

INTEGRATED ELECTRICAL SERVICES INC

Form 10-Q

March 30, 2012

[Table of Contents](#)

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

FORM 10-Q

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

For the Quarterly Period Ended December 31, 2011

OR

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

For the transition period from _____ to _____

Commission File Number 1-13783

Integrated Electrical Services, Inc.

(Exact name of registrant as specified in its charter)

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

Delaware
(State or other jurisdiction of
incorporation or organization)

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

4801 Woodway Drive, Suite 200-E, Houston, Texas 77056

(Address of principal executive offices and ZIP code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☐

Non-accelerated filer ☒ Smaller reporting company ☐

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

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

On March 30, 2012, there were 15,013,840 shares of common stock outstanding.

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES

INDEX

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Condensed Consolidated Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets as of December 31, 2011 and September 30, 2011</u>	5
<u>Condensed Consolidated Statements of Operations for the Three Months Ended December 31, 2011 and 2010</u>	6
<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended December 31, 2011 and 2010</u>	7
<u>Notes to Condensed Consolidated Financial Statements</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	33
<u>Item 4. Controls and Procedures</u>	33
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings.</u>	34
<u>Item 1A. Risk Factors</u>	34
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	34
<u>Item 3. Defaults Upon Senior Securities</u>	34
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	34
<u>Item 5. Other Information</u>	34
<u>Item 6. Exhibits</u>	34
<u>Signatures</u>	36
Exhibit 31.1	
Exhibit 31.2	
Exhibit 32.1	
Exhibit 32.2	

Table of Contents

PART I

DEFINITIONS

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

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

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

fluctuations in operating activity due to downturns in levels of construction, seasonality and differing regional economic conditions;

competition in the construction industry, both from third parties and former employees, which could result in the loss of one or more customers or lead to lower margins on new contracts;

a general reduction in the demand for our services;

a change in the mix of our customers, contracts and business;

our ability to successfully manage construction projects;

possibility of errors when estimating revenue and progress to date on percentage-of-completion contracts;

inaccurate estimates used when entering into fixed-priced contracts;

challenges integrating new types of work or new processes into our divisions;

the cost and availability of qualified labor;

accidents resulting from the physical hazards associated with our work and the potential for accidents;

success in transferring, renewing and obtaining electrical and construction licenses;

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

our ability to pass along increases in the cost of commodities used in our business, in particular, copper, aluminum, steel, fuel and certain plastics;

potential supply chain disruptions due to credit or liquidity problems faced by our suppliers;

loss of key personnel and effective transition of new management;

warranty losses or other latent defect claims in excess of our existing reserves and accruals;

warranty losses or other unexpected liabilities stemming from former divisions which we have sold or closed;

growth in latent defect litigation in states where we provide residential electrical work for home builders not otherwise covered by insurance;

limitations on the availability of sufficient credit or cash flow to fund our working capital needs;

difficulty in fulfilling the covenant terms of our credit facilities;

increased cost of surety bonds affecting margins on work and the potential for our surety providers to refuse bonding or require additional collateral at their discretion;

increases in bad debt expense and days sales outstanding due to liquidity problems faced by our customers;

changes in the assumptions made regarding future events used to value our stock options and performance-based stock awards;

the recognition of potential goodwill, long-lived assets and other investment impairments;

uncertainties inherent in estimating future operating results, including revenues, operating income or cash flow;

Table of Contents

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

the recognition of tax benefits related to uncertain tax positions;

complications associated with the incorporation of new accounting, control and operating procedures;

the financial impact of new or proposed accounting regulations;

the ability of our controlling shareholder to take action not aligned with other shareholders;

the possibility that certain tax benefits of our net operating losses may be restricted or reduced in a change in ownership;

credit and capital market conditions, including changes in interest rates that affect the cost of construction financing and mortgages, and the inability for some of our customers to retain sufficient financing which could lead to project delays or cancellations;

the sale or disposition of the shares of our common stock held by our majority shareholder, which, under certain circumstances, would trigger change of control provisions in contracts such as employment agreements and financing and surety arrangements; and

Additional closures or sales of facilities in our Commercial & Industrial segment could result in significant future charges and a significant disruption of our operations.

You should understand that the foregoing, as well as other risk factors discussed in our annual report on Form 10-K/A for the year ended September 30, 2011, could cause future outcomes to differ materially from those experienced previously or those expressed in such forward-looking statements. We undertake no obligation to publicly update or revise information concerning our restructuring efforts, borrowing availability, cash position or any forward-looking statements to reflect events or circumstances that may arise after the date of this report. Forward-looking statements are provided in this quarterly report on Form 10-Q pursuant to the safe harbor established under the Private Securities Litigation Reform Act of 1995 and should be evaluated in the context of the estimates, assumptions, uncertainties and risks described herein.

General information about us can be found at www.ies-co.com under Investor Relations . Our annual report on Form 10-K/A, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments to those reports, are available free of charge through our website as soon as reasonably practicable after we file them with, or furnish them to, the Securities and Exchange Commission. You may also contact our Investor Relations department at 713-860-1500, and they will provide you with copies of our public reports.

Table of Contents**INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES****Consolidated Balance Sheets****(In Thousands, Except Share Information)**

	December 31, 2011 (Unaudited)	September 30, 2011 Restated
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 17,318	\$ 35,577
Restricted cash	8,812	
Accounts receivable:		
Trade, net of allowance of \$2,146 and \$2,645, respectively	78,365	85,728
Retainage	16,118	17,944
Inventories	8,191	8,443
Costs and estimated earnings in excess of billings on uncompleted contracts	7,805	9,963
Prepaid expenses and other current assets	6,766	2,840
Total current assets	143,375	160,495
LONG-TERM RECEIVABLE, net of allowance of \$53 and \$4,051, respectively	206	200
PROPERTY AND EQUIPMENT, net	8,646	8,016
GOODWILL	4,446	4,446
OTHER NON-CURRENT ASSETS, net	5,289	7,087
Total assets	\$ 161,962	\$ 180,244
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 2,168	\$ 209
Accounts payable and accrued expenses	63,099	78,980
Billings in excess of costs and estimated earnings on uncompleted contracts	18,260	19,585
Total current liabilities	83,527	98,774
LONG-TERM DEBT, net of current maturities	10,228	10,289
LONG-TERM DEFERRED TAX LIABILITY	284	284
OTHER NON-CURRENT LIABILITIES	7,295	6,596
Total liabilities	101,334	115,943
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.01 par value, 10,000,000 shares authorized, none issued and outstanding		
Common stock, \$0.01 par value, 100,000,000 shares authorized; 15,407,802 and 15,407,802 shares issued and 15,013,840 and 14,938,071 outstanding, respectively	154	154
Treasury stock, at cost, 393,962 and 451,329 shares, respectively	(4,475)	(5,595)
Additional paid-in capital	163,194	164,262
Retained deficit	(98,245)	(94,520)
Total stockholders' equity	60,628	64,301

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

Total liabilities and stockholders' equity	\$ 161,962	\$ 180,244
--	------------	------------

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents**INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES****Consolidated Statements of Operations****(In Thousands, Except Share Information)**

	Three Months Ended December 31,	
	2011	2010 Restated
Revenues	\$ 115,293	\$ 109,811
Cost of services	104,384	98,753
Gross profit	10,909	11,058
Selling, general and administrative expenses	13,375	18,652
Gain on sale of assets	17	(6,729)
Asset Impairment		3,551
Restructuring charges	600	
Loss from operations	(3,083)	(4,416)
Interest and other (income) expense:		
Interest expense	622	599
Interest income	(85)	(25)
Other (income) expense, net	(65)	(15)
Interest and other expense, net	472	559
Loss from operations before income taxes	(3,555)	(4,975)
Provision (benefit) for income taxes	168	(676)
Net loss	\$ (3,723)	\$ (4,299)
(Loss) per share:		
Basic	\$ (0.26)	\$ (0.30)
Diluted	\$ (0.26)	\$ (0.30)
Shares used in the computation of loss per share		
Basic	14,569,089	14,447,841
Diluted	14,569,089	14,447,841

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents**INTEGRATED ELECTRICAL SERVICES, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows****(In Thousands)**

	Three Months Ended December 31,	
	2011	2010
	(Unaudited)	Restated
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (3,723)	\$ (4,299)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Bad debt expense	(25)	(16)
Deferred financing cost amortization	21	84
Depreciation and amortization	522	1,856
Gain on sale of business units		(6,729)
Non-cash compensation expense	145	170
Asset impairment		3,551
Equity in losses of investment		96
Changes in operating assets and liabilities		
Accounts receivable	7,412	5,457
Inventories	252	(860)
Costs and estimated earnings in excess of billings	2,158	(979)
Prepaid expenses and other current assets	(2,114)	473
Other non-current assets	(50)	286
Accounts payable and accrued expenses	(12,401)	(11,958)
Billings in excess of costs and estimated earnings	(1,325)	(2,091)
Other non-current liabilities	127	(125)
Net cash (used in) provided by operating activities	(9,001)	(15,084)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(302)	(391)
Proceeds from sales of property and equipment	11	
Proceeds from sales of facilities		9,859
Distribution from unconsolidated affiliates		(57)
Changes in restricted cash	(8,812)	
Net cash (used in) provided by continuing operations	(9,103)	9,411
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of debt	(61)	(242)
Purchase of treasury stock	(94)	(63)
Payments for debt issuance costs		
Net cash used in financing activities	(155)	(305)
NET DECREASE IN CASH EQUIVALENTS	(18,259)	(5,978)
CASH AND CASH EQUIVALENTS, beginning of period	35,577	32,924
CASH AND CASH EQUIVALENTS, end of period	\$ 17,318	\$ 26,946
SUPPLEMENTAL DISCLOSURE OF CASH FLOW	2011	2010

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

INFORMATION:

Cash paid for interest	\$	277	\$	513
Cash paid for income taxes	\$	48	\$	30

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC.

Notes to Consolidated Financial Statements

(All Amounts in Thousands Except Share Amounts)

1. BUSINESS

Description of the Business

Integrated Electrical Services, Inc., a Delaware corporation, is a leading national provider of electrical infrastructure services to the communications, residential, commercial and industrial industries. Originally established as IES in 1997, we provide services from 57 locations serving the continental United States as of December 31, 2011. Our operations are organized into three business segments, based upon the nature of its products and services:

Communications Nationwide provider of products and services for mission critical infrastructure, such as data centers, of large corporations.

Residential Regional provider of electrical installation services for single-family housing and multi-family apartment complexes.

Commercial & Industrial Provider of electrical design, construction, and maintenance services to the commercial and industrial markets in various regional markets and nationwide in certain areas of expertise, such as the power infrastructure market.

Sale of Non-Strategic Manufacturing Facility

On November 30, 2010, a subsidiary of the Company sold substantially all the assets and certain liabilities of a non-strategic manufacturing facility engaged in manufacturing and selling fabricated metal buildings housing electrical equipment, such as switchgears, motor starters and control systems, to Siemens Energy, Inc. As part of this transaction, Siemens Energy, Inc. also acquired certain real property where the fabrication facilities are located from another subsidiary of the Company. The purchase price of \$10,086 was adjusted to reflect working capital variances. The transaction was completed on December 10, 2010 at which time we recognized a gain of \$6,763.

Sale of Non-Core Electrical Distribution Facility

On February 28, 2011, Key Electrical Supply, Inc, a wholly owned subsidiary of the Company, sold substantially all the assets and certain liabilities of a non-core electrical distribution facility engaged in distributing wiring, lighting, electrical distribution, power control and generators for residential and commercial applications to Elliot Electric Supply, Inc. The purchase price of \$6,676 was adjusted to reflect working capital variances. The loss on this transaction was immaterial.

Controlling Shareholder

At December 31, 2011, Tontine Capital Partners, L.P. and its affiliates (collectively, "Tontine"), was the controlling shareholder of the Company's common stock. Accordingly, Tontine has the ability to exercise significant control of our affairs, including the election of directors and any action requiring the approval of shareholders, including the approval of any potential merger or sale of all or substantially all assets or divisions of the Company, or the Company itself. In its most recent Schedule 13D, Tontine stated that it has no current plans to make any material change in the Company's business or corporate structure. For a more complete discussion on our relationship with Tontine, please refer to Note 2 "Controlling Shareholder" in the notes to these Consolidated Financial Statements.

Summary of Significant Accounting Policies

These unaudited condensed consolidated financial statements reflect, in the opinion of management, all adjustments necessary to present fairly the financial position as of, and the results of operations for, the periods presented. All adjustments are considered to be normal and recurring

unless otherwise described herein. Interim period results are not

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC.

Notes to Consolidated Financial Statements

(All Amounts in Thousands Except Share Amounts)

necessarily indicative of results of operations or cash flows for the full year. During interim periods, we follow the same accounting policies disclosed in our annual report of Form 10-K/A for the year ended September 30, 2011. Please refer to the *Notes to Consolidated Financial Statements* in our annual report on Form 10-K/A for the year ended September 30, 2011, when reviewing our interim financial results set forth herein.

Revenue Recognition

As of December, 31, 2011 the Company had revenue totaling \$1,098 associated with one contract claim. We recognize revenue associated with unapproved change orders and claims to the extent that related costs have been incurred, recovery is probable and the value can be reliably estimated.

Fair Value of Financial Instruments

Our financial instruments consist of cash and cash equivalents, accounts receivable, notes receivable, investments, accounts payable, a line of credit, a note payable issued to finance an insurance policy, and a \$10,000 senior subordinated loan agreement (the "Tontine Term Loan"). We believe that the carrying value of financial instruments, with the exception of the Tontine Term Loan and our cost method investment in EnerTech, in the accompanying Consolidated Balance Sheets approximates their fair value due to their short-term nature. We estimate that the fair value of the Tontine Term Loan is \$10,554 based on comparable debt instruments at December 31, 2011. For additional information, please refer to Note 4, "Debt - The Tontine Term Loan" of this report.

We estimate that the fair value of our investment in EnerTech is \$1,049 at December 31, 2011. For additional information, please refer to Note 8, "Securities and Equity Investments - Investment in EnerTech."

Asset Impairment

During the three months ended December 31, 2010, the Company ceased use of certain internally-developed software. As a result, the software has a fair value of zero. The net charge of \$3,551 was recorded separately in the accompanying consolidated statements of operations as a component of loss from operations.

Use of Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires the use of estimates and assumptions by management in determining the reported amounts of assets and liabilities, disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates are primarily used in our revenue recognition of construction in progress, fair value assumptions in analyzing goodwill, investments, intangible assets and long-lived asset impairments and adjustments, allowance for doubtful accounts receivable, stock-based compensation, reserves for legal matters, assumptions regarding estimated costs to exit certain divisions, realizability of deferred tax assets, and self-insured claims liabilities and related reserves.

Cash and Cash Equivalents

We consider all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. We have restricted cash to collateralize our letters of credit.

Seasonality and Quarterly Fluctuations

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

Results of operations from our Residential construction segment are more seasonal, depending on weather trends, with typically higher revenues generated during spring and summer and lower revenues during fall and winter. The Communications and Commercial & Industrial segments of our business are less subject to seasonal trends, as work in these segments generally is performed inside structures protected from the weather. Our service and maintenance business is generally not affected by seasonality. In addition, the construction industry has historically been highly cyclical. Our volume of business may be adversely affected by declines in construction projects resulting from adverse regional or national

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC.

Notes to Consolidated Financial Statements

(All Amounts in Thousands Except Share Amounts)

economic conditions. Quarterly results may also be materially affected by the timing of new construction projects. Accordingly, operating results for any fiscal period are not necessarily indicative of results that may be achieved for any subsequent fiscal period.

Subsequent Events

On January 20, 2012, the Senior Vice President and Chief Financial Officer retired from the company. The company will incur approximately \$430 in related severance expense during the second quarter of 2012.

2. CONTROLLING SHAREHOLDER

As of December 31, 2011, \$10,000 remains outstanding on the Tontine Term Loan.

Although Tontine has not indicated any plans to alter its ownership level, should Tontine reconsider its investment plans and sell its controlling interest in the Company, a change in ownership would occur. A change in ownership, as defined by Internal Revenue Code Section 382, could reduce the availability of net operating losses for federal and state income tax purposes. Furthermore, a change in control would trigger the change of control provisions in a number of our material agreements, including our \$40,000 Revolving Credit Facility, bonding agreements with our sureties and certain employment contracts with certain officers and employees of the Company.

Tontine Capital Partners, L.P. and its affiliates own the majority of our common stock. As a significant stakeholder, Tontine provides strategic, general corporate, operational, organizational and financial advice to our board of directors and management. Although such advice may be considered by the board and management, neither the board nor management is under any legal obligation to follow such advice.

3. STRATEGIC ACTIONS

The 2011 Restructuring Plan

In the second quarter of our 2011 fiscal year, we began a restructuring program (the 2011 Restructuring Plan) that was designed to consolidate operations within our Commercial & Industrial business. Pursuant to the 2011 Restructuring Plan, during the next three to nine months, we will finalize the sale or closure of certain underperforming facilities within our Commercial & Industrial operations. The 2011 Restructuring Plan is a key element of our commitment to return the Company to profitability.

The facilities directly affected by the 2011 Restructuring Plan are in several locations throughout the country, including Arizona, Florida, Iowa, Massachusetts, Louisiana, Nevada and Texas. These facilities were selected due to current business prospects and the extended time frame needed to return the facilities to a profitable position. We expect that closure costs could range from \$4,500 to \$5,500 in the aggregate. Closure costs associated with the 2011 Restructuring Plan include equipment and facility lease termination expenses, incremental management consulting expenses and severance costs for employees. The Company is in the process of winding down these facilities. As part of our restructuring charges within our Commercial & Industrial segment we recognized \$69 in severance costs, \$483 in consulting services, and \$48 in costs related to lease terminations during the three months ended December 31, 2011.

Table of Contents**INTEGRATED ELECTRICAL SERVICES, INC.****Notes to Consolidated Financial Statements****(All Amounts in Thousands Except Share Amounts)**

The following table summarizes the activities related to our restructuring activities by component:

	Severance Charges	Consulting Charges	Lease Termination & Other Charges	Total
Restructuring liability at September 30, 2011	\$ 1,081	\$ 336	\$ 790	\$ 2,207
Restructuring charges incurred	69	483	48	600
Cash payments made	(391)	(776)	(154)	(1,321)
Restructuring liability at September 30, 2012	\$ 759	\$ 43	\$ 684	\$ 1,486

Additional Facility Closing

During the first quarter of fiscal 2012, the Company determined the underperforming Baltimore facility within its Commercial & Industrial and Communications divisions would be either sold or closed over the next three to six months. This closing is a key element of management's overall plan to return the Company to profitability. The Baltimore location was selected based upon current businesses performance and the extended time frame needed to return the operation to profitability. We expect that closure costs could range from \$340 to \$480 in the aggregate.

4. DEBT

Debt consists of the following:

	December 31, 2011	September 30, 2011
Tontine Term Loan, due May 15, 2013, bearing interest at 11.00%	\$ 10,000	\$ 10,000
Insurance Financing Agreements	1,947	
Capital leases and other	449	498
Total debt	12,396	10,498
Less Short-term debt and current maturities of long-term debt	(2,168)	(209)
Total long-term debt	\$ 10,228	\$ 10,289

Future payments on debt at December 31, 2011 are as follows:

	Capital Leases and Other	Insurance Financing	Term Debt	Total
2012	\$ 242	\$ 1,947	\$	\$ 2,189
2013	317		10,000	10,317
2014	26			26

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

2015				
2016				
Thereafter				
Less: Imputed Interest	(136)			(136)
Total	\$ 449	\$ 1,947	\$ 10,000	\$ 12,396

For the three months ended December 31, 2011 and 2010, we incurred interest expense of \$622 and \$599, respectively.

The Revolving Credit Facility

On May 12, 2006, we entered into a Loan and Security Agreement (the "Loan and Security Agreement"), for a revolving credit facility (the "Revolving Credit Facility") with Bank of America, N.A. and certain other lenders. On May 7, 2008, we renegotiated the terms of our Revolving Credit Facility and entered into an amended agreement with the same financial

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC.

Notes to Consolidated Financial Statements

(All Amounts in Thousands Except Share Amounts)

institutions. On April 30, 2010, we renegotiated the terms of, and entered into an amendment to, the Loan and Security Agreement pursuant to which the maturity date was extended to May 31, 2012. In connection with the amendment, we incurred an amendment fee of \$200, which is being amortized over 24 months.

On December 15, 2011, we renegotiated the terms of, and entered into an amendment to, the Loan and Security Agreement without incurring termination charges. Under the terms of the amended Revolving Credit Facility, the size of the facility was reduced to \$40,000 and the maturity date was extended to November 12, 2012. Further, we were required to cash collateralize all of our letters of credit issued by the banks. The cash collateral is added to the borrowing base calculation at 100% through out the term of the agreement. The Revolving Credit Facility requires that we maintain a fixed charge coverage ratio of not less than 1.0:1.0 at any time that our aggregate amount of unrestricted cash on hand plus availability is less than \$25,000 and, thereafter, until such time as our aggregate amount of unrestricted cash on hand plus availability has been at least \$25,000 for a period of 60 consecutive days. Additionally, if there are any loans outstanding on or after the April 30, 2012, the Company's EBITDA for the period from October 2011 through March 2012, may not exceed a negative \$2,500 and we will be required to have a cumulative fixed charge coverage ratio of at least 1.0:1.0 at all times beginning April 1, 2012 to maintain any borrowings under the agreement. The measurement period for this additional test for borrowings begins with the monthly operating results for April 2012 and adds the monthly operating results for each month thereafter to determine the cumulative test during such time as revolving loans are outstanding. Failure to meet this performance test will result in an immediate event of default. The amended Agreement also calls for cost of borrowings of 4.0% over LIBOR per annum. Cost for letters of credit are the same as borrowings and also include a 25 basis point fronting fee. All other terms and conditions remain unchanged. In connection with the amendment, we incurred an amendment fee of \$60 which, together with the unamortized balance of the prior amendment, is being amortized using the straight line method through November 12, 2012.

The Revolving Credit Facility is guaranteed by our subsidiaries and secured by first priority liens on substantially all of our subsidiaries' existing and future acquired assets, exclusive of collateral provided to our surety providers. The Revolving Credit Facility contains customary affirmative, negative and financial covenants. The Revolving Credit Facility also restricts us from paying cash dividends and places limitations on our ability to repurchase our common stock.

Borrowings under the Revolving Credit Facility may not exceed a borrowing base that is determined monthly by our lenders based on available collateral, primarily certain accounts receivables and inventories. Under the terms of the Revolving Credit Facility in effect as of December 31, 2011, interest for loans and letter of credit fees is based on our Total Liquidity, which is calculated for any given period as the sum of average daily availability for such period plus average daily unrestricted cash on hand for such period as follows:

Total Liquidity	Annual Interest Rate for Loans	Annual Interest Rate for Letters of Credit
Greater than or equal to \$60,000	LIBOR plus 3.00% or Base Rate plus 1.00%	3.00% plus 0.25% fronting fee
Greater than \$40,000 and less than \$60,000	LIBOR plus 3.25% or Base Rate plus 1.25%	3.25% plus 0.25% fronting fee
Less than or equal to \$40,000	LIBOR plus 3.50% or Base Rate plus 1.50%	3.50% plus 0.25% fronting fee
At December 31, 2011, we had \$21,384 available to us under the Revolving Credit Facility, with no outstanding borrowings. We had \$8,812 in outstanding letters of credit which were fully collateralized with restricted cash.		

At December 31, 2011, our Total Liquidity was \$47,513. For the three months ended December 31, 2011, we paid no interest for loans under the Revolving Credit Facility and had a weighted average interest rate, including fronting fees, of 3.50% for letters of credit. In addition, we are charged monthly in arrears (1) an unused commitment fee of 0.50%, and (2) certain other fees and charges as specified in the Loan and Security Agreement, as amended.

As of December 31, 2011, we were subject to the financial covenant under the Revolving Credit Facility requiring that we maintain a fixed charge coverage ratio of not less than 1.0:1.0 at any time that our aggregate amount of unrestricted cash on hand plus availability is less than \$25,000 and, thereafter, until such time as our aggregate amount of unrestricted cash on

Table of Contents**INTEGRATED ELECTRICAL SERVICES, INC.****Notes to Consolidated Financial Statements****(All Amounts in Thousands Except Share Amounts)**

hand plus availability has been at least \$25,000 for a period of 60 consecutive days. As of December 31, 2011, our Total Liquidity was in excess of \$25,000 for the prior 60 day period. Had our Total Liquidity been less than \$25,000 at December 31, 2011, we would not have met the 1.0:1.0 fixed charge coverage ratio test, had it been applicable.

The Tontine Term Loan

On December 12, 2007, we entered into the Tontine Term Loan, a \$25,000 senior subordinated loan agreement, with Tontine. The Tontine Term Loan bears interest at 11.0% per annum and is due on May 15, 2013. Interest is payable quarterly in cash or in-kind at our option. Any interest paid in-kind will bear interest at 11.0% in addition to the loan principal. On April 30, 2010, we prepaid \$15,000 of principal on the Tontine Term Loan. On May 1, 2010, Tontine assigned the Tontine Term Loan to TCP Overseas Master Fund II, L.P. We may repay the Tontine Term Loan at any time prior to the maturity date at par, plus accrued interest without penalty. The Tontine Term Loan is subordinated to the Revolving Credit Facility. The Tontine Term Loan is an unsecured obligation of the Company and its subsidiary borrowers. The Tontine Term Loan contains no financial covenants or restrictions on dividends or distributions to stockholders.

5. PER SHARE INFORMATION

Basic earnings per share is calculated as income (loss) available to common stockholders, divided by the weighted average number of common shares outstanding during the period. If the effect is dilutive, participating securities are included in the computation of basic earnings per share. Our participating securities do not have a contractual obligation to share in the losses in any given period. As a result, these participating securities will not be allocated any losses in the periods of net losses, but will be allocated income in the periods of net income using the two-class method.

The following table reconciles the components of the basic and diluted earnings (loss) per share for the three months ended December 31, 2011 and 2010, (in thousands, except share information):

	Three Months Ended December 31,	
	2011	2010
Numerator:		
Net income (loss) attributable to common shareholders	\$ (3,723)	\$ (4,299)
Net income (loss) attributable to restricted shareholders		
Net income (loss)	\$ (3,723)	\$ (4,299)
Denominator:		
Weighted average common shares outstanding basic	14,569,089	14,447,357
Effect of dilutive stock options and non-vested restricted stock		
Weighted average common and common equivalent shares outstanding diluted	14,569,089	14,447,357
Basic loss per share	\$ (0.26)	\$ (0.30)
Diluted loss per share	\$ (0.26)	\$ (0.30)

For the three months ended December 31, 2011 and 2010, 20,000 and 158,500 stock options, respectively, were excluded from the computation of fully diluted earnings per share because the exercise prices of the options were greater than the average price of our common stock. For the three months ended December 31, 2011 and 2010, 388,860 and 258,600 shares, respectively, of restricted stock were excluded from the

computation of fully diluted earnings per share because we reported a loss from continuing operations.

Table of Contents**INTEGRATED ELECTRICAL SERVICES, INC.****Notes to Consolidated Financial Statements****(All Amounts in Thousands Except Share Amounts)****6. OPERATING SEGMENTS**

We manage and measure performance of our business in three distinct operating segments: Communications, Residential and Commercial & Industrial. These segments are reflective of how the Company's Chief Operating Decision Maker (CODM) reviews operating results for the purposes of allocating resources and assessing performance. The Company's CODM is its Chief Executive Officer. The Communications segment consists of low voltage installation, design, planning and maintenance for mission critical infrastructure such as data centers. The Residential segment consists of electrical installation, replacement and renovation services in single-family, condominium, townhouse and low-rise multifamily housing units.

The Commercial & Industrial segment provides electrical design, installation, renovation, engineering and maintenance and replacement services in facilities such as office buildings, high-rise apartments and condominiums, theaters, restaurants, hotels, hospitals and critical-care facilities, school districts, light manufacturing and processing facilities, military installations, airports, outside plants, network enterprises, switch network customers, manufacturing and distribution centers, water treatment facilities, refineries, petrochemical and power plants, and alternative energy facilities.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. We evaluate performance based on income from operations of the respective business units prior to the allocation of Corporate office expenses. Transactions between segments are eliminated in consolidation. Our Corporate office provides general and administrative as well as support services to our three operating segments. Management allocates costs between segments for selling, general and administrative expenses and depreciation expense.

Segment information for the three months ended December 31, 2011 and 2010 is as follows:

	\$000,000	\$000,000	\$000,000	\$000,000	\$000,000
	Three Months Ended December 31, 2011				
	Communications	Residential	Commercial & Industrial	Corporate	Total
Revenues	\$ 26,102	\$ 29,272	\$ 59,919	\$	\$ 115,293
Cost of services	22,764	24,626	56,994		104,384
Gross profit	3,338	4,646	2,925		10,909
Selling, general and administrative	2,522	3,942	3,082	3,829	13,375
Corporate allocations	474	472	1,423	(2,369)	
Loss (gain) on sale of assets	11	4	2		17
Restructuring charge			582	18	600
Income (loss) from operations	\$ 331	\$ 228	\$ (2,164)	\$ (1,478)	\$ (3,083)
Other data:					
Depreciation and amortization expense	\$ 65	\$ 82	\$ 88	\$ 287	\$ 522
Capital expenditures	\$ 42	\$ 260	\$	\$ 861	\$ 1,163
Total assets	\$ 17,899	\$ 23,095	\$ 73,383	\$ 47,585	\$ 161,962

Three Months Ended December 31, 2010 as Restated

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

	Communications	Residential	Commercial & Industrial	Corporate	Total
Revenues	\$ 19,921	\$ 26,045	\$ 63,845	\$	\$ 109,811
Cost of services	16,716	21,508	60,529		98,753
Gross profit	3,205	4,537	3,316		11,058
Selling, general and administrative	1,757	4,195	5,297	7,403	18,652
Corporate allocations	550	588	2,146	(3,284)	
(Gain) Loss on sale of assets		(22)	(6,805)	98	(6,729)

Table of Contents**INTEGRATED ELECTRICAL SERVICES, INC.****Notes to Consolidated Financial Statements****(All Amounts in Thousands Except Share Amounts)**

Asset impairment				3,551	3,551
Income (loss) from operations	\$ 898	\$ (224)	\$ 2,678	\$ (7,768)	\$ (4,416)
Other data:					
Depreciation and amortization expense	\$ 26	\$ 99	\$ 235	\$ 1,546	\$ 1,906
Capital expenditures	\$	\$ 27	\$ 226	\$ 138	\$ 391
Total assets	\$ 20,486	\$ 27,680	\$ 82,401	\$ 56,624	\$ 187,191

7. STOCKHOLDERS EQUITY

The 2006 Equity Incentive Plan became effective on May 12, 2006 (as amended, the 2006 Equity Incentive Plan). The 2006 Equity Incentive Plan provides for grants of stock options as well as grants of stock, including restricted stock. We have approximately 1.0 million shares of common stock authorized for issuance under the 2006 Equity Incentive Plan.

On May 12, 2008, 10,555 shares of outstanding common stock that were reserved for issuance upon exchange of previously issued shares pursuant to our Plan were cancelled.

Treasury Stock

During the three months ended December 31, 2011, we repurchased 34,578 common shares from our employees to satisfy minimum tax withholding requirements upon the vesting of restricted stock issued under the 2006 Equity Incentive Plan, and 8,055 unvested shares were forfeited by former employees and returned to treasury stock. We issued 100,000 shares out of treasury stock under our share-based compensation programs.

During the three months ended December 31, 2010, we repurchased 18,153 common shares from our employees to satisfy minimum tax withholding requirements upon the vesting of restricted stock issued under the 2006 Equity Incentive Plan and 27,675 unvested shares were forfeited by former employees and returned to treasury stock. We issued 4,000 shares out of treasury stock under our share-based compensation programs.

Restricted Stock

Restricted Stock Awards:

Fiscal Year	Shares Granted	Weighted Average Fair Value at Date of Grant	Vested	Forfeitures	Shares Outstanding	Expense recognized through December 31, 2011
2006	384,850	\$ 24.78	258,347	126,503		\$ 6,402
2006	25,000	\$ 17.36	25,000			\$ 434
2007	20,000	\$ 25.08	20,000			\$ 502
2007	4,000	\$ 26.48	4,000			\$ 106
2008	101,650	\$ 19.17	85,750	15,900		\$ 1,779
2009	185,100	\$ 8.71	146,400	38,700		\$ 1,344
2010	225,486	\$ 3.64	42,701	68,585	114,200	\$ 404

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

2011	320,000	\$	3.39	86,288	59,052	174,660	\$	248
2012	100,000	\$	2.00			100,000	\$	22

During the three months ended December 31, 2011 and 2010, we recognized \$142, and \$153, respectively, in compensation expense related to these restricted stock awards. At December 31, 2011, the unamortized compensation cost related to outstanding unvested restricted stock was \$923. We expect to recognize \$426 of this unamortized compensation expense during the remaining nine months of our 2012 fiscal year and \$497 thereafter. A summary of restricted stock awards for the years ended September 30, 2012, 2011 and 2010 is provided in the table below:

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC.

Notes to Consolidated Financial Statements

(All Amounts in Thousands Except Share Amounts)

	Years Ended September 30,		
	2012	2011	2010
Unvested at beginning of year	376,200	352,086	230,716
Granted	100,000	320,000	225,486
Vested	(79,285)	(165,628)	(66,116)
Forfeited	(8,055)	(130,258)	(38,000)
Unvested at end of year	388,860	376,200	352,086

All the restricted shares granted under the 2006 Equity Incentive Plan (vested or unvested) participate in dividends issued to common shareholders, if any.

Phantom Stock Units

We granted 24,632 and 26,191 shares of performance-based phantom stock units (PSUs) to the members of the Board of Directors in 2011 and 2010, respectively. These PSU s will be paid via unrestricted stock grants to each director upon his departure from the Board of Directors.

Table of Contents**INTEGRATED ELECTRICAL SERVICES, INC.****Notes to Consolidated Financial Statements****(All Amounts in Thousands Except Share Amounts)***Stock Options*

We utilized a binomial option pricing model to measure the fair value of stock options granted. Our determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards, the risk-free rate of return, and actual and projected employee stock option exercise behaviors. The expected life of stock options is not considered under the binomial option pricing model that we utilize. The assumptions used in the fair value method calculation for the years ended September 30, 2012, 2011 and 2010 are disclosed in the following table:

	Years Ended December 31,		
	2012	2011	2010
Weighted average value per option granted during the period	\$ N/A	2.05	\$ N/A
Dividends (1)	\$ N/A		\$ N/A
Stock price volatility (2)	N/A	69.9%	N/A
Risk-free rate of return	N/A	1.9%	N/A
Option term	N/A	10.0 years	N/A
Expected life	N/A	6.0 years	N/A
Forfeiture rate (3)	N/A	0.0%	N/A

- (1) We do not currently pay dividends on our common stock.
- (2) Based upon the Company's historical volatility.
- (3) The forfeiture rate for these options was assumed on the date of grant to be zero based on the limited number of employees who have been awarded stock options.

Stock-based compensation expense recognized during the period is based on the value of the portion of the share-based payment awards that is ultimately expected to vest during the period. As stock-based compensation expense recognized in the Consolidated Statements of Operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. We estimate our forfeitures at the time of grant and revise, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The following table summarizes activity under our stock option plans.

	Shares	Weighted Average Exercise Price
Outstanding, September 30, 2008	161,000	\$ 26.66
Options granted	7,500	17.09
Exercised		
Forfeited and Cancelled	(10,000)	41.61
Outstanding, September 30, 2009	158,500	\$ 18.66
Options granted		
Exercised		
Forfeited and Cancelled		

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

Outstanding, September 30, 2010	158,500	\$	18.66
Options granted	20,000		3.24
Exercised			
Forfeited and Cancelled	(158,500)		18.66
Outstanding, September 30, 2011	20,000	\$	3.24
Options granted			
Exercised			
Forfeited and Cancelled			
Outstanding, December 31, 2011	20,000	\$	3.24

Table of Contents**INTEGRATED ELECTRICAL SERVICES, INC.****Notes to Consolidated Financial Statements****(All Amounts in Thousands Except Share Amounts)**

The following table summarizes options outstanding and exercisable at December 31, 2011:

Range of Exercise Prices	Outstanding as of December 31, 2011	Remaining Contractual Life in Years	Weighted-Average Exercise Price	Exercisable as of December 31, 2011	Weighted-Average Exercise Price
\$ 3.24	20,000	9.55	\$ 3.24		\$ 3.24
	20,000	9.55	\$ 3.24		\$ 3.24

All of our outstanding options vest over a three-year period at a rate of one-third per year upon the annual anniversary date of the grant and expire ten years from the grant date if they are not exercised. Upon exercise of stock options, it is our policy to first issue shares from treasury stock, then to issue new shares. Unexercised stock options expire by July 2021.

8. SECURITIES AND EQUITY INVESTMENTS*Investment in EnerTech Capital Partners II L.P.*

Our investment in EnerTech was approximately 2% of the overall ownership in EnerTech at December 31, 2011 and September 30, 2011. As such, we accounted for this investment using the cost method of accounting.

EnerTech's investment portfolio periodically results in unrealized losses reflecting a possible, other-than-temporary impairment of our investment. If the facts arise that lead us to determine that any unrealized losses are not temporary, we would write-down our investment in EnerTech through a charge to other expense in the period of such determination. The carrying value of our investment in EnerTech at December 31, 2011 and September 30, 2011 was \$1,003 and \$1,003, respectively, and is currently recorded as a component of Other Non-Current Assets in our Consolidated Balance Sheets. The following table presents the reconciliation of the carrying value and unrealized gains (losses) to the fair value of the investment in EnerTech as of December 31, 2011 and September 30, 2011:

	December 31, 2011	September 30, 2011
Carrying value	\$ 1,003	\$ 1,003
Unrealized gains (losses)	46	
Fair value	\$ 1,049	\$ 1,003

On December 31, 2011, EnerTech's general partner, with the consent of the fund's investors, extended the fund through December 31, 2012. The fund will terminate on this date unless extended by the fund's valuation committee. The fund may be extended for another one-year period through December 31, 2013 with the consent of the fund's valuation committee.

9. EMPLOYEE BENEFIT PLANS*401(k) Plan*

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

In November 1998, we established the Integrated Electrical Services, Inc. 401(k) Retirement Savings Plan (the 401(k) Plan). All full-time IES employees are eligible to participate on the first day of the month subsequent to completing thirty days of service and attaining age twenty-one. Participants become vested in our matching contributions following three years of service.

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC.

Notes to Consolidated Financial Statements

(All Amounts in Thousands Except Share Amounts)

On February 13, 2009, we suspended company matching cash contributions to employee's contributions due to the significant impact the economic recession has had on the Company's financial performance. We made no contributions to the 401(k) plan for the three months ended December 31, 2011 and 2010, respectively.

Executive Deferred Compensation Plan

Under the Executive Deferred Compensation Plan certain employees are permitted to defer a portion (up to 75%) of their base salary and/or bonus for a Plan Year. The Compensation Committee of the Board of Directors may, in its sole discretion, credit one or more participants with an employer deferral (contribution) in such amount as the Committee may choose (Employer Contribution). The Employer Contribution, if any, may be a fixed dollar amount, a fixed percentage of the participant's compensation, base salary, or bonus, or a matching amount with respect to all or part of the participant's elective deferrals for such plan year, and/or any combination of the foregoing as the Committee may choose.

On February 13, 2009, we suspended Company matching cash contributions to employee's contributions due to the significant impact the economic recession has had on the Company's financial performance. We made no contributions to the Executive Deferred Compensation Plan for the three months ended December 31, 2011 and 2010, respectively.

Post Retirement Benefit Plans

Certain individuals at one of the Company's locations are entitled to receive fixed annual payments that reach a maximum amount, as specified in the related agreements, for a ten year period following retirement or, in some cases, the attainment of 62 years of age. We recognize the unfunded status of the plan as part of current liabilities and non-current liabilities in our Consolidated Balance Sheet. Benefits vest 50% after ten years of service, which increases by 10% per annum until benefits are fully vested after 15 years of service. We had an unfunded benefit liability of \$791 and \$576 recorded as of December 31, 2011 and 2010, respectively.

10. FAIR VALUE MEASUREMENTS

Fair Value Measurement Accounting

This disclosure relates to the activity for assets and liabilities measured at fair value on a recurring basis, including transfers of assets and liabilities between Level 1 and Level 2 of the fair value hierarchy and the separate presentation of purchases, sales, issuances and settlements of assets and liabilities within Level 3 of the fair value hierarchy. In addition, we provide enhanced disclosure of the valuation techniques and inputs used in the fair value measurements within Level 2 and Level 3.

Fair value is considered the price to sell an asset, or transfer a liability, between market participants on the measurement date. Fair value measurements assume that the asset or liability is (1) exchanged in an orderly manner, (2) the exchange is in the principal market for that asset or liability, and (3) the market participants are independent, knowledgeable, able and willing to transact an exchange. Fair value accounting and reporting establishes a framework for measuring fair value by creating a hierarchy for observable independent market inputs and unobservable market assumptions and expands disclosures about fair value measurements. Considerable judgment is required to interpret the market data used to develop fair value estimates. As such, the estimates presented herein are not necessarily indicative of the amounts that could be realized in a current exchange. The use of different market assumptions and/or estimation methods could have a material effect on the estimated fair value.

Financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 are summarized in the following table by the type of inputs applicable to the fair value measurements:

Total Fair Value

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

		Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
Money market accounts	\$	8,813	\$ 8,813	
Executive Savings Plan assets		508	508	
Executive Savings Plan liabilities		(580)	(580)	
Total	\$	8,741	\$ 8,741	

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC.

Notes to Consolidated Financial Statements

(All Amounts in Thousands Except Share Amounts)

Below is a description of the inputs used to value the assets summarized in the preceding table:

Level 1 Inputs represent unadjusted quoted prices for identical assets exchanged in active markets.

Level 2 Inputs include directly or indirectly observable inputs other than Level 1 inputs such as quoted prices for similar assets exchanged in active or inactive markets; quoted prices for identical assets exchanged in inactive markets; and other inputs that are considered in fair value determinations of the assets.

Level 3 Inputs include unobservable inputs used in the measurement of assets. Management is required to use its own assumptions regarding unobservable inputs because there is little, if any, market activity in the assets or related observable inputs that can be corroborated at the measurement date.

11. COMMITMENTS AND CONTINGENCIES

Legal Matters

From time to time we are a party to various claims, lawsuits and other legal proceedings that arise in the ordinary course of business. We maintain various insurance coverages to minimize financial risk associated with these proceedings. None of these proceedings, separately or in the aggregate, are expected to have a material adverse effect on our financial position, results of operations or cash flows. With respect to all such proceedings, we record reserves when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. We expense routine legal costs related to these proceedings as they are incurred.

The following is a discussion of our significant legal matters:

Ward Transformer Site

One of our subsidiaries has been identified as one of more than 200 potentially responsible parties (PRPs) with respect to the clean-up of an electric transformer resale and reconditioning facility, known as the Ward Transformer Site, located in Raleigh, North Carolina. The facility built, repaired, reconditioned and sold electric transformers from approximately 1964 to 2005. We did not own or operate the facility but a subsidiary that we acquired in July 1999 is believed to have sent transformers to the facility during the 1990 s. During the course of its operation, the facility was contaminated by Polychlorinated Biphenyls (PCBs), which also have been found to have migrated off the site.

Four PRPs have commenced clean-up of on-site contaminated soils under an Emergency Removal Action pursuant to a settlement agreement and Administrative Order on Consent entered into between the four PRPs and the U.S. Environmental Protection Agency (EPA) in September 2005. We are not a party to that settlement agreement or Order on Consent. In April 2009, two of these PRPs, Carolina Power and Light Company and Consolidation Coal Company, filed suit against us and most of the other PRPs in the U.S. District Court for the Eastern District of North Carolina (Western Division) to contribute to the cost of the clean-up. In addition to the on-site clean-up, the EPA has selected approximately 50 PRPs to which it sent a Special Notice Letter in late 2008 to organize the clean-up of soils off site and address contamination of groundwater and other miscellaneous off-site issues. We were not a recipient of that letter.

Based on our investigation to date, there is evidence to support our defense that our subsidiary contributed no PCB contamination to the site. In addition, we have tendered a demand for indemnification to the former owner of our subsidiary that may have transacted business with the facility and are exploring the existence and applicability of insurance policies that could mitigate potential exposure. As of December 31, 2011, we have not recorded a reserve for this matter, as we believe the likelihood of our responsibility for damages is not probable and a potential range of exposure is not estimable.

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC.

Notes to Consolidated Financial Statements

(All Amounts in Thousands Except Share Amounts)

Risk-Management

We retain the risk for workers' compensation, employer's liability, automobile liability, general liability and employee group health claims, resulting from uninsured deductibles per accident or occurrence which are subject to annual aggregate limits. Our general liability program provides coverage for bodily injury and property damage. Losses up to the deductible amounts are accrued based upon our known claims incurred and an estimate of claims incurred but not reported. As a result, many of our claims are effectively self-insured. Many claims against our insurance are in the form of litigation. At December 31, 2011, we had \$6,861 accrued for insurance liabilities. We are also subject to construction defect liabilities, primarily within our Residential segment. As of December 31, 2011, we had reserved \$410 for these claims.

Some of the underwriters of our casualty insurance program require us to post letters of credit as collateral. This is common in the insurance industry. To date, we have not had a situation where an underwriter has had reasonable cause to effect payment under a letter of credit. At December 31, 2011, \$8,182 of our outstanding letters of credit were utilized to collateralize our insurance program.

Surety

Many customers, particularly in connection with new construction, require us to post performance and payment bonds issued by a surety. Those bonds provide a guarantee to the customer that we will perform under the terms of our contract and that we will pay our subcontractors and vendors. If we fail to perform under the terms of our contract or to pay subcontractors and vendors, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the sureties for any expenses or outlays they incur on our behalf. To date, we have not been required to make any reimbursements to our sureties for bond-related costs.

As is common in the surety industry, sureties issue bonds on a project-by-project basis and can decline to issue bonds at any time. We believe that our relationships with our sureties will allow us to provide surety bonds as they are required. However, current market conditions, as well as changes in our sureties' assessment of our operating and financial risk, could cause our sureties to decline to issue bonds for our work. If our sureties decline to issue bonds for our work, our alternatives would include posting other forms of collateral for project performance, such as letters of credit or cash, seeking bonding capacity from other sureties, or engaging in more projects that do not require surety bonds. In addition, if we are awarded a project for which a surety bond is required but we are unable to obtain a surety bond, the result can be a claim for damages by the customer for the costs of replacing us with another contractor.

As of December 31, 2011, the estimated cost to complete our bonded projects was approximately \$89,592. We evaluate our bonding requirements on a regular basis, including the terms offered by our sureties. On May 7, 2010 we entered into a new surety agreement. We believe the bonding capacity presently provided by our current sureties is adequate for our current operations and will be adequate for our operations for the foreseeable future. As of December 31, 2011, we had cash totaling \$3,985 to collateralize our obligations to certain of our previous sureties (as is included in Other Non-Current Assets in our Consolidated Balance Sheet). Posting letters of credit in favor of our sureties reduces the borrowing availability under our Revolving Credit Facility.

Other Commitments and Contingencies

Some of our customers and vendors require us to post letters of credit as a means of guaranteeing performance under our contracts and ensuring payment by us to subcontractors and vendors. If our customer has reasonable cause to effect payment under a letter of credit, we would be required to reimburse our creditor for the letter of credit. At December 31, 2011, \$630 of our outstanding letters of credit were to collateralize our vendors.

Between October 2004 and September 2005, we sold all or substantially all of the assets of certain of our wholly-owned subsidiaries. As these sales were assets sales, rather than stock sales, we may be required to fulfill obligations that were assigned or sold to others, if the purchaser is unwilling or unable to perform the transferred liabilities. If this were to occur, we would seek reimbursement from the purchasers. These potential liabilities will continue to diminish over time. To date, we have not been required to perform on any projects sold under this divestiture program.

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

From time to time, we may enter into firm purchase commitments for materials such as copper or aluminum wire which we expect to use in the ordinary course of business. These commitments are typically for terms less than one year and require us to buy minimum quantities of materials at specific intervals at a fixed price over the term. As of December 31, 2011, we had no such open purchase commitments.

Table of Contents

INTEGRATED ELECTRICAL SERVICES, INC.

Notes to Consolidated Financial Statements

(All Amounts in Thousands Except Share Amounts)

12. RESTATEMENT

Restatement

The September 30, 2011 consolidated financial statements included in our Original Form 10-K filed on December 20, 2011, contained errors primarily related to the understatement of our vacation accrual that should have been recorded at September 30, 2008 and in each subsequent annual and interim period to September 30, 2011. Additionally, for all restated periods we recorded other immaterial adjustments. These adjustments included, but were not limited to, recording billing, payroll and other accruals, and the associated revenue impacts, in the proper accounting period. Accordingly, the September 30, 2011 consolidated financial statements, and all quarterly periods therein, were restated to properly record these transactions and other immaterial adjustments. Refer to our amended form 10-K/A for a more detailed explanation. In addition, we have restated the Statement of Cash Flows and segment information for the three months ended December 31, 2010 to correct for these errors in these financial statements.

Table of Contents

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

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our audited consolidated financial statements, the related notes, and management's discussion and analysis included in our annual report on Form 10-K/A for the year ended September 30, 2011. This discussion contains forward-looking statements and involves numerous risks and uncertainties, including, but not limited to the risk factors discussed in the Risk Factors section of our annual report on Form 10-K/A for the year ended September 30, 2011, and in the Disclosures Regarding Forward-Looking Statements, and elsewhere in this quarterly report on form 10-Q. Actual results may differ materially from those contained in any forward-looking statements.

All dollar values reported in this section are reported in thousands of dollars unless otherwise specified.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operation are based on our condensed consolidated financial statements, which have been prepared in accordance with GAAP. Preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses.

We have identified the accounting principles that we believe are most critical to our reported financial status by considering accounting policies that involve the most complex or subjective decisions or assessments. These accounting policies are those related to revenue recognition, the assessment of goodwill impairment, our allowance for doubtful accounts receivable, the recording of our self-insurance liabilities and our estimation of the valuation allowance for deferred tax assets. These accounting policies, as well as others, are described in Part 2. Item 8. Financial Statements and Supplementary Data Note 2, Summary of Significant Accounting Policies in our annual report on Form 10-K/A for the year ended September 30, 2011

SALE OF FACILITIES

Sale of Non-Strategic Manufacturing Facility

On November 30, 2010, a subsidiary of the Company sold substantially all the assets and certain liabilities of a non-strategic manufacturing facility engaged in manufacturing and selling fabricated metal buildings housing electrical equipment, such as switchgears, motor starters and control systems, to Siemens Energy, Inc. As part of this transaction, Siemens Energy, Inc. also acquired certain real property where the fabrication facilities are located from another subsidiary of the Company. The purchase price of \$10,086 was adjusted to reflect working capital variances. The transaction was completed on December 10, 2010 at which time we recognized a gain of \$6,763.

Sale of Non-Core Electrical Distribution Facility

On February 28, 2011, Key Electrical Supply, Inc, a wholly owned subsidiary of the Company, sold substantially all the assets and certain liabilities of a non-core electrical distribution facility engaged in distributing wiring, lighting, electrical distribution, power control and generators for residential and commercial applications to Elliot Electric Supply, Inc. The purchase price of \$6,676 was adjusted to reflect working capital variances. The loss on this transaction was immaterial.

Seasonality and Quarterly Fluctuations

Results of operations from our Residential construction segment are more seasonal, depending on weather trends, with typically higher revenues generated during spring and summer and lower revenues during fall and winter. The Communications and Commercial & Industrial segments of our business are less subject to seasonal trends, as work in these segments generally is performed inside structures protected from the weather. Our service and maintenance business is generally not affected by seasonality. In addition, the construction industry has historically been highly cyclical. Our volume of business may be adversely affected by declines in construction projects resulting from adverse regional or national economic conditions. Quarterly results may also be materially affected by the timing of new construction projects. Accordingly, operating results for any fiscal period are not necessarily indicative of results that may be achieved for any subsequent fiscal period.

Table of Contents

The 2011 Restructuring Plan

In the second quarter of our 2011 fiscal year, we began a new restructuring program (the 2011 Restructuring Plan) that was designed to consolidate operations within our Commercial & Industrial business. Pursuant to the 2011 Restructuring Plan we will either sell or close certain underperforming facilities within our Commercial & Industrial operations. The 2011 Restructuring Plan is a key element of our commitment to return the Company to profitability.

The facilities directly affected by the 2011 Restructuring Plan are in several locations throughout the country, including Arizona, Florida, Iowa, Massachusetts, Louisiana, Nevada and Texas. These facilities were selected due to current business prospects and the extended time frame needed to return the facilities to a profitable position. We expect that closure costs could range from \$4,500 to \$5,500 in the aggregate. Closure costs associated with the 2011 Restructuring Plan include equipment and facility lease termination expenses, incremental management consulting expenses and severance costs for employees. The Company is in the process of winding down these facilities. As part of our restructuring charges within our Commercial & Industrial segment we recognized \$69 in severance costs, \$483 in consulting services, and \$48 in costs related to lease terminations. The Company is in the process of winding down these facilities. As the Company concludes the wind-down and closure process for each of these facilities, their respective results of operations will be reclassified and presented within future statements of operations as Discontinued Operations. US GAAP does not permit an earlier reclassification. At December 31, 2011, the estimated costs to complete the 37 projects remaining at these facilities totaled approximately \$4.7 million; of which all but approximately \$0.6 million has been subcontracted to other electrical contractors.

The following table summarizes our operating activities related to our restructuring plan:

	Three Months Ended December 31, 2011	Three Months Ended December 31, 2010
Revenues	\$ 3,083	\$ 13,620
Gross profit (loss)	(1,391)	84
Selling, general, & administrative expenses	186	1,164
Restructuring	582	
Loss / (gain) from sale of assets	10	(15)
Loss from operations	\$ (2,169)	\$ (1,065)
Other data:		
Working capital	\$ 3,752	\$ 19,141
Total assets:	\$ 6,529	\$ 24,374

THREE MONTHS ENDED DECEMBER 31, 2011 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2010

Results of Operations

We report our operating results across three operating segments: Communications, Residential and Commercial & Industrial. Expenses associated with our Corporate office are classified as a fourth segment. The following table presents selected historical results of operations of IES and subsidiaries.

	Three Months Ended December 31, 2011		Three Months Ended December 31, 2010	
	\$	%	Restated \$	%
(Dollars in thousands, Percentage of revenues)				
Revenues	\$ 115,293	100.0%	\$ 109,811	100.0%
Cost of services	104,384	90.5%	98,753	89.9%

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

Gross profit	10,909	9.5%	11,059	10.1%
Selling, general and administrative expenses	13,375	11.6%	18,652	17.0%
Gain on sale of assets	17	%	(6,729)	(6.1)%
Asset impairment		%	3,551	3.2%

Table of Contents

	\$000.000	\$000.000	\$000.000	\$000.000
Restructuring charges	600	0.5%		%
Loss from operations	(3,083)	(2.6)%	(4,416)	(4.0)%
Interest and other expense, net	472	0.4%	559	0.5%
Loss from operations before income taxes	(3,555)	(3.0)%	(4,975)	(4.5)%
Provision (benefit) for income taxes	168	0.1%	(676)	(0.6)%
Net loss from continuing operations	(3,723)	(3.1)%	(4,299)	(3.9)%
Net loss	\$ (3,723)	(3.1)%	\$ (4,299)	(3.9)%

Revenues

	\$000,000	\$000,000	\$000,000	\$000,000
	Three Months Ended December 31, 2011		Three Months Ended December 31, 2010	
			Restated	
	\$	%	\$	%
(Dollars in thousands, Percentage of revenues)				
Communications	\$ 26,102	22.6%	\$ 19,921	18.1%
Residential	29,272	25.4%	26,045	23.7%
Commercial & Industrial	59,919	52.0%	63,845	58.2%
Total Consolidated	\$ 115,293	100.0%	\$ 109,811	100.0%

Consolidated revenues for the three months ended December 31, 2011 were \$5,482 more than the three months ended December 31, 2010, an increase of 5.0%.

Our Communications segment revenues increased \$6,181 during the three months ended December 31, 2011, a 31.0% increase compared to the three months ended December 31, 2010. This increase is due to an increase in data center projects, an increase in material usage as a percentage of the segments total revenue and increased business from our national account activity.

Our Residential segment revenues increased \$3,227 during the three months ended December 31, 2011, an increase of 12.4% as compared to the three months ended December 31, 2010. Approximately \$4,884 of the revenue during the three months ended December 31, 2010 is attributable to the non-core electrical distribution facility that was sold in February 2011. Removing this revenue from the comparison, our Residential segment showed an increase quarter over quarter of \$8,111. The increase is due primarily from an increase in single-family revenues, along with an increase in revenue from solar installations.

Revenues in our Commercial & Industrial segment decreased \$3,926 during the three months ended December 31, 2011, a decrease of 6.1% compared to the three months ended December 31, 2010 primarily due to an decrease in the Company's wind-down facilities described in the 2011 Restructuring Plan. Revenues associated with the wind-down facilities described in the 2011 Restructuring Plan totaled \$3,145, a decrease of \$10,475 when compared to the three months ended December 31, 2010. Excluding the revenues associated with the wind-down facilities, revenue increased \$779. Many of our Commercial & Industrial locations were essentially unchanged as the rate of decline for most industry sectors have begun to stabilize.

Table of Contents

Gross Profit

	\$000,000,00		\$000,000,00	\$000,000,00	\$000,000,00
			Three Months Ended December 31,		
			2011		2010
					Restated
	\$	%	\$	%	%
	(Dollars in thousands, Percentage of revenues)				
Communications	\$ 3,338	12.8%	\$ 3,205		16.1%
Residential	4,646	15.9%	4,537		17.5%
Commercial & Industrial	2,925	4.9%	3,317		5.1%
Total Consolidated	\$ 10,909	9.5%	\$ 11,059		10.1%

The \$150 decrease in our consolidated gross profit for the three months ended December 31, 2011, as compared to the three months ended December 31, 2010, was primarily the result of the negative gross profit of \$1,329 associated with the wind-down operations, offset by an increased gross profit at Residential and the go-forward portion of Commercial & Industrial. Our overall gross profit percentage decreased to 9.5% during the three months ended December 31, 2011 as compared to 10.1% during the three months ended December 31, 2010.

Our Communications segment's gross profit during the three months ended December 31, 2011 increased \$133, as compared to the three months ended December 31, 2010. The increase in gross profit is offset by a decrease in gross profit in its Baltimore office. The Baltimore office had a negative gross profit of \$612 during the three months ended December 31, 2011, a decrease of \$567, as compared to the three months ended December 31, 2010. The Baltimore location was selected for closure based upon current business performance and the extended time frame needed to return the operation to profitability.

During the three months ended December 31, 2011, our Residential segment experienced a \$109 increase in gross profit as compared to the three months ended December 31, 2010. Gross margin percentage in the Residential segment decreased to 15.9% during the three months ended December 31, 2011. We attribute much of the decline in Residential's gross margin to increased costs of materials creating lower margins in both single-family and multi-family construction.

Our Commercial & Industrial segment's gross profit during the three months ended December 31, 2011 decreased \$392, as compared to the three months ended December 31, 2010. The negative gross margins associated with the wind-down operations described in the Company's 2011 Restructuring Plan resulted in \$1,329 of negative gross profit during the three months ended December 31, 2011, compared to a positive gross profit of \$84 during the three months ended December 31, 2010. The negative gross margins recorded for the wind-down operations described in the Company's 2011 Restructuring Plan are primarily due to higher costs associated with either subcontracting or assigning certain contracts to other electrical subcontractors together with the extensive operating difficulties relating to labor productivity following the notice of the potential sale or closure of these facilities. The Baltimore facility within Commercial & Industrial had a negative gross profit of \$1,036 during the three months ended December 31, 2011, a decrease of \$399, as compared to the three months ended December 31, 2010. The Baltimore location was selected for closure based upon current business performance and the extended time frame needed to return the operation to profitability.

Selling, General and Administrative Expenses

	\$000,000,00		\$000,000,00	\$000,000,00	\$000,000,00
			Three Months Ended December 31,		
			2011		2010
					Restated
	\$	%	\$	%	%
	(Dollars in thousands, Percentage of revenues)				
Communications	\$ 2,996	11.5%	\$ 2,307		11.6%
Residential	4,414	15.1%	4,783		18.4%
Commercial & Industrial	4,505	7.5%	7,443		11.7%

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

Corporate	1,460	4,119
-----------	-------	-------

Total Consolidated	\$ 13,375	11.6%	\$ 18,652	17.0%
--------------------	-----------	-------	-----------	-------

Selling, general and administrative expenses include costs not directly associated with performing work for our customers. These costs consist primarily of compensation and benefits related to corporate and division management, occupancy and utilities, training, professional services, information technology costs, consulting fees, travel and certain types of depreciation and amortization. We allocate certain corporate selling, general and administrative costs across our segments as we believe this more accurately reflects the costs associated with operating each segment.

Table of Contents

During the three months ended December 31, 2011, our selling, general and administrative expenses were \$13,375, a decrease of \$5,277, or 28.3%, as compared to the three months ended December 31, 2010.

Our Communications segment's selling, general and administrative expenses increased \$689 during the three months ended December 31, 2011 compared to the three months ended December 31, 2010. Selling, general and administrative expenses as a percentage of revenues in the Communication segment increased to 11.5% of segment revenue during the three months ended December 31, 2011. The increase in selling, general and administrative expenses is primarily due to higher expenses associated with our growth initiative relating to the expansion of facilities in Southern California and to a lesser extent, incentive awards for achieving specific performance goals.

Our Residential segment experienced a \$369 reduction in selling, general and administrative expenses during the three months ended December 31, 2011 compared to the three months ended December 31, 2010. Approximately \$1,094 of the selling, general and administrative expense included in the three months ended December 31, 2010 is attributable to the non-core electrical distribution facility that was sold in February 2011. Removing this from the comparison, the actual change period over period was an increase of \$729. Selling, general and administrative expenses as a percentage of revenues in the Residential segment declined to 15.1% of segment revenue during the three months ended December 31, 2011. We attribute much of the decline in Residential selling, general and administrative expenses to lower management and incentive compensation expense.

Our Commercial & Industrial segment's selling, general and administrative expenses during the three months ended December 31, 2011 decreased \$2,938 compared to the year three months ended December 31, 2010. Selling, general and administrative expenses as a percentage of revenues in the Commercial & Industrial segment declined to 7.5% of segment revenue during the three months ended December 31, 2011, primarily due to a decrease in operations, along with a reduction in the related employment and operational expenses.

Our Corporate segment's selling, general and administrative expenses decreased \$2,659 during the three months ended December 31, 2011 compared to the three months ended December 31, 2010. This decrease is primarily attributable to a significant reduction to our corporate office operations, including a decrease in headcount and related employment expenses.

Restructuring Charges

The following table presents the elements of costs incurred for both the 2011 and 2009 Restructuring Plans.

	Three Months Ended December 31,	
	2011	2010
	(In thousands)	
Severance compensation	\$ 69	\$
Consulting and other charges	483	
Lease termination costs	48	
Total restructuring charges	\$ 600	\$

Interest and Other Expense, net

	Three Months Ended December 31,	
	2011	2010
	(In thousands)	
Interest expense	\$ 530	\$ 515
Deferred financing charges	91	84
Total interest expense	621	599
Interest income	(85)	(25)
Other (income) expense, net	(64)	(15)

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

Total interest and other expense, net	\$ 472	\$ 559
---------------------------------------	--------	--------

During the three months ended December 31, 2011, we incurred interest expense of \$530 primarily comprised of the Tontine Term Loan (as defined in Working Capital below), an average letter of credit balance of \$10.7 million under the Revolving

Table of Contents

Credit Facility (as defined in *Working Capital* below) and an average unused line of credit balance of \$47.5 million. This compares to interest expense of \$515 for the three months ended December 31, 2010, on a debt balance primarily comprised of the Tontine Term Loan and the Insurance Financing Agreements, an average letter of credit balance of \$15.9 million under the Revolving Credit Facility and an average unused line of credit balance of \$44.1 million.

For the three months ended December 31, 2011 and 2010, we earned interest income of \$85 and \$25, respectively, on the average Cash and Cash Equivalents balances of \$21.6 million and \$31.9 million, respectively.

Provision for Income Taxes

On May 12, 2006, we had a change in ownership as defined in Internal Revenue Code Section 382. As such, our net operating loss utilization after the change date will be subject to Section 382 limitation for federal income taxes and some state income taxes. We have provided valuation allowance on all net operating losses where it is determined it is more likely than not that the net operating loss will expire without being utilized.

The provision for income taxes increased from a benefit of \$676 for the three months ended December 31, 2010 to an expense of \$168 for the three months ended December 31, 2011. The increase in expense for the three months ended December 31, 2011 is attributable to an increase in state income tax expense.

Surety

Many customers, particularly in connection with new construction, require us to post performance and payment bonds issued by a surety. These bonds provide a guarantee to the customer that we will perform under the terms of our contract and that we will pay our subcontractors and vendors. If we fail to perform under the terms of our contract or to pay subcontractors and vendors, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the sureties for any expenses or outlays they incur on our behalf. To date, we have not been required to make any reimbursements to our sureties for bond-related costs.

As is common in the surety industry, sureties issue bonds on a project-by-project basis and can decline to issue bonds at any time. We believe that our relationships with our sureties will allow us to provide surety bonds as they are required. However, current market conditions, as well as changes in our sureties' assessment of our operating and financial risk, could cause our sureties to decline to issue bonds for our work. If our sureties decline to issue bonds for our work, our alternatives would include posting other forms of collateral for project performance, such as letters of credit or cash, seeking bonding capacity from other sureties, or engaging in more projects that do not require surety bonds. In addition, if we are awarded a project for which a surety bond is required but we are unable to obtain a surety bond, the result could be a claim for damages by the customer for the costs of replacing us with another contractor.

As of December 31, 2011, the estimated cost to complete our bonded projects was approximately \$89,592. We believe the bonding capacity presently provided by our sureties is adequate for our current operations and will be adequate for our operations for the foreseeable future. As of December 31, 2011, we utilized \$3,986 of cash (as is included in *Other Non-Current Assets* in our Consolidated Balance Sheet) as collateral for certain of our previous bonding programs.

The Revolving Credit Facility

On May 12, 2006, we entered into a Loan and Security Agreement (the *Loan and Security Agreement*), for a revolving credit facility (the *Revolving Credit Facility*) with Bank of America, N.A. and certain other lenders. On May 7, 2008, we renegotiated the terms of our Revolving Credit Facility and entered into an amended agreement with the same financial institutions. On April 30, 2010, we renegotiated the terms of, and entered into an amendment to, the Loan and Security Agreement, pursuant to which the maturity date was extended to May 12, 2012. In connection with the amendment, we incurred an amendment fee of \$0.2 million.

On December 15, 2011, we renegotiated the terms of, and entered into an amendment to, the Loan and Security Agreement without incurring termination charges. Under the terms of the amended Revolving Credit Facility, the size of the facility was reduced to \$40.0 million and the maturity date was extended to November 12, 2012. Further, we were required to cash collateralize all of our letters of credit issued by the banks. The cash collateral is added to the borrowing base calculation at 100% throughout the term of the agreement. The Revolving Credit Facility requires that we maintain a fixed charge coverage ratio of not less than 1.0:1.0 at any time that our aggregate amount of unrestricted cash on hand plus availability is less than \$25.0 million and, thereafter, until such time as our aggregate amount of unrestricted cash on hand plus availability has been at least \$25.0 million for a period of 60 consecutive days. Additionally, if there are any loans outstanding on or after

Table of Contents

the April 30, 2012, the Company's EBITDA for the period from October 2011 through March 2012, may not exceed a negative \$2.5 million and we will be required to have a cumulative fixed charge coverage ratio of at least 1.0:1.0 at all times beginning April 1, 2012 to maintain any borrowings under the agreement. The measurement period for this additional test for borrowings begins with the monthly operating results for April 2012 and adds the monthly operating results for each month thereafter to determine the cumulative test during such time as revolving loans are outstanding. Failure to meet this performance test will result in an immediate event of default. The amended agreement also calls for cost of borrowings of 4.0% over LIBOR per annum. Cost for letters of credit are the same as borrowings and also include a 25 basis point fronting fee. All other terms and conditions remain unchanged. In connection with the amendment, we incurred an amendment fee of \$0.1 million which, together with unamortized balance of the prior amendment is being amortized using the straight line method through November 12, 2012.

The Revolving Credit Facility is guaranteed by our subsidiaries and secured by first priority liens on substantially all of our subsidiaries' existing and future acquired assets, exclusive of collateral provided to our surety providers. The Revolving Credit Facility contains customary affirmative, negative and financial covenants. The Revolving Credit Facility also restricts us from paying cash dividends and places limitations on our ability to repurchase our common stock.

Borrowings under the Revolving Credit Facility may not exceed a borrowing base that is determined monthly by our lenders based on available collateral, primarily certain accounts receivables and cash collateral supporting our letters of credit. None of our inventories qualified for borrowing availability after we sold the inventory attributable to our Key Electrical Supply company in February 2011. Under the terms of the Revolving Credit Facility in effect as of December 31, 2011, interest for loans and letter of credit fees is based on our Total Liquidity, which is calculated for any given period as the sum of average daily availability for such period plus average daily unrestricted cash on hand for such period as follows:

At December 31, 2011, we had \$21,384 available to us under the Revolving Credit Facility with no outstanding borrowings. We had \$8,812 in outstanding letters of credit fully collateralized with restricted cash.

As of December 31, 2011, we were subject to the financial covenant under the Revolving Credit Facility requiring that we maintain a fixed charge coverage ratio of not less than 1.0:1.0 at any time that our aggregate amount of unrestricted cash on hand plus availability is less than \$25.0 million and, thereafter, until such time as our aggregate amount of unrestricted cash on hand plus availability has been at least \$25.0 million for a period of 60 consecutive days. As of December 31, 2011, our Total Liquidity was in excess of \$25.0 million; had our Total Liquidity been less than \$25.0 million at December 31, 2011, we would not have met the required 1.0:1.0 fixed charge coverage ratio test.

The Tontine Term Loan

On December 12, 2007, we entered into a \$25.0 million senior subordinated loan agreement (the "Tontine Term Loan") with Tontine Capital Partners, L.P., a related party. The Tontine Term Loan bears interest at 11.0% per annum and is due on May 15, 2013. Interest is payable quarterly in cash or in-kind at our option. Any interest paid in-kind will bear interest at 11.0% in addition to the loan principal. On April 30, 2010, we prepaid \$15.0 million of principal on the Tontine Term Loan. On May 1, 2010, Tontine assigned the Tontine Term Loan to TCP Overseas Master Fund II, L.P. We may repay the Tontine Term Loan at any time prior to the maturity date at par, plus accrued interest without penalty. The Tontine Term Loan is subordinated to our Revolving Credit Facility. The Tontine Term Loan is an unsecured obligation of the Company and its subsidiary borrowers. The Tontine Term Loan contains no financial covenants or restrictions on dividends or distributions to stockholders.

Liquidity and Capital Resources

As of December 31, 2011, we had cash and cash equivalents of \$17,318, working capital of \$59,848 and \$21,384 of available capacity under our Revolving Credit Facility. We anticipate that the combination of cash on hand, cash flows and available capacity under our Revolving Credit Facility will provide sufficient cash to enable us to meet our working capital needs, debt service requirements and capital expenditures for property and equipment through the next twelve months. Our ability to generate cash flow is dependent on many factors, including demand for our services, the availability of projects at margins acceptable to us, the ultimate collectability of our receivables, and our ability to borrow on our amended Revolving Credit Facility, if needed. We were not required to test our covenants under our Revolving Credit Facility in the period as our Total Liquidity was greater than the minimum under our Revolving Credit Facility. Had we been required to test our covenants, we would have failed at December 31, 2011.

We continue to closely monitor the financial markets and general national and global economic conditions. To date, we have experienced no loss or lack of access to our invested cash or cash equivalents; however, we can provide no assurances that access to our invested cash and cash equivalents will not be impacted in the future by adverse conditions in the financial markets.

Table of Contents

Operating Activities

Our cash flow from operations is not only influenced by cyclicalities, demand for our services, operating margins and the type of services we provide, but can also be influenced by working capital needs such as the timing of our receivable collections. Working capital needs are generally lower during our fiscal first and second quarters due to the seasonality that we experience in many regions of the country.

Operating activities used net cash of \$9,001 during the three months ended December 31, 2011, as compared to \$15,084 of net cash used in the three months ended December 31, 2010. The decrease in the use of cash from operating activities in the three months ended December 31, 2011 is due primarily to a decrease in the net loss of \$576, a decrease in working capital usage of \$3,856, a decrease of depreciation expense of \$1,334.

Investing Activities

In the three months ended December 31, 2011, net cash used from investing activities was \$9,103 as compared to \$9,411 of net cash provided by investing activities in the three months ended December 31, 2010. Investing activities in the three months ended December 31, 2011 included \$302 used for capital expenditures, and an \$8,812 increase to restricted cash required by our credit facility. Investing activities in the three months ended December 31, 2010 included \$9.9 million from the sale of facilities, partially offset by \$391 used for capital expenditures.

Financing Activities

Financing activities used net cash of \$155 in the three months ended December 31, 2011 compared to \$305 used in the three months ended December 31, 2010. Financing activities in the three months ended December 31, 2011 included \$61 used for payments of debt. Financing activities in the three months ended December 31, 2010 included \$242 used for repayments of debt netted against \$0 provided by new financing.

Bonding Capacity

At December 31, 2011, we had adequate surety bonding capacity under our surety agreements. Our ability to access this bonding capacity is at the sole discretion of our surety providers. As of December 31, 2011, the expected cumulative cost to complete for projects covered by our surety providers was \$89,592. We believe we have adequate remaining available bonding capacity to meet our current needs, subject to the sole discretion of our surety providers. For additional information, please refer to Note 11 *Commitments and Contingencies* *Surety* of this report.

Controlling Shareholder

On October 3, 2011, the Company entered into an amended and restated letter agreement with James M. Lindstrom, to memorialize Mr. Lindstrom's appointment, effective October 3, 2011, as Chief Executive Officer and President of the Company. Mr. Lindstrom previously served in such capacities on an interim basis since June 2011 and has served as Chairman of the Company's Board of Directors since February 2011. Mr. Lindstrom was an employee of Tontine from 2006 until October 2011. In his capacity as Chief Executive Officer and President, Mr. Lindstrom has the ability to affect the composition of the Company's management and influence the business operations of the Company or extraordinary transactions outside the normal course of the Company's business.

On July 21, 2011, Tontine, filed an amended Schedule 13D indicating its ownership level of 57.4% of the Company's outstanding common stock. Although Tontine has not indicated any plans to alter its ownership level, should Tontine reconsider its investment plans and sell its controlling interest in the Company, a change in ownership would occur. A change in ownership, as defined by Internal Revenue Code Section 382, could reduce the availability of net operating losses for federal and state income tax purposes. Furthermore, a change in control would trigger the change of control provisions in a number of our material agreements, including our Revolving Credit Facility, bonding agreements with our sureties and employment contracts with certain officers and employees of the Company. On April 30, 2010, we prepaid \$15.0 million of the original \$25.0 million principal outstanding on the Tontine Term Loan; accordingly \$10.0 million remains outstanding under the Tontine Term Loan.

Table of Contents

Off-Balance Sheet Arrangements and Contractual Obligations

As is common in our industry, we have entered into certain off-balance sheet arrangements that expose us to increased risk. Our significant off-balance sheet transactions include commitments associated with non-cancelable operating leases, letter of credit obligations, firm commitments for materials and surety guarantees.

We enter into non-cancelable operating leases for many of our vehicle and equipment needs. These leases allow us to retain our cash because we do not own the vehicles or equipment, and we pay a monthly lease rental fee. At the end of the lease, we have no further obligation to the lessor. We may cancel or terminate a lease before the end of its term. Typically, we would be liable to the lessor for various lease cancellation or termination costs and the difference between the fair market value of the leased asset and the implied book value of the leased asset as calculated in accordance with the lease agreement.

Some of our customers and vendors require us to post letters of credit as a means of guaranteeing performance under our contracts and ensuring payment by us to subcontractors and vendors. If our customer has reasonable cause to effect payment under a letter of credit, we would be required to reimburse our creditor for the letter of credit. At December 31, 2011, \$630 of our outstanding letters of credit were to collateralize our customers and vendors.

Some of the underwriters of our casualty insurance program require us to post letters of credit as collateral, as is common in the insurance industry. To date, we have not had a situation where an underwriter has had reasonable cause to effect payment under a letter of credit. At December 31, 2011, \$8.2 million of our outstanding letters of credit were to collateralize our insurance programs.

From time to time, we may enter into firm purchase commitments for materials such as copper wire and aluminum wire, among others, which we expect to use in the ordinary course of business. These commitments are typically for terms less than one year and require us to buy minimum quantities of materials at specified intervals at a fixed price over the term. As of December 31, 2011, we did not have any open purchase commitments.

Many of our customers require us to post performance and payment bonds issued by a surety. Those bonds guarantee the customer that we will perform under the terms of a contract and that we will pay subcontractors and vendors. In the event that we fail to perform under a contract or pay subcontractors and vendors, the customer may demand the surety to pay or perform under our bond. Our relationship with our sureties is such that we will indemnify the sureties for any expenses they incur in connection with any of the bonds they issue on our behalf. To date, we have not incurred any costs to indemnify our sureties for expenses they incurred on our behalf.

As of December 31, 2011, our future contractual obligations due by September 30 of each of the following fiscal years include (in thousands) (1):

	Less than 1 Year	1 to 3 Years	3 to 5 Years	More than 5 Years	Total
Long-term debt obligations	\$ 1,947	\$ 10,000	\$	\$	\$ 11,947
Operating lease obligations	\$ 5,647	\$ 5,897	\$ 530	\$ 942	\$ 13,016
Capital lease obligations	\$ 209	\$ 290	\$	\$	\$ 499
Total	\$ 7,803	\$ 16,187	\$ 530	\$ 942	\$ 25,462

(1) The tabular amounts exclude the interest obligations that will be created if the debt and capital lease obligations are outstanding for the periods presented.

Our other commitments expire by September 30 of each of the following fiscal years (in thousands):

FYE Sept 30, 2012	FYE Sept 30, 2013	FYE Sept 30, 2014	Thereafter	Total
----------------------	----------------------	----------------------	------------	-------

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

Standby letters of credit	\$ 5,216	\$ 3,596	\$	\$	\$ 8,812
Other commitments	\$	\$	\$	\$	\$
Total	\$ 5,216	\$ 3,596	\$	\$	\$ 8,812

Table of Contents

Outlook

We anticipate that the combination of cash on hand, cash flows and available capacity under our Revolving Credit Facility will provide sufficient cash to enable us to meet our working capital needs, debt service requirements and capital expenditures for property and equipment through the next twelve months. We expect that our capital expenditures will range from \$1.0 to \$1.5 million for the fiscal year ending on September 30, 2012. Our ability to generate cash flow is dependent on our successful finalization of our restructuring efforts and many other factors, including demand for our products and services, the availability of projects at margins acceptable to us, the ultimate collectability of our receivables and our ability to borrow on our amended Revolving Credit Facility. For additional information see *Disclosure Regarding Forward-Looking Statements* in Part I of this Form 10-Q.

Table of Contents**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Management is actively involved in monitoring exposure to market risk and continues to develop and utilize appropriate risk management techniques. Our exposure to significant market risks includes fluctuations in commodity prices for copper, aluminum, steel and fuel. Commodity price risks may have an impact on our results of operations due to the fixed price nature of many of our contracts. We are also exposed to interest rate risk with respect to our outstanding debt obligations on the Revolving Credit Facility. For additional information see *Disclosure Regarding Forward-Looking Statements* in Part I of this Form 10-Q.

Commodity Risk

Our exposure to significant market risks includes fluctuations in commodity prices for copper, aluminum, steel and fuel. Commodity price risks may have an impact on our results of operations due to fixed nature of many of our contracts. During 2011 and 2010, commodity prices were volatile, and we experienced overall increases in prices of copper, aluminum, steel and fuel. Over the long-term, we expect to be able to pass along a portion of these costs to our customers, as market conditions in the construction industry will allow.

Interest Rate Risk

We are also exposed to interest rate risk, with respect to our outstanding revolving debt obligations as well as our letters of credit.

The following table presents principal or notional amounts and related interest rates by fiscal year of maturity for our debt obligations at December 31, 2011 (Dollar amounts in thousands):

	2012	2013	2014	2015	2016	Thereafter	Total
Debt Obligations - Fixed Rate:							
Tontine Term Loan (11%)	\$	\$ 10,000	\$	\$	\$	\$	\$ 10,000
Capital Lease (22%)	\$ 238	\$ 317	\$ 26				581
Fair Value of Debt:							
Fixed Rate	\$ 214	\$ 10,792	\$ 18	\$	\$	\$	\$ 11,024

Item 4. Controls and Procedures**Disclosure controls and procedures**

In connection with the restatements discussed in the explanatory note and in Notes 17 and 18 of our financial statements in our Form 10-K/A, under the direction of our Chief Executive Officer and Chief Financial Officer, we reevaluated our disclosure controls and procedures. We identified two material weaknesses in our internal control over financial reporting with respect to our inter-departmental communications processes at our Corporate office and within our Commercial & Industrial segment. Specifically, the Company's policies, procedures and personnel resources responsible for both our vacation accrual and certain other expenses, including software amortization, were not effective. Solely as a result of these material weaknesses, we concluded that our disclosure controls and procedures were not effective as of December 31, 2011.

During the first and second quarters of our 2012 fiscal year, we improved our inter-departmental communications at our Corporate office and Commercial & Industrial segment. We additionally implemented staffing changes, which we believe remediated each material weakness. In connection with the filing of our Form 10-K/A under the direction of our Chief Executive Officer and Chief Financial Officer, we have evaluated our disclosure controls and procedures as currently in effect, including the remedial actions discussed above, and we have concluded that, as of the filing of this Form 10-Q, our disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

As we mentioned above there were two material weaknesses that we identified. The first relates to a control deficiency at our corporate office that resulted in the inadequate reporting of certain software amortization expense. The corporate office failed to provide adequate managerial oversight, did not perform a timely review of the useful lives of its assets and did not engage in adequate inter-department communications between the IT and finance departments. The deficiency was identified by corporate management as of September 30, 2011, resulting in material revision of software amortization expense among the quarterly

Table of Contents

periods of fiscal 2011. The second material weakness identified relates to a control deficiency at our Commercial & Industrial segment that resulted in the under accrual of vacation expense. The vacation accrual for salaried employees within this segment was understated due to inadequate inter-department communications between the human resources and finance departments. This deficiency impacted our vacation accrual balance for all annual and interim periods from September 30, 2008 through 2011. The deficiency was identified by corporate management during the close process within our first quarter of fiscal year 2012, resulting in the restatement of our September 30, 2011 Form 10-K.

Remediation of Material Weakness

Management believes it has remediated the material weakness related to the review of the useful lives of its assets. The remediation included enhanced inter-department communication, additional internal financial review and a specific review of all material software currently capitalized and amortized during the company's financial close process.

Management believes it has remediated the material weakness related to the required vacation accrual. The remediation included updating the accrual process at the Commercial & Industrial segment to include the previously absent employees as of the first quarter in fiscal year 2012 and enhanced inter-departmental communication as well as the hiring of an additional resource in the finance department within our Commercial & Industrial segment.

As of the filing of this form 10-Q we believe the steps identified above have remediated the identified material weaknesses. Apart from the completion of this remediation process, there have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2011 that have materially effected, or are reasonably likely to materially effect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. *Legal Proceedings*

For further information regarding legal proceedings, see Note 11, *Commitments and Contingencies - Legal Matters* to the Consolidated Financial Statements, which is incorporated herein by reference.

Item 1A. *Risk Factors*

There have been no material changes to the risk factors disclosed under Item 1A *Risk Factors* in our annual report on Form 10-K/A for the year ended September 30, 2011.

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

None.

Item 3. *Defaults Upon Senior Securities*

None.

Item 4. *(Removed and Reserved)*

Item 5. *Other Information*

None.

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

Item 6. *Exhibits*

- 3.1 Second Amended and Restated Certificate of Incorporation of Integrated Electrical Services, Inc. (Incorporated by reference to Exhibit 4.1 to the Company's registration statement on Form S-8 filed on May 12, 2006)
- 3.2 Bylaws of Integrated Electrical Services, Inc. (Incorporated by reference to Exhibit 4.2 to the Company's registration statement on Form S-8, filed on May 12, 2006)

Table of Contents

* 31.1	Rule 13a-14(a)/15d-14(a) Certification of James M. Lindstrom, Chief Executive Officer(1)
* 31.2	Rule 13a-14(a)/15d-14(a) Certification of Robert W. Lewey, Chief Financial Officer(1)
* 32.1	Section 1350 Certification of James M. Lindstrom, Chief Executive Officer(1)
* 32.2	Section 1350 Certification of Robert W. Lewey, Chief Financial Officer(1)
** 101.INS	XBRL Instance Document
** 101.SCH	XBRL Schema Document
** 101.LAB	XBRL Label Linkbase Document
** 101.PRE	XBRL Presentation Linkbase Document
** 101.DEF	XBRL Definition Linkbase Document
** 101.CAL	XBRL Calculated Linkbase Document
* Filed herewith.	
** Furnished herewith.	

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, who has signed this report on behalf of the registrant and as the principal financial officer of the registrant.

INTEGRATED ELECTRICAL SERVICES, INC.

Date: March 30, 2012

By: /s/ ROBERT W. LEWEY
Robert W. Lewey
Senior Vice President and Chief Financial Officer