TEAM INC
Form 10-Q
April 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended February 29, 2012

OR

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

For the transition period to

Commission File Number 001-08604

TEAM, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**74-1765729**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
200 Hermann Drive, Alvin, Texas	**77511**
(Address of Principal Executive Offices)	**(Zip Code)**

(281) 331-6154

(Registrant s Telephone Number, Including Area Code)

None

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 x 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 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	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	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 x

The Registrant had 19,906,121 shares of common stock, par value $0.30, outstanding and 89,569 shares of treasury stock as of April 3, 2012.

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EXHIBITS

31.1 Certification of CEO Pursuant to Section 302
31.2 Certification of CFO Pursuant to Section 302
32.1 Certification of CEO Pursuant to Section 906
32.2 Certification of CFO Pursuant to Section 906
*101.INS XBRL Instance Document.
*101.SCH XBRL Taxonomy Schema Document.
*101.CAL XBRL Calculation Linkbase Document.
*101.LAB XBRL Label Linkbase Document.
*101.PRE XBRL Presentation Linkbase Document.

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PART I FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

TEAM, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS

(in thousands, except share and per share data)

	February 29, 2012 (unaudited)	May 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 27,460	$ 14,078
Receivables, net of allowance of $4,402 and $4,222	133,877	143,120
Inventory	23,346	21,335
Prepaid income taxes	1,881	
Deferred income taxes	3,138	3,795
Prepaid expenses and other current assets	5,833	7,946
Total current assets	195,535	190,274
Property, plant and equipment, net	65,725	58,567
Intangible assets, net of accumulated amortization of $5,101 and $3,218	18,188	14,819
Goodwill	99,250	89,520
Other assets, net	2,874	2,189
Deferred income taxes	297	117
Total assets	$ 381,869	$ 355,486
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	$	$ 212
Accounts payable	17,005	24,371
Other accrued liabilities	31,873	32,511
Income taxes payable		2,641
Deferred income taxes		6
Total current liabilities	48,878	59,741
Deferred income taxes	12,019	10,431
Long-term debt	88,093	75,868
Total liabilities	148,990	146,040
Commitments and contingencies		
Stockholders equity:		
Preferred stock, 500,000 shares authorized, none issued		
Common stock, par value $0.30 per share, 30,000,000 shares authorized; 19,893,521 and 19,571,138 shares issued	5,967	5,871
Non-controlling interest	5,016	4,983
Additional paid-in capital	83,854	77,867
Retained earnings	138,285	119,138
Accumulated other comprehensive income	1,101	2,931
Treasury stock at cost, 89,569 and 89,569 shares	(1,344)	(1,344)

Total stockholders equity		232,879		209,446
Total liabilities and stockholders equity	$	381,869	$	355,486

See notes to unaudited consolidated condensed financial statements.

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TEAM, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED CONDENSED STATEMENTS OF INCOME

(in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	February 29, 2012	February 28, 2011	February 29, 2012	February 28, 2011
Revenues	$ 136,523	$ 108,820	$ 435,889	$ 346,462
Operating expenses	99,920	78,083	304,393	240,435
Gross margin	36,603	30,737	131,496	106,027
Selling, general and administrative expenses	33,210	27,616	100,116	82,969
Earnings from unconsolidated affiliates	63	120	911	755
Operating income	3,456	3,241	32,291	23,813
Interest expense, net	619	525	1,769	1,371
Foreign currency (gain) loss	(90)	(42)	74	(53)
Earnings before income taxes	2,927	2,758	30,448	22,495
Provision for income taxes (see Note 3)	946	(1,173)	11,266	6,722
Net income	1,981	3,931	19,182	15,773
Less: (loss) income attributable to non-controlling interest	(30)	34	35	9
Net income available to Team shareholders	$ 2,011	$ 3,897	$ 19,147	$ 15,764
Net income per share: Basic	$ 0.10	$ 0.20	$ 0.98	$ 0.82
Net income per share: Diluted	$ 0.10	$ 0.19	$ 0.93	$ 0.79

See notes to unaudited consolidated condensed financial statements.

TEAM, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Three Months Ended		Nine Months Ended	
	February 29, 2012	February 28, 2011	February 29, 2012	February 28, 2011
Net income	$ 1,981	$ 3,931	$ 19,182	$ 15,773
Foreign currency translation adjustment	3,293	4,061	(3,037)	6,393
Foreign currency hedge	(117)	(933)	1,164	(1,868)
Tax provision attributable to other comprehensive income	(754)	(3,551)	41	(2,760)
Total comprehensive income	4,403	3,508	17,350	17,538
Less: total comprehensive income attributable to non-controlling interest	2	37	33	9
Total comprehensive income available to Team shareholders	$ 4,401	$ 3,471	$ 17,317	$ 17,529

See notes to unaudited consolidated condensed financial statements.

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TEAM, INC. AND SUBSIDIARIES

UNAUDITED CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended	
	February 29, 2012	February 28, 2011
Cash flows from operating activities:		
Net income	$ 19,182	$ 15,773
Adjustments to reconcile net income to net cash provided by operating activities:		
Earnings from unconsolidated affiliates	(911)	(755)
Depreciation and amortization	12,913	10,686
Loss on asset sales		129
Amortization of deferred loan costs	228	228
Foreign currency loss (gain)	74	(53)
Deferred income taxes	2,135	578
Non-cash compensation cost	3,518	3,848
(Increase) decrease:		
Receivables	7,554	17,823
Inventory	(2,170)	(851)
Prepaid expenses and other current assets	2,056	1,300
Increase (decrease):		
Accounts payable	(7,150)	(6,479)
Other accrued liabilities	(229)	3,020
Income taxes	(4,572)	(5,483)
Net cash provided by operating activities	32,628	39,764
Cash flows from investing activities:		
Capital expenditures	(15,825)	(8,064)
Business acquisitions, net of cash acquired	(19,351)	(41,376)
Proceeds from sale of assets	220	
Distributions from joint venture	800	750
Decrease (increase) in other assets, net	13	(138)
Net cash used in investing activities	(34,143)	(48,828)
Cash Flows From Financing Activities:		
Borrowings under revolving credit agreement, net	13,710	19,435
Payments related to term and auto notes	(236)	(243)
Debt issuance costs	(799)	
Corporate tax effect from share-based payment arrangements	1,195	(844)
Issuance of common stock from share-based payment arrangements	2,227	2,000
Payments related to withholding tax for share-based payment arrangements	(853)	(434)
Purchase of treasury stock		(1,344)
Net cash provided by financing activities	15,244	18,570
Effect of exchange rate changes on cash	(347)	519
Net increase in cash and cash equivalents	13,382	10,025
Cash and cash equivalents at beginning of period	14,078	12,610

Cash and cash equivalents at end of period	$ 27,460	$ 22,635

See notes to unaudited consolidated condensed financial statements.

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TEAM, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED CONDENSED

FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PRACTICES

Introduction. Unless otherwise indicated, the terms Team, Inc., Team, the Company, we, our and us are used in this report to refer to Tea Inc., to one or more of our consolidated subsidiaries or to all of them taken as a whole. We are incorporated in the State of Delaware and our company website can be found at *www.teamindustrialservices.com*. Our corporate headquarters is located at 200 Hermann Drive, Alvin, Texas, 77511 and our telephone number is (281) 331-6154. Prior to January 3, 2012 our stock was traded on the NASDAQ Global Select Market (NASDAQ) under the symbol TISI . Beginning January 3, 2012 our stock is now traded on the New York Stock Exchange (NYSE) under the same symbol. Our fiscal year ends on May 31 of each calendar year.

We are a leading provider of specialty maintenance and construction services required in maintaining high temperature and high pressure piping systems and vessels that are utilized extensively in heavy industries. We offer an array of complementary services including:

- Inspection and Assessment,
- Field Heat Treating,
- Leak Repair,
- Fugitive Emissions Control,
- Hot Tapping,
- Field Machining,
- Technical Bolting, and
- Field Valve Repair.

We offer these services in over 100 locations throughout the world. Our industrial services are available 24 hours a day, 7 days a week, 365 days a year. We market our services to companies in a diverse array of heavy industries which include petrochemical, refining, power, pipeline, steel, pulp and paper industries, as well as municipalities, shipbuilding, original equipment manufacturers (OEMs), distributors, and some of the world s largest engineering and construction firms. Our services are also provided across a broad geographic reach.

Basis for presentation. These interim financial statements are unaudited, but in the opinion of our management, reflect all adjustments, consisting of normal recurring adjustments necessary for a fair presentation of results for such periods. The consolidated condensed balance sheet at May 31, 2011 is derived from the May 31, 2011 audited consolidated financial statements. The results of operations for any interim period are not necessarily indicative of results for the full year. These financial statements should be read in conjunction with the financial statements and notes thereto contained in our annual report on Form 10-K for the fiscal year ended May 31, 2011.

Consolidation. The consolidated financial statements include the accounts of Team, Inc. and our majority-owned subsidiaries where we have control over operating and financial policies. Investments in affiliates in which we have the ability to exert significant influence over operating and financial policies, but where we do not control the operating and financial policies, are accounted for using the equity method. All material intercompany accounts and transactions have been eliminated in consolidation.

Use of estimates. Our accounting policies conform to Generally Accepted Accounting Principles in the U.S. (GAAP). The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and judgments that affect our reported financial position and results of operations. We review significant estimates and judgments affecting our consolidated financial statements on a recurring basis and record the effect of any necessary adjustments

prior to their publication. Estimates and judgments are based on information available at the time such estimates and judgments are made. Adjustments made with respect to the use of these estimates and judgments often relate to information not previously available. Uncertainties with respect to such estimates and judgments are inherent in the preparation of financial statements. Estimates and judgments are used in, among other things, (1) aspects of revenue recognition, (2) valuation of tangible and intangible assets and subsequent assessments for possible impairment, (3) the fair value of the non-controlling interest in subsidiaries that are not wholly-owned, (4) estimating various factors used to accrue liabilities for workers compensation, auto, medical and general liability, (5) establishing an allowance for uncollectible accounts receivable, (6) estimating the useful lives of our assets and (7) assessing future tax exposure and the realization of tax assets.

Income taxes. We follow the guidance of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740, *Income Taxes* (ASC 740), which requires that we use the asset and liability method of accounting for deferred income taxes and provide deferred income taxes for all significant temporary differences. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax payable and related tax expense together with assessing temporary differences resulting from differing treatment of certain items, such as depreciation, for tax and accounting purposes. These differences can result in deferred tax assets and liabilities, which are included within our consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that it is more likely than not (a likelihood of more than 50%) that some portion or all of the deferred tax assets will not be realized, we must establish a valuation allowance. We consider all available evidence to determine whether, based on the weight of the evidence, a valuation allowance is needed. Evidence used includes information about our current financial position and our results of operations for the current and preceding years, as well as all currently available information about future years, including our anticipated future performance, the reversal of deferred tax liabilities, share-based compensation and tax planning strategies.

Fair value of financial instruments. Our financial instruments consist primarily of cash, cash equivalents, accounts receivable, accounts payable and debt obligations. The carrying amount of cash, cash equivalents, trade accounts receivable and trade accounts payable are representative of their respective fair values due to the short-term maturity of these instruments. The fair value of our banking facility is representative of the carrying value based upon the variable terms and management s opinion that the current rates available to us with the same maturity and security structure are equivalent to that of the banking facility.

Cash and cash equivalents. Cash and cash equivalents consist of all demand deposits and funds invested in highly liquid short-term investments with original maturities of three months or less.

Inventory. Inventory is stated at the lower of cost (first-in, first-out method) or market. Inventory includes material, labor and certain fixed overhead costs.

Property, plant and equipment. Property, plant and equipment are stated at cost less accumulated depreciation and amortization. Leasehold improvements are amortized over the shorter of their respective useful life or the lease term. Depreciation and amortization of assets are computed by the straight-line method over the following estimated useful lives of the assets:

Classification	Useful Life
Buildings	20-40 years
Leasehold improvements	2-10 years
Machinery and equipment	2-12 years
Furniture and fixtures	2-10 years
Computers and computer software	2-5 years
Automobiles	2-5 years

Goodwill, Intangible Assets, and Non-controlling Interest. Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business

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combination and determined to have an indefinite useful life are not amortized, but are instead tested for impairment at least annually in accordance with the provisions of ASC 350, *Intangibles Goodwill and Other* (ASC 350). Intangible assets with estimated useful lives are amortized over their respective estimated useful lives to their estimated residual values and reviewed for impairment in accordance with ASC 350.

We operate in only one segment the industrial services segment (see Note 11). Within the industrial services segment, we are organized as two divisions. Our TCM division provides the services of inspection and assessment and field heat treating. Our TMS division provides the services of leak repair, fugitive emissions control, hot tapping, field machining, technical bolting and field valve repair. Each division has goodwill relating to past acquisitions and we assess goodwill for impairment at the lower TCM and TMS divisional level.

Our annual goodwill impairment test is conducted as of May 31 of each year, which is our fiscal year end. Conducting the impairment test as of May 31 of each fiscal year aligns with our annual budget process which is typically completed during the fourth quarter of each year. In addition, performing our annual goodwill impairment test as of this date allows for a thorough consideration of the valuations of our business units subsequent to the completion of our annual budget process but prior to our financial year end reporting date. The annual impairment test for goodwill is a two-step process that involves comparing the estimated fair value of each business unit to the unit s carrying value, including goodwill. If the fair value of a business unit exceeds its carrying amount, the goodwill of the business unit is not considered impaired; therefore, the second step of the impairment test is unnecessary. If the carrying amount of a business unit exceeds its fair value, we would then perform a second step to the goodwill impairment test to measure the amount of goodwill impairment loss to be recorded. Consistent with prior years, the fair values of reporting units in fiscal years 2011 and 2010 were determined using a method based on discounted cash flow models with estimated cash flows based on internal forecasts of revenues and expenses over a four year period plus a terminal value period (the income approach). The income approach estimates fair value by discounting each reporting unit s estimated future cash flows using a discount rate that approximates both our weighted-average cost of capital and reflects current market conditions.

The fair value derived from the income approach in our most recent test for impairment, in the aggregate, approximated our market capitalization. At May 31, 2011, our market capitalization exceeded the carrying value of our consolidated net assets by approximately $250 million, or 117%, and the fair value of both our individual reporting units significantly exceeded their respective carrying amounts as of that date. Projected growth rates and other market inputs to our impairment test models, such as the discount rate, are sensitive to the risk of future variances due to market conditions as well as business unit execution risks. Consequently, if future results fall below our forward-looking projections for an extended period of time, the results of future impairment tests could indicate an impairment. Although we believe the cash flow projections in our income approach make reasonable assumptions about our business, a significant increase in competition or reduction in our competitive capabilities could have a significant adverse impact on our ability to retain market share and thus on the projected margins included in the income approach used to value our reporting units. We periodically review our projected growth rates and other market inputs used in our impairment test models as well as changes in our business and other factors that could represent indicators of impairment. Subsequent to our May 31, 2011 annual impairment test, no such indicators of impairment were identified.

There was $99.3 million and $89.5 million of goodwill at February 29, 2012 and May 31, 2011, respectively. A summary of goodwill is as follows (in thousands):

		Nine Months Ended February 29, 2012	
	TCM Division	TMS Division	Total
Balance at May 31, 2011	$ 76,872	$ 12,648	$ 89,520
Acquisition and purchase price adjustments		11,084	11,084
Foreign currency adjustments	(522)	(832)	(1,354)
Balance at February 29, 2012	$ 76,350	$ 22,900	$ 99,250

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Allowance for doubtful accounts. In the ordinary course of business, a percentage of our accounts receivable are not collected due to billing disputes, customer bankruptcies, dissatisfaction with the services we performed and other various reasons. We establish an allowance to account for those accounts receivable that will eventually be deemed uncollectible. The allowance for doubtful accounts is based on a combination of our historical experience and management s review of long outstanding accounts receivable.

Workers compensation, auto, medical and general liability accruals. In accordance with ASC 450, *Contingencies* (ASC 450), we record a loss contingency when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We review our loss contingencies on an ongoing basis to ensure that we have appropriate reserves recorded on our balance sheet. These reserves are based on historical experience with claims incurred but not received, estimates and judgments made by management, applicable insurance coverage for litigation matters, and are adjusted as circumstances warrant. For workers compensation and automobile liability our self-insured retention is currently $500,000 per occurrence. For general liability claims we have an effective self-insured retention of $5 million per occurrence. Our historical claims occurring before June 1, 2009 had a lower self-insured retention, typically $250,000. For medical claims, our self-insured retention is $150,000 per individual claimant determined on an annual basis. For environmental liability claims, our self-insured retention is $500,000 per occurrence. We maintain insurance for claims that exceed such self-retention limits. The insurance is subject to terms, conditions, limitations and exclusions that may not fully compensate us for all losses. Our estimates and judgments could change based on new information, changes in laws or regulations, changes in management s plans or intentions, or the outcome of legal proceedings, settlements or other factors. If different estimates and judgments were applied with respect to these matters, it is likely that reserves would be recorded for different amounts.

Revenue recognition. We determine our revenue recognition guidelines for our operations based on guidance provided in applicable accounting standards and positions adopted by the FASB or the Securities and Exchange Commission (the SEC). Most of our projects are short-term in nature and we predominantly derive revenues by providing a variety of industrial services on a time and material basis. For all of these services our revenues are recognized when services are rendered or when product is shipped and risk of ownership passes to the customer. However, due to various contractual terms with our customers, at the end of any reporting period, there may be earned but unbilled revenue that is accrued to properly match revenues with related costs. At February 29, 2012 and May 31, 2011, the amount of earned but unbilled revenue included in accounts receivable was $19.5 million and $12.4 million, respectively.

Concentration of credit risk. No single customer accounts for more than 10% of consolidated revenues.

Earnings per share. Basic earnings per share is computed by dividing net income available to Team shareholders by the weighted-average number of shares of common stock outstanding during the year. Diluted earnings per share is computed by dividing net income available to Team shareholders, less income or loss for the period attributable to the non-controlling interest, by the sum of, (1) the weighted-average number of shares of common stock, net of treasury stock, outstanding during the period, (2) the dilutive effect of the assumed exercise of share-based compensation using the treasury stock method and (3) the dilutive effect of the assumed conversion of our non-controlling interest to our common stock (see Note 2).

Amounts used in basic and diluted earnings per share, for the three and nine months ended February 29, 2012 and February 28, 2011, are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	February 29, 2012	February 28, 2011	February 29, 2012	February 28, 2011
Weighted-average number of basic shares outstanding	19,733	19,342	19,610	19,114
Stock options, stock units and performance awards	792	852	757	684
Assumed conversion of non-controlling interest	203	209	233	116
Total shares and dilutive securities	20,728	20,403	20,600	19,914

There were 578,000 and 652,000 options to purchase shares of common stock outstanding during the three month periods ended February 29, 2012 and February 28, 2011, excluded from the computation of diluted earnings per share because the options exercise prices were greater than the average market price of common shares during the periods. There were 643,000 and 777,000 options to purchase shares of common stock outstanding during the nine month periods ended February 29, 2012 and February 28, 2011, excluded from the computation of diluted earnings per share because the options exercise prices were greater than the average market price of common shares during the periods.

***Foreign currency*.** For subsidiaries whose functional currency is not the U.S. Dollar, assets and liabilities are translated at period ending rates of exchange and revenues and expenses are translated at period average exchange rates. Translation adjustments for the asset and liability accounts are included as a separate component of accumulated other comprehensive income in stockholders equity. Foreign currency transaction gains and losses are included in our statement of income. We account for our Venezuelan operations as a highly-inflationary economy and the effect of currency fluctuations between the Bolivar and the U.S. Dollar are recorded in our statement of income (see Note 13).

Accounting principles not yet adopted. In June 2011, the FASB issued an update to existing guidance on the presentation of comprehensive income. This update requires the presentation of the components of net income and other comprehensive income either in a single continuous statement or in two separate but consecutive statements. In addition, companies are also required to present reclassification adjustments for items that are reclassified from other comprehensive income to net income on the face of the financial statements. In December 2011, the FASB issued an accounting update to defer the effective date for presentation of reclassification of items out of accumulated other comprehensive income to net income. These updates are effective for fiscal years and interim periods beginning after December 15, 2011 with early adoption permitted. We do not anticipate the FASB update to have a material effect on our results of operations, financial position or cash flows.

2. ACQUISITIONS

On November 3, 2010, we purchased Quest Integrity Group, LLC (Quest), a privately held advanced inspection services and engineering assessment company. We effectively purchased 95% of Quest for a total consideration paid to Quest shareholders of $41.7 million, consisting of a cash payment of $39.1 million and the issuance of our restricted common stock with a fair value of $2.6 million (approximately 186,000 shares). Additionally, we also assumed debt, net of cash on hand, with a value of $2.3 million. We repaid the debt upon consummation of the purchase. In connection with this transaction, we borrowed $41.4 million under our banking credit facility (our Credit Facility) which was used to fund the cash portion of the purchase price, including the retirement of Quest debt. We expect to purchase the remaining 5% in fiscal year 2015 for a purchase consideration based upon the future financial performance of Quest as defined in the purchase agreement. Future consideration would be payable in unregistered shares of our common stock for an aggregate value of no less than $2.4 million, provided the aggregate value of the consideration does not exceed 20% of our outstanding common stock. Our valuation of the remaining 5% equity of Quest at the date of acquisition was $4.9 million, and the current carrying value is reflected in the shareholders equity section of the Consolidated Balance Sheet as Non-controlling interest.

Headquartered near Seattle, Washington, Quest has leading technical capabilities related to the measurement and assessment of facility and pipeline mechanical integrity. Quest has developed several proprietary tools for advanced tube and pipeline inspection and measurement. Supporting and augmenting these proprietary inspection tools, Quest has an advanced technical team that provides specialized engineering assessments of facility conditions and serviceability. Quest maintains operations in Seattle, Boulder, and New Zealand, and has service locations in Houston, Calgary, Australia, The Netherlands, and the Middle East. The results of Quest are reflected in our TCM division.

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We obtained independent valuations of the tangible and intangible asset values of Quest, and the resulting residual goodwill. As a result of the independent valuations, a significant portion of the purchase price was determined to be attributable to amortizable intangible assets. Intangible assets are amortized over their useful lives which range from 5 to 20 years. Accordingly, we have included $0.4 million and $1.3 million of amortization expense for the three and nine months ended February 29, 2012 and $0.5 million and $0.7 million for the three and nine months ended February 28, 2011 in our results of operations to reflect accumulated amortization of intangible assets. Information regarding the allocation of the purchase price is set forth below (in thousands):

Fair value allocation:	
Bank debt assumed	$ 2,276
Cash paid to Quest shareholders	39,100
Restricted stock issued to Quest shareholders	2,635
Total purchase price	44,011
Fair value of non-controlling interest	4,917
Fair value allocation	$ 48,928
Net assets acquired:	
Receivables	$ 5,687
Prepaid expenses and other current assets	505
Property, plant and equipment	2,966
Other assets	78
Assets acquired	9,236
Accounts payable	1,291
Other accrued liabilities	3,136
Liabilities assumed	4,427
Net assets acquired	$ 4,809
Intangible assets:	
Customer relationships (6 year life)	$ 5,623
Non-compete agreements (5 year life)	394
Trade name (20 year life)	2,962
Technology (10 year life)	5,250
Goodwill	29,890
Intangible assets	$ 44,119

Information regarding the change in carrying value of the non-controlling interest is set forth below (in thousands):

Fair value of non-controlling interest at November 3, 2010	$ 4,917
Income attributable to non-controlling interest	74
Other comprehensive loss attributable to non-controlling interest	25
Carrying value of non-controlling interest at February 29, 2012	$ 5,016

From time to time we acquire companies that are not significant to our financial statements but are intended to enhance our services or expand our geographic coverage. While not significant, these small acquisitions may result in the creation of goodwill and other intangible assets. We perform preliminary purchase price allocations based on our most current assessments of fair value of the assets acquired and the liabilities assumed. During the process of completing certain post acquisition procedures, including valuation of some intangible assets and

other items, finalizing the assessments of fair value may affect the final allocation of the purchase price. As such, the purchase price allocations related to these small acquisitions are subject to change as the procedures are completed.

Included in intangible assets attributable to our TCM division is $2.3 million related to a recent acquisition completed during the second quarter of the current fiscal year and is primarily attributable to customer relationships and non-compete agreements. In December 2011, we also used $17.1 million for an acquisition of a mechanical services business. The business acquisition was an asset purchase in which the most significant items acquired consisted of inventory, equipment, non-compete agreements and customer relationships. We are in the process of obtaining valuations of both the tangible and intangible assets. These acquisitions were financed through borrowings on our Credit Facility.

3. TAX PROVISION

During the third quarter of fiscal year 2011, the Company identified and corrected accounting errors relating to the effect of share-based compensation on tax provisions for fiscal years 2007 through 2010 and the first two quarters of fiscal year 2011. During those periods, reported earnings were understated because effective tax rates were overstated as a result of the previously undetected errors in the tax provision calculation. No restatement of previously issued financial statements was required because the effect on those statements was immaterial. The cumulative effect of the errors in the tax provision calculation was a tax benefit, which was recorded in the third quarter of fiscal year 2011, consisting of $1.8 million associated with the years prior to fiscal year 2011 and $0.5 million associated with the first two quarters of the prior fiscal year.

The impact of the adjustment was determined not to be material to our results of operations, financial position or cash flows for the three and nine months ended February 28, 2011, nor to any of our previously issued financial statements for prior periods. This determination involved both quantitative assessments and qualitative assessments that considered, among many things:

- the adjustment had no impact on key operational GAAP measures such as revenues, gross margin or operating income,
- the non-cash nature of the adjustment,
- the adjustment had no impact on any banking covenants or key non-GAAP measures such as EBITDA,
- the adjustment had no impact on executive compensation in any period, and
- the adjustment had no quantitative material impact to any prior period.

Excluding the effect of the cumulative adjustments, the Company s effective tax rate for the three months and nine months ended February 28, 2011 was 38%.

4. RECEIVABLES

A summary of accounts receivable as of February 29, 2012 and May 31, 2011 is as follows (in thousands):

	February 29, 2012 (unaudited)	May 31, 2011
Trade accounts receivable	$ 118,795	$ 134,955
Unbilled revenues	19,484	12,387
Allowance for doubtful accounts	(4,402)	(4,222)
Total	$ 133,877	$ 143,120

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5. INVENTORY

A summary of inventory as of February 29, 2012 and May 31, 2011 is as follows (in thousands):

	February 29, 2012 (unaudited)	May 31, 2011
Raw materials	$ 3,416	$ 3,165
Work in progress	773	722
Finished goods	19,157	17,448
Total	$ 23,346	$ 21,335

6. PROPERTY, PLANT AND EQUIPMENT

A summary of property, plant and equipment as of February 29, 2012 and May 31, 2011 is as follows (in thousands):

	February 29, 2012 (unaudited)	May 31, 2011
Land	$ 6,013	$ 6,026
Buildings and leasehold improvements	9,569	9,386
Machinery and equipment	118,704	105,997
Furniture and fixtures	2,065	1,849
Computers and computer software	7,803	7,223
Automobiles	2,689	2,719
Construction in progress	6,870	3,582
Total	153,713	136,782
Accumulated depreciation and amortization	(87,988)	(78,215)
Property, plant and equipment, net	$ 65,725	$ 58,567

At February 29, 2012, there was $0.4 million of capitalized interest included in property, plant and equipment attributable to 50 acres purchased in October 2007 to construct future facilities in Houston, Texas. At February 29, 2012, total capitalized cost of the project, inclusive of the capitalized interest, property purchase and related development cost was $6.8 million. Due to the 2008 economic recession, we postponed construction of the future facilities until such time as economic conditions and our growth necessitate the addition of the new facilities. Starting in the third quarter of fiscal year 2009, we ceased to further capitalize interest until the project resumes.

7. OTHER ACCRUED LIABILITIES

A summary of other accrued liabilities as of February 29, 2012 and May 31, 2011 is as follows (in thousands):

	February 29, 2012 (unaudited)	May 31, 2011
Payroll and other compensation expenses	$ 22,541	$ 22,600
Insurance accruals	4,189	5,394
Property, sales and other non-income related taxes	1,170	2,024
Auto lease rebate	2	15
Other	3,971	2,478

Total	$	31,873	$	32,511

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8. LONG-TERM DEBT, DERIVATIVES AND LETTERS OF CREDIT

In July 2011, we renewed our Credit Facility with our banking syndicate. The Credit Facility has borrowing capacity of up to $150 million in multiple currencies, bears interest based on a variable Eurodollar rate option (LIBOR plus 1.75% margin at February 29, 2012) with the margin based on financial covenants set forth in the Credit Facility, and matures in July 2016. In connection with the renewal of the Credit Facility, we capitalized $0.8 million of associated debt issuance costs which are amortized over the life of the Credit Facility. At February 29, 2012, we were in compliance with all covenants of the Credit Facility.

A summary of long-term debt as of February 29, 2012 and May 31, 2011 is as follows (in thousands):

	February 29, 2012	May 31, 2011
Revolving loan portion of the Credit Facility	$ 88,093	$ 75,848
Vendor financing and other		232
Total	88,093	76,080
Less: current maturities		(212)
Long-term debt, excluding current maturities	$ 88,093	$ 75,868

ASC 815, *Derivatives and Hedging* (ASC 815) established accounting and reporting standards requiring that derivative instruments be recorded at fair value and included in the balance sheet as assets or liabilities. The accounting for changes in the fair value of a derivative instrument depends on the intended use of the derivative and the resulting designation, which is established at the inception date of a derivative. Special accounting for derivatives qualifying as fair value hedges allows a derivative s gains and losses to offset related results on the hedged item in the statement of income. For derivative instruments designated as cash flow hedges, changes in fair value, to the extent the hedge is effective, are recognized in other comprehensive income until the hedged item is recognized in earnings. Hedge effectiveness is measured at least quarterly based on the relative cumulative changes in fair value between the derivative contract and the hedged item over time. Credit risks related to derivatives include the possibility that the counter-party will not fulfill the terms of the contract. We considered counter-party credit risk to our derivative contracts when valuing our derivative instruments.

The amounts recognized in other comprehensive income, and reclassified into income, for the three and nine months ended February 29, 2012 and February 28, 2011, are as follows (in thousands):

	Gain (Loss) Recognized in Other Comprehensive Income Three Months Ended		Gain (Loss) Reclassified from Other Comprehensive Income to Earnings Three Months Ended	
	February 29, 2012	February 28, 2011	February 29, 2012	February 28, 2011
Euro denominated long-term debt	$ (117)	$ (933)	$	$
Total	$ (117)	$ (933)	$	$

	Gain (Loss) Recognized in Other Comprehensive Income Nine Months Ended	Gain (Loss) Reclassified from Other Comprehensive Income to Earnings Nine Months Ended

	February 29, 2012	February 28, 2011	February 29, 2012	February 28, 2011
Euro denominated long-term debt	$ 1,164	$ (1,868)	$	$
Total	$ 1,164	$ (1,868)	$	$

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Our borrowing of 12.3 million under the Credit Facility serves as an economic hedge of our net investment in our European operations as fluctuations in the fair value of the borrowing attributable to the U.S. Dollar/Euro spot rate will offset translation gains or losses attributable to our investment in our European operations. At February 29, 2012, the 12.3 million borrowing had a U.S. Dollar value of $16.5 million.

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. Any ineffectiveness related to our hedges was not material for any of the periods presented.

The following table presents the fair value totals and balance sheet classification for derivatives designated as hedges under ASC 815 (in thousands):

	February 29, 2012			May 31, 2011		
	Classification	Balance Sheet Location	Fair Value	Classification	Balance Sheet Location	Fair Value
Euro denominated long-term debt	Liability	Long-term debt	$ 1,457	Liability	Long-term debt	$ 293
Total derivatives			$ 1,457			$ 293

In order to secure our insurance programs we are required to post letters of credit generally issued by a bank as collateral. A letter of credit commits the issuer to remit specified amounts to the holder, if the holder demonstrates that we failed to meet our obligations under the letter of credit. If this were to occur, we would be obligated to reimburse the issuer for any payments the issuer was required to remit to the holder of the letter of credit. We were contingently liable for outstanding stand-by letters of credit totaling $13.5 million at February 29, 2012 and $8.8 million at May 31, 2011. Outstanding letters of credit reduce amounts available under our Credit Facility and are considered as having been funded for purposes of calculating our financial covenants under the Credit Facility.

9. FAIR VALUE MEASUREMENTS

Effective June 1, 2008, we adopted the provisions of ASC 820, *Fair Value Measurements and Disclosures* (ASC 820), which among other things, requires enhanced disclosures about assets and liabilities carried at fair value.

As defined in ASC 820, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We utilize market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. We primarily apply the market approach for recurring fair value measurements and endeavor to utilize the best information available. Accordingly, we utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The use of unobservable inputs is intended to allow for fair value determinations in situations in which there is little, if any, market activity for the asset or liability at the measurement date. We are able to classify fair value balances based on the observability of those inputs. ASC 820 establishes a fair value hierarchy such that Level 1 measurements include unadjusted quoted market prices for identical assets or liabilities in an active market, Level 2 measurements include quoted market prices for identical assets or liabilities in an active market which have been adjusted for items such as effects of restrictions for transferability and those that are not quoted but are observable through corroboration with observable market data, including quoted market prices for similar assets, and Level 3 measurements include those that are unobservable and of a highly subjective measure.

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The following table sets forth, by level within the fair value hierarchy, our financial assets and liabilities that are accounted for at fair value on a recurring basis as of February 29, 2012. As required by ASC 820, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement (in thousands):

	February 29, 2012			
	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Euro denominated long-term debt	$	$ 1,457	$	$ 1,457
Net liabilities	$	$ 1,457	$	$ 1,457

10. SHARE-BASED COMPENSATION

We have adopted stock incentive plans and other arrangements pursuant to which our Board of Directors (the Board) may grant stock options, restricted stock, stock units, stock appreciation rights, common stock or performance awards to officers, directors and key employees. At February 29, 2012, there were approximately 2.0 million stock options, restricted stock units and performance awards outstanding to officers, directors and key employees. The exercise price, terms and other conditions applicable to each form of share-based compensation under our plans is generally determined by the Compensation Committee of our Board at the time of grant and may vary.

Our share-based payments consist primarily of stock options, stock units, common stock and performance awards. The governance of our share-based compensation does not directly limit the number of future awards. At our annual shareholders meeting held in September 2011, our shareholders approved an increase to 7,020,000 for the total number of shares cumulatively authorized to be issued under our stock incentive plans. Shares issued in connection with our share-based compensation are issued out of authorized but unissued common stock. Compensation expense related to share-based compensation totaled $3.5 million and $3.8 million for the nine months ended February 29, 2012 and February 28, 2011, respectively. The tax benefit related to share-based compensation was $0.6 million for the nine months ended February 29, 2012 and February 28, 2011. At February 29, 2012, $7.6 million of unrecognized compensation expense related to share-based compensation is expected to be recognized over a remaining weighted-average period of 2.8 years.

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We determine the fair value of each stock option at the grant date using a Black-Scholes model and recognize the resulting expense of our stock option awards over the period during which an employee is required to provide services in exchange for the awards, usually the vesting period. Compensation expense related to stock options totaled $0.8 million and $1.9 million for the nine months ended February 29, 2012 and February 28, 2011. Our options typically vest in equal annual installments over a four year service period. Expense related to an option grant is recognized on a straight line basis over the specified vesting period for those options. Stock options generally have a ten year term. Transactions involving our stock options during the nine months ended February 29, 2012 and February 28, 2011 are summarized below:

	Nine Months Ended February 29, 2012		Nine Months Ended February 28, 2011	
	No. of Options (in thousands)	Weighted Average Exercise Price	No. of Options (in thousands)	Weighted Average Exercise Price
Shares under option, beginning of period	1,856	$ 17.81	2,213	$ 16.50
Changes during the period:				
Granted		$		$
Exercised	(217)	$ 10.27	(309)	$ 7.86
Cancelled	(2)	$ 30.33	(11)	$ 30.33
Expired	(10)	$ 30.33	(15)	$ 26.56
Shares under option, end of period	1,627	$ 18.73	1,878	$ 17.76
Exercisable at end of period	1,623	$ 18.70	1,727	$ 16.65

Options exercisable at February 29, 2012 had a weighted-average remaining contractual life of 4.4 years. For total options outstanding at February 29, 2012, the range of exercise prices and remaining contractual lives are as follows:

Range of Prices	No. of Options (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Life (in years)
$0.00 to $3.21		$	
$3.22 to $6.41	71	$ 4.17	1.1
$6.42 to $9.62	313	$ 8.53	2.9
$9.63 to $12.82	167	$ 11.19	3.9
$12.83 to $16.03	444	$ 14.81	4.4
$16.04 to $32.05	632	$ 30.16	5.6
	1,627	$ 18.73	4.4

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Performance awards are settled with common stock upon vesting unless it is not legally feasible to issue shares, in which case the value of the award is settled in cash. We determine the fair value of each performance award based on the market price on the date of grant. Performance awards granted to our Chairman of our Board vest over the longer of four years or the achievement of performance goals based upon our future results of operations. Compensation expense related to performance awards totaled $0.4 million and $0.3 million for the nine months ended February 29, 2012 and February 28, 2011. Transactions involving our performance awards during the nine months ended February 29, 2012 and February 28, 2011 are summarized below:

	Nine Months Ended February 29, 2012		Nine Months Ended February 28, 2011	
	No. of Performance Awards (in thousands)	Weighted Average Fair Value	No. of Performance Awards (in thousands)	Weighted Average Fair Value
Performance awards, beginning of period	61	$ 20.33	51	$ 20.84
Changes during the period:				
Granted	24	$ 25.16	25	$ 20.04
Vested and settled	(20)	$ 21.14	(15)	$ 21.61
Cancelled		$		$
Performance awards, end of period	65	$ 21.86	61	$ 20.33

Stock units are settled with common stock upon vesting unless it is not legally feasible to issue shares, in which case the value of the award is settled in cash. We determine the fair value of each stock unit based on the market price on the date of grant. Stock units generally vest in annual installments over four years and the expense associated with the units is recognized over the same vesting period. We also grant common stock to our directors which typically vest immediately. Compensation expense related to stock units and director stock grants totaled $2.3 million and $1.7 million for the nine months ended February 29, 2012 and February 28, 2011. Transactions involving our stock units and director stock grants during the nine months ended February 29, 2012 and February 28, 2011 are summarized below:

	Nine Months Ended February 29, 2012		Nine Months Ended February 28, 2011	
	No. of Stock Units (in thousands)	Weighted Average Fair Value	No. of Stock Units (in thousands)	Weighted Average Fair Value
Stock and stock units, beginning of period	310	$ 19.80	247	$ 20.53
Changes during the period:				
Granted	159	$ 24.78	163	$ 18.90
Vested and settled	(119)	$ 20.80	(93)	$ 20.20
Cancelled	(5)	$ 21.19	(6)	$ 20.62
Stock and stock units, end of period	345	$ 21.73	311	$ 19.77

11. ENTITY WIDE DISCLOSURES

ASC 280, *Segment Reporting* (ASC 280) requires we disclose certain information about our operating segments where operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. We operate in only one segment the industrial services segment. Within the industrial services segment, we are organized as two divisions. Our TCM division (inclusive of Quest) provides the services of inspection and assessment and field heat treating. Our TMS division provides the services of leak repair, fugitive emissions control, hot tapping, field machining, technical bolting and field

valve repair. Each division has goodwill relating to past acquisitions and we assess goodwill for impairment at

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the lower TCM and TMS divisional level. Both divisions derive substantially all their revenues from providing specialized labor intensive industrial services and the market for their services is principally dictated by the population of process piping systems in industrial plants and facilities. Services provided by both the TCM and TMS divisions are predominantly provided through a network of field branch locations located in proximity to industrial plants. The structure of those branch locations is similar, with locations overseen by a branch/regional manager, one or more sales representatives and a cadre of technicians to service the business requirements of our customers. Both the TCM and TMS division field locations share the same chief operating decision maker and both divisions are supported by common and often centralized technical and commercial support staffs, quality assurance, training, finance, legal, human resources and health and safety departments.

Revenues and total assets in the U.S. and other countries are as follows (in thousands):

	Three Months Ended February 29, 2012 (unaudited)	Three Months Ended February 28, 2011 (unaudited)	Nine Months Ended February 29, 2012 (unaudited)	Nine Months Ended February 28, 2011 (unaudited)
Revenues:				
United States	$ 99,132	$ 78,217	$ 301,652	$ 252,913
Canada	22,927	18,198	87,724	61,654
Europe	9,672	7,130	26,559	18,510
Other foreign countries	4,792	5,275	19,954	13,385