INTEGRATED ELECTRICAL SERVICES INC
Form 10-K
December 21, 2006

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

FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended September 30, 2006
OR
o **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)

Delaware	**76-0542208**
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
1800 West Loop South	
Suite 500	
Houston, Texas	**77027**
(Address of principal executive offices)	(zip code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $.01 per share	NASDAQ

Securities registered pursuant to Section 12(g) of the Act: None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes o No þ

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 þ No o

Indicate by checkmark 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 the 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. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer þ

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

The aggregate market value of the voting stock of the Registrant on March 31, 2006 held by non-affiliates was approximately $37.9 million.

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

As of December 15, 2006, there were outstanding 15,377,742 shares of common stock of the Registrant (includes 32,272 shares reserved for issuance upon exchange of previously issued shares pursuant to the Company s Plan of Reorganization approved by the United States Bankruptcy Court for the Northern District of Texas, Dallas Division which became effective on May 12, 2006).

DOCUMENTS INCORPORATED BY REFERENCE

Certain information contained in the Proxy Statement for the Annual Meeting of Stockholders of the registrant to be held on February 8, 2007 is incorporated by reference into Part III of this Form 10-K.

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Subsidiaries of the Registrant
Consent of Ernst & Young LLP
Rule 13a-14(a)/15d-14(a) Certification of Michael Caliel
Rule 13a-14(a)/15d-14(a) Certification of David A. Miller
Section 1350 Certification of Michael Caliel
Section 1350 Certification of David A. Miller

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DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K 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:

potential difficulty in fulfilling the restrictive terms of, and the high cost of, the Company s credit facilities and term loan;

the Company s ability to meet debt service obligations and related financial and other covenants, and the possible resulting material default under the Company s credit agreements if not waived or rectified;

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

the increased costs of surety bonds;

risk associated with failure to provide surety bonds on jobs where the Company has commenced work or is otherwise contractually obligated to provide surety bonds;

the inherent uncertainties relating to estimating future operating results and the Company s ability to generate sales, operating income, or cash flow;

potential difficulty in addressing material weaknesses identified by the Company and its independent auditors;

fluctuations in operating results because of downturns in levels of construction, seasonality and differing regional economic conditions;

fluctuations in financial results from operations caused by the increases in and fluctuations of pricing of commodities used in Company s business particularly copper, steel, gasoline, lumber and certain plastics.

general economic and capital markets conditions, including fluctuations in interest rates that affect construction;

inaccurate estimates used in entering into and executing contracts;

inaccuracies in estimating revenue and percentage of completion on contracts;

difficulty in managing the operation of existing entities;

the high level of competition in the construction industry both from third parties and ex-employees;

increases in costs or limitations on availability of labor, especially qualified electricians;

accidents resulting from the numerous physical hazards associated with the Company s work and the number of miles of driving of Company vehicles with the level of exposure to vehicle accidents;

loss of key personnel;

business disruption and costs associated with the Securities and Exchange Commission investigation, class action or other litigation now pending;

unexpected liabilities or losses associated with warranties or other liabilities attributable to the retention of the legal structure or retained liabilities of business units where the Company has sold substantially all of the assets;

difficulties in integrating new types of work into existing subsidiaries;

inability of the Company to incorporate new accounting, control and operating procedures and consolidations of back office functions;

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- the loss of productivity, either at the corporate office or operating level;
- the residual effect with customers and vendors from the bankruptcy process leading to less work or less favorable delivery or credit terms;
- the lowered efficiency and higher costs associated with projects at subsidiaries that the Company has determined to wind down or close; and
- growth in latent defect litigation in the residential market and the expansion of such litigation into other states where the Company provides residential electrical work for new home builders.

You should understand that the foregoing, as well as other risk factors discussed in this document, including those listed in Part I. Item 1A. of this report under the heading Risk Factors could cause future outcomes to differ materially from those expressed in such forward looking statements. We undertake no obligation to publicly update or revise information concerning the Company s borrowing availability, or its cash position or any forward-looking statements to reflect events or circumstances that may arise after the date of this report. Forward-looking statements are provided in this Form 10-K 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.

PART I

Item 1. *Business*

In this annual report, the words IES , the Company , we , our , ours , and us refer to Integrated Electrical Servic and, except as otherwise specified herein, to our subsidiaries. Our fiscal year ends on September 30.

We are a leading provider of electrical contracting services in the United States. We provide a broad range of services including competitive bid design, building, maintaining and servicing electrical, data communications and utilities systems for commercial, industrial and residential customers.

Our electrical contracting services include design of the electrical distribution systems within a building or complex, procurement and installation of wiring and connection to power sources, end-use equipment and fixtures as well as long-term contract maintenance. We service commercial, industrial and residential markets and have a diverse customer base including: general contractors; property managers and developers; corporations; government agencies and municipalities; and homeowners. We provide services for a variety of projects including: high-rise residential and office buildings, power plants, manufacturing facilities, municipal infrastructure and health care facilities and residential developments. We also offer low voltage contracting services as a complement to our electrical contracting business. Our low voltage services include design and installation of external cables for corporations, universities, data centers and switching stations for data communications companies as well as the installation of fire and security alarm systems. Our utility services consist of overhead and underground installation and maintenance of electrical and other utilities transmission and distribution networks, installation and splicing of high-voltage transmission and distribution lines, substation construction and substation and right-of-way maintenance. Our maintenance services generally provide recurring revenues that are typically less affected by levels of construction activity. We focus on projects that require special expertise, such as design-and-build projects that utilize the capabilities of our in-house engineers or projects that require specific market expertise such as hospitals or power generation facilities, as well as service, maintenance and certain renovation and upgrade work, which tends to either be recurring, have lower sensitivity to economic cycles, or both.

As of December 2006, we provide our services from 121 locations currently serving the continental 48 states. We continue to focus internally on integrating our information technology systems to enhance operating controls of our organization, as well as integrating a consolidated procurement program to manage vendors on a national basis.

Voluntary Reorganization Under Chapter 11

On February 14, 2006, we filed voluntary petitions for reorganization under Chapter 11 of Title 11 of the United States Code in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division. The Bankruptcy Court jointly administered these cases as *In re Integrated Electrical Services, Inc. et. al.*, Case No. 06-30602-BJH-11 . On April 26, 2006, the Bankruptcy Court entered an order approving and confirming the plan of reorganization. The plan was filed as Exhibit 2.1 to our current report on Form 8-K, filed on April 28, 2006. We operated our businesses and managed our properties as debtors-in-possession in accordance with the Bankruptcy Code from February 14, 2006 through emergence from Chapter 11 on May 12, 2006.

In accordance with the plan:

(i) The holders of the senior subordinated notes received on the date we emerged from bankruptcy, in exchange for their total claims (including principal and interest), 82% of the fully diluted new common stock representing

12,631,421 shares, before giving effect to options to be issued under a new employee and director stock option plan which could be up to 10% of the fully diluted shares of new IES common stock outstanding as of the effective date of the plan.

(ii) The holders of old common stock received 15% of the fully diluted new common stock representing 2,310,614 shares, before giving effect to the 2006 equity incentive plan.

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(iii) Certain members of management received 384,850 restricted shares of new common stock equal to 2.5% of the fully diluted new common stock with an additional 0.5% reserved for new key employees, before giving effect to our 2006 equity incentive plan. The restricted shares of new common stock vest over approximately a three-year period.

(iv) $50 million in senior convertible notes were refinanced from the proceeds of the $53 million term loan.

(v) All other allowed claims were either paid in full in cash or reinstated.

Competitive Strengths

Our competitive strengths include the following:

Geographic diversity We have 121 locations, currently serving the continental 48 states and have worked on more than 1,300 contracts over $250,000 and more than 4,100 contracts overall in 2006. Our national presence sometimes mitigates much of the region specific economic slowdowns. Since 1997, much of our revenues have been derived from the Sunbelt states, which have had higher growth rates than overall U.S. construction. Our geographic diversity also enables us to serve national customers with multiple locations.

Customer diversity Our diverse customer base includes general contractors, property developers and managers, facility owners and managers of large retail establishments, manufacturing and processing facilities, utilities, government agencies and homeowners. No single customer accounted for more than 10% of our revenues for the year ended September 30, 2006. We believe that customer diversity provides us with many advantages including reducing our dependence on any single customer. Additionally, our expertise in a variety of industries coupled with our national reach allows us to be flexible and to share our expertise across regions.

Expertise We have expertise in high-rise buildings including hotels, condominiums and office buildings, retail centers, hospitals, switching centers and utility substations and single-family and multi-family residential homes. We believe that our technical expertise provides us with (1) access to higher margin design-and-build projects; (2) access to growth markets including wireless telecommunications, high voltage line work, video and security and fire systems; and (3) the ability to deliver quality service with greater reliability than that of many of our competitors.

Ability to Service National Projects Our nationwide presence and name recognition helps us compete for larger, national contracts with customers that operate throughout the U.S. Additionally, we believe our size and national service offering uniquely positions us as the only single source open shop electrical contracting service provider able to execute projects on a national basis. We are able to take on very large and complex projects, often with a national scope, that would strain the capabilities and resources of most of our competitors. This type of work represents a growing market and we have made progress in pursuing these sizable accounts.

Access to resources Access to resources is a key to success, especially in this robust market environment. We, like many of our competitors, have experienced increased costs and limited availability of bonding required for specific projects. Losses experienced by the surety industry in recent years have caused surety providers to limit capacity and increase prices for all participants, including us, even though we have incurred no surety losses on any project in our almost nine-year history. Currently there are restrictions on the amount of surety we have available and limits on the types of projects we may bond. As a result, we attempt to pursue those contracts that are the most economically attractive and those where the bonding costs can be justified by the expected return. As of September 30, 2006, the expected costs to complete for projects covered by Chubb and SureTec was $44.2 million. We also had $22.4 million in aggregate face value of bonds issued under Scarborough. We believe we have adequate remaining available bonding capacity, subject to the sole discretion of our surety providers (See Part II, Item 7. Surety). Additionally, we have access to our credit facility. As of September 30, 2006, we had cash and cash equivalents of $28.2 million, restricted cash of

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$20.0 million, $55.6 million in outstanding borrowings under our term loan, $45.5 million of letters of credit outstanding and available capacity under our revolving credit facility of $34.5 million.

Proprietary systems and processes We have proprietary systems and processes that help us bid on projects, manage projects once they have been awarded and maintain and track customer information. In addition, we developed techniques and processes for installation on a variety of different projects, including a prefabrication process we implemented throughout the organization.

Utilization of prefabrication processes Our size and 100% merit shop environment has allowed us to implement best prefabrication practices across our company quickly. We prefabricate and preassemble or prepackage significant portions of electrical installations off-site and ship materials to the installation sites in specific sequences to optimize materials management, improve efficiency and minimize our employees time on job sites. This is safer, more efficient and more cost effective for both us and our customers.

Experienced management We have developed a strong team of executive officers, which have a vast range of experiences and well-known reputations in the markets they have served. This team has been put in place to identify challenges that may arise in the business functions, seek opportunities for change and improvement and react accordingly. Our focus as management is to drive operational improvements, set strategy and build capabilities. We believe management and our employees currently own approximately 1-2% of our outstanding common stock.

Short Term Initiatives

Fiscal year 2006 was a year of transition for IES. We proceeded through and successfully emerged from a voluntary reorganization under Chapter 11. As part of the rebuilding processes we:

hired a new President and Chief Executive Officer who we believe will provide the leadership to rebuild, strengthen, and grow IES;

continued to divest or close non-core and underperforming subsidiaries, keeping sight of our long-term strategic goals;

began a comprehensive review of all project, operations, and financial processes to increase visibility and predictability of our subsidiaries and corporate functions;

continued our focus on safety, again exceeding the prior year s safety performance. We are resolute that a culture focused on safety is central to excellence in project execution and significantly reduces risks to our employees and consequent costs to the business.

We are focused on strengthening the foundation of the company.

During the fall of 2006, under the leadership of our Executive Management Team, we began a systematic program to strengthen our core processes, which will review all key elements of the IES enterprise, including our personnel, processes and business systems. This systematic review is guided by an assembly of expert teams from within our business units supported by our Executive Management Team and operational management.

Industry Overview

Reviewing the most recently available data from McGraw Hill Construction Analytics, FMI Construction Outlook and the U.S. Census Bureau, we believe inflation is a valid concern but we have not yet seen a significant downturn in residential construction as many economists had predicted. However, according to FMI Construction Outlook there is projected growth in non-residential construction, which is projected to be offset by decreased spending in residential. Using data from all three sources mentioned above, the five-year compounded annual growth rate for non-residential construction is 3.4%, which is an increase over the five-year compounded annual growth rate for non-residential construction this time last year of 1.4%. The five-year compounded annual growth rate for residential construction is still increasing, but at a reduced rate, of 9.8% versus this time last year with a five-year compounded annual growth rate for residential construction of 11.4%.

Over the longer term, the housing market is anticipated to return to a moderate growth rate. Based on research provided by FMI Construction Outlook and McGraw-Hill Construction, residential construction is projected to continue to grow, but at a decreased rate with the projected five-year compounded annual growth rate to be 1.6%. This decreased growth in residential construction is expected to be offset by an increase in non-residential construction. This expected increase in non-residential construction is partly due to price inflation including rising labor and material costs and due to upgrades and the use of higher end materials and increased square footage. The projected five-year compounded annual growth rate for non-residential construction is 4.5%.

The Markets We Serve

Commercial and Industrial Market. Our commercial and industrial work consists primarily of electrical, communications, utility installations and upgrade, renovation, replacement and service and maintenance work in:

- airports;
- community centers;
- high-rise apartments and condominiums;
- hospitals and health care centers;
- hotels;
- manufacturing and processing facilities;
- military installations;
- office buildings;
- refineries, petrochemical and power plants;
- retail stores and centers;
- schools; and
- theaters, stadiums and arenas.

Our commercial and industrial customers include:

- general contractors;
- developers;
- building owners and managers;
- engineers;
- architects; and
- consultants.

Demand for our commercial and industrial services is driven by construction and renovation activity levels, as well as more stringent local and national electrical codes. From fiscal 2002 through 2006, our compound annual growth rate from commercial and industrial revenue has remained essentially flat compared to the industry average where the non-residential construction industry has grown at a compound annual rate of approximately 4.4% per year. Commercial and industrial work represented approximately 66%, 63% and 58% of our revenues for the years ended September 30, 2004, 2005 and 2006, respectively. For additional segment information for each of the three years ended September 30, 2006, see Note 12 to the Consolidated Financial Statements.

New commercial and industrial work begins with either a design request or engineer s plans from the owner or general contractor. Initial meetings with the parties allow us to prepare preliminary, detailed design specifications, engineering drawings and cost estimates. Projects we design and build generally provide us with higher margins. Design and build gives full or partial responsibility for the design specifications of the installation. Design and build is an alternative to the traditional plan and spec model, where the contractor builds to the exact specifications of the architect and engineer. We prefer to perform design and build work, because it allows us to use past experience to install a more cost effective project for the customer with higher profitability to us. Once a project is awarded, it is conducted in scheduled phases and progress billings are rendered to our customer for payment, less retention of 5% to 10% of the construction cost of the project. We generally provide the materials to be installed as a part of these contracts, which vary significantly in size from a few hundred dollars to several million dollars and vary in duration from less than a day to more than a year. Actual fieldwork is coordinated during this time, including:

- ordering of equipment and materials;
- fabricating or assembling of certain components (pre-fabrication);
- delivering of materials and components to the job site; and
- scheduling of work crews, inspection and quality control.

Our service and maintenance revenues are derived from service calls and routine maintenance contracts, which tend to be recurring and less sensitive to economic fluctuations. Service and maintenance is supplied on a long-term and per-call basis. Long-term service and maintenance is provided through contracts that require the customer to pay an annual or semiannual fee for periodic diagnostic services. Per-call service and maintenance is initiated when a customer requests emergency repair service. Service technicians are scheduled for the call or routed to the customer s residence or business by the dispatcher. We will then follow up with the customer to schedule periodic maintenance work. Most service work is warranted for thirty days. Service personnel work out of our service vehicles, which carry an inventory of equipment, tools, parts and supplies needed to complete the typical variety of jobs. The technician assigned to a service call:

- travels to the residence or business;
- interviews the customer;
- diagnoses the problem;
- prepares and discusses a price quotation; and
- performs the work and often collects payment from the customer immediately.

We design and install communications and utility infrastructure systems and low voltage systems for the commercial and industrial market as a complement to our primary electrical contracting services. We believe the demand for our communications services is driven by the following factors: the pace of technological change; the overall growth in voice and data traffic; and the increasing use of personal computers and modems, with particular emphasis on the market for broadband internet access. Demand for our utilities services is driven by industry deregulation, limited maintenance or capital expenditures on existing systems and increased loads and supply and delivery requirements. Demand for our low voltage systems is driven by the construction industry growth rate and our ability to cross-sell among our customers.

Residential Market Our work for the residential market consists primarily of electrical installations in new single-family housing and low-rise, multi-family housing, for local, regional and national homebuilders and developers. We believe demand for our residential services is dependent on the number of single-family and multi-family home starts in the markets we serve. Single-family home starts are affected by the level of interest rates and general economic conditions. A competitive factor particularly important in the residential market is our ability to develop relationships with homebuilders and developers by providing services in multiple areas of their operations. This ability has become increasingly important as consolidation has occurred in the residential construction industry, and homebuilders and developers have sought out service providers that can provide consistent service in all of their operating regions.

We are currently one of the largest providers of electrical contracting services to the U.S. residential construction market. Our residential business has experienced significant growth. Our compound annual growth rate from residential electrical revenue has grown 11.3% from fiscal 2002 through 2006 compared to an industry average of approximately 8.3% over the same period. Residential electrical contracting represented approximately 34%, 37% and 42% of our revenues for the years ended September 30, 2004, 2005 and 2006, respectively.

The residential business is generally more profitable and less capital intensive than our commercial and industrial business. It also has lower barriers to entry and has a much lower surety bonding need. For additional segment information for each of the three years ended September 30, 2006, see Note 12 to the Consolidated Financial Statements. Our results of operations from residential construction are seasonal, depending on weather trends, with typically higher revenues generated during spring and summer and lower revenues during fall and winter.

Customers

We have a diverse customer base. We will continue our emphasis on developing and maintaining relationships with our customers by providing superior, high-quality service. During the years ended September 30, 2004, 2005 and 2006, no single customer accounted for more than 10% of our revenues.

Backlog

For the fiscal year ended September 30, 2006, we had backlog associated with our continuing operations of approximately $370.9 million compared to a backlog of approximately $332.5 million for the fiscal year ended September 30, 2005. We had backlog associated with our discontinued operations of approximately $3.7 million for the fiscal year ended September 30, 2006 versus $48.2 million for the fiscal year ended September 30, 2005.

Company Operations

Employee Screening, Training and Development. We are committed to providing the highest level of customer service through the development of a highly trained workforce. Employees are encouraged to complete a progressive training program to advance their technical competencies and to ensure that they understand and follow the applicable codes, our safety practices and other internal policies. We support and fund continuing education for our employees, as well as apprenticeship training for technicians under the Bureau of Apprenticeship and Training of the Department of Labor and similar state agencies. Employees who train as apprentices for four years may seek to become journeymen electricians and, after additional years of experience, master electricians. We pay progressive increases in compensation to employees who acquire this additional training, and more highly trained employees serve as foremen, estimators and project managers. Our master electricians are licensed in one or more cities or other jurisdictions in order to obtain the permits required in our business. Some employees have also obtained specialized licenses in areas including security systems and fire alarm installation. In some areas, licensing boards have set continuing education requirements for maintenance of licenses. Because of the lengthy and difficult training and licensing process for electricians, we believe that the number, skills and licenses of our employees constitute a competitive strength in the industry.

We actively recruit and screen applicants for our technical positions and have established programs in some locations to recruit apprentice technicians directly from high schools and vocational technical schools. Prior to hiring new employees, we assess their technical competence level, confirm background references and conduct drug testing.

Control and Information Systems. We are committed to performing those controls and procedures that improve our efficiency and the monitoring of our operations. In fiscal 2006, we completed our deployment of a standard financial accounting software to all of our construction companies for their accounting and reporting needs. We believe having this common system is paramount to growing our business. Additionally, we have implemented a financial reporting and planning application to complement the standard financial accounting software that provides a uniform structure and analytical tool for the reporting process. Implementation of this system and the complementary financial reporting application allows us to obtain more timely results of operating performance and perform a more detailed analysis. In addition to our financial accounting system, other controls and procedures we have in place include but are not limited to:

Pre-determined approval levels for bidding jobs. Each subsidiary may approve certain jobs based on each subsidiary s gross revenues, the level of experienced estimating personnel on staff, the type of work to be bid (i.e. niche vs. non-niche work), and manpower availability. If a job exceeds these parameters, additional approvals must be obtained;

A uniform monthly reporting process with data controls; and

A series of monthly reviews conducted by our senior management team. The content of such meetings includes discussing safety performance, previous operating results, forecasts, opportunities and concerns.

Competition

The electrical contracting industry is highly fragmented and competitive. Most of our competitors are small, owner-operated companies that typically operate in a limited geographic area. There are few public companies focused on providing electrical contracting services. In the future, we may encounter competition from new market entrants.

Regulations

Our operations are subject to various federal, state and local laws and regulations, including:

licensing requirements applicable to electricians;
building and electrical codes;
regulations relating to consumer protection, including those governing residential service agreements;
regulations relating to worker safety and protection of the environment; and
qualifications of our business legal structure in the jurisdictions where we do business.

We believe we have all licenses required to conduct our operations and are in substantial compliance with applicable regulatory requirements. Our failure to comply with applicable regulations could result in substantial fines or revocation of our operating licenses or an inability to perform government work.

Many state and local regulations governing electricians require permits and licenses to be held by individuals. In some cases, a required permit or license held by a single individual may be sufficient to authorize specified activities for all our electricians who work in the state or county that issued the permit or license. It is our policy to ensure that, where possible, any permits or licenses that may be material to our operations in a particular geographic area are held by multiple IES employees within that area.

Risk Management and Insurance

The primary risks in our operations include health, bodily injury, property damage and injured workers compensation. We maintain automobile and general liability insurance for third party health, bodily injury and property damage and workers compensation coverage, which we consider appropriate to insure against these risks. Our third-party insurance is subject to large deductibles for which we establish reserves and, accordingly, we effectively self-insure for much of our exposures.

Employees

At September 30, 2006, we had 7,183 employees. We are not a party to any collective bargaining agreements with our employees. We believe that our relationship with our employees is satisfactory.

Available Information

We file our interim and annual financial reports, as well as other reports required by the Securities Exchange Act of 1934 with the United States Securities and Exchange Commission (the SEC). Our annual

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report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments and exhibits to those reports are free of charge through our website at *www.ies-co.com* as soon as it is reasonably practicable after we file them with, or furnish them to, the SEC.

We have adopted a Code of Ethics for Financial Executives, a Code of Business Conduct and Ethics for directors, officers and employees (the legal Compliance and Corporate Policy Manual) and established Corporate Governance Guidelines and adopted charters outlining the duties of our Audit, Human Resources and Compensation and Nominating/ Governance Committees, copies of which may be found on our website at *www.ies-co.com.* Paper copies of these documents are also available free of charge upon written request to us. We have designated an audit committee financial expert as that term is defined by the SEC. Further information about this designee may be found in the Proxy Statement for the Annual Meeting of Stockholders of the Company.

Item 1A. *Risk Factors*

You should consider carefully the risks described below, as well as the other information included in this document before making an investment decision. Our business, results of operations or financial condition could be materially and adversely affected by any of these risks, and the value of your investment may decrease due to any of these risks.

Our internal control over financial reporting and our disclosure controls and procedures may not prevent all possible errors that could occur. Internal control over financial reporting and disclosure controls and procedures, no matter how well designed and operated can provide only reasonable, not absolute, assurance that the control system s objective will be met.

Evaluations are made of our internal control over financial reporting and our disclosure controls and procedures, which include a review of the objectives, design, implementation and effect of the controls and the information generated for use in our periodic reports. In the course of our controls evaluation, we sought (and seek) to identify data errors, control problems and to confirm that appropriate corrective action, including process improvements, were being undertaken. This type of evaluation is conducted on a quarterly basis so that the conclusions concerning the effectiveness of our controls can be reported in our periodic reports.

A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system s objectives will be satisfied. Internal control over financial reporting and disclosure controls and procedures are designed to give a reasonable assurance that they are effective to achieve their objectives. We cannot provide absolute assurance that all possible future control issues within our company have been detected. These inherent limitations include the real world possibility that judgments in our decision-making can be faulty, and that isolated breakdowns can occur because of simple human error or mistake. The design of our system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed absolutely in achieving our stated goals under all potential future or unforeseeable conditions. Because of the inherent limitations in a cost-effect control system, misstatements due to error could occur and not be detected.

The Class Action Securities Litigation if continued or if decided against us could have a material adverse effect.

Resulting from our inability to timely file a 10-Q for the quarter ended June 30, 2004 and the associated decline in the trading price of our stock, a series of class action securities claims were filed and later consolidated into one action pending in Houston, Texas. We have Directors and Officers insurance that provides coverage for this action. It is difficult to predict liability or any potential range of damages that we might incur in connection with this action. An adverse result could have a material adverse effect on our business, financial condition or cash flows.

Downturns in construction could adversely affect our business because more than half of our business is dependent on levels of new construction activity.

More than half of our business involves the installation of electrical systems in newly constructed and renovated buildings, plants and residences. The construction industry is cyclical and downturns in levels of construction or housing starts could have a material adverse effect on our business, financial condition and results of operations. Our ability to maintain or increase revenues from new installation services will depend on the number of new construction starts and renovations, which will likely correlate with the cyclical nature of the construction industry. The number of new building starts will be affected by local economic conditions, and other factors, including the following:

employment and income levels;
interest rates and other factors affecting the availability and cost of financing;
tax implications for homebuyers and commercial construction;
consumer confidence;
housing demand; and
commodity costs such as copper, steel, lumber and gasoline.

A majority of our business is focused in the southeastern and southwestern portions of the United States, concentrating our exposure to local economic conditions in those regions. Downturns in levels of construction or housing starts in these geographic areas could result in a material reduction in our activity levels. The residential construction portion of our business is beginning to see slowed growth and cost pressures which may affect the profitability of that portion of our business in some areas.

Completion of the jobs at the subsidiaries that IES determined to close could have a material adverse affect.

Five companies were closed but work remained at those five companies that had to be completed. This work has continued to lose money as many employees left for other positions before the work was completed. The high turnover resulted in loss of productivity, loss of continuity and familiarity with the job and additional training costs. Although the cost to complete such work is down to less than $4.1 million, there are still potentially future losses. The losses can result in covenant violations under the credit facility and the term loan as both have shut-down covenants.

The highly competitive nature of our industry could affect our profitability by reducing our profit margins.

The electrical contracting industry is served by many small, owner-operated private companies, public companies and several large regional companies. We could also face competition in the future from new competitors entering these markets because electrical contracting has a relatively low capital requirement for entry. Some of our competitors offer a greater range of services, including mechanical construction, facilities management, plumbing and heating, ventilation and air conditioning services. Competition in our markets depends on a number of factors, including price. Some of our competitors may have lower overhead cost structures and may, therefore, be able to provide services comparable to ours at lower rates than we do. If we are unable to offer our services at competitive prices or if we have to reduce our prices to remain competitive, our profitability would be impaired.

There is a shortage of qualified electricians. Since the majority of our work is performed by electricians, this shortage may negatively impact our business, including our ability to grow.

There is a shortage of qualified electricians in the United States. In order to conduct our business, it is necessary to employ electricians and have those electricians qualified in the states where they do business. While overall economic growth has diminished, our ability to increase productivity and profitability may be limited by our ability to employ, train and retain skilled electricians required to meet our needs. Accordingly there can be no assurance, among other things, that:

- we will be able to maintain the skilled labor force necessary to operate efficiently;
- our labor expenses will not increase as a result of a shortage in the skilled labor supply; and
- we will be able to maintain the skilled labor force necessary to implement our planned internal growth and respond to improving construction market and work from the hurricane damaged Gulf Coast region.

Due to seasonality and differing regional economic conditions, our results may fluctuate from period to period.

Our business is subject to seasonal variations in operations and demand that affect the construction business, particularly in residential construction. Untimely weather delay from rain, ice, cold or snow can not only delay our work but can negatively impact our schedules and profitability by delaying the work of other trades on a construction site. Our quarterly results may also be affected by regional economic conditions that affect the construction market.

Accordingly, our performance in any particular quarter may not be indicative of the results that can be expected for any other quarter or for the entire year. Additionally, increases in construction materials such as steel and lumber can alter the rate of new construction.

The estimates we use in placing bids could be materially incorrect. The use of incorrect estimates could result in losses on a fixed price contract. These losses could be material to our business.

We currently generate, and expect to continue to generate, more than half of our revenues under fixed price contracts. The cost of gasoline, labor and materials, however, may vary significantly from the costs we originally estimate. Variations from estimated contract costs along with other risks inherent in performing fixed price contracts may result in actual revenue and gross profits for a project differing from those we originally estimated and could result in losses on projects. Depending upon the size of a particular project, variations from estimated contract costs can have a significant impact on our operating results.

Commodity costs may fluctuate materially and the company many not be able to pass on all cost increases during the term of a contract.

We enter into many contracts at fixed prices and if the cost associated with commodities such as copper, steel, gasoline and certain plastics increase, the companies expect profit may decline under that contract.

We may experience difficulties in managing consolidations.

We expect to expend significant time and effort managing and merging existing operations. We cannot guarantee that our systems, procedures and controls will be adequate to support operations, including the timely receipt of financial information. As we have consolidated some support functions of human resources, payroll, estimating, safety, accounting, and other administrative support functions it has offered some cost savings. Those savings only arise after the consolidations and after additional time and effort managing that consolidation.

We may experience difficulties in managing our working capital.

Our billings under fixed price contracts are generally based upon achieving certain benchmarks and will be accepted by the customer once we demonstrate those benchmarks have been met. If we are unable to demonstrate compliance with billing requests, or if we fail to issue a project billing, our likelihood of collection could be delayed or impaired, which could have a materially adverse effect on our operations if this occurred over several large projects.

To service our indebtedness and to fund working capital, we will require a significant amount of cash. Our ability to generate cash depends on many factors.

Our ability to make payments on and to refinance our indebtedness and to fund planned capital expenditures will depend on our ability to generate cash in the future. This is subject to our operational performance, as well as general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

We cannot provide assurance that our business will generate sufficient cash flow from operations or asset sales and that future borrowings will be available to us under our credit facility in an amount sufficient to enable us to pay our indebtedness, or to fund our other liquidity needs. We may need to refinance all or a portion of our indebtedness, on or before maturity. We cannot provide assurance that we will be able to refinance any of our indebtedness on commercially reasonable terms or at all. Our inability to refinance our debt on commercially reasonable terms could materially adversely affect our business.

We have adopted tax positions that a taxing authority may view differently. If a taxing authority differs with our tax positions, our results may be adversely affected.

Our effective tax rate and cash paid for taxes are impacted by numerous tax positions that we have adopted. Taxing authorities may not always agree with the positions we have taken. We believe that we have adequate reserves in the event that a taxing authority differs with positions we have taken, however, there can be no assurance that our results of operations will not be adversely affected.

Our reported operating results could be adversely affected as a result of goodwill impairment write-offs.

When we acquire a business, we record an asset called goodwill if the amount we pay for the business, including liabilities assumed, is in excess of the fair value of the assets of the business we acquire. Statement of Financial Accounting Standards (SFAS) No. 142 Goodwill and Other Intangible Assets established accounting and reporting requirements for goodwill and other intangible assets. SFAS No. 142 requires that goodwill attributable to each of four reporting units be tested at least annually (absent any impairment indicators). The testing includes comparing the fair value of each reporting unit with its carrying value. Fair value is determined using discounted cash flows, market multiples and market capitalization. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates, weighted average cost of capital and estimates of market multiples for each of the reportable units. On an ongoing basis (absent any impairment indicators), we expect to perform impairment tests at least annually during the last fiscal quarter of each year. Impairment adjustments recognized after adoption, if any, generally are required to be recognized as operating expenses. We cannot assure that we will not have future impairment adjustments to our recorded goodwill.

Our operations are subject to numerous physical hazards associated with the construction of electrical systems. If an accident occurs, it could result in an adverse effect on our business.

Hazards related to our industry include, but are not limited to, electrocutions, fires, machinery caused injuries, mechanical failures or transportation accidents. These hazards can cause personal injury and loss of life, severe damage to or destruction of property and equipment and may result in suspension of operations. Our insurance does not cover all types or amounts of liabilities. Our third-party insurance is subject to deductibles for which we establish reserves and, accordingly, we effectively self-insure for much of our exposures. No assurance can be given either that our insurance or our provisions for incurred claims and incurred but not reported claims will be adequate to cover all losses or liabilities we may incur in our operations or that we will be able to maintain adequate insurance at reasonable rates.

The loss of a group of key personnel, either at the corporate or operating level, could adversely affect our business.

The loss of key personnel or the inability to hire and retain qualified employees could have an adverse effect on our business, financial condition and results of operations. Our operations depend on the continued efforts of our current and future executive officers, senior management and management personnel at the companies. We cannot guarantee that any member of management at the corporate or subsidiary level will continue in their capacity for any particular period of time. During these volatile times we have an increased risk of employees departing. If we lose a group of key personnel or even one key person at a company, our operations could be adversely affected. We do not maintain key man life insurance.

We have restrictions and covenants under our credit facilities and term loan.

We may not be able to remain in compliance with the covenants in the term loan or the credit facility. We have already been required to amend the credit facility to adjust covenants for the shut down companies. A failure to fulfill the terms may result in a default under one or more of the material agreements.

The loss of productivity, either at the corporate office or operating level, could adversely affect our business.

Our business is primarily driven by labor. The ability to perform contracts at acceptable margins depends on our ability to deliver substantial labor productivity. We cannot guarantee that productivity will continue at acceptable levels at our corporate office and our operating subsidiaries for a particular period of time. With the increased activity of de-levering our balance sheet and the uncertainty in the market there is an increased difficulty in maintaining morale and focus of employees. The loss of productivity could adversely affect the margins on existing contracts or the ability to obtain new contracts.

Litigation and claims can cause unexpected losses.

In the construction business there are always claims and litigation. Latent defect litigation is a normal course for residential home builders in some parts of the country. Legislation in other states indicate such litigation may increase to those states. There is also the inherent claims and litigation risk of the number of people that work on construction sites and the fleet of vehicles on the road everyday. Those claims and litigation risks are managed through safety programs, insurance programs, litigation management at the corporate office and the local level and attorneys and law firms throughout the country. Nevertheless, claims are sometimes made and lawsuits filed and some for amounts in excess of their value or amounts for which they are eventually resolved. Claims and litigation normally follow a predictable course of time to resolution. Because of the large number of claims of a company with so many contracts and employees, there can be periods of time where a disproportionate amount of the claims and litigation may come to the point of resolution through the court system, arbitration, mediation, or settlement all in the same quarter or year. If these matters resolve near the same time then the cumulative effect can be higher than the ordinary level in any one reporting period.

Latent defect litigation is increasing in states where we perform work. Such increases can put additional pressure on the profitability of the residential segment of our business.

Independent of the normal litigation risks, as a result IES inability to timely file its third quarter Form 10-Q and the subsequent events, a class action lawsuit has been filed, and a formal SEC investigation is ongoing. Those matters are discussed in more detail in Item 3 of this document.

The sale of subsidiaries may expose us to losses.

We determined to sell all or substantially all of the assets of certain wholly owned subsidiaries. Those sales were made to facilitate the business needs and purposes of the organization as a whole. Since we were a consolidator of electrical contracting businesses, often the best candidate to purchase those assets was a previous owner of those assets. That previous owner may sometimes still be associated with the subsidiary as an officer of that subsidiary. To facilitate the desired timing, the sales were being made with more than ordinary reliance on the representations of the purchaser, who is often the person most familiar with the business unit being sold. There is the potential in retaining our corporate legal entity where we have sold substantially all of the assets. If the purchaser is unwilling or unable to perform the transferred liabilities, we may be forced to fulfill obligations that were assumed by others. We would then seek reimbursement from the parties that assumed those liabilities.

Item 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

We operate a fleet of approximately 2,500 owned and leased service trucks, vans and support vehicles. We believe these vehicles generally are adequate for our current operations.

At September 30, 2006, we maintained branch offices, warehouses, sales facilities and administrative offices at 121 locations. Substantially all of our facilities are leased. We lease our corporate office located in Houston, Texas.

Our properties are generally adequate for our present needs, and we believe that suitable additional or replacement space will be available as required.

Item 3. *Legal Proceedings*

Refer to Note 16 of Notes to Consolidated Financial Statements which is incorporated herein by reference.

Item 4. *Submission of Matters to a Vote of Security Holders*

None.

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PART II

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

Prior to December 15, 2005, our common stock traded on the NYSE under the symbol IES. Between December 15, 2005 and May 12, 2006 our common stock traded over-the-counter on the pink sheets under the symbol IESR. On May 12, 2006, concurrent with the completion of our restructuring and emergence from bankruptcy, our common stock effectively underwent a reverse stock split which converted 17.0928 shares of old common stock into the right to receive one share of new common stock. On May 15, 2006, our common stock commenced trading on NASDAQ under the ticker symbol IESC. The following table sets forth (1) the high and low close price on any given day within the quarter and the close price on the last day of the quarter for our common stock as reported on the NYSE for fiscal 2005 and a portion of the first quarter of fiscal 2006, (2) the high and low bid quotation on any given day within the quarter and the close bid quotation on the last day of the quarter for our common stock as reported in the over-the-counter market on the pink sheets for a portion of the first quarter and the second quarter and a portion of the third quarter of fiscal 2006, and (3) the high and low close price on any given day within the quarter and the close price on the last day of the quarter for our common stock as reported on NASDAQ for a portion of the third quarter and for the fourth quarter of fiscal 2006. The over-the-counter quotations reflect inter-dealer prices, without retail markup, markdown or commissions, and may not necessarily represent actual transactions. The following per share amounts prior to May 1, 2006 have been adjusted for the effect of the 17.0928 to 1 reverse stock split.

Predecessor Company

	High	Low
Fiscal Year Ended September 30, 2005		
First Quarter	$ 92.98	$ 35.89
Second Quarter	$ 81.36	$ 46.66
Third Quarter	$ 49.40	$ 23.93
Fourth Quarter	$ 57.09	$ 31.62
Fiscal Year Ended September 30, 2006		
First Quarter	$ 49.23	$ 6.84
Second Quarter	$ 19.14	$ 8.03
Third Quarter (Through May 12, 2006)	$ 26.15	$ 17.43

Successor Company

	High	Low
Third Quarter (From May 15, 2006)	$ 21.81	$ 17.47
Fourth Quarter	$ 18.49	$ 11.90

As of December 15, 2006, the closing market price of our Common Stock was $15.08 per share and there were approximately 222 holders of record.

We do not anticipate paying cash dividends on or repurchasing our common stock in the foreseeable future. We expect that we will utilize all available earnings generated by our operations, proceeds from sales of operations and borrowings under our credit facility for the development and operation of our business. Any future determination as to the payment of dividends will be made at the discretion of our Board of Directors and will depend upon our operating results, financial condition, capital requirements, general business conditions and such other factors as the Board of Directors deems relevant. Our debt instruments restrict us from paying cash dividends on the common stock. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

Item 6. ***Selected Financial Data***

The following selected consolidated historical financial information for IES should be read in conjunction with the audited historical consolidated financial statements of Integrated Electrical Services, Inc. and subsidiaries and the notes thereto included in Item 8, Financial Statements and Supplementary Data.

	Predecessor					Successor
	Year Ended September 30,				Seven Months Ended April 30,	Five Months Ended September 30,
	2002	2003	2004	2005	2006 (Restated)	2006
	(In thousands, except per share data)					
Continuing Operations:						
Revenue	$ 908,951	$ 860,099	$ 838,054	$ 869,125	$ 530,381	$ 419,853
Cost of services	767,038	719,089	709,154	740,085	449,706	361,010
Gross profit	141,913	141,010	128,900	129,040	80,675	58,843
Selling, general & administrative expenses	129,244	112,293	119,970	131,562	70,311	53,800
Restructuring charges	5,556					
Goodwill impairment			65,265	53,122		
Income (loss) from operations	7,113	28,717	(56,335)	(55,644)	10,364	5,043
Reorganization items, net					(27,663)	1,419
Other (income) expense:						
Interest expense, net	26,686	25,759	23,184	28,291	14,929	2,570
Other, net	1,146	212	6,010	2,517	(596)	13
Interest & other expense, net	27,832	25,971	29,194	30,808	14,333	2,583
Income (loss) from continuing operations	(20,719)	2,746	(85,529)	(86,452)	23,694	1,041
Provision (benefit) for income taxes	(8,280)	(2,516)	7,738	10,024	758	425
Net income (loss) from continuing operations	(12,439)	5,262	(93,267)	(96,476)	22,936	616
Discontinued Operations:						
Income (loss) from discontinued operations	34,191	24,268	(28,251)	(41,346)	(15,148)	(8,787)

Provision (benefit) for income taxes	13,476	10,093	3,346	(8,190)		
Net income (loss) from discontinued operations	20,715	14,175	(31,597)	(33,156)	(15,148)	(8,787)
Cumulative effect of change in Accounting Principle, net of tax	(283,284)					
Net income (loss)	$ (275,008)	$ 19,437	$ (124,864)	$ (129,632)	$ 7,788	$ (8,171)

	Predecessor										Successor	
	Year Ended September 30,								Seven Months Ended April 30,		Five Months Ended September 30,	
	2002		2003		2004		2005		2006 (Restated)		2006	
	(In thousands, except per share data)											
Basic earnings (loss) per share:												
Basic earnings (loss) per share from continuing operations	$	(0.83)	$	0.34	$	(6.23)	$	(6.44)	$	1.49	$	0.04
Basic earnings (loss) per share from discontinued operations	$	1.38	$	0.92	$	(2.11)	$	(2.21)	$	(1.01)	$	(0.59)
Cumulative effect of change in accounting principle	$	(18.92)	$		$		$		$		$	
Basic earnings (loss) per share	$	(18.37)	$	1.26	$	(8.34)	$	(8.66)	$	0.51	$	(0.55)
Diluted earnings (loss) per share:												
Diluted earnings (loss) per share from continuing operations	$	(0.83)	$	0.34	$	(6.23)	$	(6.44)	$	1.49	$	0.04
Diluted earnings (loss) per share from discontinued operations	$	1.38	$	0.92	$	(2.11)	$	(2.21)	$	(0.99)	$	(0.57)
Cumulative effect of change in accounting principle	$	(18.92)	$		$		$		$		$	
Diluted earnings (loss) per share	$	(18.37)	$	1.26	$	(8.34)	$	(8.66)	$	0.51	$	(0.53)
Shares used in the computation of earnings (loss) per share:												

Basic	14,970,502	14,970,502	14,970,502	14,970,502	14,970,502	14,970,502
Diluted	14,970,502	15,373,969	14,970,502	14,970,502	15,373,969	15,373,969
Balance Sheet Data:						
Cash and cash equivalents	$ 32,779	$ 40,201	$ 22,232	$ 37,945	$ 16,973	$ 28,166
Working capital	306,582	326,023	222,853	(32,564)	151,473	136,125
Total assets	711,530	714,487	580,933	412,854	379,322	375,515
Total debt	249,009	248,378	231,280	223,884	53,158	55,765
Total stockholders equity	252,775	264,907	143,168	15,861	160,342	154,643

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes appearing elsewhere in the Form 10-K. See Disclosure Regarding Forward-Looking Statements .