to steady-state. Again, I would stress to you that this kind of transaction and these kind of activities have been tested over time in past mergers and what we have done.

Procurement is another important place to look. There is a 60 percent overlap in our major spend areas between AT&T and SBC in terms of the vendors that we do business with. Past practice as we have done these consolidations would result in about a 10 to 12 percent reduction in the spend of the company that we have typically picked up in a transaction.

In this particular case we have tried to be a little bit more moderate about that. We think spend intensity maybe has dropped off as capital programs have changed. Our assumption here, we are probably going to get about 5 percent out of this new spend as we move forward. But it will generate again some fairly mechanical and significant savings back to the business that will get us where we need to get.

Then there is a host of a couple of other remaining value drivers. There are places like corporate overheads on headcount and HR and legal. Ultimately, eliminating lease and transport fees like usage fees that we pay to Wildsell (ph) to carry traffic on their network, or collocation space that we rent outside of our region that we no longer need to have, or physical facilities that we may lease outside a region that are duplicative to what AT&T has. Again these are pretty straightforward, mechanical operations to achieve these kinds of changes, and they are phased in over time to allow for the transition.

So in summary, if you look at the operational headcount savings that I discussed, couple those with the numbers that Mark shared with you in the salesforce and sales operations piece, and about 58 percent of the net value comes out of pretty straightforward operational changes. Operational changes that are largely contained in the enterprise, long distance, data portion of our business, something that we think we have a lot of control and ability to manage.

The combined Companies are going to bring together a workforce of the best in class folks at running longhaul backbone networks and a great group of people who know how to run local networks that should unleash the synergies to get these networks running together as one and tread new ground in the area.

Finally I would tell you that the nonoperational related savings are largely mechanical and repeatable from things that we have done in the past. They are easily identified, managed, and executed on; and we have people who have done this multiple times.

In summary, the targets are achievable; they are linked to operations that we control and have limited exposure to exogenous variables. So we are highly confident we get this done. I would now like to ask Rick Lindner to come up and share with you a little bit more information on the financial aspects of the transaction.

Rick Lindner ***SBC Communications - SEVP & CFO***

Thank you, John. Good afternoon, everyone. I really appreciate we all appreciate you taking the time to be with us this afternoon. As John said, I would like to cover with you the financial implications of this transaction to SBC. I think a good place to start is with a

quick outline of the transaction.

As you probably know, each shareowner of AT&T will receive 0.77942 shares of SBC, and based on the closing price last Friday that is valued at about $15 billion. In addition, they will receive a special dividend of $1.30 per share that will be received from AT&T just prior to closing; and that is worth approximately $1 billion.

As of the end of last year, AT&T had net debt on their balance sheet of about $6 billion, bringing the total transaction value to 22 billion.

There will be a number of approvals required to close the transaction, approvals from the AT&T shareowners, the Department of Justice, the FCC, certain state PUCs, and certain foreign authorities. We expect the transaction to close on the first half of 2006; and as you heard Ed say earlier today, we are going to target a very aggressive timeline and work as quickly as possible to get this transaction closed.

The merger agreement includes some customary features. There is a 3.5 percent breakup fee that is worth approximately $560 million; and customary material and adverse change clauses, which include both regulatory requirements that may be imposed on the deal as well as any significant deterioration in AT&T results.

You know, as you have listened this afternoon you have heard us talk a lot about synergies, and the reason for that is very simple. A large part of the value of this transaction is in the synergies we can produce when we bring the complementary assets of these 2 Companies together. I m not going to go through all the numbers on this slide; there is a lot of detail there. You have it in your binders. But the bottom line is we expect pretax synergies of $2.5 billion or more by 2009.

As you also see there are some integration costs in order to achieve those synergies. Those are most significant in about the first 18 months after closing. Those include things like provisions for additional advertising to launch the new combined (technical difficulty); the transaction fees associated with the merger. Severance and retention costs, there is a retention pool built-in because we believe it is going to be very important to retain key talented managers from AT&T. There is also some various contract termination costs that have been anticipated and included in these estimates.

At the bottom of this slide you see there is also some non-cash purchase accounting impact. These come primarily from a valuation that will be placed on the AT&T customer base and customer contracts at closing. That intangible asset will then be

amortized over a few years; it will be a relatively short period of time; but it does impact the reported EPS dilution in the transaction.

Let me talk a little bit about the synergies. As you see and as John spoke to you about a little bit earlier, the synergies ramp up very quickly. The reason for that is very simple, as he said. For the most part, these don t require best practice type of implementation and major changes to processes. It simply is consolidation of operations, elimination of redundant functions, and elimination of redundant facilities.

Over 85 percent of the synergies that are projected in this view are cost based. I think we have been very conservative with respect to revenue synergies. I do believe as we bring these assets together and as we have the asset base that you have heard Dave and Randall talk about, there are going to be revenue opportunities. I think that represents some upside to these numbers.

Nearly 60 percent of the synergies are headcount related. I hope, as you got a feel for the presentations from both Mark and John, we have done a lot of work digging into the organizations. I think we have been conservative in some of those estimates, and they are very countable.

Finally, much of the balance of the synergies you see on this page comes from simply taking traffic that exists today at SBC and traffic that exists today at AT&T, and moving it on net to this new combined Company.

The synergies that we talked about drive significant EPS improvement in the initial years after the merger. The transaction does have some dilution up front. It is estimated right now at about 30 cents in 2006. As you see on this slide, it is primarily from integration costs and some of the accounting costs, the amortization of intangibles I spoke about a minute ago. That dilution number is cut in half in 2007; and this transaction is incrementally EPS positive in 2008, and contributes 25 cents to earnings per share in 2009.

I want to also point out when you look at this slide, if you put aside the upfront integration costs and the intangible amortization, this transaction is accretive day 1.

As we looked and modeled and went through due diligence it became apparent that a large piece of the value here had to do with the synergy. That is why we have spent so much time this afternoon talking about it. But in addition we did a lot of modeling looking at all of our assumptions, running sensitivities that reduce the absolute value of the synergies achieved, that delayed the time frame that the synergies would be achieved, that we took some slices at reduced margins in the underlying business.

What I wanted to show you on this slide is just a sample of how we looked at the transaction. On the left side of this slide, what you see is the reported EPS numbers that we believe are in the base case for the transaction. On the right side, what we have done is we have reduced the net synergies that you heard us talk about today by 25 percent. So if we miss the mark by 25 percent, this transaction is still EPS positive in 2008 and still contributes 15 cents to earnings in 2009 and growing thereafter.

I would also like to talk a little bit about cash flow. Because frankly as I look at this transaction and as we have modeled it out, it is one of the areas in our business that I get very excited about. The synergies that we talked about also drive strong increases in cash flow. This transaction on an incremental basis is free cash flow positive in 2007.

Let me talk a little bit about what you may expect to see as we go forward between now and closing. Between now and closing, SBC will be paying down some debt currently on our balance sheet. As you know, we borrowed some additional funds at the end of last year to complete the AT&T Wireless acquisition. Our plan has been and continues to be to bring those debt levels down in 05. So you will see that happen.

In addition, AT&T will be paying down some of their debt as it matures over the next year to year and a half before closing. The result is now fast forward with me to 2007 after closing. What you re going to see is a combined Company whose balance sheet and credit metrics are very strong. We are estimating debt to EBITDA numbers at that point in the 1.3 to 1.5 range; EBITDA interest coverage ratios in the 10 to 11 range.

In addition to that, keep in mind, 2007 we are past the major integration of AT&T Wireless and Cingular. As we move past that integration, CapEx levels will come down; the synergies will drive additional cash flow to us from Cingular; and on top of that, this transaction is free cash flow positive. At that point, SBC will have a strong balance sheet, an absolutely terrific set of assets to take to the marketplace unmatched in the industry, and growing cash flow. And that is a combination I think is incredibly powerful.

In summary, I think what you have heard from us today is there are significant synergies in this transaction. In fact, the more we went through due diligence, the more our people get involved from an operating standpoint, the more opportunity we have seen.

Synergies that are achievable and total more than $15 billion in net present value. Transaction is EPS positive in 2008. Cash flow positive in 2007. The combined Company is going to have a strong balance sheet and strong credit metrics, and an increasing free cash flow profile that will support dividend growth and share repurchase.

I think the bottom line from our standpoint is that executing on this transaction, combined with Cingular and combined with Project Lightspeed, puts us in an absolutely premiere position in the

industry, and a position based on both capabilities we will be able to bring to market as well as superior financial strength.

That concludes my remarks this afternoon. At this point, I would like to turn it back to Rich Dietz, and Rich is going to orchestrate the Q&A session for us. Rich?

QUESTION AND ANSWER

Rich Dietz ***SBC Communications - VP IR***

We re going to move into a Q&A session. We are going to bring some chairs up here and ask the speakers, plus Bill and Tom, would you join us on stage, please? Again, I will remind you for analysts to identify your name, company, please, with the question.

We have got mikes in the audience and they will recognize you and bring a mike to you. We will direct that question to one of the speakers or other executives to respond to. Just give us just a moment to get organized. Okay. I will turn to the monitors and the floor.

Frank Louthan ***Raymond James - Analyst***

Frank Louthan with Raymond James. Just real quick on some of the cost synergies. Can you give us a little bit of an idea of where they re coming from? Is it mostly from the SBC side or the AT&T side? With that, just kind of a quick breakout, what percentage are from expense in total; and what percentage are in CapEx over the time period that you re looking at? Thanks.

Rick Lindner ***SBC Communications - SEVP & CFO***

Let me take the last part of the question; and then, John, I will ask you to add some color to the first part of it. I think with respect to the synergies you look at, we have got a pretty good breakout in the materials. What you will see there is we have been pretty conservative with respect to CapEx synergies.

They are modeled at about 3 to 4 percent currently of the combined CapEx of the 2 Companies in 04. SBC was 5.1 billion in CapEx; and AT&T was just under 2 billion. It gives you a sense for the synergy estimate there. Again it is an area where I think we have been conservative. John, do you want to speak to some of the breakdown of the synergy numbers you talked about?

John Stankey ***SBC Communications - SEVP & CTO***

I thought the roadmap was fairly clear, but in terms of what side of the fence they come from, most of the work activity that is being eliminated is work activity that is occurring within the SBC entities. However, we will have to be looking at where the work is structured and what centers survive. That is typical any time you put these two companies together. Exactly to say what the percentage breakout of one employee group versus another is, is really premature at this point.

I would also tell you when you kind of look at the vast majority of that work that I addressed, most of it is day to day operating work that is largely expense. The exception to that might be when you look at the engineering functions that have to do with the design and placing long-lived capital assets, that there may be a percentage of that labor that ultimately gets capitalized.

Rich Dietz ***SBC Communications - VP IR***

Great. The next question?

Simon Flannery ***Morgan Stanley - Analyst***

It s Simon Flannery at Morgan Stanley. Can you talk a little bit about what changes in 2005 as a result of this deal? You both have headcount reduction goals; do those change? Are those accelerated? Are you able to do things like use AT&T selling through Cingular instead of through Sprint, for example? And any other opportunities perhaps to go more slowly on the SBC enterprise push, given that some of your spending might be redundant in 06 and beyond?

Unidentified Company Representative

Let me start out with that, Simon. First of all, both Companies are going to continue to compete aggressively in the marketplace, and we have got a fiduciary responsibility to run these businesses as separate organizations.

We will, as we go through this next year, certainly from the SBC point of view be thinking about the opportunities when this transaction closes. That may impact some decisions we make in terms of investments through the year. We re going to do the smart thing but we re also going to keep the customers in mind in terms of what we need to bring to them over this next year or so. I think with respect to that I don t know, Randall, if you want to add to that?

Randall Stephenson ***SBC Communications - COO***

Simon, I would add that there are some opportunities where AT&T is looking for wireless opportunity to bring to their customers; obviously we would like to see them using Cingular. We can do some type of arms-length deals there, some transport arrangements. We can also do some of those types of opportunities. So there are a number of things where on an arms-length basis we would like to be doing some things with AT&T or Cingular that we can; and we will pursue those.

Rich Dietz ***SBC Communications - VP IR***

Next, please? Way in the back.

Daniel Berninger ***Tier 1 Research - Analyst***

Daniel Berninger, Tier 1 Research. Can you talk a little bit about how this transaction would change your relationship with the other Bell operating companies?

Ed Whitacre ***SBC Communications - Chairman & CEO***

As you know, we are in the Cingular business with BellSouth. We are 60 percent; they re 40. I do not anticipate it changing. I have talked to Duane Ackerman. I don t anticipate any change there. I really don t see any with Ivan (ph) or with Qwest or BellSouth. I just don t see any change.

Rich Dietz ***SBC Communications - VP IR***

Next question, please?

Todd Rosenbluth ***Standard & Poor s Equity Research - Analyst***

Todd Rosenbluth with Standard & Poor s Equity Research Services. Primarily focused on what happens to the AT&T customer base that is going on. You ve got 25 million consumer long distance in a bundle kind of package, many of them that are 3 or more years out. How do you try to retain those customers in order that they can then move over, and how does SBC operate, considering a number of these customers aren t in SBC s local territory? And then I guess on the enterprise customer front, again, most of these customers are operating outside are headquartered on the AT&T side outside of SBC s territory. Do how do you keep the relationship with the other Bell companies not in an aggressive manner following on that last question?

Unidentified Company Representative

Well, on the consumer side, as we ve said, this consumer base of stand-alone long distance customers is eroding at north of 20 percent. The overall revenue is declining at a slower rate than that because we have other services in that mix. But stand-alone long distance is going away because as SBC has said, 61 percent of their customers I think now take a bundle, so over the course of the year of approval

will certainly shrink. I don t think people have thought about the fact that where are these customers going. Well, they are either going back to the Bell company in the region as they add long distance to the portfolio. SBC has a footprint of about 40 percent of the access lines, I think, of the U.S., somewhere in that range. Certainly cable and other providers are trying to sell to those customers as well. So part of our loss is not going outside the two companies.

FINAL TRANSCRIPT

SBC - SBC Communications and AT&T Analyst Meeting Webcast

On the business side, I m not quite sure I understood your question. We have relationships in the enterprise space with companies that do business globally. Thousands of location spread across the U.S. and the world. The relationships with the other Bells really don t come into that, except as access providers which are covered under tariff services, either special access or switched access. We manage that and optimize that against our own network assets where we have fiber deployed, particularly densely in the Northeast. That really comes from the original TelePort CLEC that we bought back in 1998, which was historically in the Eastern Seaboard. We have added some fiber facilities across the country, but the densest part of that is not in SBC s territory.

Lee Cooperman *Omega Advisors - Analyst*

Lee Cooperman; I m with Omega Advisors. I m an AT&T shareholder, and I have a sense the question is coming from somebody that is more optimistic about our business than the management of AT&T. But there are 3 interrelated questions I would like to get out and then have you respond to them.

Number 1 is why should AT&T shareholders accept an offer that gives them less than 16 percent of the combined company when at least one-third of the combined company cash flow and perhaps 40 percent of the free cash flow based upon commonly accepted 05 estimates is coming from AT&T?

Second, if you dock (ph) into your year-end conference call the other day, it looks like there d be at least $2.5 billion of free cash flow for AT&T in 05, after CapEx and dividends, and that is excluding any special dividends. When this is added to the year-end 2004 unrestricted cash on hand of 3.658 billion, this would imply doing nothing, at the end of 05, you would have had $6.1 billion. I m assuming that maybe minimal cash operating requirements of the Company are about 2 billion.

So really doing nothing at year-end, we re going to have $4 billion of excess cash, yet we are only returning $1 billion of cash as part of this transaction. It seems to me that that doesn t make any great deal of sense.

Finally without being impolite, is there any soft or hard understandings regarding management s succession as part of this deal? Also if we attempt, because as far as I m concerned, with 14 or percent to the combined ownership, we re selling the company. Did we broadly shop this Company to other possible interested parties before reaching this transaction?

And as for SBC, what I would ask frankly, is given this dynamite presentation you have put on and the market s desultory reaction to it, are we in a position to capitalize on the market s distrust of us by buying back a fair amount of equity? Or we are not capable of doing that until the transaction closes? That is really 4 different questions.

Rich Dietz *SBC Communications - VP IR*

Think you got your fair share here. (multiple speakers)

Dave Dorman *AT&T - Chairman & CEO*

Let me talk about the math around the cash. We have maturities in 2005 that will take some of that cash. We had intended to as we have said buy back some debt at market up to the authorized level. So I think the cash number for year end that you have suggested is not consistent with what we have in the plan based on other uses of the cash.

Secondly, in terms of broadly shopping the business, we have not been hiding under a bushel basket. Let s face it, there are if you really think this through, in terms of people who could possibly do this transaction, probably 3. They know who we are, we know who they are, there have been abundant rumors.

One of them has said consistently they re not interested; as late as last week after the leak on Thursday, I am not interested. So as far as auctioning a company like AT&T is concerned I think that would be incredibly risky for shareholders. I believe that we got a very fair deal from SBC. We have broadened in the portfolio of the Company.

We were certain, and if you look at the dynamics of our revenue stream, $10 billion of our revenue in 05 is in businesses we are exiting. Consumer and small business. Approximately 20 billion of our revenue, this is 04 numbers applied to 05, are in businesses that we are competing in vigorously which still have difficult pricing dynamics in it, given the abundant number of competitors.

In my view we are getting 16 percent of a broader enterprise with very rich synergies which we will participate in. So the total value package to the AT&T shareowner is not only a premium to our trading range over the last 6 months, 3 months, 1 month, other than the post leak period of time; but it is also getting this opportunity to participate in a percentage of those synergies which we could not achieve by ourself.

Rich Dietz *SBC Communications - VP IR*

Next question, please? In the back.

Sturges Woodberry *Meridian Asset Management - Analyst*

I d like to follow up on those questions, please. This is Sturges Woodberry from Meridian Asset Management. You did not address the question that was asked about any understanding regarding employment for the current AT&T management.

Also, yesterday SBC management glowingly almost bragged that the shares being offered are less than the actual net present value of the synergies. Given that you have $10 billion of revenue coming off, there must be some residual value that should have been included in the consideration offer to AT&T shareholders.

Finally, I could not care less that 3 people are going to go from the Board of AT&T to the Board of SBC, given the presiding over a relative industrial decline that that enterprise has witnessed over the last 25 years. So if you could (technical difficulty) comment.

Dave Dorman ***AT&T - Chairman & CEO***

In terms of the Board of AT&T, I think there are 3 4 Board members of the 9 outside directors who joined shortly before or shortly after I became CEO. So 6 of the 10 did not preside over the industrial decline or whatever phrase you talked about. They came in afterwards.

As far as the directors going on the SBC Board, I cannot speak for Ed, but SBC s Board is a very experienced Board. On average the age of SBC s Board members is older than AT&T s Board members. I think it is opportunity for SBC to pick up with their consent a couple of great directors, in addition to myself.

As far as my role is concerned it is very straightforward. That is up to SBC, Ed, and the Board of Directors. I have offered my services to be there as long as they would like me to in an appropriate role. So there is no soft promise or hard promise or anything else. My intent is to make this successful and deliver value for shareholders, and I will participate in it as long as I m welcome to participate.

Rich Dietz ***SBC Communications - VP IR***

Next question, please?

Tom Watts ***SG Cowen - Analyst***

Tom Watts of SG Cowen. To what extent do the synergy numbers you ve outlined include synergies with Cingular? You have also referred to potential revenue synergies (technical difficulty) marketing. Can you talk a little bit both from the revenue side and the cost side what synergies we might see with Cingular?

Just a second question. AT&T has a very robust posting and managed applications business. I think Mark referred to perhaps doing managed applications on the wireless side. Are we going to see changes in that business at all with SBC? And are there any specific opportunities SBC can bring to build that?

Rick Lindner ***SBC Communications - SEVP & CFO***

Thanks. Let me talk just a minute about the wireless question, and I will hand off to talk about the managed services question. On the wireless side, in terms of what we have modeled, we have not modeled additional synergies, and the numbers that you have seen today do not include additional synergies from the wireless side.

Having said that, we think this transaction brings additional value to Cingular. It gives us the opportunity to jointly market the advanced data services and wireless into the largest businesses in the United States with 2 footprints, both on the wireline, the data, the advanced services side, and the wireless side that are very complementary.

So I think there is a tremendous opportunity there. It is an upside to any of the numbers that we have shown you today. Secondly, I don t know; Bill?

Bill Hannigan ***AT&T - President & COO***

I would like to comment on the wireless offer. We re going in the market in the next couple of months with a managed wireless service. You think about the assets that Mark and Randall and Rick and John talked about.

We re recalibrating as we think about commercial terms that we could take advantage of potentially in 05; and then the broader portfolio of owned assets in 06, with the pre-eminent set of assets for wireline, wireless, services over IP, convergence worldwide; they make us pretty darn exciting in the roadmap we can bring to our enterprise customers.

John Stankey ***SBC Communications - SEVP & CTO***

I want to build on Rick s comment. He s absolutely on the mark. There is no assumptions around how what upside there is from Cingular on the product set and other operational things. The one exception is in the LD traffic that we re looking to bring on net that we would bring in with AT&T.

There are Cingular minutes of use that are included in some of those synergies that I talked about. It is one of the fastest growing components of our wireless traffic, and it is all the more reason why getting to a good cost structure on that is really exciting to us as well. Because as those wireless minutes continue to grow we get a really robust architecture to deliver them on.

Rich Dietz ***SBC Communications - VP IR***

Next question, please?

Steve Glick ***CSFB - Analyst***

Steve Glick from Credit Suisse First Boston. Just looking at the synergy assumptions; you said there s about 2.5 billion or so by 2009, 60 percent of that is employee related. You said there are about 7,700 layoffs, gets you to around 200,000 (technical difficulty) Seems a little high. I was wondering if there are other redundancies that have yet to be announced. In addition was wondering if there are any issues related to unions at all that would be (indiscernible) occurring?

Rick Lindner ***SBC Communications - SEVP & CFO***

I think first with respect to the employee numbers, I think your math is off there. If you go through the presentation slides, start adding up those components, we think there s more opportunities in terms of force as we consolidate these operations. Roughly close to double what you were talking about, in the 13,000 kind of range.

I am sorry, your second question was? With respect to the unions, we have strong relationships as you know with the CWA. AT&T has strong relationships with the CWA. As we move forward on these initiatives and I should mention both Companies have efficiency and workforce reduction plans in place that we have announced on a stand-alone basis, relative to 2005. All the things we re talking about today obviously are incremental to that and in essence a continuation of it post-closing.

We have the ability within those agreements to manage force, and rules in place to do that. We will obviously follow that. We will work with the union on that. But in addition, if you just look at the AT&T portion of the employee base, their workforce from a union CWA standpoint is much smaller.

Dave Dorman ***AT&T - Chairman & CEO***

I think ended the year at AT&T with about 15,000 represented employees between the CWA and IBEA. Our current plans including announced center closings that we had in the last 2 weeks would see that number decline well below 10,000 by year-end.

So if you look at AT&T s total workforce, we re talking about less than 10,000 union employees, with some significant percentage of them being call center employees in the declining consumer business, which undoubtedly could be combined with SBC on a productivity and efficiency basis. So the union from our perspective is pretty small part of our overall base just as our business has changed.

Unidentified Company Representative

We have been able to effectively manage force without doing significant layoffs over the last couple of years. Our attrition rates are really fairly high, particularly when you look at some of the areas we re talking about downsizing here, that will attrite somewhere around 1,000 employees of month. So we think if we are very aggressive and manage our force, we can do this without dramatic layoffs.

Rich Dietz ***SBC Communications - VP IR***

In the middle here?

Rick Klugman ***Jefferies - Analyst***

Rick Klugman, Jefferies. You present substantial detail on the synergies, but I guess I have a question for SBC management here. That is, what to the best of your ability do you think is the stand-alone value of the AT&T business you are acquiring? Because a lot of us in the investment community have viewed it, with all due respect to Dave Dorman and his team, as kind of a good chunk of it is a self-liquidating trust over time. I don t know if that is what you are factoring into your analysis.

Second question if I could, you talked about a material adverse change clause. AT&T is forecasting a 15 percent revenue decline this year. If that becomes 20 or 25, is that what would you define as material? Thanks.

Rick Lindner ***SBC Communications - SEVP & CFO***

I think with respect how we have modeled and looked at the business, clearly we have taken into account the fact that within AT&T there are several things happening and several moving parts.

One, as you heard Dave talk about, is they have pulled back and are declining revenues fairly rapidly in their consumer business. There are portions of their business revenue stream that are voice related or LD voice related; and those have been declining. Or in many cases what is happening is you see customers moving to new technologies, and that is causing some of the revenue decline.

At the same time, I hope what you got the impression of today and a good feel for today is, as we move traffic and customers to new services and an IP-based broadbased network, that network also carries with it a much lower operating costs. In doing that, what AT&T has been successful in is, as revenues have been declining, their cost side has been declining also.

So that is how we have looked at the business. Frankly it is one of the things that makes this transaction a little more difficult to analyze. You have to get beyond that.

We do believe what comes out the other side of this though, with the combination of assets we have talked about, is a very strong Company particularly when you are looking at the enterprise

FINAL TRANSCRIPT

SBC - SBC Communications and AT&T Analyst Meeting Webcast

space. In the enterprise space there is going to be and is demand there for future services, integrated voice and data networks, managed services, all of the things that this Company is going to be able to provide.

When you break down the revenues, it is true there are some categories that are declining rapidly. There also categories that are increasing at double-digit rates. As you look ahead, there s certainly next year AT&T has already provided guidance that indicates a substantial decline next year, double-digit decline. But as you get out a couple of years, our belief is, as that transition slows, the revenues begin to stabilize as well and the margins stabilize.

I think you talked about the material adverse change clause; and that would be really based off of the kinds of projections and the outlook that they have put forward as the base case.

Dave Dorman ***AT&T - Chairman & CEO***

Could I add one thing to that? When you talk about valuing this business, and Rick talked about the declining revenue streams where they re leaving the business, the business assets that they have created there is not another business like that. There is not another set of assets like this available. I would suggest to you worldwide you could not find another side of assets like this. So you are getting a very, very unique set of assets.

But there is a second piece to that when you look at it from SBC s side. That is, these large fixed cost businesses, you don t get many shots at changing your cost structure like we ve got a shot at changing ours with this one. This will fundamentally change the cost structure of our business, and that is as big a driver to this transaction from our side as anything else we can come up with.

It changes the way you look at the whole access regime and how you are exposed on the access revenue side that John talked about. So this goes beyond buying a declining revenue stream. There is a great set of core assets; and at the end of the day we will be able to fundamentally change our cost structure and be in a class we think that is best in class ahead of anybody else. Bill, do you want to talk about the (technical difficulty) ?

Bill Hannigan ***AT&T - President & COO***

I was just going to comment on Rick s comment on the mix of our revenue stream by segment, that he talked about earlier, 30 billion in revenue in 2004. 10 billion of that is mass market. So think about the 85 percent of our business portfolio that is enterprise, global, and government, more than $20 billion. The rate of decline is, we anticipate, single digit.

So there is still plenty of price pressure in the marketplace, but we re holding or taking share in that 85 percent of the revenue stream that is in the business portfolio of AT&T.

Rich Dietz ***SBC Communications - VP IR***

We have time for one last question. In the back here.

Oliver Boone ***Alliance Capital - Analyst***

Oliver Boone (ph) from Alliance Capital. Two questions, the first is on the SBC side. At closing, will you guarantee the remaining AT&T bonds that are outstanding?

The second related question for Mr. Dorman is, if you could just remind us what the remaining part of the debt retirement program is? I know there are a couple of maturities between here and there, but what is sort of remaining outstanding in terms of going back to the previous question on excess free cash flow?

Dave Dorman ***AT&T - Chairman & CEO***

The first part of your question related to the debt, we are reviewing the AT&T outstanding debt and the covenants associated with it. We have not made final determinations on guarantees. But I will tell you that many of those debt issuances include some rate adjustment that is based on the ratings.

So certainly from our perspective, once the transaction is closed, there may be some advantages to guaranteeing that debt, if we re able to reduce the interest expense, and we ll certainly factor that into our thought process there. Tom, do you want to take the second part?

Tom Horton ***AT&T - Vice Chairman & Financial Officer***

Sure, Rick. As you may recall, we had a $3 billion Board-approved debt buyback program last year. We still have a couple hundred million authorized under that. And we re going to take a step a back and decide what we want to do in terms of buying back debt in the context of this transaction in 05.

Rich Dietz ***SBC Communications - VP IR***

Very good. Thank you all very much for attending. The speakers will be available for a short period of time up front. Thanks again for attending. See you soon.

FINAL TRANSCRIPT

SBC - SBC Communications and AT&T Analyst Meeting Webcast

DISCLAIMER

Cautionary Language Concerning Forward-Looking Statements

Information set forth in this document contains financial estimates and other forward-looking statements that are subject to risks and uncertainties, and actual results might differ materially Such statements include, but are not limited to, statements about the benefits of the business combination transaction involving SBC and AT&T Corporation, including future financial and operating results, the new company s plans, objectives, expectations and intentions and other statements that are not historical facts. Such statements are based upon the current beliefs and expectations of SBC s and AT&T s management and are subject to significant risks and uncertainties. Actual results may differ from those set forth in the forward-looking statements.

The following factors, among others, could cause actual results to differ from those set forth in the forward-looking statements: the ability to obtain governmental approvals of the transaction on the proposed terms and schedule; the failure of AT&T shareholders to approve the transaction; the risk that the businesses will not be integrated successfully; the risk that the cost savings and any other synergies from the transaction may not be fully realized or may take longer to realize than expected; disruption from the transaction making it more difficult to maintain relationships with customers, employees or suppliers; competition and its effect on pricing, spending, third-party relationships and revenues. Additional factors that may affect future results are contained in SBC s filings with the Securities and Exchange Commission (SEC), which are available at the SEC s Web site http://www.sec.gov. SBC disclaims any obligation to update and revise statements contained in this presentation based on new information or otherwise.

This document may contain certain non-GAAP financial measures. Reconciliations between the non-GAAP financial measures and the GAAP financial measures are available on SBC s Web site at www.sbc.com/investor_relations.

">

Leased
Bakersfield, California

Regional office

All segments

Leased
Bellingham, Washington

Regional office, fabrication facility and warehouse

Oil Gas & Chemical, Storage Solutions, Industrial

Owned
Canonsburg, Pennsylvania

Regional office

Electrical Infrastructure, Oil Gas & Chemical, Industrial

Leased
Catoosa, Oklahoma

Fabrication facilities, regional office and warehouse

Oil Gas & Chemical, Storage Solutions, Industrial

Leased & Owned [(1)]
Columbus, Ohio

Regional office

All segments

Leased
Eddystone, Pennsylvania

Regional office, fabrication facility and warehouse

All segments

Leased
Hammond, Indiana

Regional office, fabrication facility, and warehouse

Oil Gas & Chemical, Industrial

Leased
Houston, Texas

Regional offices and warehouse

Oil Gas & Chemical, Storage Solutions

Leased & Owned
Metairie, Louisiana

Regional office

All segments

Leased
Norco, California

Regional office and warehouse

Storage Solutions, Oil Gas & Chemical

Leased
Orange, California

Fabrication facility, regional office and warehouse

Oil Gas & Chemical, Storage Solutions, Industrial

Leased & Owned
Pittsburgh, Pennsylvania

Regional office

All segments

Leased
Rahway, New Jersey

Regional office and warehouse

Electrical Infrastructure, Oil Gas & Chemical, Industrial

Leased
Sewickley, Pennsylvania

Regional office

Oil Gas & Chemical, Storage Solutions, Industrial

Leased
Temperance, Michigan

Regional office and warehouse

Storage Solutions

Owned
Tucson, Arizona

Regional office and warehouse

Industrial, Storage Solutions, Oil Gas & Chemical

Leased
International:

Burlington, Ontario, Canada

Regional office

Electrical Infrastructure, Industrial, Storage Solutions

Owned
Calgary, Alberta, Canada

Regional office

Storage Solutions

Leased
Leduc, Alberta, Canada

Regional office and warehouse

Storage Solutions

Leased
Sarnia, Ontario, Canada

Regional office and warehouse

Storage Solutions

Owned
Paju-si, Gyeonggi-do, South Korea

Fabrication facility, regional office and warehouse

Storage Solutions

Owned
Sydney, New South Wales, Australia

Regional office

Storage Solutions

Leased

(1) Certain facilities were constructed by the Company on land acquired through ground leases with renewal options.

In addition to the locations listed above, Matrix has smaller regional locations and temporary office facilities at numerous customer locations throughout the United States and Canada.

Table of Contents

Item 3. Legal Proceedings

We are a party to a number of legal proceedings. We believe that the nature and number of these proceedings are typical for a company of our size engaged in our type of business and that none of these proceedings will result in a material effect on our business, results of operations, financial condition, cash flows or liquidity.

Item 4. Mine Safety Disclosures

Section 1503 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") requires domestic mine operators to disclose violations and orders issued under the Federal Mine Safety and Health Act of 1977 (the "Mine Act") by the federal Mine Safety and Health Administration. We do not act as owner of any mines, but as a result of our performing services or construction at mine sites as an independent contractor, we may be considered an "operator" within the meaning of the Mine Act.

Information concerning mine safety violations or other regulatory matters required to be disclosed in this annual report under Section 1503(a) of the Dodd-Frank Act and Item 104 of Regulation S-K is included in Exhibit 95 to this Annual Report on Form 10-K.

Table of Contents

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Price Range of Common Stock

Our common stock trades on the NASDAQ Global Select Market ("NASDAQ") under the trading symbol "MTRX". The following table sets forth the high and low sale prices for our common stock as reported by NASDAQ for the periods indicated:

	Fiscal Year 2018		Fiscal Year 2017	
	High	Low	High	Low
First quarter	$15.45	$9.05	$19.57	$15.88
Second quarter	18.50	12.76	23.20	16.20
Third quarter	20.25	13.00	23.45	15.00
Fourth quarter	19.90	13.15	17.70	7.80

Substantially all of our stockholders maintain their shares in "street name" accounts and are not individually stockholders of record. As of July 31, 2018, there were 22 holders of record of our common stock.

Dividend Policy

We have never paid cash dividends on our common stock, and the terms of our Credit Agreement (see Item 8. Financial Statements and Supplementary Data, Note 5 - Debt for more information about our Credit Agreement) limit the amount of cash dividends we can pay. Under our Credit Agreement, we may declare and pay cash dividends on our capital stock during any fiscal year up to an amount which, when added to all other cash dividends paid during such fiscal year, does not exceed 50% of our cumulative net income for such fiscal year to date. While we currently do not intend to pay cash dividends, any future dividend payments will depend on our financial condition, capital requirements and earnings as well as other relevant factors.

Issuer Purchases of Equity Securities

Our Credit Agreement limits the Company's purchases of its equity securities to $30.0 million in any calendar year. The table below sets forth the information with respect to purchases made by the Company of its common stock during the fourth quarter of the fiscal year ended June 30, 2018:

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (C)
April 1 to April 30, 2018				
Share Repurchase Program (A)	—	—	—	1,362,398
Employee Transactions (B)	39	$ 15.85	—	
May 1 to May 31, 2018				
Share Repurchase Program (A)	—	—	—	1,362,398
Employee Transactions (B)			—	
June 1 to June 30, 2018				
Share Repurchase Program (A)	—	—	—	1,362,398
Employee Transactions (B)	—	—	—	

(A) Represents shares purchased under our stock buyback program.

(B) Represents shares withheld to satisfy the employee's tax withholding obligation that is incurred upon the vesting of deferred shares granted under the Company's stock incentive plans.

(C)

On December 12, 2016, the Board of Directors approved a new stock buyback program (the "December 2016 Program"). Under the December 2016 Program, the Company may repurchase common stock of the Company in any calendar year commencing with calendar year 2016 and continuing through calendar year 2018, up to a maximum of $25.0 million per calendar year. The Company may repurchase its stock from time to time in the open market at prevailing market prices or in privately negotiated transactions. The December 2016 Program will continue through December 31, 2018 unless and until revoked by the Board of Directors. The amount shown as the maximum number of shares that may yet be purchased was calculated using the closing price of our stock on the last trading day of the fiscal period and the cumulative limit of $25.0 million remaining under the program.

Table of Contents

Item 6. Selected Financial Data

Selected Financial Data
(In thousands, except percentages and per share data)

	Fiscal Years Ended				
	June 30, 2018 (1)	June 30, 2017	June 30, 2016	June 30, 2015	June 30, 2014
Revenues	$1,091,553	$1,197,509	$1,311,917	$1,343,135	$1,263,089
Cost of revenues	999,617	1,116,506	1,185,926	1,255,765	1,126,616
Gross profit	91,936	81,003	125,991	87,370	136,473
Gross margin %	8.4 %	6.8 %	9.6 %	6.5 %	10.8 %
Selling, general and administrative expenses	84,417	76,144	85,109	78,568	77,866
Selling, general and administrative %	7.7 %	6.4 %	6.5 %	5.8 %	6.2 %
Operating income (loss)	(10,479)	4,859	40,882	8,802	58,607
Operating income (loss) %	(1.0)%	0.4 %	3.1 %	0.7 %	4.6 %
Net income (loss)	(11,480)	138	25,537	(1,898)	36,877
Net income (loss) attributable to noncontrolling interest	—	321	(3,326)	(19,055)	1,067
Net income (loss) attributable to Matrix Service Company	(11,480)	(183)	28,863	17,157	35,810
Earnings (loss) per share-basic	(0.43)	(0.01)	1.09	0.64	1.36
Earnings (loss) per share-diluted	(0.43)	(0.01)	1.07	0.63	1.33
Working capital	118,581	139,654	129,416	114,209	105,687
Total assets	558,033	586,030	564,967	561,689	568,932
Long-term debt	—	44,682	—	8,804	11,621
Capital expenditures	8,711	11,908	13,939	15,773	23,589
Cash flows provided (used) by operations	74,671	(18,746)	33,587	26,240	76,988
Backlog	1,218,596	682,273	868,672	1,420,598	915,826

(1) See Item 8. Financial Statements and Supplementary Data, Note - 4 Goodwill and Other Intangible Assets for a discussion of intangible asset impairment charges totaling $18.0 million included in the Company's fiscal 2018 operating results.

Refer to the Results of Operations section included in Part II, Item 7 of this Annual Report on Form 10-K for a discussion of the impacts of business combinations and contract charges that materially impacted the comparability of information in the Selected Financial Data table above, particularly for the fiscal year ended 2018 in comparison to the fiscal year ended 2017, and the fiscal year ended 2017 in comparison to the fiscal year ended 2016.

Table of Contents

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Management’s discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). GAAP represents a comprehensive set of accounting and disclosure rules and requirements, the application of which requires management judgments and estimates including, in certain circumstances, choices between acceptable GAAP alternatives. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, if any, at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from these estimates under different assumptions or conditions. Note 1- Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements included in Part II, Item 8 - Financial Statements and Supplementary Data in this Annual Report on Form 10-K, contains a comprehensive summary of our significant accounting policies. The following is a discussion of our most critical accounting policies, estimates, judgments and uncertainties that are inherent in our application of GAAP.

CRITICAL ACCOUNTING POLICIES

Revenue Recognition

Matrix records revenue on fixed-price contracts on a percentage-of-completion basis, primarily based on costs incurred to date compared to the total estimated cost. The Company records revenue on cost-plus and time-and-material contracts on a proportional performance basis as costs are incurred. Contracts in process are valued at cost plus accrued profits less billings on uncompleted contracts. Contracts are generally considered substantially complete when field construction is completed. The elapsed time from award of a contract to completion of performance may be in excess of one year. Matrix includes pass-through revenue and costs on cost-plus contracts, which are customer-reimbursable materials, equipment and subcontractor costs, when Matrix determines that it is responsible for the procurement and management of such cost components.

Matrix has numerous contracts that are in various stages of completion, which require estimates to determine the appropriate cost and revenue recognition. The Company has a history of making reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs, and accordingly, does not believe significant fluctuations are likely to materialize. However, current estimates may be revised as additional information becomes available. If estimates of costs to complete fixed-price contracts indicate a loss, a provision is made through a contract write-down for the total loss anticipated. A number of our contracts contain various cost and performance incentives and penalties that impact the earnings we realize from our contracts. Adjustments related to these incentives and penalties are recorded in the period on a percentage of completion basis when estimable and probable.

Indirect costs, such as salaries and benefits, supplies and tools, equipment costs and insurance costs, are charged to projects based upon direct labor hours and overhead allocation rates per direct labor hour or a percentage of cost incurred. Warranty costs are normally incurred prior to project completion and are charged to project costs as they are incurred. Warranty costs incurred subsequent to project completion were not material for the periods presented. Overhead allocation rates are established annually during the budgeting process and evaluated for accuracy throughout the year based upon actual direct labor hours and actual costs incurred.

Change Orders and Claims

Change orders are modifications of an original contract that effectively change the existing provisions of the contract. Change orders may include changes in specifications or designs, manner of performance, facilities, equipment, materials, sites and period of completion of the work. Matrix or our clients may initiate change orders. The client's agreement to the terms of change orders is, in many cases, reached prior to work commencing; however, sometimes circumstances require that work progress prior to obtaining client agreement. Costs related to change orders are recognized as incurred. Revenues attributable to change orders that are unapproved as to price or scope are recognized to the extent that costs have been incurred if the amounts can be reliably estimated and their realization is probable. Revenues in excess of the costs attributable to change orders that are unapproved as to price or scope are recognized

only when realization is assured beyond a reasonable doubt. Change orders that are unapproved as to both price and scope are evaluated as claims.
Claims are amounts in excess of the agreed contract price that we seek to collect from customers or others for delays, errors in specifications and designs, contract terminations, change orders in dispute or unapproved as to both scope and price or other causes of anticipated additional costs incurred by us. Recognition of amounts as additional contract revenue related to claims is appropriate only if it is probable that the claims will result in additional contract revenue and if the amount can be reliably estimated. We must determine if:

- there is a legal basis for the claim;
- the additional costs were caused by circumstances that were unforeseen by the Company and are not the result of deficiencies in our performance;
- the costs are identifiable or determinable and are reasonable in view of the work performed; and
- the evidence supporting the claim is objective and verifiable.

If all of the these requirements are met, revenue from a claim is recorded only to the extent that we have incurred costs relating to the claim.

As of June 30, 2018 and June 30, 2017, costs and estimated earnings in excess of billings on uncompleted contracts included revenues for unapproved change orders and claims of $15.0 million and $11.0 million, respectively. Historically, our collections for unapproved change orders and claims have approximated the amount of revenue recognized.

Loss Contingencies

Various legal actions, claims, and other contingencies arise in the normal course of our business. Contingencies are recorded in the consolidated financial statements, or are otherwise disclosed, in accordance with Accounting Standard Codification ("ASC") Topic 450-20, “Loss Contingencies”. Specific reserves are provided for loss contingencies to the extent we conclude that a loss is both probable and estimable. We use a case-by-case evaluation of the underlying data and update our evaluation as further information becomes known. We believe that any amounts exceeding our recorded accruals should not materially affect our financial position, results of operations or liquidity. However, the results of litigation are inherently unpredictable and the possibility exists that the ultimate resolution of one or more of these matters could result in a material effect on our financial position, results of operations or liquidity.

Legal costs are expensed as incurred.

Goodwill

Goodwill represents the excess of the purchase price of acquisitions over the acquisition date fair value of the net identifiable tangible and intangible assets acquired. In accordance with current accounting guidance, goodwill is not amortized and is tested at least annually for impairment at the reporting unit level, which is a level below our reportable segments.

We perform our annual test during the fourth quarter of each fiscal year and in any other period in which indicators of impairment warrant additional tests. The goodwill impairment test involves comparing management’s estimate of the fair value of a reporting unit with its carrying value, including goodwill. If the fair value of a reporting unit exceeds its carrying value, then goodwill is not impaired. If the fair value of a reporting unit is less than its carrying value, then goodwill is impaired to the extent of the difference, but the impairment may not exceed the balance of goodwill assigned to that reporting unit.

We performed our annual goodwill impairment test as of May 31, 2018. The test indicated that the carrying amount of our Electrical Infrastructure reporting unit exceeded its estimated fair value, resulting in an impairment to goodwill of $17.3 million. The impairment was triggered by lower financial projections as a result of the Company's decision to shift its strategy away from EPC power generation projects to smaller, individual packages that better fit the Company's strategy and risk profile, and the recent trend of sluggish maintenance and capital spending by some key clients in our Northeast and Mid-Atlantic high voltage markets.

We utilize a discounted cash flow analysis, referred to as an income approach, and market multiples, referred to as a market approach, to determine the estimated fair value of our reporting units. For the income approach, significant judgments and assumptions including forecasted project awards, discount rate, anticipated revenue growth rate, gross margins, operating expenses, working capital needs and capital expenditures are inherent in the fair value estimates, which are based on our operating and capital budgets and on our strategic plan. As a result, actual results may differ from the estimates utilized in our income approach. For the market approach, significant judgments and assumptions include the selection of guideline companies, forecasted guideline company EBITDA and our forecasted EBITDA. The use of alternate judgments and/or assumptions could result in a fair value that differs from our estimate and could result in the recognition of additional impairment charges in the financial statements. As a test for reasonableness, we also consider the combined carrying values of our reporting units to our market capitalization.

Table of Contents

We also consider the amount of headroom for each reporting unit when determining whether an impairment existed. We define "headroom" as the percentage difference between the fair value of a reporting unit and its carrying value. The amount of headroom varies by reporting unit. Our significant assumptions, including revenue growth rates, gross margins, discount rate and other factors may change in light of changes in the economic and competitive environment in which we operate. Assuming that all other components of our fair value estimate remain unchanged, a change in the following assumptions would have the following effect on headroom:

Sensitivity Analysis

	Goodwill as of June 30, 2018 (in thousands)	Headroom	Decline of 100 Basis Points in Revenue Growth Rate	Decline of 100 Basis Points in Gross Margin Percentage	Increase of 100 Basis Points in Discount Rate
Reporting Unit 1[(1)]	$24,900	0%	-3%	-19%	-8%
Reporting Unit 2	$7,980	15%	11%	-21%	4%
Reporting Unit 3	$6,112	34%	28%	-2%	21%
All other reporting units	$57,170	17% to 292%	11% to 277%	1% to 233%	6% to 254%

(1) We recorded a $17.3 million impairment to this reporting unit, which is described fully in the paragraphs above. As a result, the cushion for this reporting unit is zero since the impairment was the amount by which the carrying amount of the reporting unit exceeded its fair value. Accordingly, an adverse change in one or more of the key assumptions could result in an additional impairment.

If our market view of project opportunities or gross margins changes for any of the reporting units, we may need to perform an interim impairment analysis, which could result in a material impairment of goodwill. The Company will continue to monitor the operating results of its reporting units each period and perform additional tests as needed.

Income Taxes

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

Recently Issued Accounting Standards

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

On May 28, 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09. The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that “an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” The ASU also requires entities to disclose both quantitative and qualitative information that enables users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The ASU's disclosure requirements are significantly more comprehensive than those in existing revenue standards. The ASU applies to all contracts with customers except those that are within the scope of other topics in the ASC. The ASU is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period.

Table of Contents

The Company adopted this standard on July 1, 2018 using the modified retrospective method of application. Under the modified retrospective method, revenue recognized on completed contracts is not restated, however contracts in progress are accounted for as if they were under the new standard at inception. Any difference between historical revenue and revenue under the new standard is recorded as a cumulative effect adjustment to retained earnings as of the date of adoption. The Company has completed the analysis of its contracts in progress and noted that the modified retrospective adjustment was immaterial. The Company does not expect the new standard to have a material impact to its financial statements going forward.

Accounting Standards Update 2016-02, Leases (Topic 842) and Accounting Standards Update No. 2018-11, Leases (Topic 842)

On February 25, 2016, the FASB issued ASU 2016-02. The amendments in this update require, among other things, that lessees recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Prior to the issuance of ASU 2018-11, lessees and lessors must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The amendments in ASU 2018-11 provide, among other things, an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, the Company may apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption rather than having to apply the new standard to the earliest comparative period presented in the financial statements.

Both amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption of the amendments is permitted, but we do not plan to do so at this time.

We are currently evaluating the amendments' expected impact on our financial statements. As of June 30, 2018 the Company had $33.1 million of future minimum lease payments under non-cancelable operating leases, primarily for facilities. See Note 8 - Operating Leases of Item 8. Financial Statements and Supplementary Data for more information about the timing and amount of future operating lease payments, which we believe is indicative of the materiality of adoption of these amendments to our financial statements.

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

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

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

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

Accounting Standards Update 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting

In May 2017, the FASB issued ASU 2017-09 which clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as a modification. Entities should apply the modification accounting guidance if the value, vesting conditions or classification of the award changes. ASU 2017-09 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted and prospective application is required. The adoption of ASU 2017-09 did not have a material impact on our financial position, results of operations or cash flows.

Table of Contents

Results of Operations

Overview

We operate our business through four reportable segments: Electrical Infrastructure; Oil, Gas & Chemical; Storage Solutions; and Industrial.

The Electrical Infrastructure segment consists of high voltage services provided to investor owned utilities, including construction of new substations, upgrades of existing substations, short-run transmission line installations, distribution upgrades and maintenance, as well as emergency and storm restoration services. We also provide construction and maintenance services to a variety of power generation facilities, such as combined cycle plants, and natural gas fired power stations.

The Oil, Gas & Chemical segment serves customers primarily in the downstream and midstream petroleum industries who are engaged in refining crude oil and processing, fractionating, and marketing of natural gas and natural gas liquids. We also perform work in the petrochemical, upstream petroleum, and sulfur extraction, recovery and processing markets. Our services include turnarounds, plant maintenance, engineering and capital construction. We also offer industrial cleaning services including hydro-blasting, hydro-excavating, advanced chemical cleaning and vacuum services.

The Storage Solutions segment consists of work related to aboveground storage tanks and terminals. Also included in this segment are cryogenic and other specialty storage tanks and terminals including liquefied natural gas, liquid nitrogen/liquid oxygen, liquid petroleum, other specialty vessels such as spheres as well as marine structures and truck and rail loading/offloading facilities. Our services include engineering, fabrication and construction, maintenance and repair, which includes planned and emergency services of both tanks and full terminals. Finally, we offer AST products, including geodesic domes, aluminum internal floating roofs, floating suction and skimmer systems, roof drain systems and floating roof seals.

The Industrial segment consists of work for integrated iron and steel companies, major mining and minerals companies engaged primarily in the extraction of copper, as well as other companies in aerospace and defense, cement, agriculture and grain, food and other industries. Our services include engineering, fabrication and construction, maintenance and repair, which includes planned and emergency services. We also design instrumentation and control systems and offer specialized expertise in the design and construction of bulk material handling systems.

The majority of the work for all segments is performed in the United States, with 10.1% of revenues generated internationally during fiscal 2018, 19.7% in fiscal 2017 and 14.0% in fiscal 2016. The percentage of revenues generated internationally decreased in fiscal 2018 compared to fiscal 2017 due to the completion of a significant Canadian power generation project in our Electrical Infrastructure segment in fiscal 2018.

Significant period to period changes in revenues, gross profits and operating results are discussed below on a consolidated basis and for each segment:

Table of Contents

Matrix Service Company
Results of Operations
(In thousands)

	Electrical Infrastructure	Oil Gas & Chemical	Storage Solutions	Industrial	Total
Fiscal Year 2018					
Consolidated revenues	$255,931	$322,772	$314,696	$198,154	$1,091,553
Gross profit	18,300	33,423	25,778	14,435	91,936
Gross profit %	7.2 %	10.4 %	8.2 %	7.3 %	8.4 %
Selling, general and administrative expenses	17,550	23,908	31,685	11,274	84,417
Operating income (loss)	(16,531)	8,798	(5,907)	3,161	(10,479)
Operating income (loss) %	(6.5)%	2.7 %	(1.9)%	1.6 %	(1.0)%
Fiscal Year 2017					
Consolidated revenues	$373,384	$240,523	$481,696	$101,906	$1,197,509
Gross profit	7,137	12,675	55,651	5,540	81,003
Gross profit %	1.9 %	5.3 %	11.6 %	5.4 %	6.8 %
Selling, general and administrative expenses	15,446	21,458	32,723	6,517	76,144
Operating income (loss)	(8,309)	(8,783)	22,928	(977)	4,859
Operating income (loss) %	(2.2)%	(3.7)%	4.8 %	(1.0)%	0.4 %
Fiscal Year 2016					
Consolidated revenues	$349,011	$249,795	$563,512	$149,599	$1,311,917
Gross profit	29,301	18,553	67,843	10,294	125,991
Gross profit %	8.4 %	7.4 %	12.0 %	6.9 %	9.6 %
Selling, general and administrative expenses	18,157	22,056	34,394	10,502	85,109
Operating income (loss)	11,144	(3,503)	33,449	(208)	40,882
Operating income (loss) %	3.2 %	(1.4)%	5.9 %	(0.1)%	3.1 %
Variances Fiscal Year 2018 to Fiscal Year 2017 Increase/(Decrease)					
Consolidated revenues	$(117,453)	$82,249	$(167,000)	$96,248	$(105,956)
Gross profit	11,163	20,748	(29,873)	8,895	10,933
Selling, general and administrative expenses	2,104	2,450	(1,038)	4,757	8,273
Operating income	(8,222)	17,581	(28,835)	4,138	(15,338)
Variances Fiscal Year 2017 to Fiscal Year 2016 Increase/(Decrease)					
Consolidated revenues	$24,373	$(9,272)	$(81,816)	$(47,693)	$(114,408)
Gross profit	(22,164)	(5,878)	(12,192)	(4,754)	(44,988)
Selling, general and administrative expenses	(2,711)	(598)	(1,671)	(3,985)	(8,965)
Operating income	(19,453)	(5,280)	(10,521)	(769)	(36,023)

Table of Contents

Fiscal 2018 Versus Fiscal 2017

Consolidated

Consolidated revenue was $1.092 billion for the fiscal year ended June 30, 2018, compared to $1.198 billion in fiscal 2017. On a segment basis, consolidated revenue decreased in the Storage Solutions and Electrical Infrastructure segments by $167.0 million and $117.5 million, respectively. These decreases were partially offset by increases in consolidated revenue for the Industrial and Oil Gas & Chemical segments of $96.3 million and $82.3 million, respectively.

Consolidated gross profit was $91.9 million in fiscal 2018 compared to $81.0 million in fiscal 2017. Gross margin increased to 8.4% in fiscal 2018 compared to 6.8% in fiscal 2017. The increase in gross margin in fiscal 2018 is primarily attributable to the financial impact of a large power generation project in the Electrical Infrastructure segment in fiscal 2017 and better recovery of overhead costs in fiscal 2018.

Consolidated SG&A expenses were $84.4 million in fiscal 2018 compared to $76.1 million in fiscal 2017. The increase in fiscal 2018 is primarily attributable to overhead associated with a mid-year fiscal 2017 acquisition (see Note 2 - Acquisitions, Item 8. Financial Statements and Supplementary Data) that expanded the Company's engineering business, as well as higher project pursuit costs.

We performed our annual goodwill impairment test as of May 31, 2018. The test indicated that the carrying amount of our Electrical Infrastructure reporting unit exceeded its estimated fair value, resulting in an impairment to goodwill of $17.3 million. The impairment was triggered by lower financial projections as a result of the Company's decision to shift its strategy away from EPC power generation projects to smaller, individual packages that better fit the Company's strategy and risk profile, and the recent trend of sluggish maintenance and capital spending by some key clients in our Northeast and Mid-Atlantic high voltage markets. We also recorded an impairment of $0.7 million associated with the customer relationships of a previous acquisition. This impairment was recorded in the Oil Gas & Chemical segment.

Net interest expense was $2.2 million in fiscal 2018 and $2.1 million in fiscal 2017. Interest expense in both fiscal years is primarily attributable to borrowings used to fund a mid-year fiscal 2017 acquisition, borrowings used to fund working capital requirements for a major project in the Electrical Infrastructure segment, and an increase in the unused senior secured revolving credit facility fee. The Company repaid all of its outstanding debt under its senior secured revolving credit facility in the fourth quarter of fiscal 2018.

As a result of the Tax Cuts and Jobs Act and its transitional application to our June 30 fiscal year end, we expected our effective income tax rate to be approximately 32.0% during fiscal 2018. Our effective tax rate for fiscal 2018 was 5.5% compared to 94.4% in fiscal 2017. The rate for fiscal 2018 was negatively impacted by the impairment of $8.3 million of non-deductible goodwill and by a $0.8 million valuation allowance recorded on a deferred tax asset in connection with stock-based compensation. The fiscal 2017 tax rate was negatively impacted, in part, by the Electrical Infrastructure project discussed above. The loss on this project produced a tax benefit in Canada, which had a lower tax rate than the U.S. during fiscal 2017. At the same time, the Company earned most of its taxable income domestically, which was taxed at a higher rate. A full analysis of the Company's provision for income taxes is included in Item 8. Financial Statements and Supplementary Data, Note 6 - Income Taxes. In fiscal 2019, we expect our effective income tax rate to decrease to 27.0%.

In fiscal 2018, the Company had a net loss of $11.5 million, or $0.43 per fully diluted share, compared to a net loss of $0.2 million, or $0.01 per fully diluted share, in fiscal 2017.

Electrical Infrastructure

Revenue for the Electrical Infrastructure segment decreased $117.5 million to $255.9 million in fiscal 2018 compared to $373.4 million in fiscal 2017. The decrease is due to the expected reduction in power generation revenue in connection with our strategic decision to exit full EPC power generation work and a reduction in high voltage revenue. The segment gross margin of 7.2% in fiscal 2018 was impacted by under recovery of construction overhead costs, lower than expected direct margins and increased competition. The fiscal 2017 segment gross margin was 1.9%, which was primarily attributable to the financial impact of an increased cost estimate on the power generating facility project mentioned above that was caused by various factors that delayed schedule progress and reduced productivity.

30

Table of Contents

Oil Gas & Chemical

Revenue for the Oil Gas & Chemical segment was $322.8 million in fiscal 2018 compared to $240.5 million in the same period a year earlier. The increase of $82.3 million is primarily attributable to higher turnaround and maintenance and construction volumes. The segment gross margin was 10.4% in fiscal 2018 compared to 5.3% in the same period last year. The segment gross margin for fiscal 2018 was positively impacted by strong project execution and improved recovery of construction overhead costs. Fiscal 2017 gross margin was negatively impacted by project execution and lower volume which led to higher under recovery of construction overhead costs.

Storage Solutions

Revenue for the Storage Solutions segment was $314.7 million in fiscal 2018 compared to $481.7 million in fiscal 2017, a decrease of $167.0 million. The decrease in segment revenue is primarily the result of delays in project awards during fiscal 2017 and the first half of fiscal 2018, which prevented the Company from replacing higher revenue generated in fiscal 2017 in connection with work on the construction of a significant crude gathering terminals project. The segment gross margin was 8.2% in fiscal 2018 and 11.6% in fiscal 2017. The fiscal 2018 segment gross margin was negatively impacted by lower direct margins and under recovery of construction overhead costs. The fiscal 2017 segment gross margin was supported by strong project execution, partially offset by under recovery of construction overhead costs.

Industrial

Revenue for the Industrial segment was $198.2 million in fiscal 2018 compared to $101.9 million in fiscal 2017, an increase of $96.3 million. The increase in revenue is primarily attributable to higher business volumes in the iron and steel industry. The segment gross margin was 7.3% in fiscal 2018 compared to 5.4% in fiscal 2017. The fiscal 2018 segment gross margin was positively impacted by higher volumes, which led to improved recovery of construction overhead costs, and a favorable project closeout. The fiscal 2017 segment gross margin was negatively impacted by lower than anticipated volumes, which led to under recovery of construction overhead costs.

Fiscal 2017 Versus Fiscal 2016

Consolidated

Consolidated revenue was $1.198 billion in fiscal 2017, a decrease of $114.4 million, or 8.7% from consolidated revenue of $1.312 billion in fiscal 2016. On a segment basis, consolidated revenue decreased in the Storage Solutions, Industrial and Oil Gas & Chemical segments by $81.8 million, $47.7 million, and $9.3 million, respectively, which were partially offset by higher revenue in the Electrical Infrastructure segment of $24.4 million.

Consolidated gross profit was $81.0 million in fiscal 2017 compared to $126.0 million in fiscal 2016. Gross margin decreased to 6.8% in fiscal 2017 compared to 9.6% in fiscal 2016. The reduction in gross margin in fiscal 2017 is primarily attributable to lower volumes, which led to increased under recovery of construction overhead costs, and the financial impact of an Electrical Infrastructure project (more fully discussed in Item 8. Financial Statements and Supplementary Data, Note 3 - Uncompleted Contracts).

Consolidated SG&A expenses were $76.1 million in fiscal 2017 compared to $85.1 million in the prior year. The decrease is primarily related to lower incentive compensation expense in fiscal 2017 and a bad debt charge of $5.2 million from a client bankruptcy in fiscal 2016. Fiscal 2017 SG&A expense included $1.1 million of acquisition and integration costs from the Houston Interests acquisition and fiscal 2016 SG&A expense included $1.2 million of acquisition and integration costs from the Baillie Tank Equipment acquisition (See Item 8. Financial Statements and Supplementary Data, Note 2 - Acquisitions and Disposals).

Net interest expense was $2.1 million in fiscal 2017, and $0.7 million in the prior year. The higher interest expense in fiscal 2017 is primarily attributable to the higher average debt balance in fiscal 2017, which is largely attributable to the borrowings used to fund the Houston Interests acquisition, which was completed in the second quarter of fiscal 2017, and borrowings due to the timing of collections and disbursements on the previously announced Electrical Infrastructure project.

Our effective tax rate for fiscal 2017 was 94.4% compared to 35.6% in the same period a year earlier. Our effective tax rate for fiscal 2017 was impacted, in part, by the Electrical Infrastructure project discussed above. The loss on this project produced a tax benefit in Canada, which had a lower tax rate than the U.S. At the same time, the Company earned most of its taxable income domestically, which was taxed at a much higher rate. A full analysis of the Company's provision for income taxes is included in Item 8. Financial Statements and Supplementary Data, Note 6 - Income Taxes.

Net loss attributable to Matrix Service Company and the related fully diluted loss per share were $0.2 million and $0.01, respectively, in fiscal 2017 compared to net income and fully diluted earnings per share of $28.9 million and $1.07, respectively, in fiscal 2016.

Table of Contents

Electrical Infrastructure

Revenue for the Electrical Infrastructure segment increased $24.4 million to $373.4 million in fiscal 2017 compared to $349.0 million in fiscal 2016. The increase in revenue was primarily a result of higher volumes on a significant power generation project, partially offset by lower volumes in transmission and distribution work. The fiscal 2017 gross margin was 1.9% compared to 8.4% in fiscal 2016. The lower fiscal 2017 gross margin was primarily attributable to the financial impact of the project referenced in the discussion of consolidated results above (more fully discussed in Item 8. Financial Statements and Supplementary Data, Note 3 - Uncompleted Contracts). Fiscal 2016 gross margin was negatively impacted by charges recorded in connection with an acquired EPC joint venture project.

Oil Gas & Chemical

Revenue for the Oil Gas & Chemical segment was $240.5 million in fiscal 2017 compared to $249.8 million in fiscal 2016. The decrease in revenue is related to lower volume across the business as refiners continue to limit spending as the result of continued volatility in commodity prices and market uncertainty, partially offset by incremental revenues associated with Houston Interests, which was acquired in December 2016 (See Item 8. Financial Statements and Supplementary Data, Note 2 - Acquisitions). The gross margin was 5.3% in fiscal 2017 compared to 7.4% in fiscal 2016. The gross margin for fiscal 2017 was affected by lower volume, which led to increased under recovery of overhead costs.

Storage Solutions

Revenue for the Storage Solutions segment was $481.7 million in fiscal 2017 compared to $563.5 million in the prior year. The decrease is primarily attributable to reduced activity during the second half of fiscal 2017 in connection with work on the construction of a significant crude gathering terminals project and lower volumes in our domestic storage business. Gross margin was 11.6% in fiscal 2017 as a result of strong project execution, partially offset by increased under recovery of overhead costs due to lower volumes. Gross margin in fiscal 2016 was 12.0% as a result of effective project execution.

Industrial

Revenue for the Industrial segment was $101.9 million in fiscal 2017 compared to $149.6 million in fiscal 2016. The decline in revenue is primarily attributable to lower business volumes in the iron and steel and mining markets as a result of depressed commodity prices, and lower revenue recognized on a large fertilizer project. The gross margin was 5.4% in fiscal 2017 compared to 6.9% in the prior year. The fiscal 2017 gross margin was negatively impacted by the under recovery of construction overhead costs due to reduced volume.

Impact of Commodity Price Volatility

A significant decline in crude oil prices beginning in late 2014 caused a period of uncertainty in the energy industry. Although the price of West Texas Intermediate Crude Oil has increased significantly during fiscal 2018, the level uncertainty that existed prior to fiscal 2018 resulted in the delay of significant project awards during the fiscal years prior to fiscal 2018. These delays in project awards negatively impacted our operating results in fiscal 2018, particularly in the Storage Solutions segment. However, with the increasing price of crude oil, we have seen some significant near-term positive developments in our Storage Solutions segment, especially in the second half of fiscal 2018. For the fiscal year, we received $786.5 million of project awards and achieved a book-to-bill ratio of 2.5.

In the Industrial segment, our iron and steel customers have increased maintenance spending and resumed major capital projects in response to improving business conditions led by a stronger U.S. economy and a weaker U.S. Dollar. In the mining and minerals markets, copper prices have increased since fiscal 2017. As a result, we are seeing increased bidding activity, but we have not yet seen a corresponding increase in project awards.

We do not expect fluctuation in commodity prices to have a significant impact on the Electrical Infrastructure segment.

Table of Contents

Non-GAAP Financial Measures

Adjusted EBITDA

We have presented Adjusted EBITDA, which we define as net income (loss) attributable to Matrix Service Company before impairment of goodwill and other intangible assets, interest expense, income taxes, depreciation and amortization, because it is used by the financial community as a method of measuring our performance and of evaluating the market value of companies considered to be in similar businesses. We believe that the line item on our Consolidated Statements of Income entitled "Net income (loss) attributable to Matrix Service Company" is the most directly comparable GAAP measure to Adjusted EBITDA. Since Adjusted EBITDA is not a measure of performance calculated in accordance with GAAP, it should not be considered in isolation of, or as a substitute for, net earnings as an indicator of operating performance. Adjusted EBITDA, as we calculate it, may not be comparable to similarly titled measures employed by other companies. In addition, this measure is not a measure of our ability to fund our cash needs. As Adjusted EBITDA excludes certain financial information compared with net income (loss) attributable to Matrix Service Company, the most directly comparable GAAP financial measure, users of this financial information should consider the type of events and transactions that are excluded. Our non-GAAP performance measure, Adjusted EBITDA, has certain material limitations as follows:

- It does not include impairments to goodwill and other intangible assets. While impairments to intangible assets are non-cash expenses in the period recognized, cash or other consideration was still transferred in exchange for the intangible assets in the period of the acquisition. Any measure that excludes impairments to intangible assets has material limitations since these expenses represent the loss of an asset that was acquired in exchange for cash or other assets.

- It does not include interest expense. Because we have borrowed money to finance our operations and to acquire businesses, pay commitment fees to maintain our senior secured revolving credit facility, and incur fees to issue letters of credit under the senior secured revolving credit facility, interest expense is a necessary and ongoing part of our costs and has assisted us in generating revenue. Therefore, any measure that excludes interest expense has material limitations.

- It does not include income taxes. Because the payment of income taxes is a necessary and ongoing part of our operations, any measure that excludes income taxes has material limitations.

- It does not include depreciation or amortization expense. Because we use capital and intangible assets to generate revenue, depreciation and amortization expense is a necessary element of our cost structure. Therefore, any measure that excludes depreciation or amortization expense has material limitations.

A reconciliation of Adjusted EBITDA to net income (loss) attributable to Matrix Service Company follows:

	Fiscal Years Ended		
	June 30, 2018	June 30, 2017	June 30, 2016
	(in thousands)		
Net income (loss) attributable to Matrix Service Company	$(11,480)	$(183)	$28,863
Goodwill and other intangible asset impairment	17,998	—	—
Interest expense	2,600	2,211	852
Provision (benefit) for federal, state and foreign income taxes	(668)	2,308	14,116
Depreciation and amortization	20,347	21,602	21,441
Adjusted EBITDA	$28,797	$25,938	$65,272

Table of Contents

LIQUIDITY AND CAPITAL RESOURCES

Overview

We define liquidity as the ability to pay our liabilities as they become due, fund business operations and meet all contractual and financial obligations. Our primary sources of liquidity in fiscal 2018 were cash on hand, capacity under our senior secured revolving credit facility and cash generated from operations. Cash on hand at June 30, 2018 totaled $64.1 million and availability under the senior secured revolving credit facility totaled $73.2 million, resulting in total liquidity of $137.2 million. The United States Dollar equivalent of Canadian, South Korean and Australian deposits totaled $5.2 million and is included in our consolidated cash balance. We expect to fund our operations for the next twelve months through the use of cash generated from operations, existing cash balances and borrowings under our senior secured revolving credit facility, as necessary. The Company's liquidity continues to be adequate to support its long-term strategic growth plans.

The following table provides a summary of changes in our liquidity for the fiscal year ended June 30, 2018 (in thousands):

Liquidity as of June 30, 2017	$122,206
Net increase in cash	20,252
Increase in credit facility capacity constraint	(20,649)
Net repayments on credit facility	44,931
Increase in letters of credit outstanding	(29,248)
Foreign currency translation of outstanding borrowings	(249)
Liquidity as of June 30, 2018	$137,243

Factors that routinely impact our short-term liquidity and that may impact our long-term liquidity include, but are not limited to:

- Changes in costs and estimated earnings in excess of billings on uncompleted contracts and billings on uncompleted contracts in excess of costs due to contract terms that determine the timing of billings to customers and the collection of those billings:
- Some cost plus and fixed price customer contracts are billed based on milestones which may require us to incur significant expenditures prior to collections from our customers.
- Time and material contracts are normally billed in arrears. Therefore, we are routinely required to carry these costs until they can be billed and collected.
- Some of our large construction projects may require significant cash retentions or security in the form of letters of credit. The timing of collection of retentions is often uncertain.
- Other changes in working capital.
- Capital expenditures.

Other factors that may impact both short and long-term liquidity include:

- Acquisitions and disposals of businesses.
- Strategic investments in new operations.
- Purchases of shares under our stock buyback program.
- Contract disputes which can be significant.
- Collection issues, including those caused by weak commodity prices or other factors which can lead to credit deterioration of our customers
- Capacity constraints under our senior secured revolving credit facility and remaining in compliance with all covenants contained in the Credit Agreement
- Cash on hand outside of the United States that cannot be repatriated without incremental taxation

Table of Contents

Cash Flows Provided by Operating Activities

Cash flows provided by operating activities for the fiscal year ended June 30, 2018 totaled $74.7 million. Major components of cash flows from operating activities for the year ending June 30, 2018 are as follows:

Net Cash Provided by Operating Activities
(In thousands)

Net income	$(11,480)
Goodwill and other intangible asset impairment	17,998
Non-cash expenses	28,410
Deferred income tax	(1,186)
Cash effect of changes in working capital, net of acquisitions	40,532
Other	397
Net cash provided by operating activities	$74,671

Working capital changes, net of effects from acquisitions, at June 30, 2018 in comparison to June 30, 2017 include the following:

- Accounts receivable, net of bad debt expense recognized during the period and the settlement of $2.0 million of accounts receivable in exchange for backlog (see Item 1. Financial Statements and Supplementary Data, Note 4 - Intangible Assets Including Goodwill), decreased by $5.5 million during fiscal 2018, which increased cash flows from operating activities. The variance is primarily attributable to the timing of billing and collections and a decline in business volumes compared to the prior year.
- Costs and estimated earnings in excess of billings on uncompleted contracts ("CIE") decreased $14.5 million while billings on uncompleted contracts in excess of costs and estimated earnings ("BIE") increased $45.6 million, both of which increased cash flows from operating activities. The changes were due to the timing of invoice billings and collections. CIE and BIE balances can experience significant day-to-day fluctuations based on contract terms, the timing of when job costs are incurred, the invoicing of those job costs to the customer and subsequent cash collection, and other factors.
- Accounts payable decreased by $25.9 million, which reduced cash flows from operating activities. The decrease was primarily due to the timing of payments and lower volumes of work in fiscal 2018 compared to the prior year.

Cash Flows Used for Investing Activities

Investing activities used $9.3 million of cash during the fiscal year ended June 30, 2018 due to capital expenditures of $8.7 million and a $1.7 million working capital payment in connection with the Houston Interests acquisition, partially offset by proceeds from asset dispositions of $1.1 million. Capital expenditures included $3.2 million for office equipment and software, $2.2 million for the purchase of construction equipment, fabrication equipment and small tools, $1.8 million for transportation equipment, and $1.5 million for land and buildings. The Company expects to spend approximately $28.3 million on capital expenditures in fiscal 2019. The increase in planned capital expenditures in fiscal 2019 is in connection with funding anticipated growth and expanding the Company's project opportunities.

Cash Flows Used by Financing Activities

Financing activities used $45.3 million of cash during the fiscal year ended June 30, 2018 primarily due to net repayments under our senior secured revolving credit facility of $44.9 million, the repurchase of $0.6 million of Company stock for payment of withholding taxes due on equity-based compensation, and the payment of $0.4 million for debt amendment fees, partially offset by $0.3 million of proceeds from the exercise of stock options and $0.3 million of proceeds from the issuance of common stock under the employee stock purchase plan.

Table of Contents

Senior Secured Revolving Credit Facility

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

The Credit Agreement provides for a five-year senior secured revolving credit facility of $300.0 million that expires February 8, 2022. The credit facility may be used for working capital, acquisitions, capital expenditures, issuances of letters of credit and other lawful purposes. The Credit Agreement includes the following covenants and borrowing limitations:

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

The credit facility includes a sub-facility for revolving loans denominated in Australian Dollars, Canadian Dollars, Euros and Pounds Sterling in an aggregate amount not to exceed the U.S. Dollar equivalent of $75.0 million and a $200.0 million sublimit for letters of credit.

Each revolving borrowing under the Credit Agreement will bear interest at a rate per annum equal to:

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

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

The unused credit facility fee is between 0.25% and 0.45% based on the Leverage Ratio.

The Credit Agreement includes a Leverage Ratio covenant, which provides that Consolidated Funded Indebtedness, as of the end of any fiscal quarter, may not exceed 3.0 times Consolidated EBITDA, as defined in the Credit Agreement, over the previous four quarters. For the four quarters ended June 30, 2018, Consolidated EBITDA, as defined in the Credit Agreement, was $36.8 million. Consolidated Funded Indebtedness, as defined in the Credit Agreement, at June 30, 2018 was $37.1 million.

Consolidated EBITDA, as defined in the Credit Agreement, or "Covenant EBITDA," differs from Adjusted EBITDA, as reported under "Results of Operations - Non-GAAP Financial Measure," in Item 7 primarily because it permits the Company to:

- exclude non-cash stock-based compensation expense,
- include pro forma EBITDA of acquired businesses as if the acquisition occurred at the beginning of the previous four quarters, and
- exclude certain other extraordinary items, as defined in the Credit Agreement.

Table of Contents

Availability under the senior secured revolving credit facility is as follows:

	June 30, 2018	June 30, 2017
	(In thousands)	
Senior secured revolving credit facility	$300,000	$300,000
Capacity constraint due to the Leverage Ratio	189,741	169,092
Capacity under the senior secured revolving credit facility	110,259	130,908
Borrowings outstanding	—	44,682
Letters of credit	37,073	7,825
Availability under the senior secured revolving credit facility	$73,186	$78,401

The Company is in compliance with all other affirmative, negative, and financial covenants under the Credit Agreement.

At June 30, 2018, the Company was at the lowest margin tier for all categories of loans and the unused revolving credit facility fee under the Credit Agreement.

Dividend Policy

We have never paid cash dividends on our common stock, and the terms of our Credit Agreement limit the amount of cash dividends we can pay. Under our Credit Agreement, we may declare and pay cash dividends on our capital stock during any fiscal year up to an amount which, when added to all other cash dividends paid during such fiscal year, does not exceed 50% of our cumulative net income for such fiscal year to date. While we currently do not intend to pay cash dividends, any future dividend payments will depend on our financial condition, capital requirements and earnings as well as other relevant factors.

Treasury Shares

On December 12, 2016, the Board of Directors approved a new stock buyback program (the "December 2016 Program"), which replaced the previous program that had been in place since November 2014. Under the December 2016 Program, the Company may repurchase common stock of the Company in any calendar year commencing with calendar year 2016 and continuing through calendar year 2018, up to a maximum of $25.0 million per calendar year. The Company may repurchase its stock from time to time in the open market at prevailing market prices or in privately negotiated transactions. The December 2016 Program will continue through December 31, 2018 unless and until it is modified or revoked by the Board of Directors. No shares have been repurchased under the December 2016 Program as of June 30, 2018.

In addition to the stock buyback program, the Company may withhold shares of common stock to satisfy the tax withholding obligations upon vesting of an employee's deferred shares. Matrix withheld 52,950 and 134,535 shares of common stock during fiscal 2018 and 2017, respectively, to satisfy these obligations. These shares were returned to the Company's pool of treasury shares. The Company has 1,034,394 treasury shares as of June 30, 2018 and intends to utilize these treasury shares in connection with equity awards under the Company's stock incentive plans and for sales to the Employee Stock Purchase Plan.

Off-Balance Sheet Arrangements

As of June 30, 2018, the following off-balance sheet arrangements were in place to support our ordinary course obligations:

	Expiration Period				
	Less than 1 Year	1–3 Years	3–5 Years	More than 5 Years	Total
	(In thousands)				
Letters of credit[1]	$28,474	$15,734	$ —	$ —	$44,208
Surety bonds	268,384	18,190	1,538	—	288,112
Total	$296,858	$33,924	$ 1,538	$ —	$332,320

(1) All letters of credit issued under our senior secured revolving credit facility are in support of our workers' compensation insurance programs or certain construction contracts. The letters of credit that support our workers' compensation programs are expected to renew annually through the term of our senior secured revolving credit facility. The letters of credit that support construction contracts will expire within a year. Our Credit Agreement allows exclusion of letters of credit that support our workers' compensation programs when calculating availability under the credit facility.

37

Table of Contents

Contractual Obligations

Contractual obligations at June 30, 2018 are summarized below:

	Contractual Obligations by Expiration Period				
	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years	Total
	(In thousands)				
Operating leases	$7,541	$ 12,143	$ 7,218	$ 6,201	$33,103
Purchase obligations	1,495	1,975	—	—	3,470
Total contractual obligations	$9,036	$ 14,118	$ 7,218	$ 6,201	$36,573

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

Our interest rate risk results primarily from our variable rate indebtedness under our Credit Agreement, which is influenced by movements in short-term rates. Borrowings under our $300.0 million senior secured revolving credit facility bear interest at a rate per annum equal to:

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

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

The Company had no financial instruments with interest rate risk at June 30, 2018.

Foreign Currency Risk

Matrix Service Company has subsidiaries with operations in Canada and South Korea, which use the Canadian Dollar and South Korean Won, respectively, as their functional currencies. The Company also has a subsidiary with operations in Australia, but its functional currency is the U.S. Dollar since its sales are primarily denominated in U.S. Dollars. The Company's operations in South Korea and Australia were acquired in the Baillie Tank Equipment, Ltd. acquisition, which is disclosed in detail in Note 2 of the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K.

Historically, movements in the Canadian Dollar to U.S. Dollar exchange rate have not significantly impacted the Company's results. Also, the Company does not expect exchange rate fluctuations in its South Korean and Australian operations to materially impact its financial results since these operations represent an insignificant portion of the Company's consolidated revenues and expenses. However, further growth in its Canadian, South Korean and/or Australian operations and/or significant fluctuations in the Canadian Dollar, South Korean Won and/or Australian Dollar to U.S. Dollar exchange rates could impact the Company’s financial results in the future.

Management has not entered into derivative instruments to hedge foreign currency risk, but periodically evaluates the materiality of our foreign currency exposure. To mitigate our risk, on occasion we borrow Canadian Dollars under our senior secured revolving credit facility to settle U.S. Dollar account balances. A 10% unfavorable change in the Canadian Dollar against the U.S. Dollar would not have had a material impact on the financial results of the Company for the fiscal year ended June 30, 2018.

Table of Contents

Commodity Price Risk

The Company has no direct commodity exposure, but we do have exposure to materials derived from certain commodities including steel plate, steel pipe, and copper which are key materials used by the Company. Supplies of these materials are available throughout the United States and worldwide. We anticipate that adequate amounts of these materials will be available in the foreseeable future. However, the price, quantity, and delivery schedules of these materials could change rapidly due to various factors, including producer capacity, the level of foreign imports, worldwide demand, the imposition or removal of tariffs on imported steel and other market conditions. We mitigate these risks primarily by procuring materials upon contract execution to ensure that our purchase price approximates the costs included in the project estimate, and also by negotiating contract escalation clauses to cover unexpected costs due to fluctuations in materials derived from certain commodities.

Table of Contents

Item 8. Financial Statements and Supplementary Data

Financial Statements of the Company

Financial Statement Schedules

The financial statement schedule is filed as a part of this report under Schedule II – Valuation and Qualifying Accounts for the three fiscal years ended June 30, 2018, June 30, 2017 and June 30, 2016 immediately following Quarterly Financial Data (Unaudited). All other schedules are omitted because they are not applicable or the required information is shown in the financial statements, or notes thereto, included herein.

Table of Contents

MANAGEMENT’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Matrix Service Company (the “Company”) and its wholly-owned subsidiaries are responsible for establishing and maintaining adequate internal control over financial reporting. The Company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Internal control over financial reporting includes policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements.

All internal control systems, no matter how well designed, have inherent limitations and cannot provide absolute assurance that all objectives will be met. Internal control over financial reporting is a process that involves diligence and is subject to lapses in judgment and human error. Internal control over financial reporting can also be circumvented by collusion or management override of controls. Because of these limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis.

The Company’s management assessed the effectiveness of the Company’s internal control over financial reporting as of June 30, 2018. In making this assessment, the Company’s management used the criteria established in Internal Control—Integrated Framework (2013) set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in Internal Control-Integrated Framework.

Management’s assessment included an evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies, overall control environment and information systems control environment. Based on this assessment, the Company’s management has concluded that the Company’s internal control over financial reporting as of June 30, 2018 was effective.

Deloitte & Touche LLP, an independent registered public accounting firm, has issued an attestation report on the effectiveness of the Company’s internal control over financial reporting as of June 30, 2018. Deloitte & Touche LLP’s report on the Company’s internal control over financial reporting is included herein.

/S/ John R. Hewitt	/S/ Kevin S. Cavanah
John R. Hewitt	Kevin S. Cavanah
President and Chief Executive Officer	Vice President and Chief Financial Officer
September 12, 2018	

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Matrix Service Company

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Matrix Service Company and subsidiaries (the "Company") as of June 30, 2018, based on the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2018 based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements as of and for the fiscal year ended June 30, 2018 of the Company and our report dated August 30, 2018, expressed an unqualified opinion on those financial statements.

Basis of Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/S/ DELOITTE & TOUCHE LLP
Tulsa, Oklahoma
September 12, 2018

42

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Matrix Service Company

Opinion on the Financial Statements

We have audited the accompanying Consolidated Balance Sheets of Matrix Service Company and subsidiaries (the "Company") as of June 30, 2018 and 2017, and the related Consolidated Statements of Income, Comprehensive Income, Cash Flows and Changes in Stockholders' Equity for each of the three years in the period ended June 30, 2018 and the related notes and schedules listed in the Index at Item 8 (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of June 30, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 30, 2018 expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis of Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/S/ DELOITTE & TOUCHE LLP
Tulsa, Oklahoma
September 12, 2018

We have served as the Company auditor since 2006.

Table of Contents

Matrix Service Company
Consolidated Statements of Income
(In thousands, except per share data)

	Fiscal Years Ended		
	June 30, 2018	June 30, 2017	June 30, 2016
Revenues	$1,091,553	$1,197,509	$1,311,917
Cost of revenues	999,617	1,116,506	1,185,926
Gross profit	91,936	81,003	125,991
Selling, general and administrative expenses	84,417	76,144	85,109
Goodwill and other intangible asset impairment	17,998	—	—
Operating income (loss)	(10,479)	4,859	40,882
Other income (expense):			
Interest expense	(2,600)	(2,211)	(852)
Interest income	381	132	190
Other	550	(334)	(567)
Income (loss) before income tax expense	(12,148)	2,446	39,653
Provision (benefit) for federal, state and foreign income taxes	(668)	2,308	14,116
Net income (loss)	(11,480)	138	25,537
Less: Net income (loss) attributable to noncontrolling interest	—	321	(3,326)
Net income (loss) attributable to Matrix Service Company	$(11,480)	$(183)	$28,863
Basic earnings (loss) per common share	$(0.43)	$(0.01)	$1.09
Diluted earnings (loss) per common share	$(0.43)	$(0.01)	$1.07
Weighted average common shares outstanding:			
Basic	26,769	26,533	26,597
Diluted	26,769	26,533	27,100

See accompanying notes
44

Table of Contents

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

	Fiscal Years Ended		
	June 30, 2018	June 30, 2017	June 30, 2016
Net income (loss)	$(11,480)	$ 138	$25,537
Other comprehensive loss, net of tax:			
Foreign currency translation loss (net of tax expense (benefit) of ($24), $180 and $236 for the fiscal years ended June 30, 2018, 2017 and 2016, respectively)	(87)	(479)	(919)
Comprehensive income (loss)	(11,567)	(341)	24,618
Less: Comprehensive income (loss) attributable to noncontrolling interest	—	321	(3,326)
Comprehensive income (loss) attributable to Matrix Service Company	$(11,567)	$ (662)	$27,944

See accompanying notes
45

Table of Contents

Matrix Service Company
Consolidated Balance Sheets
(In thousands)

	June 30, 2018	June 30, 2017
Assets		
Current assets:		
Cash and cash equivalents	$64,057	$43,805
Accounts receivable, less allowances (2018 - $6,327; 2017 - $9,887)	203,388	210,953
Costs and estimated earnings in excess of billings on uncompleted contracts	76,632	91,180
Inventories	5,152	3,737
Income taxes receivable	3,359	4,042
Other current assets	4,458	4,913
Total current assets	357,046	358,630
Property, plant and equipment, at cost:		
Land and buildings	40,424	38,916
Construction equipment	89,036	94,298
Transportation equipment	48,339	48,574
Office equipment and software	41,236	36,556
Construction in progress	1,353	5,952
Total property, plant and equipment - at cost	220,388	224,296
Accumulated depreciation	(147,743)	(144,022)
Property, plant and equipment - net	72,645	80,274
Goodwill	96,162	113,501
Other intangible assets	22,814	26,296
Deferred income taxes	4,848	3,385
Other assets	4,518	3,944
Total assets	$558,033	$586,030

See accompanying notes
46

Table of Contents

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

	June 30, 2018	June 30, 2017
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$79,439	$105,649
Billings on uncompleted contracts in excess of costs and estimated earnings	120,740	75,127
Accrued wages and benefits	24,375	20,992
Accrued insurance	9,080	9,340
Income taxes payable	7	169
Other accrued expenses	4,824	7,699
Total current liabilities	238,465	218,976
Deferred income taxes	429	128
Borrowings under senior secured revolving credit facility	—	44,682
Other liabilities	296	435
Total liabilities	239,190	264,221
Commitments and contingencies		
Stockholders’ equity:		
Common stock—$.01 par value; 60,000,000 shares authorized; 27,888,217 shares issued as of June 30, 2018 and June 30, 2017; 26,853,823 and 26,600,562 shares outstanding as of June 30, 2018 and June 30, 2017	279	279
Additional paid-in capital	132,198	128,419
Retained earnings	211,494	222,974
Accumulated other comprehensive loss	(7,411)	(7,324)
	336,560	344,348
Less treasury stock, at cost — 1,034,394 and 1,287,655 shares as of June 30, 2018 and June 30, 2017	(17,717)	(22,539)
Total stockholders' equity	318,843	321,809
Total liabilities and stockholders’ equity	$558,033	$586,030

See accompanying notes
47

Table of Contents

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

	Fiscal Years Ended		
	June 30, 2018	June 30, 2017	June 30, 2016
Operating activities:			
Net income (loss)	$(11,480)	$138	$25,537
Adjustments to reconcile net income to net cash provided (used) by operating activities, net of effects of acquisitions:			
Depreciation and amortization	20,347	21,602	21,441
Goodwill and other intangible asset impairment	17,998	—	—
Deferred income tax	(1,186)	(2,556)	1,871
Gain on sale of property, plant and equipment	(662)	(142)	(39)
Provision for uncollectible accounts	107	1,748	6,034
Stock-based compensation expense	8,618	7,461	6,317
Other	397	289	240
Changes in operating assets and liabilities increasing (decreasing) cash, net of effects from acquisitions:			
Accounts receivable	5,504	(11,932)	4,152
Costs and estimated earnings in excess of billings on uncompleted contracts	14,548	13,567	(17,930)
Inventories	(1,415)	198	606
Other assets and liabilities	369	(7,641)	7,380
Accounts payable	(25,883)	(37,047)	14,698
Billings on uncompleted contracts in excess of costs and estimated earnings	45,613	5,212	(38,377)
Accrued expenses	1,796	(9,643)	1,657
Net cash provided (used) by operating activities	74,671	(18,746)	33,587
Investing activities:			
Acquisitions, net of cash acquired (Note 2)	(1,687)	(40,819)	(13,049)
Acquisition of property, plant and equipment	(8,711)	(11,908)	(13,939)
Proceeds from asset sales	1,062	1,308	422
Net cash used by investing activities	$(9,336)	$(51,419)	$(26,566)

See accompanying notes
48

Table of Contents

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

	Fiscal Years Ended		
	June 30, 2018	June 30, 2017	June 30, 2016
Financing activities:			
Advances under senior secured revolving credit facility	$85,317	$126,933	$10,213
Repayments of advances under senior secured revolving credit facility	(130,248)	(82,251)	(19,017)
Payment of debt amendment fees	(364)	(1,073)	—
Open market purchase of treasury shares	—	—	(10,461)
Issuances of common stock	317	253	638
Proceeds from issuance of common stock under employee stock purchase plan	293	305	335
Repurchase of common stock for payment of statutory taxes due on equity-based compensation	(627)	(2,290)	(4,588)
Capital contributions from noncontrolling interest	—	855	10,892
Repayment of acquired long-term debt	—	—	(1,858)
Net cash provided (used) by financing activities	(45,312)	42,732	(13,846)
Effect of exchange rate changes on cash	229	(418)	(758)
Net increase (decrease) in cash and cash equivalents	20,252	(27,851)	(7,583)
Cash and cash equivalents, beginning of period	43,805	71,656	79,239
Cash and cash equivalents, end of period	$64,057	$43,805	$71,656
Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Income taxes	$1,410	$11,968	$9,365
Interest	$2,719	$1,788	$881
Non-cash investing and financing activities:			
Accrued acquisition working capital adjustment (Note 2)	$—	$1,687	$—
Purchases of property, plant and equipment on account	$156	$483	$193
Assumption of debt from acquisition (Note 2)	$—	$—	$1,858

See accompanying notes
49

Table of Contents

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

	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income(Loss)	Non-Controlling Interest	Total
Balances, July 1, 2015	$ 279	$123,038	$194,394	$(18,489)	$ (5,926)	$ (8,742)	$284,554
Capital contributions from noncontrolling interest	—	—	—	—	—	10,892	10,892
Net income (loss)	—	—	28,863	—	—	(3,326)	25,537
Other comprehensive loss	—	—	—	—	(919)	—	(919)
Treasury Shares sold to Employee Stock Purchase Plan (17,304 shares)	—	177	—	158	—	—	335
Exercise of stock options (68,037 shares)	—	14	—	624	—	—	638
Issuance of deferred shares (631,443 shares)	—	(5,849)	—	5,849	—	—	—
Treasury shares repurchased to satisfy tax withholding obligations (205,504 shares)	—	—	—	(4,588)	—	—	(4,588)
Tax effect of exercised stock options and vesting of deferred shares	—	3,261	—	—	—	—	3,261
Open market purchases of treasury shares (654,958 shares)	—	—	—	(10,461)	—	—	(10,461)
Stock-based compensation expense	—	6,317	—	—	—	—	6,317
Balances, June 30, 2016	279	126,958	223,257	(26,907)	(6,845)	(1,176)	315,566
Retrospective adjustment for change in accounting for stock-based compensation forfeitures upon adoption of ASU 2016-09	—	100	(100)	—	—	—	—
Balances, July 1, 2016, as adjusted	279	127,058	223,157	(26,907)	(6,845)	(1,176)	315,566
Capital contributions from noncontrolling interest	—	—	—	—	—	855	855
Net income (loss)	—	—	(183)	—	—	321	138
Other comprehensive loss	—	—	—	—	(479)	—	(479)
Treasury Shares sold to Employee Stock Purchase Plan (16,609 shares)	—	(25)	—	330	—	—	305
Exercise of stock options (24,813 shares)	—	(317)	—	570	—	—	253
Issuance of deferred shares (396,530 shares)	—	(5,758)	—	5,758	—	—	—
Treasury shares repurchased to satisfy tax withholding obligations	—	—	—	(2,290)	—	—	(2,290)

(134,535 shares)							
Stock-based compensation expense	—	7,461	—	—	—	—	7,461
Balances, June 30, 2017	279	128,419	222,974	(22,539)	(7,324)	—	321,809
Net income (loss)	—	—	(11,480)	—	—	—	(11,480)
Other comprehensive loss	—	—	—	—	(87)	—	(87)
Treasury Shares Sold to Employee Stock Purchase Plan (21,920 shares)	—	(130)	—	423	—	—	293
Exercise of stock options (31,050 shares)	—	(240)	—	557	—	—	317
Issuance of deferred shares (253,241 shares)	—	(4,469)	—	4,469	—	—	—
Treasury shares repurchased to satisfy tax withholding obligations (52,950 shares)	—	—	—	(627)	—	—	(627)
Stock-based compensation expense	—	8,618	—	—	—	—	8,618
Balances, June 30, 2018	$ 279	$132,198	$211,494	$(17,717)	$ (7,411)	$ —	$318,843

See accompanying notes

Table of Contents

Matrix Service Company
Notes to Consolidated Financial Statements
Note 1—Summary of Significant Accounting Policies
Organization and Basis of Presentation
The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and include the accounts of Matrix Service Company ("Matrix" or the "Company") and its subsidiaries, all of which are wholly owned. Intercompany transactions and balances have been eliminated in consolidation.
The Company operates in the United States, Canada, South Korea and Australia. The Company's reportable segments are Electrical Infrastructure, Oil Gas & Chemical, Storage Solutions and Industrial.
Use of Estimates
The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. We believe the most significant estimates and judgments are associated with revenue recognition, the recoverability tests that must be periodically performed with respect to our goodwill and other intangible assets, valuation reserves on our accounts receivable and deferred tax assets, and the estimation of loss contingencies, including liabilities associated with litigation and with the self-insured retentions on our insurance programs. Actual results could materially differ from those estimates.
Revenue Recognition
Matrix records revenue on fixed-price contracts on a percentage-of-completion basis, primarily based on costs incurred to date compared to the total estimated contract cost. The Company records revenue on reimbursable and time and material contracts on a proportional performance basis as costs are incurred. Contracts in process are valued at cost plus accrued profits less billings on uncompleted contracts. Contracts are generally considered substantially complete when field construction is completed. The elapsed time from award of a contract to completion of performance may be in excess of one year. Matrix includes pass-through revenue and costs on cost-plus contracts, which are customer-reimbursable materials, equipment and subcontractor costs, when Matrix determines that it is responsible for the procurement and management of such cost components.
Matrix has numerous contracts that are in various stages of completion which require estimates to determine the appropriate cost and revenue recognition. The Company has a history of making reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs, and accordingly, does not believe significant fluctuations are likely to materialize. However, current estimates may be revised as additional information becomes available. If estimates of costs to complete fixed-price contracts indicate a loss, provision is made through a contract write-down for the total loss anticipated. A number of our contracts contain various cost and performance incentives and penalties that impact the earnings we realize from our contracts, and adjustments related to these incentives and penalties are recorded in the period, on a percentage-of-completion basis, when estimable and probable.
Indirect costs, such as salaries and benefits, supplies and tools, equipment costs and insurance costs, are charged to projects based upon direct labor hours and overhead allocation rates per direct labor hour. Warranty costs are normally incurred prior to project completion and are charged to project costs as they are incurred. Warranty costs incurred subsequent to project completion were not material for the periods presented. Overhead allocation rates are established annually during the budgeting process.
Precontract Costs
Precontract costs are costs incurred in anticipation of obtaining a contract that will result in no future benefit unless the contract is obtained. The Company generally expenses precontract costs to cost of revenue as incurred, but, in certain cases their recognition may be deferred if specific criteria are met. We had no deferred precontract costs at June 30, 2018 or 2017.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Change Orders and Claims Recognition
Change orders are modifications of an original contract that effectively change the existing provisions of the contract. Change orders may include changes in specifications or designs, manner of performance, facilities, equipment, materials, sites and period of completion of the work. Matrix or our clients may initiate change orders. The client's agreement to the terms of change orders is, in many cases, reached prior to work commencing; however, sometimes circumstances require that work progress prior to obtaining client agreement. Costs related to change orders are recognized as incurred. Revenues attributable to change orders that are unapproved as to price or scope are recognized to the extent that costs have been incurred if the amounts can be reliably estimated and their realization is probable. Revenues in excess of the costs attributable to change orders that are unapproved as to price or scope are recognized only when realization is assured beyond a reasonable doubt. Change orders that are unapproved as to both price and scope are evaluated as claims.
Claims are amounts in excess of the agreed contract price that we seek to collect from customers or others for delays, errors in specifications and designs, contract terminations, change orders in dispute or unapproved as to both scope and price or other causes of anticipated additional costs incurred by us. Recognition of amounts as additional contract revenue related to claims is appropriate only if it is probable that the claims will result in additional contract revenue and if the amount can be reliably estimated. We must determine if:

- there is a legal basis for the claim;
- the additional costs were caused by circumstances that were unforeseen by the Company and are not the result of deficiencies in our performance;
- the costs are identifiable or determinable and are reasonable in view of the work performed; and
- the evidence supporting the claim is objective and verifiable.

If all of these requirements are met, revenue from a claim is recorded only to the extent that we have incurred costs relating to the claim. Unapproved change orders and claims are more fully discussed in Note 7—Contingencies.
Cash and Cash Equivalents
The Company includes as cash equivalents all investments with original maturities of three months or less which are readily convertible into cash. The Company had approximately $0.3 million of restricted cash related to a customer deposit at June 30, 2018 and 2017. We have cash on deposit at June 30, 2018 with banks in the United States, Canada, South Korea and Australia in excess of Federal Deposit Insurance Corporation ("FDIC"), Canada Deposit Insurance Corporation ("CDIC"), Korea Deposit Insurance Corporation ("KDIC") and Financial Claims Scheme ("FCS") protection limits, respectively. The United States Dollar equivalent of Canadian, South Korean and Australian deposits totaled $5.2 million as of June 30, 2018.
Accounts Receivable
Accounts receivable are carried on a gross basis, less the allowance for uncollectible accounts. The Company’s customers consist primarily of major integrated oil companies, steel companies, independent refiners and marketers, power companies, petrochemical companies, pipeline companies, mining companies, contractors and engineering firms. The Company is exposed to the risk of individual customer defaults or depressed cycles in our customers’ industries. To mitigate this risk many of our contracts require payment as projects progress or advance payment in some circumstances. In addition, in most cases the Company can place liens against the property, plant or equipment constructed or terminate the contract if a material contract default occurs. Management estimates the allowance for uncollectible accounts based on existing economic conditions, the financial condition of its customers and the amount and age of past due accounts. Accounts are written off against the allowance for uncollectible accounts only after all collection attempts have been exhausted.
Retentions
Contract retentions collectible beyond one year are included in Other assets in the Consolidated Balance Sheets. Accounts payable retentions are generally settled within one year.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Loss Contingencies

Various legal actions, claims and other contingencies arise in the normal course of our business. Contingencies are recorded in the consolidated financial statements, or are otherwise disclosed, in accordance with ASC 450-20, "Loss Contingencies". Specific reserves are provided for loss contingencies to the extent we conclude that a loss is both probable and estimable. We use a case-by-case evaluation of the underlying data and update our evaluation as further information becomes known. We believe that any amounts exceeding our recorded accruals should not materially affect our financial position, results of operations or liquidity. However, the results of litigation are inherently unpredictable and the possibility exists that the ultimate resolution of one or more of these matters could result in a material effect on our financial position, results of operations or liquidity.

Legal costs are expensed as incurred.

Inventories

Inventories consist primarily of steel plate and pipe and aluminum coil and extrusions. Cost is determined primarily using the average cost method and inventories are stated at the lower of cost or net realizable value.

Depreciation

Depreciation is computed using the straight-line method over the estimated useful lives of the depreciable assets. Depreciable lives are as follows: buildings—40 years, construction equipment—3 to 15 years, transportation equipment—3 to 5 years, and office equipment and software—3 to 10 years. Leasehold improvements are amortized over the shorter of the useful life of the asset or the lease term.

Impairment of Long-Lived Assets

The Company evaluates long-lived assets for impairment when events or changes in circumstances indicate, in management's judgment, that the carrying value of such assets used in operations may not be recoverable. The determination of whether an impairment has occurred is based on management's estimate of undiscounted future cash flows attributable to the assets as compared to the carrying value of the assets. If an impairment has occurred, the amount of the impairment recognized is determined by estimating the fair value of the assets and, to the extent the carrying value exceeds the fair value of the assets, recording a loss provision.

For assets identified to be disposed of in the future, the carrying value of the assets are compared to the estimated fair value less the cost of disposal to determine if an impairment has occurred. Until the assets are disposed of, an estimate of the fair value is redetermined when related events or circumstances change.

Goodwill

Goodwill represents the excess of the purchase price of acquisitions over the acquisition date fair value of the net identifiable tangible and intangible assets acquired. In accordance with current accounting guidance, goodwill is not amortized and is tested at least annually for impairment at the reporting unit level, which is a level below our reportable segments.

We perform our annual test during the fourth quarter of each fiscal year and in any other period in which indicators of impairment warrant additional tests. The goodwill impairment test involves comparing management's estimate of the fair value of a reporting unit with its carrying value, including goodwill. If the fair value of a reporting unit exceeds its carrying value, then goodwill is not impaired. If the fair value of a reporting unit is less than its carrying value, then goodwill is impaired to the extent of the difference, but the impairment may not exceed the balance of goodwill assigned to that reporting unit.

We utilize a discounted cash flow analysis, referred to as an income approach, and market multiples, referred to as a market approach, to determine the estimated fair value of our reporting units. For the income approach, significant judgments and assumptions including forecasted project awards, discount rate, anticipated revenue growth rate, gross margins, operating expenses, working capital needs and capital expenditures are inherent in the fair value estimates, which are based on our operating and capital budgets and on our strategic plan. As a result, actual results may differ from the estimates utilized in our income approach. For the market approach, significant judgments and assumptions include the selection of guideline companies, forecasted guideline company EBITDA and our forecasted EBITDA.

The use of alternate judgments and/or assumptions could result in a fair value that differs from our estimate and could result in the recognition of an impairment charge in the financial statements. As a test for reasonableness, we also consider the combined carrying values of our reporting units to our market capitalization.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Other Intangible Assets

Intangible assets that have finite useful lives are amortized by the straight-line method over their useful lives ranging from 4 years to 15 years. A finite intangible asset is considered impaired when its carrying amount is not recoverable and exceeds the asset's fair value. The carrying amount is deemed unrecoverable if it is greater than the sum of undiscounted cash flows expected to result from use and eventual disposition of the asset. An impairment loss is equal to the excess of the carrying amount over the fair value of the asset. If quoted market prices are not available, the fair values of the intangible assets are based on present values of expected future cash flows or royalties avoided using discount rates commensurate with the risks involved.

Insurance Reserves

We maintain insurance coverage for various aspects of our operations. However, we retain exposure to potential losses through the use of deductibles, coverage limits and self-insured retentions. We establish reserves for claims using a combination of actuarially determined estimates and case-by-case evaluations of the underlying claim data and update our evaluations as further information becomes known. Judgments and assumptions are inherent in our reserve accruals; as a result, changes in assumptions or claims experience could result in changes to these estimates in the future. If actual results of claim settlements are different than the amounts estimated we may be exposed to future gains and losses that could be material.

Stock-Based Compensation

The Company has issued stock options and nonvested deferred share awards under its long-term incentive compensation plans. The fair value of these awards is calculated at grant date. The fair value of time-based, nonvested deferred shares is the value of the Company’s common stock at the grant date. The fair value of market-based nonvested deferred shares is based on several factors, including the probability that the market condition specified in the grant will be achieved, which is calculated using a Monte Carlo model. The fair value of stock options is determined based on the Black-Scholes option pricing model. For all stock-based awards, expense is recognized over the requisite service period with forfeitures recorded as they occur.

Income Taxes

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

Foreign Currency

The functional currencies of the Company’s operations in Canada, South Korea and Australia are the Canadian Dollar, South Korean Won and U.S. Dollar, respectively. For subsidiaries with operations using a foreign functional currency, assets and liabilities are translated at the year-end exchange rates and the income statement accounts are translated at average exchange rates throughout the year. Translation gains and losses are reported in Accumulated Other Comprehensive Income (Loss) in the Consolidated Statements of Changes in Stockholders’ Equity and in Other Comprehensive Income (Loss) in the Consolidated Statements of Comprehensive Income. Transaction gains and losses are reported as a component of Other income (expense) in the Consolidated Statements of Income.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Recently Issued Accounting Standards

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

On May 28, 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09. The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that “an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” The ASU also requires entities to disclose both quantitative and qualitative information that enables users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The ASU's disclosure requirements are significantly more comprehensive than those in existing revenue standards. The ASU applies to all contracts with customers except those that are within the scope of other topics in the FASB Accounting Standards Codification ("ASC"). The ASU is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period.

The Company adopted this standard on July 1, 2018 using the modified retrospective method of application. Under the modified retrospective method, revenue recognized on completed contracts is not restated, however contracts in progress are accounted for as if they were under the new standard at inception. Any difference between historical revenue and revenue under the new standard is recorded as a cumulative effect adjustment to retained earnings as of the date of adoption. The Company has completed the analysis of its contracts in progress and noted that the modified retrospective adjustment was immaterial. The Company does not expect the new standard to have a material impact to its financial statements going forward.

Accounting Standards Update 2016-02, Leases (Topic 842) and Accounting Standards Update No. 2018-11, Leases (Topic 842)

On February 25, 2016, the FASB issued ASU 2016-02 that amends accounting for leases. Under the new guidance, lessees will recognize the following for all leases (with the exception of short-term leases) at the lease commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Prior to the issuance of ASU 2018-11 in July 2018, lessees and lessors were required to adopt the new standard using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, even though those leases may have expired before the new standard's effective date. The amendments in ASU 2018-11 provide, among other things, an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, the Company may apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption rather than having to apply the new standard to the earliest comparative period presented in the financial statements.

Both amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption of the amendments is permitted, but we do not plan to do so at this time.

We are currently assessing the impact of the adoption of the amendments on the Company's results of operations, financial position and cash flows. As of June 30, 2018 the Company had $33.1 million of future minimum lease payments under non-cancelable operating leases, primarily for facilities. See Note 8 - Operating Leases for more information about the timing and amount of future operating lease payments, which we believe is indicative of the materiality of adoption of these amendments to our financial statements.

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

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

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

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

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

Accounting Standards Update 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting

In May 2017, the FASB issued ASU 2017-09 which clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as a modification. Entities should apply the modification accounting guidance if the value, vesting conditions or classification of the award changes. ASU 2017-09 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted and prospective application is required. The adoption of ASU 2017-09 did not have a material impact on our financial position, results of operations or cash flows.

Note 2—Acquisitions and Disposals

Sale of Process Heating Business - Subsequent Event

In August 2018, the Company sold non-core assets associated with a business that marketed process heating equipment for $3.7 million in cash, subject to customary final post-closing adjustments. The fiscal 2018 revenues and operating results of the business, which were included in the Oil Gas & Chemical segment, are not material.

Purchase of Houston Interests, LLC

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

The Company purchased all of the equity interests of Houston Interests for $42.5 million, net of working capital adjustments and cash acquired. The consideration paid is as follows (in thousands):

Cash paid for equity interest	$46,000
Cash paid for working capital	6,837
Less: cash acquired	(10,331)
Net purchase price	$42,506

The Company funded the equity interest portion of the consideration paid from borrowings under the Company's senior secured revolving credit facility (See Note 5). The purchase of working capital was paid with cash on hand. The net purchase price was allocated to the major categories of assets and liabilities based on their estimated fair value at the acquisition date.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

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

Cash and cash equivalents	$10,331
Accounts receivable	10,273
Costs and estimated earnings in excess of billings on uncompleted contracts	746
Other current assets	454
Current assets	21,804
Property, plant and equipment	942
Goodwill	35,146
Other intangible assets	10,220
Total assets acquired	68,112
Accounts payable	962
Billings on uncompleted contracts in excess of costs and estimated earnings	11,648
Other accrued expenses	2,475
Current liabilities	15,085
Other liabilities	190
Net assets acquired	52,837
Less: cash acquired	10,331
Net purchase price	$42,506

The goodwill recognized from the acquisition is primarily attributable to the technical expertise of the acquired workforce and the complementary nature of Houston Interests' operations, which the Company believes will enable the combined entity to expand its service offerings and enter new markets. All of the goodwill recognized is deductible for income tax purposes.

The Company agreed to pay the previous owners up to $2.6 million for any unused portion of acquired warranty obligations outstanding as of June 30, 2017. This agreement was settled for $1.7 million, which was paid in July 2017. This settlement was reflected as a decrease to the acquired current liabilities and an increase to the net purchase price.

The Company incurred $0.6 million of expenses related to closing the acquisition during the fiscal year ended June 30, 2017, which were included within selling, general and administrative expenses in the Consolidated Statements of Income.

The unaudited financial information in the table below summarizes the combined results of operations of Matrix Service Company and Houston Interests for the fiscal years ended June 30, 2017 and 2016, on a pro forma basis, as though the companies had been combined as of July 1, 2015. The pro forma financial information presented in the table below is for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at July 1, 2015 nor should it be taken as indicative of future consolidated results of operations.

	Fiscal Years Ended	
	June 30, 2017	June 30, 2016
	(In thousands, except per share data)	
Revenues	$1,233,372	$1,427,313
Net income attributable to Matrix Service Company	$7,326	$32,352
Basic earnings per common share	$0.28	$1.22
Diluted earnings per common share	$0.27	$1.19

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

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

- The combined entities recorded approximately $3.3 million of acquisition and integration expenses during the fiscal year ended June 30, 2017, which were transferred in the pro forma earnings to the fiscal year ended June 30, 2016 in order to report them as if they were incurred on July 1, 2015. Pro forma earnings were adjusted to include integration expenses that would have been recognized had the acquisition occurred on July 1, 2015 of $0.8 million and $0.9 million during the fiscal years ended June 30, 2017 and 2016, respectively.
- Interest expense for the combined entities was increased by $0.7 million for the fiscal year ended June 30, 2017 and by $1.4 million during the fiscal year ended June 30, 2016. The increase was attributable to the assumption that the Company's borrowings of $46.0 million used to fund a portion of the acquisition had been outstanding as of July 1, 2015. This increase was partially offset by the assumption that Houston Interests' former debt was extinguished as of July 1, 2015.
- Depreciation and intangible asset amortization expense for the combined entities was reduced by $1.4 million during the fiscal year ended June 30, 2017 and was increased by $1.8 million during the fiscal year ended June 30, 2016. These adjustments are primarily due to the recognition of amortizable intangible assets as part of the acquisition and the effect of fair value adjustments to acquired property, plant and equipment.
- Pro forma earnings were adjusted to include additional income tax expense of $2.0 million and $2.2 million during the fiscal years ended June 30, 2017 and 2016, respectively. Houston Interests was previously an exempt entity and income taxes were not assessed in its historical financial information.

Purchase of Baillie Tank Equipment, Ltd.

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

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

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

The goodwill recognized from the acquisition is attributable to the synergies of combining our operations and the technical expertise of the acquired workforce. None of the goodwill recognized is deductible for income tax purposes. The Company incurred $1.2 million of expenses related to the acquisition for the fiscal year ended June 30, 2016, which are included within Selling, general and administrative expenses in the Consolidated Statements of Income.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 3—Uncompleted Contracts

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

	June 30, 2018	June 30, 2017
	(In thousands)	
Costs and estimated earnings recognized on uncompleted contracts	$2,081,799	$1,919,054
Billings on uncompleted contracts	2,125,907	1,903,001
	$(44,108)	$16,053
Shown in balance sheet as:		
Costs and estimated earnings in excess of billings on uncompleted contracts	$76,632	$91,180
Billings on uncompleted contracts in excess of costs and estimated earnings	120,740	75,127
	$(44,108)	$16,053

Progress billings in accounts receivable at June 30, 2018 and June 30, 2017 included retentions to be collected within one year of $25.9 million and $54.3 million, respectively. Contract retentions collectible beyond one year are included in other assets in the Consolidated Balance Sheets and totaled $2.6 million at June 30, 2018 and $1.9 million at June 30, 2017.

Other

Our fiscal 2017 results were negatively impacted by an increased cost estimate related to a large project in the Electrical Infrastructure segment, which resulted in a decrease in gross profit. The change in cost estimate resulted from a deterioration in the financial forecast of the project during the third fiscal quarter and was caused by various factors that delayed schedule progress and reduced productivity. At June 30, 2018, the Company's scope of work is complete and the remaining impact of the project on the Company's future results is expected to be insignificant.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 4—Goodwill and Other Intangible Assets
Goodwill
The changes in the carrying amount of goodwill by segment are as follows:

	Electrical Infrastructure	Oil Gas & Chemical	Storage Solutions	Industrial	Total
	(In thousands)				
Net balance at June 30, 2015	$42,374	$ 14,008	$9,664	$5,472	$71,518
Purchase of BTE (Note 2)	—	—	6,942	—	6,942
Translation adjustment [1]	(204)	—	75	(38)	(167)
Net balance at June 30, 2016	42,170	14,008	16,681	5,434	78,293
Purchase of Houston Interests (Note 2)	—	19,596	—	15,550	35,146
Acquisition related adjustments	—	—	88	—	88
Translation adjustment [1]	(18)	—	(5)	(3)	(26)
Net balance at June 30, 2017	42,152	33,604	16,764	20,981	113,501
Goodwill impairment	(17,281)	—	—	—	(17,281)
Translation adjustment [1]	(45)	—	(4)	(9)	(58)
Net balance at June 30, 2018	$24,826	$ 33,604	$16,760	$20,972	$96,162

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

We performed our annual goodwill impairment test as of May 31, 2018. The test indicated that the carrying amount of our Electrical Infrastructure reporting unit exceeded its estimated fair value, resulting in an impairment to goodwill of $17.3 million. The impairment was triggered by lower financial projections as a result of the Company's decision to shift its strategy away from EPC power generation projects to smaller, individual packages that better fit the Company's strategy and risk profile, and the recent trend of sluggish maintenance and capital spending by some key clients in our Northeast and Mid-Atlantic high voltage markets. The estimated fair value of the reporting unit was derived by utilizing a combination of discounted cash flow analysis and market multiples.

If our market view of project opportunities or gross margin changes, the Company may need to perform an interim analysis, which could result in the recognition of an additional material impairment to goodwill. The Company will continue to monitor the operating results of its reporting units each period and perform additional tests as needed.

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

		At June 30, 2018		
	Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(Years)	(In thousands)		
Intellectual property	9 to 15	$2,579	$ (1,603)	$ 976
Customer based	6 to 15	38,562	(16,763)	21,799
Non-compete Agreements	4	1,453	(1,414)	39
Trade names	—	1,630	(1,630)	—
Total other intangible assets		$44,224	$ (21,410)	$ 22,814

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

		At June 30, 2017		
	Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(Years)	(In thousands)		
Intellectual property	9 to 15	$2,579	$ (1,425)	$ 1,154
Customer based	1 to 15	38,207	(13,543)	24,664
Non-compete agreements	4 to 5	1,453	(1,298)	155
Trade name	1 to 3	1,630	(1,307)	323
Total other intangible assets		$43,869	$ (17,573)	$ 26,296

In June 2018, the Company recorded a $0.7 million impairment to a customer relationship intangible asset associated with an acquisition that was completed in fiscal 2013. The impairment was triggered by lower than anticipated revenue and operating income. The impairment is included in the Oil Gas & Chemical segment and is presented within the Goodwill and other intangible asset impairment caption in the Consolidated Statements of Income.

In December 2017, the Company settled a portion of an account receivable with a customer in exchange for $50.0 million of backlog, which the Company expects to recognize as revenue over the next six years. The Company has recognized the backlog as a customer-based intangible asset with an estimated fair value of $2.0 million. The value assigned to the backlog approximated the net book value of the account receivable included in the settlement. The amortization expense will be recognized as the work is completed.

Amortization expense totaled $4.8 million, $4.9 million, and $3.6 million in fiscal 2018, 2017, and 2016, respectively.

We estimate that future amortization of other intangible assets will be as follows (in thousands):

For year ending:	
June 30, 2019	$3,699
June 30, 2020	3,688
June 30, 2021	3,669
June 30, 2022	2,821
June 30, 2023	2,369
Thereafter	6,568
Total estimated amortization expense	$22,814

Note 5—Debt

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

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

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

The Credit Agreement includes the following covenants and borrowing limitations:

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

The credit facility includes a sub-facility for revolving loans denominated in Australian Dollars, Canadian Dollars, Euros and Pounds Sterling in an aggregate amount not to exceed the U.S. Dollar equivalent of $75.0 million and a $200.0 million sublimit for letters of credit.

Each revolving borrowing under the Credit Agreement will bear interest at a rate per annum equal to:

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

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

The unused credit facility fee is between 0.25% and 0.45% based on the Leverage Ratio.

The Credit Agreement includes a Leverage Ratio covenant, which provides that Consolidated Funded Indebtedness, as of the end of any fiscal quarter, may not exceed 3.0 times Consolidated EBITDA, as defined in the Credit Agreement, over the previous four quarters. For the four quarters ended June 30, 2018, Consolidated EBITDA was $36.8 million. Consolidated Funded Indebtedness, as defined in the Credit Agreement, at June 30, 2018 was $37.1 million.

Availability under the senior secured revolving credit facility is as follows:

	June 30, 2018	June 30, 2017
	(In thousands)	
Senior secured revolving credit facility	$300,000	$300,000
Capacity constraint due to the Leverage Ratio	189,741	169,092
Capacity under the senior secured revolving credit facility	110,259	130,908
Letters of credit issued	37,073	7,825
Borrowings outstanding	—	44,682
Availability under the senior secured revolving credit facility	$73,186	$78,401

The Company is in compliance with all other affirmative, negative, and financial covenants under the Credit Agreement. At June 30, 2018, the Company was at the lowest margin tier for all categories of loans and the unused revolving credit facility fee under the Credit Agreement. The carrying value of the senior secured revolving credit facility approximates its fair value at each balance sheet date.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 6—Income Taxes

Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The Act makes broad and complex changes to the U.S. tax code, which have affected our current results and will affect our future results. The following were significant changes in the tax code that became effective for the Company beginning January 1, 2018:

- reducing the Company's U.S. federal corporate income tax rate from 35% to a blended rate of 28.06% for fiscal 2018 as stipulated by the Internal Revenue Code for companies using a June 30 fiscal year end and to 21% for fiscal years thereafter;
- generally eliminating U.S. federal income tax on dividends from foreign subsidiaries;
- requiring current inclusion in U.S. federal taxable income of certain earnings of controlled foreign corporations;
- allowing full expensing of certain assets placed in service from September 27, 2017 and before January 1, 2023;
- restricting further deductibility of executive performance compensation in excess of $1.0 million; and
- disallowing certain entertainment expenses.

The following are significant changes in the tax code that are effective for the Company beginning July 1, 2018:

- eliminating the deduction for domestic production activity;
- limiting the annual deduction for business interest;
- taxing global intangible low-tax income;
- allowing a deduction for domestically earned foreign intangible income; and
- establishing a new base erosion and anti-abuse tax on payments between U.S. taxpayers and foreign related parties.

The SEC staff issued SAB 118 which provides guidance on accounting for the tax effects of the Act. SAB 118 provides a measurement period that should not extend beyond one year from the Act’s enactment date for companies to complete the accounting under ASC 740. As of June 30, 2018, we have not completed our accounting for the tax effect of the Act. In accordance with SAB 118 and as discussed below, we have reflected the income tax effects of the those items where the accounting is complete; have recorded a provisional amount with regards for those items where the accounting is not complete but we have made a reasonable estimate; and have continued to account for items based on our existing accounting under ASC 740 in those areas where we have not been able to make a reasonable estimate.

Accounting Complete

Deferred Taxes Remeasurement

We remeasured our domestic deferred tax assets and liabilities based on the rates at which we expect them to reverse in the future. Section 15 of the Internal Revenue Code stipulates that our fiscal year ending June 30, 2018 will have a blended U.S. federal corporate income tax rate of 28.06%, which is based on the applicable tax rates before and after the Act and the number of days in the tax year. Therefore, domestic deferred taxes reversing prior to July 1, 2018 will be taxed based on the blended rate and reversals occurring thereafter will be taxed at the new 21% tax rate. As of June 30, 2018, we have completed the remeasurement of our domestic deferred tax assets and liabilities which resulted in an income tax benefit of $0.5 million, which is included in Provision (benefit) for federal, state and foreign income taxes in the Consolidated Statements of Income.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Accounting not Complete - Provisional Amount Recorded
One-time Transition Tax on Unpatriated Earnings of Certain Foreign Subsidiaries
The Act includes a one-time transition tax based on our total post-1986 foreign earnings and profits (E&P) which we have previously deferred from U.S. income taxes. We have not completed the calculations surrounding this tax, but based on our preliminary calculations, our foreign subsidiaries have overall negative E&P. Therefore, we do not anticipate incurring tax related to this provision of the Act since any return of assets would be a return of capital, not earnings. Due to the preliminary nature of our calculations, no additional income taxes have been provided for any remaining undistributed foreign earnings not subject to the transition tax and any outside basis difference inherent in these entities as these amounts continue to be indefinitely reinvested in foreign operations.
Accounting not Complete - Using Existing Accounting Under ASC 740
Valuation Allowances on Foreign Tax Credit Carryforwards
We are currently assessing and have not completed our analysis of how various aspects of the Act such as deemed repatriation of foreign income, global intangible low taxes income ("GILTI") inclusions, and new categories of foreign tax credits affect our ability to utilize our existing foreign tax credit carryforwards before they expire. Currently we have stated our foreign tax credits at the amount at which we are more likely than not to realize the tax benefit before consideration of the tax law changes under the Act. Our completed analysis may result in an increased valuation allowance against our current foreign tax credit carryforwards.
Indefinite Reinvestment Assertion
Currently we do not provide for outside basis differences under the indefinite reinvestment assertion of ASC 740-30. Our complete analysis of the Act may require us to provide for additional taxes to basis differences or withholding taxes on remitted foreign earnings.
GILTI
The Act creates a new requirement that certain income earned by controlled foreign corporations must be included currently in the gross income of the U.S. shareholder. Because of the complexity of the new GILTI rules, we are continuing to evaluate this provision of the Act and the application of ASC 740. Under US GAAP, we are allowed to make an accounting policy choice of either: 1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred or 2) factoring such amounts into the measurement of our deferred taxes. Our selection of an accounting policy will depend, in part, on analyzing our global income and the expected GILTI inclusions that, in turn, depend on our estimated future results of global operations. As such, we are not yet able to reasonably estimate the effect of the potential GILTI tax on our financial statements and have not made a policy decision regarding whether to recorded deferred tax on GILTI.
Sources of pretax income (loss)

	Fiscal Years Ended		
	June 30, 2018	June 30, 2017	June 30, 2016
	(In thousands)		
Domestic	$(2,656)	$19,763	$33,986
Foreign	(9,492)	(17,317)	5,667
Total	$(12,148)	$2,446	$39,653

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Components of the provision for income tax expense (benefit)

	Fiscal Years Ended		
	June 30, 2018	June 30, 2017	June 30, 2016
	(In thousands)		
Current:			
Federal	$(121)	$6,522	$9,930
State	135	(185)	2,570
Foreign	504	(1,509)	(262)
	518	4,828	12,238
Deferred:			
Federal	1,093	618	887
State	(590)	101	67
Foreign	(1,689)	(3,239)	924
	(1,186)	(2,520)	1,878
	$(668)	$2,308	$14,116

Reconciliation between the expected income tax provision applying the domestic federal statutory tax rate and the reported income tax provision

	Fiscal Years Ended		
	June 30, 2018	June 30, 2017	June 30, 2016
	(In thousands)		
Expected provision (benefit) for federal income taxes at the statutory rate	$(3,408)	$857	$13,879
State income taxes, net of federal benefit	247	808	1,827
Impairment of non-deductible goodwill(1)	2,342	—	—
Charges without tax benefit	1,100	1,741	2,187
Change in valuation allowance	1,173	1,295	311
Excess tax expense (benefit) on stock-based compensation(2)	511	(496)	—
Remeasurement of deferred taxes(3)	(455)	—	—
IRC S199 deduction	—	(749)	(999)
Research and development and other tax credits	(1,665)	(1,626)	(1,928)
Foreign tax differential	(10)	1,496	(815)
Noncontrolling interest	—	(112)	1,164
Change in uncertain tax positions	(7)	(22)	(569)
Adjustment to tax accounts	(435)	(924)	(786)
Other	(61)	40	(155)
Provision (benefit) for federal, state and foreign income taxes	$(668)	$2,308	$14,116

(1) Relates to a $17.3 million impairment of goodwill, which included $8.3 million of non-deductible goodwill. See Note 4 - Goodwill and Other Intangible Assets for more information about the impairment.

(2) This represents the amount recognized for excess tax benefits upon the vesting or exercise of nonvested deferred share awards and stock options, respectively, for which the Company expects to receive an income tax deduction. The Company adopted ASU 2016-09 in fiscal 2017, which required that excess tax benefits and tax deficiencies be recognized as part of the provision for income taxes.

(3)

This represents the remeasurement of deferred taxes in connection with Tax Cuts and Jobs Act - see Deferred Taxes Remeasurement paragraph above.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Significant components of the Company’s deferred tax assets and liabilities

	June 30, 2018	June 30, 2017
	(In thousands)	
Deferred tax assets:		
Warranty reserve	$206	$312
Bad debt reserve	1,629	3,869
Paid-time-off accrual	575	821
Insurance reserve	1,608	2,284
Legal reserve	27	82
Net operating loss benefit and credit carryforwards	10,169	9,332
Valuation allowance	(1,638)	(1,719)
Accrued compensation and pension	758	1,346
Stock compensation expense on nonvested deferred shares	2,733	3,731
Accrued losses	171	340
Foreign currency translation and other	1,066	1,080
Total deferred tax assets	17,304	21,478
Deferred tax liabilities:		
Tax over book depreciation	8,137	11,446
Tax over book amortization	702	3,325
Branch future liability	3,018	2,538
Receivable holdbacks and other	1,028	912
Total deferred tax liabilities	12,885	18,221
Net deferred tax asset	$4,419	$3,257

As reported in the Consolidated Balance Sheets

	June 30, 2018	June 30, 2017
	(In thousands)	
Deferred income tax assets	4,848	3,385
Deferred income tax liabilities	(429)	(128)
Net deferred tax asset	$4,419	$3,257

Operating loss and tax credit carryforwards

The Company has state net operating loss carryforwards, state tax credit carryforwards, federal foreign tax credit carryforwards, foreign net operating loss carryforwards and foreign tax credit carryforwards. The valuation allowance at June 30, 2018 and June 30, 2017 reduces the recognized tax benefit of these carryforwards to an amount that is more likely than not to be realized. These carryforwards will generally expire as shown below:

Operating Loss Carryforwards	Expiration Period	Amount (in thousands)
State net operating losses	June 2023 to June 2038	$ 22,230
Foreign net operating losses	December 2029; June 2032 to June 2037	$ 20,733

66

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Tax Credit Carryforwards	Expiration Period	Amount (in thousands)
State tax credits	June 2018 to June 2033	$ 679
Federal foreign tax credits	June 2019 to June 2025	$ 1,244
Foreign tax credits	June 2035 to June 2037	$ 668

Other

The Company files tax returns in multiple domestic and foreign taxing jurisdictions. With a few exceptions, the Company is no longer subject to examination by taxing authorities through fiscal 2013. At June 30, 2018, the Company updated its evaluation of its open tax years in all known jurisdictions. We have recorded a $0.5 million liability as of June 30, 2018 for unrecognized tax positions and the payment of related interest and penalties. We treat the related interest and penalties as income tax expense. Due to the uncertainties related to these tax matters, we are unable to make a reasonably reliable estimate as to when cash settlement with a taxing authority will occur.

Note 7—Contingencies

Insurance Reserves

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

Typically our contracts require us to indemnify our customers for injury, damage or loss arising from the performance of our services and provide warranties for materials and workmanship. The Company may also be required to name the customer as an additional insured up to the limits of insurance available, or we may be required to purchase special insurance policies or surety bonds for specific customers or provide letters of credit in lieu of bonds to satisfy performance and financial guarantees on some projects. Matrix maintains a performance and payment bonding line sufficient to support the business. The Company generally requires its subcontractors to indemnify the Company and the Company's customer and name the Company as an additional insured for activities arising out of the subcontractors' work. We also require certain subcontractors to provide additional insurance policies, including surety bonds in favor of the Company, to secure the subcontractors' work or as required by the subcontract.

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

Unapproved Change Orders and Claims

As of June 30, 2018 and June 30, 2017, costs and estimated earnings in excess of billings on uncompleted contracts included revenues for unapproved change orders and claims of $15.0 million and $11.0 million, respectively. Generally, collection of amounts related to unapproved change orders and claims is expected within twelve months. However, customers may not pay these amounts until final resolution of related claims, and accordingly, collection of these amounts may extend beyond one year.

Other

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

Note 8—Operating Leases

The Company is the lessee under operating leases covering real estate and office equipment under non-cancelable operating lease agreements that expire at various times. Future minimum lease payments under non-cancelable operating leases that were in effect at June 30, 2018 total $33.1 million and are payable as follows: fiscal 2019—$7.5 million; fiscal 2020—$6.7 million; fiscal 2021—$5.5 million; fiscal 2022—$4.4 million; fiscal 2023—$2.9 million and thereafter—$6.2 million. Operating lease expense was $8.6 million, $7.9 million and $6.6 million for the fiscal years ended June 30, 2018, June 30, 2017 and June 30, 2016, respectively.

67

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 9—Stockholders’ Equity

Preferred Stock

The Company has 5.0 million shares of preferred stock authorized, none of which was issued or outstanding at June 30, 2018 or June 30, 2017.

Treasury Shares

On December 12, 2016, the Board of Directors approved a stock buyback program (the "December 2016 Program"), which replaced the previous program that had been in place since November 2014. Under the December 2016 Program, the Company may repurchase common stock of the Company in any calendar year commencing with calendar year 2016 and continuing through calendar year 2018, up to a maximum of $25.0 million per calendar year. The Company may repurchase its stock from time to time in the open market at prevailing market prices or in privately negotiated transactions. The December 2016 Program will continue through December 31, 2018 unless and until it is modified or revoked by the Board of Directors. No shares have been repurchased under the December 2016 Program as of June 30, 2018.

In addition to the stock buyback program, the Company may withhold shares of common stock to satisfy the tax withholding obligations upon vesting of an employee’s deferred shares. Matrix withheld 52,950 and 134,535 shares of common stock during fiscal 2018 and 2017, respectively, to satisfy these obligations. These shares were returned to the Company’s pool of treasury shares. The Company has 1,034,394 treasury shares as of June 30, 2018 and intends to utilize these treasury shares in connection with equity awards under the Company’s stock incentive plans and for sales to the Employee Stock Purchase Plan.

Note 10—Stock-Based Compensation

Total stock-based compensation expense for the fiscal years ended June 30, 2018, June 30, 2017, and June 30, 2016 was $8.6 million, $7.5 million and $6.3 million, respectively. Measured but unrecognized stock-based compensation expense at June 30, 2018 was $12.9 million, all of which related to nonvested deferred shares which are expected to be recognized as expense over a weighted average period of 1.7 years. The Company recognized excess tax expense of $0.5 million related to stock-based compensation vesting for the fiscal year ended June 30, 2018 and recognized excess tax benefits of $0.5 million and $3.2 million for the fiscal years ended June 30, 2017 and June 30, 2016, respectively.

Plan Information

In November 2016, the Company's stockholders approved the Matrix Service Company 2016 Stock and Incentive Compensation Plan (the "2016 Plan"), which provides stock-based and cash-based incentives for officers, directors and other key employees. Stock options, restricted stock, restricted stock units, stock appreciation rights, performance shares and cash-based awards can be issued under this plan. Upon approval of the 2016 Plan, the 2012 Stock and Incentive Compensation Plan ("2012 Plan") was frozen with the exception of normal vesting and other activity associated with awards previously granted under the 2012 Plan. However, shares awarded under the 2012 Plan that are subsequently forfeited or net settled for tax withholding purposes are returned to the treasury share pool and become available for grant under the 2016 Plan. The 2012 Plan was preceded by the 2004 Stock Incentive Plan ("2004 Plan"), which was frozen upon approval of the 2012 Plan with the exception of normal vesting, forfeiture and other activity associated with awards previously granted under the 2004 Plan.

Awards totaling 1,800,000 shares have been authorized under the 2016 Plan. At June 30, 2018 there were 1,145,949 shares available for grant under the 2016 Plan.

Stock Options

Stock options are granted at the market value of the Company’s common stock on the grant date and expire after 10 years. The Company’s policy is to issue shares upon the exercise of stock options from its treasury shares, if available. The Company did not award any new stock options in fiscal years 2018, 2017, or 2016.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Stock option activity and related information for the fiscal year ended June 30, 2018 is as follows:

	Number of Options	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Aggregate Intrinsic Value (In thousands)
Outstanding at June 30, 2017	97,250	4.4	$ 10.19	$ —
Granted	—		—	
Exercised	(31,050)		$ 10.19	$ 287
Canceled	—		—	
Outstanding at June 30, 2018	66,200	3.4	$ 10.19	$ 540
Vested at June 30, 2018	66,200	3.4	$ 10.19	$ 540
Exercisable at June 30, 2018	66,200	3.4	$ 10.19	$ 540

The total intrinsic value of stock options exercised during fiscal 2017 and 2016 was $0.3 million and $0.7 million, respectively.

Nonvested Deferred Shares

The Company has issued nonvested deferred shares under the following types of arrangements:

- Time-based awards—Employee awards generally vest in four equal annual installments beginning one year after the grant date. Director awards vest one year after the grant date.
- Market-based awards—These awards are in the form of performance units which vest 3 years after the grant date only if the Company’s common stock achieves certain levels of total shareholder return when compared to the total shareholder return of a peer group of companies as selected by the Compensation Committee of the Board of Directors. The payout can range from zero to 200% of the original award depending on the Company's relative total shareholder return during the performance period. These awards are settled in stock. As of June 30, 2018, there are approximately 183,000, and 275,000 performance units that are scheduled to vest in fiscal 2020, and fiscal 2021, respectively, assuming target performance. There were approximately 127,000 performance units that were scheduled to vest in fiscal 2019 at target performance, but total shareholder return during the performance period did not meet the threshold performance and the performance units were forfeited.

All awards vest upon the death or disability of the participant or upon a change of control of the Company.

The grant date fair value of the time-based awards is determined by the market value of the Company's common stock on the grant date. The grant date fair value of stock options is determined based on the Black-Scholes option pricing model. The grant date fair value of the market-based awards is calculated using a Monte Carlo model. For the fiscal 2018 grant, the model estimated the fair value of the award based on approximately 100,000 simulations of the future prices of the Company's common stock compared to the future prices of the common stock of its peer companies based on historical volatilities. The model also took into account the expected dividends of the peer companies over the performance period.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Nonvested deferred share activity for the fiscal year ended June 30, 2018 is as follows:

	Shares	Weighted Average Grant Date Fair Value per Share
Nonvested shares at June 30, 2017	995,353	$ 21.65
Shares granted	715,539	$ 13.64
Shares vested and released	(253,241)	$ 19.60
Shares canceled	(91,604)	$ 31.42
Nonvested shares at June 30, 2018	1,366,047	$ 17.18

There were 516,969 and 370,490 deferred shares granted in fiscal 2017 and 2016 with average grant date fair values of $19.80 and $20.77, respectively. There were 396,530 and 631,443 deferred shares that vested and were released in fiscal 2017 and 2016 with weighted average fair values of $18.24 and $22.34 per share, respectively.

Note 11—Earnings per Common Share

Basic earnings per share ("EPS") is calculated based on the weighted average shares outstanding during the period. Diluted earnings per share includes the dilutive effect of employee and director stock options and nonvested deferred shares. Stock options are considered dilutive whenever the exercise price is less than the average market price of the stock during the period and antidilutive whenever the exercise price exceeds the average market price of the common stock during the period. Nonvested deferred shares are considered dilutive (antidilutive) whenever the average market value of the shares during the period exceeds (is less than) the sum of the related average unamortized compensation expense during the period plus the related hypothetical estimated excess tax benefit that will be realized when the shares vest. Stock options and nonvested deferred shares are considered antidilutive in the event we report a net loss.

The computation of basic and diluted EPS is as follows:

	Fiscal Years Ended		
	June 30, 2018	June 30, 2017	June 30, 2016
	(In thousands, except per share data)		
Basic EPS:			
Net income (loss) attributable to Matrix Service Company	$ (11,480)	$ (183)	$ 28,863
Weighted average shares outstanding	26,769	26,533	26,597
Basic earnings (loss) per share	$ (0.43)	$ (0.01)	$ 1.09
Diluted EPS:			
Weighted average shares outstanding—basic	26,769	26,533	26,597
Dilutive stock options	—	—	68
Dilutive nonvested deferred shares	—	—	435
Diluted weighted average shares	26,769	26,533	27,100
Diluted earnings (loss) per share	$ (0.43)	$ (0.01)	$ 1.07

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

The following securities are considered antidilutive and have been excluded from the calculation of diluted earnings (loss) per share:

	Fiscal Years Ended		
	June 30, 2018	June 30, 2017	June 30, 2016
	(In thousands of shares)		
Stock options	31	43	—
Nonvested deferred shares	424	430	56
Total antidilutive securities	455	473	56

Note 12—Employee Benefit Plans

Defined Contribution Plans

The Company sponsors defined contribution savings plans for all eligible employees meeting length of service requirements. Under the primary plan, participants may contribute an amount up to 25% of pretax annual compensation subject to certain limitations. The Company matches 100% of the first 3% of employee contributions and 50% of the next 2% of employee contributions. The Company matching contributions vest immediately.

The Company's matching contributions were $5.8 million, $5.5 million, and $5.0 million for the fiscal years ended June 30, 2018, 2017 and 2016, respectively.

Multiemployer Pension Plans

The Company contributes to various union sponsored multiemployer benefit plans in the U.S. and Canada. Benefits under these plans are generally based on compensation levels and years of service.

For the Company, the financial risks of participating in multiemployer plans are different from single-employer plans in the following respects:

- Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers.
- If a participating employer discontinues contributions to a plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
- If a participating employer chooses to stop participating in a plan, a withdrawal liability may be created based on the unfunded vested benefits for all employees in the plan.

Under federal legislation regarding multiemployer pension plans, in the event of a withdrawal from a plan or plan termination, companies are required to continue funding their proportionate share of such plan's unfunded vested benefits. We are a participant in multiple union sponsored multiemployer plans, and, as a plan participant, our potential obligation could be significant. The amount of the potential obligation is not currently ascertainable because the information required to determine such amount is not identifiable or readily available.

Our participation in significant plans for the fiscal year ended June 30, 2018 is outlined in the table below. The "EIN/Pension Plan Number" column provides the Employer Identification Number ("EIN") and the three digit plan number. The zone status is based on the latest information that the Company received from the plan and is certified by the plan's actuary. Plans in the red zone are generally less than 65 percent funded, plans in the yellow zone are generally less than 80 percent funded, and plans in the green zone are generally at least 80 percent funded. The "FIP/RP Status Pending/Implemented" column indicates plans for which a financial improvement plan ("FIP") or a rehabilitation plan ("RP") is either pending or has been implemented. The "Surcharge Imposed" column includes plans in a red zone status that require a payment of a surcharge in excess of regular contributions. The last column lists the expiration date of the collective-bargaining agreement to which the plan is subject.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Pension Fund	EIN/Pension Plan Number	Pension Protection Act Zone Status		FIP/RP Status Pending or Implemented	Company Contributions Fiscal Year			Surcharge Imposed	Expiratio Date of Collectiv Bargainin Agreeme
		2018	2017		2018	2017	2016		
					(In thousands)				
Boilermaker-Blacksmith National Pension Trust	48-6168020/001	Yellow	Described below (2)	Yes	$8,525	$7,098	$7,658	No	Describe below (1
Joint Pension Fund Local Union 164 IBEW	22-6031199/001	Yellow	Described below (2)	Yes	2,391	2,709	2,635	No	5/31/202
Joint Pension Fund of Local Union No 102	22-1615726/001	Green	Green	N/A	2,489	2,392	3,063	No	5/31/201
IBEW Local 456 Pension Plan	22-6238995/001	Green	Green	N/A	6,005	2,777	1,168	No	5/31/202
Local 351 IBEW Pension Plan	22-3417366/001	Green	Green	N/A	1,187	2,796	5,018	No	12/4/202
Steamfitters Local Union No 420 Pension Plan	23-2004424/001	Red	Red	Yes	1,558	2,234	1,265	Yes	4/30/202
IBEW Local Union 98 Pension Plan	23-1990722/001	Red	Described below (2)	Yes	1,106	1,519	1,653	Yes	5/29/202
Indiana Laborers Pension Fund	35-6027150/001	Described below (2)	Described below (2)	Described below (2)	3,542	2,458	2,320	Described below (2)	5/31/201
Iron Workers Mid-America Pension Plan	36-6488227/001	Green	Green	N/A	4,412	1,785	2,248	No	5/31/201
Pipe Fitters Retirement Fund, Local 597	62-6105084/001	Green	Green	N/A	3,682	2,563	2,377	No	5/31/201
		Contributions to other multiemployer plans			19,827	20,378	16,606		
		Total contributions made			$54,724	$48,709	$46,011		

(1) Our employees are members of several Boilermaker unions that participate in the Boilermaker-Blacksmith National Pension Trust. The most significant of these unions are Boilermakers Local 374 and Boilermakers Local 128, which have collective bargaining agreements that expire on December 31, 2019 and December 31, 2020, respectively.

(2) For the Boilermaker-Blacksmith National Pension Trust, Local 164 IBEW Pension Plan, Local 98 IBEW Pension Plan and the Indiana Laborers Pension Fund, the Company has not received a funding notification that covers one or both of the Company's fiscal years 2018 and 2017 during the preparation of this Form 10-K. Under Federal pension law, if a multiemployer pension plan is determined to be in critical or endangered status, the plan must provide notice of this status to participants, beneficiaries, the bargaining parties, the Pension Benefit Guaranty Corporation, and the Department of Labor. The Company also observed that these plans have not submitted any Critical or Endangered Status Notices to the Department of Labor for calendar years that we have not received notification. The Critical or Endangered Status Notices can be accessed at https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/public-disclosure/2018-funding-status-notices.

Employee Stock Purchase Plan

The Matrix Service Company 2011 Employee Stock Purchase Plan (“ESPP”) was effective January 1, 2011. The ESPP allows employees to purchase shares through payroll deductions and members of the Board of Directors to purchase shares from amounts withheld from their cash retainers. Share purchases are limited to an aggregate market value of no greater than $60,000 per calendar year per participant and are purchased from the Company at the current market value with no discount to the participant. Contributions are with after tax earnings and are accumulated in non-interest bearing accounts for quarterly purchases of company stock. Upon the purchase of shares, the participants receive all stockholder rights including dividend and voting rights, and are permitted to sell their shares at any time. The Company has made 1,000,000 shares available under the ESPP. The ESPP can be terminated at the discretion of the Board of Directors or on January 2, 2021. Shares are issued from Treasury Stock under the ESPP. There were 21,920 shares issued in fiscal 2018, 16,609 shares in fiscal 2017, and 17,304 shares in fiscal 2016.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Note 13—Segment Information

We operate our business through four reportable segments: Electrical Infrastructure; Oil, Gas & Chemical; Storage Solutions; and Industrial.

The Electrical Infrastructure segment consists of high voltage services provided to investor owned utilities, including construction of new substations, upgrades of existing substations, short-run transmission line installations, distribution upgrades and maintenance, as well as emergency and storm restoration services. We also provide construction and maintenance services to a variety of power generation facilities, such as combined cycle plants, and natural gas fired power stations.

The Oil, Gas & Chemical segment serves customers primarily in the downstream and midstream petroleum industries who are engaged in refining crude oil and processing, fractionating, and marketing of natural gas and natural gas liquids. We also perform work in the petrochemical, upstream petroleum, and sulfur extraction, recovery and processing markets. Our services include turnarounds, plant maintenance, engineering and capital construction. We also offer industrial cleaning services including hydro-blasting, hydro-excavating, advanced chemical cleaning and vacuum services.

The Storage Solutions segment consists of work related to aboveground storage tanks and terminals. Also included in this segment are cryogenic and other specialty storage tanks and terminals including liquefied natural gas, liquid nitrogen/liquid oxygen, liquid petroleum, other specialty vessels such as spheres as well as marine structures and truck and rail loading/offloading facilities. Our services include engineering, fabrication and construction, maintenance and repair, which includes planned and emergency services of both tanks and full terminals. Finally, we offer AST products, including geodesic domes, aluminum internal floating roofs, floating suction and skimmer systems, roof drain systems and floating roof seals.

The Industrial segment consists of work for integrated iron and steel companies, major mining and minerals companies engaged primarily in the extraction of copper, as well as other companies in aerospace and defense, cement, agriculture and grain, food and other industries. Our services include engineering, fabrication and construction, maintenance and repair, which includes planned and emergency services. We also design instrumentation and control systems and offer specialized expertise in the design and construction of bulk material handling systems.

The Company evaluates performance and allocates resources based on operating income. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Intersegment sales and transfers are recorded at cost; therefore, no intercompany profit or loss is recognized. Segment assets consist primarily of accounts receivable, costs and estimated earnings in excess of billings on uncompleted contracts, property, plant and equipment, goodwill and other intangible assets.

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Results of Operations
(In thousands)

	Electrical Infrastructure	Oil Gas & Chemical	Storage Solutions	Industrial	Unallocated Corporate	Total
Fiscal Year ended June 30, 2018						
Gross revenues	$ 255,931	$ 324,546	$ 319,106	$ 198,155	$ —	$ 1,097,738
Less: inter-segment revenues	—	1,774	4,410	1	—	6,185
Consolidated revenues	255,931	322,772	314,696	198,154	—	1,091,553
Gross profit	18,300	33,423	25,778	14,435	—	91,936
Operating income (loss)	(16,531)	8,798	(5,907)	3,161	—	(10,479)
Segment assets	161,207	111,064	149,695	58,816	77,251	558,033
Capital expenditures	493	1,514	3,346	—	3,358	8,711
Depreciation and amortization expense	4,359	5,904	6,623	3,461	—	20,347
Fiscal Year ended June 30, 2017						
Gross revenues	$ 373,384	$ 247,423	$ 483,254	$ 103,449	$ —	$ 1,207,510
Less: inter-segment revenues	—	6,900	1,558	1,543	—	10,001
Consolidated revenues	373,384	240,523	481,696	101,906	—	1,197,509
Gross profit	7,137	12,675	55,651	5,540	—	81,003
Operating income (loss)	(8,309)	(8,783)	22,928	(977)	—	4,859
Segment assets	183,351	129,177	166,742	53,754	53,006	586,030
Capital expenditures	1,390	829	2,017	38	7,634	11,908
Depreciation and amortization expense	5,198	6,299	7,277	2,828	—	21,602
Fiscal Year ended June 30, 2016						
Gross revenues	$ 349,011	$ 252,973	$ 564,738	$ 149,744	$ —	$ 1,316,466
Less: inter-segment revenues	—	3,178	1,226	145	—	4,549
Consolidated revenues	349,011	249,795	563,512	149,599	—	1,311,917
Gross profit	29,301	18,553	67,843	10,294	—	125,991
Operating income (loss)	11,144	(3,503)	33,449	(208)	—	40,882
Segment assets	135,298	91,350	201,875	67,569	68,875	564,967
Capital expenditures	1,611	1,481	3,882	104	6,861	13,939
Depreciation and amortization expense	5,008	4,811	8,124	3,498	—	21,441

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Geographical information is as follows:

	Revenues		
	Fiscal Years Ended		
	June 30, 2018	June 30, 2017	June 30, 2016
	(In thousands)		
United States	$981,292	$961,049	$1,127,893
Canada	104,208	228,625	178,603
Other international	6,053	7,835	5,421
	$1,091,553	$1,197,509	$1,311,917

	Long-Lived Assets		
	June 30, 2018	June 30, 2017	June 30, 2016
	(In thousands)		
United States	$174,241	$193,164	$158,970
Canada	13,738	21,419	19,915
Other international	13,008	12,817	10,636
	$200,987	$227,400	$189,521

Matrix Service Company

Notes to Consolidated Financial Statements (continued)

Information about Significant Customers

	Significant Customers as a Percentage of Segment Revenues				
	Consolidated	Electrical Infrastructure	Oil Gas & Chemical	Storage Solutions	Industrial
Fiscal Year ended June 30, 2018					
Customer one	11.4 %	— %	— %	— %	62.9 %
Customer two	8.6 %	— %	29.0 %	— %	— %
Customer three	6.4 %	26.5 %	— %	0.6 %	— %
Customer four	6.0 %	25.4 %	— %	— %	— %
Customer five	4.2 %	— %	12.0 %	2.2 %	— %
Customer six	3.2 %	— %	10.8 %	— %	— %
Customer seven	3.2 %	— %	— %	10.9 %	— %
Customer eight	3.0 %	12.9 %	— %	— %	— %
Customer nine	2.7 %	— %	— %	— %	14.7 %
Customer ten	2.3 %	10.0 %	— %	— %	— %
Fiscal Year ended June 30, 2017					
Customer one	19.5 %	— %	— %	48.5 %	— %
Customer two	15.3 %	46.0 %	— %	2.4 %	— %
Customer three	5.2 %	— %	25.8 %	— %	— %
Customer four	4.2 %	— %	20.7 %	— %	— %
Customer five	4.0 %	12.7 %	— %	— %	— %
Customer six	2.7 %	— %	— %	— %	31.7 %
Customer seven	2.2 %	— %	— %	— %	25.8 %
Fiscal Year ended June 30, 2016					
Customer one	14.8 %	38.9 %	— %	10.2 %	— %
Customer two	10.6 %	— %	— %	24.7 %	— %
Customer three	8.3 %	— %	— %	19.3 %	— %
Customer four	4.4 %	16.6 %	— %	— %	— %
Customer five	4.2 %	— %	— %	— %	36.9 %
Customer six	3.9 %	— %	20.2 %	— %	— %
Customer seven	3.8 %	14.4 %	— %	— %	— %
Customer eight	3.4 %	12.7 %	— %	— %	— %
Customer nine	2.3 %	— %	— %	— %	20.1 %
Customer ten	2.1 %	— %	11.2 %	— %	— %
Customer eleven	1.6 %	— %	— %	— %	14.0 %

Table of Contents

Matrix Service Company
Quarterly Financial Data (Unaudited)
Fiscal Years Ended June 30, 2018 and June 30, 2017

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(In thousands, except per share amounts)			
Fiscal Year 2018				
Revenues	$269,910	$282,911	$245,645	$293,087
Gross profit	28,891	26,703	14,891	21,451
Operating income (loss)	7,321	5,174	(5,862)	(17,112)
Net income (loss)	3,824	4,532	(5,153)	(14,683)
Earnings (loss) per common share:				
Basic	0.14	0.17	(0.19)	(0.55)
Diluted	0.14	0.17	(0.19)	(0.55)
Fiscal Year 2017				
Revenues	$341,781	$312,655	$251,237	$291,836
Gross profit (loss)	32,278	28,212	(2,614)	23,127
Operating income (loss)	14,301	8,237	(21,210)	3,531
Net income (loss) attributable to Matrix Service Company	9,342	5,250	(13,821)	(954)
Earnings (loss) per common share:				
Basic	0.35	0.20	(0.52)	(0.04)
Diluted	0.35	0.20	(0.52)	(0.04)

The sum of earnings per share for the four quarters may not equal the total earnings per share for the year due to changes in the average number of common shares outstanding and rounding.

Table of Contents

Matrix Service Company
Schedule II—Valuation and Qualifying Accounts
June 30, 2018, June 30, 2017, and June 30, 2016
(In thousands)

COL. A	COL. B	COL. C ADDITIONS		COL. D		COL. E
	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Other Accounts—Describe	Deductions—Describe		Balance at End of Period
Fiscal Year 2018						
Deducted from asset accounts:						
Allowance for doubtful accounts	$ 9,887	$ 107	$ —	$ (3,667)	(A)	$ 6,327
Valuation reserve for deferred tax assets	1,719	1,020	—	(1,101)	(B)	1,638
Total	$ 11,606	$ 1,127	$ —	$ (4,768)		$ 7,965
Fiscal Year 2017						
Deducted from asset accounts:						
Allowance for doubtful accounts	$ 8,403	$ 1,748	$ —	$ (264)	(C)	$ 9,887
Valuation reserve for deferred tax assets	424	1,295	—	—		1,719
Total	$ 8,827	$ 3,043	$ —	$ (264)		$ 11,606
Fiscal Year 2016						
Deducted from asset accounts:						
Allowance for doubtful accounts	$ 561	$ 6,065	$ 1,808 (D)	$ (31)	(E)	$ 8,403
Valuation reserve for deferred tax assets	115	311	—	(2)		424
Total	$ 676	$ 6,376	$ 1,808	$ (33)		$ 8,827

(A) Relates to the reversal of reserved account receivable that was fully settled with cash and future backlog. See Note 4 - Goodwill and Other Intangible Assets for more information about the settlement.

(B) Relates to $795 of stock-based compensation expense recognized in fiscal 2018 that was not deductible for tax purposes due to not meeting a market condition vesting requirement and to $306 of foreign tax credits that expired.

(C) Relates to a $180 receivable written off against allowance for doubtful accounts, a $60 reclassification of reserves to billings on uncompleted contracts in excess of costs and estimated earnings and a $24 currency translation adjustment.

(D) Relates to a reclassification of reserves that were initially recorded in billings on uncompleted contracts in excess of costs and estimated earnings.

(E) Receivables written off against allowance for doubtful accounts.

Table of Contents

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities 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 based on the definition of “disclosure controls and procedures” in Rule 13a-15(e).

The disclosure controls and procedures are designed to provide reasonable, not absolute, assurance of achieving the desired control objectives. The Company’s management, including the Chief Executive Officer and Chief Financial Officer, does not expect that the disclosure controls and procedures or our internal controls over financial reporting will prevent or detect all errors or fraud. The design of our internal control system takes into account the fact that there are resource constraints and the benefits of controls must be weighed against the costs. Additionally, controls can be circumvented by the acts of key individuals, collusion or management override.

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2018. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level at June 30, 2018.

Management’s Report on Internal Control over Financial Reporting

See “Management’s Report on Internal Control over Financial Reporting” set forth in Item 8, Financial Statements and Supplementary Data of this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There have been no changes during the fourth fiscal quarter that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None

Table of Contents

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item with respect to the Company’s directors and corporate governance is incorporated herein by reference to the sections entitled “Proposal Number 1: Election of Directors” and “Corporate Governance and Board Matters” in the Company’s definitive Proxy Statement for the 2018 Annual Meeting of Stockholders (“Proxy Statement”). The information required by this item with respect to the Company’s executive officers is incorporated herein by reference to the section entitled “Executive Officer Information” in the Proxy Statement. The information required by this item with respect to the Section 16 ownership reports is incorporated herein by reference to the section entitled “Section 16(a) Beneficial Ownership Reporting Compliance” in the Proxy Statement.

The Company has adopted a Code of Business Conduct and Ethics applicable to all directors, officers and employees, including the principal executive officer, principal financial officer and principal accounting officer of the Company. In addition, we have adopted Corporate Governance Guidelines for the Board of Directors and Charters for the Audit, Compensation and Nominating and Corporate Governance Committees of the Board of Directors. The current version of these corporate governance documents is publicly available in the “Investors” section of the Company’s website at matrixservicecompany.com under “Corporate Governance.” If we make any substantive amendments to the Code of Business Conduct and Ethics, or grant any waivers, including implicit waivers, from the Code of Business Conduct and Ethics applicable to the principal executive officer, principal financial officer or principal accounting officer, or any person performing similar functions, we will disclose such amendment or waiver on our website or in a report on Form 8-K.

Item 11. Executive Compensation

The information required by this item is incorporated herein by reference to the sections entitled “Director Compensation” and “Executive Officer Compensation” in the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item is incorporated herein by reference to the sections entitled “Securities Authorized for Issuance Under Executive Compensation Plans” and “Security Ownership of Certain Beneficial Owners and Management” in the Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is incorporated herein by reference to the section entitled "Corporate Governance and Board Matters" and “Certain Relationships and Related Transactions” in the Proxy Statement.

Item 14. Principal Accounting Fees and Services

The information required by this item is incorporated herein by reference to the sections entitled “Fees of Independent Registered Public Accounting Firm” and “Audit Committee Pre-Approval Policy” in the Proxy Statement.

Table of Contents

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) (1) Financial Statements of the Company

The following financial statements and supplementary data are filed as a part of this report under “Item 8—Financial Statements and Supplementary Data” in this Annual Report on Form 10-K:

Financial Statements of the Company

(2) Financial Statement Schedules

The financial statement schedule is filed as a part of this report under Schedule II—Valuation and Qualifying Accounts June 30, 2018, June 30, 2017 and June 30, 2016, immediately following Quarterly Financial Data (Unaudited). All other schedules are omitted because they are not applicable or the required information is shown in the financial statements, or notes thereto, included herein.

Table of Contents

(3) The following documents are included as exhibits to this Annual Report on Form 10-K. These exhibits below incorporated by reference herein are indicated as such by the information supplied in the parenthetical hereafter.

2	Membership Interest Purchase Agreement dated as of December 12, 2016 among Matrix PDM Engineering, Inc., as purchaser, the C. Douglas Houston Revocable Trust U/T/A dated November 21, 2016, as seller, and C. Douglas Houston, as seller representative (Exhibit 2 to the Company's Current Report on Form 8-K filed December 16, 2016 (File No. 1-15461).
3.1	Amended and Restated Certificate of Incorporation of Matrix Service Company (Appendix A to the Company's Proxy Statement filed October 7, 2016 (File No. 1-15461).
3.2	Certification of Designations, Preferences and Rights of Series B Junior Preferred Stock dated November 12, 1999 (Exhibit 3.2 to the Company’s Registration Statement on Form S-3 (File No. 333-117077) filed July 1, 2004.
3.3	Certificate of Increase of Authorized Number of Shares of Series B Junior Participating Preferred Stock pursuant to Section 151 of the General Corporation Law of the State of Delaware dated July 11, 2005 (Exhibit 3.5 to the Company’s Annual Report on Form 10-K (File No. 1-15461) filed August 17, 2005).
3.4	Certificate of Increase of Authorized Number of Shares of Series B Junior Participating Preferred Stock pursuant to Section 151 of the General Corporation Law of the State of Delaware dated October 23, 2006 (Exhibit 3.7 to the Company’s Annual Report on Form 10-K (File No. 1-15461) filed August 14, 2007).
3.5	Second Amended and Restated Bylaws, effective as of May 4, 2017 (Exhibit 3.1 to the Company’s Quarterly Report on Form 10-Q (File No. 1-15461) filed May 10, 2017).
P4	Specimen Common Stock Certificate (Exhibit 4.1 to the Company’s Registration Statement on Form S-1 (File No. 33-36081) filed July 26, 1990, P).
+10.1	Matrix Service Company 2004 Stock Incentive Plan (Appendix B to the Company’s Proxy Statement filed September 15, 2006 (File No. 1-15461)).
+10.2	Amendment 1 to Matrix Service Company 2004 Stock Incentive Plan (Exhibit 10 to Amended Schedule 14A filed October 4, 2006 (File No. 1-15461)).
+10.3	Amendment 2 to Matrix Service Company 2004 Stock Incentive Plan (Exhibit 10.6 to the Company’s Annual Report on Form 10-K (File No. 1-15461) filed August 5, 2008).
+10.4	Amendment 3 to Matrix Service Company 2004 Stock Incentive Plan (Exhibit A to the Company’s Proxy Statement filed September 11, 2009 (File No. 1-15461)).
+10.5	Matrix Service Company 2012 Stock and Incentive Compensation Plan (Attachment A to the Company's Proxy Statement (File No. 1-15461) filed October 10, 2012).
+ 10.6	Amendment Number 1 to the Matrix Service Company 2012 Stock and Incentive Compensation Plan (Exhibit A to the Company's Proxy Statement (File No. 1-15461) filed October 10, 2014).

Table of Contents

+10.7	Form of Long-Term Incentive Award Agreement (2012 Stock and Incentive Compensation Plan) (Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q (File No. 1-15461) filed November 7, 2016).
+10.8	Form of Restricted Stock Unit Award Agreement for employees (2012 Stock and Incentive Compensation Plan) (Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q (File No. 1-15461) filed November 7, 2016).
+10.9	Matrix Service Company 2016 Stock and Incentive Compensation Plan (Appendix B to the Company's Proxy Statement (File No. 1-15461), filed October 7, 2016).
+10.10	Form of Restricted Stock Unit Award Agreement for Directors (2016 Stock and Incentive Compensation Plan) (Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q (File No. 1-15461), filed February 9, 2017).
*+10.11	Form of Long-Term Incentive Award Agreement (2016 Stock and Incentive Compensation Plan).
+10.12	Form of Amended and Restated Severance Agreement (Exhibit 10 to the Company's Current Report on Form 8-K filed November 15, 2016 (File No. 1-15461)).
+10.13	Amended and Restated Deferred Compensation Plan for Members of the Board of Directors (Exhibit 10.1 to the Company’s Quarterly Report on Form 10-Q (File No. 1-15461) filed January 8, 2009).
+10.14	Amendment 1 to Amended and Restated Deferred Compensation Plan for Members of the Board of Directors (Exhibit 10 to the Company's Quarterly Report on Form 10-Q (File No. 1-15461) filed November 9, 2012).
10.15	Fourth Amended and Restated Credit Agreement dated as of February 8, 2017 among the Company and certain foreign subsidiaries, as Borrowers, various subsidiaries of the Company, as Guarantors, JPMorgan Chase Bank, N.A., as Administrative Agent, Lead Arranger and Sole Bookrunner, and the other lenders party thereto (Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q (File No. 1-15461) filed May 10, 2017).
10.16	First Amendment dated as of August 31, 2017 to Fourth Amended and Restated Credit Agreement (Exhibit 10.1 to the Company’s Quarterly Report on Form 10-Q (File No. 1-15461), filed November 7, 2017).
+10.17	Form of Indemnification Agreement (Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 1-15461) filed June 9, 2015).
*21	Subsidiaries.
*23	Consent of Independent Registered Public Accounting Firm—Deloitte & Touche LLP.
*31.1	Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002—CEO.
*31.2	Certification Pursuant to Section 302 of Sarbanes-Oxley Act of 2002—CFO.
*32.1	Certification Pursuant to 18 U.S.C. 1350 (section 906 of Sarbanes-Oxley Act of 2002)—CEO.

*32.2	Certification Pursuant to 18 U.S.C. 1350 (section 906 of Sarbanes-Oxley Act of 2002)—CFO.
*95	Mine Safety Disclosure.
*101.INS	XBRL Instance Document.
*101.SCH	XBRL Taxonomy Schema Document.
*101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
*101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
*101.LAB	XBRL Taxonomy Extension Labels Linkbase Document.
*101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

*Filed herewith.

+Management Contract or Compensatory Plan.

P: Paper filing.

Item 16. Form 10-K Summary
None

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Matrix Service Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Matrix Service Company

Date : September 12, 2018 By: /S/ John R. Hewitt
John R. Hewitt, President and
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signatures	Title	Date
/S/ Tom E. Maxwell Tom E. Maxwell	Chairman of the Board of Directors	September 12, 2018
/S/ John R. Hewitt John R. Hewitt	President, Chief Executive Officer and Director (Principal Executive Officer)	September 12, 2018
/S/ Kevin S. Cavanah Kevin S. Cavanah	Vice President and Chief Financial Officer (Principal Accounting and Principal Financial Officer)	September 12, 2018
/S/ Martha Z. Carnes Martha Z. Carnes	Director	September 12, 2018
/S/ John D. Chandler John D. Chandler	Director	September 12, 2018
/S/ John W. Gibson John W. Gibson	Director	September 12, 2018
/S/ Liane K. Hinrichs Liane K. Hinrichs	Director	September 12, 2018
/S/ James H. Miller James H. Miller	Director	September 12, 2018
/S/ Jim W. Mogg Jim W. Mogg	Director	September 12, 2018