

MATRIX SERVICE CO
Form 10-K
September 01, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended June 30, 2016

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 No. 1-15461

MATRIX SERVICE COMPANY
(Exact name of registrant as specified in its charter)
Delaware 73-1352174
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

5100 E. Skelly Drive, Suite 500 74135
Tulsa, Oklahoma
(Address of Principal Executive Offices) (Zip Code)
Registrant's telephone number, including area code: (918) 838-8822

Securities Registered Pursuant to Section 12(b) of the Act:
(Title of class)

Common Stock, par value \$0.01 per share
Securities Registered Pursuant to Section 12(g) of the Act: None

Name of each exchange on which registered: NASDAQ Global Select Market (common stock)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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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

The aggregate market value of the registrant's common stock held by non-affiliates computed by reference to the price at which the common stock was last sold as of the last business day of the registrant's most recently completed second quarter was approximately \$546 million.

The number of shares of the registrant's common stock outstanding as of August 29, 2016 was 26,520,376 shares.

Documents Incorporated by Reference

Certain sections of the registrant's definitive proxy statement relating to the registrant's 2016 annual meeting of stockholders, which definitive proxy statement will be filed within 120 days of the end of the registrant's fiscal year, are incorporated by reference into Part III of this Form 10-K.

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PART I

Item 1. Business

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical facts, included in this Annual Report which address activities, events or developments, which we expect, believe or anticipate will or may occur in the future are forward-looking statements. The words “believes,” “intends,” “expects,” “anticipates,” “projects,” “estimates,” “predicts” and similar expressions are also intended to identify forward-looking statements.

These forward-looking statements include, among others, such things as:

- the impact to our business of crude oil and other commodity prices;
- amounts and nature of future revenues and margins from each of our segments;
- trends in the industries we serve;
- our ability to generate sufficient cash from operations or to raise cash in order to meet our short and long-term capital requirements;
- the likely impact of new or existing regulations or market forces on the demand for our services;
- expansion and other trends of the industries we serve;
- our expectations with respect to the likelihood of a future impairment; and
- our ability to comply with the covenants in our credit agreement.

These statements are based on certain assumptions and analyses we made in light of our experience and our historical trends, current conditions and expected future developments as well as other factors we believe are appropriate.

However, whether actual results and developments will conform to our expectations and predictions is subject to a number of risks and uncertainties which could cause actual results to differ materially from our expectations, including:

- the risk factors discussed in Item 1A of this Annual Report and listed from time to time in our filings with the Securities and Exchange Commission;
- economic, market or business conditions in general and in the oil, gas, power, iron and steel and mining industries in particular;
 - reduced creditworthiness of our customer base and the higher risk of non-payment of receivables due to low prevailing crude oil and other commodity prices;
- the inherently uncertain outcome of current and future litigation;
- the adequacy of our reserves for contingencies;
- changes in laws or regulations; and
- other factors, many of which are beyond our control.

Consequently, all of the forward-looking statements made in this Annual Report are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by us will be realized or, even if substantially realized, that they will have the expected consequences or effects on our business operations. We assume no obligation to update publicly, except as required by law, any such forward-looking statements, whether as a result of new information, future events or otherwise.

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BACKGROUND

The Company began operations in 1984 as an Oklahoma corporation under the name of Matrix Service. In 1989, we incorporated in the State of Delaware under the name of Matrix Service Company. We provide engineering, fabrication, infrastructure, construction, and maintenance services primarily to the oil, gas, power, petrochemical, industrial, mining and minerals markets. We maintain regional offices throughout the United States, Canada and other international locations, and operate through separate union and merit subsidiaries.

The Company is licensed to operate in all 50 states, in four Canadian provinces and in other international locations. Our principal executive offices are located at 5100 E. Skelly Drive, Suite 500, Tulsa, Oklahoma 74135. Our telephone number is (918) 838-8822. Unless the context otherwise requires, all references herein to “Matrix Service Company”, “Matrix”, the “Company” or to “we”, “our”, and “us” are to Matrix Service Company and its subsidiaries.

WEBSITE ACCESS TO REPORTS

Our public website is matrixservicecompany.com. We make available free of charge through the "Investor Relations" section of our website our annual reports to stockholders, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission ("SEC"). Any materials we file with or furnish to the SEC is also maintained on the SEC website (sec.gov).

The information contained on our website, or available by hyperlink from our website, is not incorporated into this Form 10-K or other documents we file with, or furnish to, the SEC. We intend to use our website as a means of disclosing material non-public information and for complying with our disclosure obligations under Regulation FD. Such disclosures will be included on our website in the "Investor Relations" section. We also intend to use social media channels as a means of disclosing material non-public information and for complying with our disclosure obligations under Regulation FD. We encourage investors, the media, and others interested in Matrix to review the information posted on the company Facebook site (facebook.com/matrixservicecompany), the company LinkedIn account (linkedin.com/company/matrix-service-company) and the company twitter account (twitter.com/matrixserviceco). Investors, the media or other interested parties can subscribe to the twitter feed at the address listed above. Any updates to the list of social media channels Matrix will use to announce material information will be posted on the "Investor Relations" page of the company's website at matrixservicecompany.com. Accordingly, investors should monitor such portions of our website and social media channels, in addition to following our press releases, SEC filings and public conference calls and webcasts.

OPERATING SEGMENTS

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

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

The Oil Gas & Chemical segment includes turnaround activities, plant maintenance services and construction in the downstream petroleum industry. Another key offering is industrial cleaning services, which include hydroblasting, hydroexcavating, chemical cleaning and vacuum services. We also perform work in the petrochemical, natural gas, gas processing and compression, and upstream petroleum markets.

The Storage Solutions segment includes new construction of crude and refined products aboveground storage tanks (“ASTs”), as well as planned and emergency maintenance services. The Storage Solutions segment also includes balance of plant work in storage terminals and tank farms. Also included in the Storage Solutions segment is work related to specialty storage tanks, including liquefied natural gas (“LNG”), liquid nitrogen/liquid oxygen (“LIN/LOX”), liquid petroleum (“LPG”) tanks and other specialty vessels, including spheres. Finally, we offer AST products, including geodesic domes, aluminum internal floating roofs, floating suction and skimmer systems, roof drain systems and

floating roof seals.

The Industrial segment includes construction and maintenance work in the iron and steel and mining and minerals industries. Our work in the mining and minerals industry is primarily for customers engaged in the extraction of copper. We also perform work in bulk material handling and fertilizer production facilities, thermal vacuum chambers, and other industrial markets.

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RECENT DEVELOPMENTS

Matrix Applied Technologies

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

The Company purchased BTE with cash on-hand for a net purchase price of \$13.0 million. The Company paid \$15.4 million when including the subsequent repayment of long-term debt acquired and the settlement of certain other liabilities acquired, and excluding the cash acquired and certain amounts owed to the former owners for working capital adjustments.

HDB Ltd. Limited Partnership

On August 22, 2014, the Company purchased substantially all of the assets of HDB Ltd. Limited Partnership ("HDB"). HDB, headquartered in Bakersfield, California provides construction, fabrication and turnaround services to energy companies throughout California's central valley. The acquisition advanced a strategic goal of the Company to expand into the upstream energy market. The acquisition purchase price was \$5.6 million and was funded with cash on hand. Commencing on August 22, 2014, HDB's operating results are included in the Oil Gas & Chemical Segment.

Matrix NAC

Effective as of December 21, 2013, the Company acquired 100% of the stock of Kvaerner North American Construction Ltd. and substantially all of the assets of Kvaerner North American Construction Inc., together referenced as "KNAC". The businesses are now known as Matrix North American Construction Ltd. and Matrix North American Construction, Inc., together referenced as "Matrix NAC". Matrix NAC is a provider of maintenance and capital construction services to power generation, integrated iron and steel, and industrial process facilities. The acquisition significantly expanded the Company's presence in the Electrical Infrastructure and Industrial segments, and to a lesser extent, the Oil Gas and Chemical segment. In addition, the KNAC acquisition has brought opportunities in additional geographical markets, the ability to execute additional and larger projects and has allowed us to expand our relationship with some existing clients.

The Company purchased KNAC for \$51.6 million, net of cash acquired. The acquisition was funded through a combination of cash-on-hand and borrowings under our senior revolving credit facility.

Impact of Commodity Price Volatility

The prolonged decline in crude prices has begun to impact our income from operations and project awards, particularly in the Oil Gas & Chemical and Storage Solutions segments. The Industrial segment continues to be negatively impacted by the low prices of other commodities, principally steel and copper. The decline in commodity prices has not had, and we do not expect a significant impact on the Electrical Infrastructure segment.

In the mid and downstream portions of the Oil Gas & Chemical segment, we are seeing lower volumes of routine maintenance and turnaround work as well as a general slowdown of capital projects. Additionally, since some of our mid and downstream customers are integrated oil companies with exposure to the price of crude, if the prices remain at current levels or decline further, spending levels may continue to be reduced. Our exposure to non-integrated upstream clients in the Oil Gas & Chemical segment is not significant.

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In our Storage Solutions segment, our customers continue to take a long-term view of the market, but continue to be cautious short-term, particularly on larger projects. Based on current market conditions, we are seeing a reduction in customer spending and project award delays. We cannot predict the direction of commodity prices or our customers' ultimate reaction to the market and therefore cannot predict the magnitude of the impact to our future earnings.

In the Industrial segment, our iron and steel customers face significant uncertainty related to the slowdown in the Chinese economy and the related impact on steel imports and steel prices, the strong United States Dollar, the domestic demand for steel and the impact of anti-dumping duties on steel imports. This uncertainty has reduced the capital, expansion and elective maintenance spending of our customers. Although we are seeing some encouraging signs in the market, we do not expect higher levels of spending until the overall uncertainty in this market is reduced and economic conditions within the industry improve. In the mining and minerals markets, we continue to see lower spending due to the softness of other commodity prices, particularly copper, to which our clients are exposed.

OTHER BUSINESS MATTERS

Customers and Marketing

The Company provided services to approximately 500 customers in fiscal 2016. One customer, TransCanada Corporation, accounted for \$194.0 million or 14.8% of our consolidated revenue, \$135.7 million of which was in the Electrical Infrastructure segment and \$57.5 million of which was in the Storage Solutions segment. Another customer, Energy Transfer Partners, L.P., accounted for \$139.5 million or 10.6% of our consolidated revenue, all of which was in the Storage Solutions segment. The loss of these major customers or other significant customers could have a material adverse effect on the Company; however, we are not dependent on any single contract or customer on an on-going basis.

Matrix markets its services and products primarily through its marketing and business development personnel, senior professional staff and its operating management. We competitively bid most of our projects; however, we have a number of preferred provider relationships with customers who award us work through long-term agreements. Our projects have durations ranging from a few days to multiple years.

Segment Financial Information

Financial information for our operating segments is provided in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, and in Note 13-Segment Information of the Notes to Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.

Competition

Our industry is highly fragmented and intensely competitive. We compete with local, regional, national and international contractors and service providers. Competitors vary with the markets we serve with few competitors competing in all of the markets we serve or in all of the services we provide. Contracts are generally awarded based on price, quality, safety performance, schedule, and customer satisfaction.

Backlog

We define backlog as the total dollar amount of revenue that we expect to recognize as a result of performing work that has been awarded to us through a signed contract, notice to proceed or other type of assurance that we consider firm. The following arrangements are considered firm:

• fixed-price awards;

• minimum customer commitments on cost plus arrangements; and

• certain time and material arrangements in which the estimated value is firm or can be estimated with a reasonable amount of certainty in both timing and amount.

For long-term maintenance contracts, we include only the amounts that we expect to recognize as revenue over the next 12 months. For all other arrangements, we calculate backlog as the estimated contract amount less revenues recognized as of the reporting date.

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The following table provides a summary of changes in our backlog in fiscal 2016:

	Electrical Infrastructure	Oil Gas & Chemical	Storage Solutions	Industrial	Total
	(In thousands)				
Backlog as of June 30, 2015	\$493,973	\$132,985	\$670,493	\$123,147	\$1,420,598
Project awards	224,829	208,288	274,045	86,448	793,610
Project delays and cancellations	—	—	(22,013)	(11,606)	(33,619)
Revenue recognized	(349,011)	(249,795)	(563,512)	(149,599)	(1,311,917)
Backlog as of June 30, 2016	\$369,791	\$91,478	\$359,013	\$48,390	\$868,672

Project awards in all segments are cyclical and are typically the result of a sales process that can take several months to complete. Backlog in the Storage Solutions and Electrical Infrastructure segments generally have the greatest volatility because individual project awards can be less frequent and more significant.

The decline in backlog in the Electrical Infrastructure segment is mainly attributable to the work related to the previously announced Napanee Power Generating Station project. Awards in power delivery continue to meet the Company's expectations.

Backlog in the Industrial segment was negatively impacted by a slowdown in the iron and steel and mining industries as well as a mining-related project cancellation of \$11.6 million in the first quarter. The cancellation was not attributable to the Company's performance on the project. It is our belief that the cancellation was attributable to softness in commodity prices, including copper, to which the client is exposed.

The decline in backlog in the Storage Solutions Segment is attributable to the work related to the previously announced project for the construction of terminals supporting the Dakota Access Pipeline. In addition, a more cautious approach to decision-making on the part of clients, together with more stringent financial and regulatory requirements, is delaying the timing of some of the larger awards. Although we are seeing increased competition, awards for small and medium sized projects are generally meeting the Company's expectations.

Backlog in the Storage Solutions segment was negatively impacted in the second quarter by \$22.0 million related to the indefinite delay of remaining work on a project for one of our Canadian customers for the construction of aboveground storage tanks at a storage terminal. At the onset of the project, the customer anticipated receiving the appropriate permitting approvals for the pipeline that would have run from the storage terminal to the Gulf Coast of the United States. In November of 2015, the President of the United States rejected approval of the pipeline. The customer was also considering deploying the storage tanks for another project that was indefinitely deferred due to the low price of crude oil.

Seasonality and Other Factors

Our operating results can exhibit seasonal fluctuations, especially in our Oil Gas & Chemical segment, for a variety of reasons. Turnarounds and planned outages at customer facilities are typically scheduled in the spring and the fall when the demand for energy is lower. Within the Electrical Infrastructure segment, transmission and distribution work is generally scheduled by the public utilities when the demand for electricity is at its lowest. Therefore, revenue volume in the summer months is typically lower than in other periods throughout the year. Also, we typically see a lower level of operating activity relating to construction projects during the winter months and early in the calendar year because many of our customers' capital budgets have not been finalized. Our business can also be affected, both positively and negatively, by seasonal factors such as energy demand or weather conditions including hurricanes, snowstorms, and abnormally low or high temperatures. Some of these seasonal factors may cause some of our offices and projects to close or reduce activities temporarily. In addition to the above noted factors, the general timing of project starts and completions could exhibit significant fluctuations. Accordingly, results for any interim period may not necessarily be indicative of future operating results.

Other factors impacting operating results in all segments come from work site permitting delays or customers accelerating or postponing work. The differing types, sizes, and durations of our contracts, combined with their geographic diversity and stages of completion, often results in fluctuations in the Company's operating results.

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Material Sources and Availability

Steel plate and steel pipe are key materials used by the Company. Supplies of these materials are available throughout the United States and globally from numerous sources. We anticipate that adequate amounts of these materials will be available in the foreseeable future. However, the price, quantity, and the delivery schedules of these materials could change rapidly due to various factors, including producer capacity, the level of imports, worldwide demand, tariffs on imported steel and other market conditions.

Insurance

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