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ENGLOBAL CORP
Form 10-Q
November 07, 2008

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

Form 10-Q

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

For the quarterly period ended September 30, 2008

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

Commission File No. 001-14217

ENGlobal Corporation

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction of
incorporation or organization)

88-0322261

(I.R.S Employer Identification No.)

654 N. Sam Houston Parkway E., Suite 400, Houston, TX 77073-6033

(Address of principal executive offices) (Zip code)

(281) 878-1000

(Registrant's telephone number, including area code)

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

Large Accelerated Filer [] Accelerated Filer [X]

Non-Accelerated Filer [] Smaller Reporting Company []

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in

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Rule 12b-2 of the Exchange Act).

Yes [] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the close of business of November 6, 2008.

\$0.001 Par Value Common Stock

27,294,591 shares

QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED SEPTEMBER 30, 2008

TABLE OF CONTENTS

Part I. Financial Information

Item 1. Financial Statements

Condensed Consolidated Statements of Income for the Three Months and
Nine Months Ended September 30, 2008 and September 30, 2007

Condensed Consolidated Balance Sheets at September 30, 2008 and December 31, 2007

Condensed Consolidated Statements of Cash Flows for the Nine Months Ended
September 30, 2008 and September 30, 2007

Notes to Condensed Consolidated Financial Statements

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

Engineering Segment Results
Construction Segment Results
Automation Segment Results
Land Segment Results

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

Part II. Other Information

Item 1. Legal Proceedings

Item 1A. Risk Factors

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

Item 3. Defaults Upon Senior Securities

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

Item 5. Other Information

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Item 6. Exhibits
Signatures

2

PART I. - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ENGlobal Corporation
Condensed Consolidated Statements of Income
(Unaudited)
(Dollars in Thousands)

	For the Three Months Ended September 30,		For the Ended S
	2008	2007	2008
Revenues	\$ 123,167	\$ 96,825	\$ 357,344
Direct costs	109,533	80,486	309,063
Gross profit	\$ 13,634	\$ 16,339	\$ 48,281
Selling, general and administrative	7,449	8,603	23,376
Operating income	\$ 6,185	\$ 7,736	\$ 24,905
Other income (expense):			
Other income	\$ 49	\$ (53)	\$ 134
Interest income (expense), net	(360)	(636)	(1,256)
Income before income taxes	\$ 5,874	\$ 7,047	\$ 23,783
Provision for federal and state income taxes	2,379	3,072	9,583
Net income	\$ 3,495	\$ 3,975	\$ 14,200
Net income per common share:			
Basic	\$ 0.13	\$ 0.15	\$ 0.52
Diluted	\$ 0.13	\$ 0.14	\$ 0.51
Weighted average shares used in computing net income per share (in thousands):			
Basic	27,272	26,953	27,143
Diluted	27,956	27,417	27,704

See accompanying notes to interim condensed consolidated financial statements.

3

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ENGlobal Corporation
 Condensed Consolidated Balance Sheets
 (Unaudited)
 (Dollars in Thousands)

ASSETS

	September 30, 2008	D 2007
	-----	-----
Current Assets:		
Cash	\$ 1,370	\$
Trade receivables, net	85,615	
Prepaid expenses and other current assets	1,524	
Current portion of notes receivable	156	
Costs and estimated earnings in excess of billings on uncompleted contracts	5,246	
Deferred tax asset	3,081	

Total Current Assets	\$ 96,992	\$
Property and equipment, net	\$ 6,106	\$
Goodwill	23,294	
Other intangible assets, net	3,370	
Long term notes receivable, net of current portion	9,110	
Deferred tax asset, non-current	281	
Other assets	1,038	

Total Assets	\$ 140,191	\$
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Accounts payable	\$ 11,634	\$
Accrued compensation and benefits	18,489	
Notes payable	--	
Current portion of long-term lease	171	
Current portion of long-term debt	1,901	
Deferred rent	459	
Billings and estimated earnings in excess of costs on uncompleted contracts	441	
Other current liabilities including taxes payable	2,381	

Total Current Liabilities	\$ 35,476	\$
Long-Term Lease, net of current portion	288	
Long-Term Debt, net of current portion	32,115	

Total Liabilities	\$ 67,879	\$

Commitments and Contingencies (Note 9)		
Stockholders' Equity:		
Common stock - \$0.001 par value; 75,000,000 shares authorized; 27,289,591 and 27,051,766 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively	\$ 27	\$
Additional paid-in capital	35,984	

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Retained earnings	36,381	
Accumulated other comprehensive income (loss)	(80)	

Total Stockholders' Equity	\$ 72,312	\$

Total Liabilities and Stockholders' Equity	\$ 140,191	\$
	=====	

See accompanying notes to interim condensed consolidated financial statements.

4

ENGlobal Corporation
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(Dollars in Thousands)

		For the Nine Septem
		----- 2008 -----
Cash Flows from Operating Activities:		
Net income		\$ 14,200
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization		3,393
Share-based compensation expense		1,063
Gain on disposal of property, plant and equipment		(85)
Deferred income taxes		(204)
Changes in current assets and liabilities, net of acquisitions:		
Trade receivables		(19,622)
Costs and estimated earnings in excess of billings on uncompleted contracts		1,735
Prepaid expenses and other assets		520
Accounts payable		1,023
Accrued compensation and benefits		1,783
Billings in excess of costs and estimated earnings		(522)
Other liabilities		(1,107)
Income taxes receivable/payable		(1,192)

Net cash provided by (used in) operating activities		\$ 985

Cash Flows from Investing Activities:		
Property and equipment acquired		\$ (1,570)
Proceeds from note receivable		1,480
Business acquisitions, net of cash acquired		(2,844)
Additional consideration for acquisitions		--
Proceeds from sale of other assets		383

Net cash used in investing activities		\$ (2,551)

Cash Flows from Financing Activities:		
Net borrowings (payments) on line of credit		\$ 2,284
Proceeds from issuance of common stock		1,327
Borrowing under capital lease		459
Long-term debt repayments		(1,967)

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Net cash (used in) provided by financing activities	\$ 2,103

Effect of Exchange Rate Changes on Cash	(75)

Net change in cash	\$ 462
Cash, at beginning of period	908

Cash, at end of period	\$ 1,370
	=====
Supplemental Disclosures:	
Interest paid	\$ 1,004

Income taxes paid	\$ 11,010

Non-cash investing and financing activities:	
Acceptance of note receivable from Oak Tree Holdings, LLC	--

Acceptance of note receivable from South Louisiana Ethanol (SLE)	--

Notes payable issued in acquisition of ACE, discounted for interest	\$ 1,941

See accompanying notes to interim condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements

NOTE 1 - BASIS OF PRESENTATION

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. Our Company consolidates all of its wholly-owned subsidiaries and all significant inter-company accounts and transactions have been eliminated in the consolidation.

The condensed consolidated financial statements of ENGlobal Corporation (which may be referred to as "ENGlobal," the "Company," "we," "us," or "our") included herein are unaudited for the three month and nine month periods ended September 30, 2008 and 2007, have been prepared from the books and records of the Company pursuant to the rules and regulations of the Securities and Exchange Commission, and in the case of the condensed balance sheet as of December 31, 2007, have been derived from the audited financial statements. These financial statements reflect all adjustments (consisting of normal recurring adjustments), which are, in the opinion of management, necessary to fairly present the results for the periods presented. Certain information and note disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission. It is suggested that these condensed financial statements be read in conjunction with the Company's audited financial statements for the year ended December 31, 2007, included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission. The Company

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believes that the disclosures made herein are adequate to make the information presented not misleading.

NOTE 2 - CRITICAL ACCOUNTING POLICIES

A summary of critical accounting policies is disclosed in Note 2 to the consolidated financial statements included in our 2007 Annual Report on Form 10-K. Our critical accounting policies are further described under the caption "Critical Accounting Policies" in Management's Discussion and Analysis of Financial Condition and Results of Operation in our 2007 Annual Report on Form 10-K.

NOTE 3 - SHARE-BASED COMPENSATION

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (Revised), "Share-Based Payment" ("SFAS No. 123(R)"). Under the fair value recognition provisions of SFAS No. 123(R), share-based compensation for employees is measured at the grant date based on the value of the awards and is recognized as expense over the requisite service period (usually a vesting period). The Company selected the modified prospective method of adoption described in SFAS No. 123(R). The fair values of awards recognized under SFAS No. 123(R) are determined based on the vested portion of the awards; however, the total compensation expense is recognized on a straight-line basis over the vesting period.

The Company maintained a share-based incentive plan, under which the Company had the ability to award non-statutory options, incentive stock options, restricted stock and stock appreciation rights to employees including non-employee directors. Under the Plan, a maximum of 3,250,000 shares of our common stock was approved to be issued or transferred to non-employee directors, officers and employees pursuant to awards granted. At the date of the Plan's expiration, June 5, 2008, 512,494 shares remained available under the Plan. This plan has not been extended or replaced.

The Company's policy regarding share issuance upon option exercise takes into consideration the optionee's eligibility and vesting status. Upon receipt of an optionee's exercise notice and payment, and the Company's subsequent determination of eligibility, the Company's Chief Governance Officer or the Chairman of the Compensation Committee instructs our transfer agent to issue shares of our common stock to the optionee.

Stock options have been granted with exercise prices at or above the market price on the date of grant. The granted options have vested generally over one year for non-employee directors and ratably over four years for officers and employees. The granted options generally have ten year contractual terms.

In accordance with the provisions of SFAS No. 123(R), total share-based compensation expense in the amount of \$247,000 and \$492,000 was recorded in the three months ended September 30, 2008, and September 30, 2007, respectively. Total share-based compensation expense in the amount of \$1,063,000 and \$947,000 was recorded in the nine months ended September 30, 2008, and September 30, 2007, respectively. The total share-based

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compensation expense was recorded in selling, general and administrative expense. The total income tax benefit recognized in the condensed consolidated statements of income for the share-based arrangements was \$24,000 and \$128,000 for the three months ended September 30, 2008, and September 30, 2007, respectively, and \$204,000 and \$205,000 for the nine months ended September 30, 2008, and September 30, 2007, respectively.

Compensation expense related to outstanding non-vested stock option awards under the Plan of \$1.2 million had not been recognized at September 30, 2008. This compensation expense is expected to be recognized over a weighted-average period of approximately 26 months.

The following table summarizes stock option activity through the third quarter of 2008:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	
	-----	-----	-----	-----
Balance at December 31, 2007	1,306,500	\$ 6.26	7.4	
Granted	140,000	9.44	9.5	
Exercised	(237,825)	5.62	--	
Canceled or expired	(30,000)	5.27	--	
	-----	-----	-----	
Balance at September 30, 2008	1,178,675	\$ 6.79	5.6	
	=====	=====	=====	
Exercisable at September 30, 2008	974,475	\$ 6.15	6.1	
	=====	=====	=====	

*Based on average stock price through the third quarter of 2008 of \$14.28 per share. The average stock price for the same period in 2007 was \$10.64 per share. Our common stock was quoted on the NASDAQ Global Select market during the nine months ended September 30, 2008 and on the American Stock Exchange during the nine months ended September 30, 2007. The total fair value of vested options outstanding as of September 30, 2008 and 2007 was \$7.9 million and \$6.0 million, respectively.

The total intrinsic value of options exercised was \$2.1 million and \$1.2 million for the nine months ended September 30, 2008 and 2007, respectively.

Restricted Stock Unit Awards

On August 8, 2008, the Company granted compensation to each of its three non-employee directors via restricted stock unit awards equivalent to 6,420 shares of common stock. The award of restricted stock units (RSUs) is intended to compensate and retain the directors over the term of the award. The fair value of the award was \$93,411 per director based on the market price of \$14.55 per share of the Company's stock on the date the award was granted. Upon vesting, the RSUs will be convertible into cash or common stock. Settlement of the RSUs with the non-employee directors is at the discretion of the Compensation Committee, subject to the requirement for stockholder approval to settle in common stock. The RSUs will vest in equal quarterly installments beginning on September 30, 2008, so long as the grantee continues to serve as an independent director of the Company. The stock price was \$13.27 on September 30, 2008, when the first installment

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vested. One-fourth of the compensation related to the restricted stock unit awards was recognized in the third quarter of 2008. The amount of compensation that was unrecognized at September 30, 2008, totals \$210,000.

7

Notes to Condensed Consolidated Financial Statements

NOTE 4 - FIXED FEE CONTRACTS

Costs, estimated earnings and billings on uncompleted contracts consisted of the following at September 30, 2008 and December 31, 2007:

	September 30, 2008
	----- (Dollars in T -----
Costs incurred on uncompleted contracts	\$ 70,715
Estimated earnings (losses) on uncompleted contracts	(1,791)

Earned revenues	68,924
Less: billings to date	64,119

Net costs and estimated earnings in excess of billings on uncompleted contracts	\$ 4,805 =====
Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 5,246
Billings and estimated earnings in excess of cost on uncompleted contracts	(441)

Net costs and estimated earnings in excess of billings on uncompleted contracts	\$ 4,805 =====

NOTE 5 - LINE OF CREDIT AND DEBT

Schedule of Long-Term Debt:

	Septemb 2008 ----- (Dol -----
Comerica Credit Facility - Line of credit, variable interest at 4.75% at September 30, 2008, maturing in August 2010	\$ 30,1
Sterling Planet and EDGI - Notes payable, interest at 5%, principal payments in installments of \$15,000 plus interest due quarterly, maturing in December 2008	
Cleveland Inspection Services, Inc., CIS Technical Services and F.D. Curtis - Notes payable, discounted at 5% interest, principal payments in installments of \$100,000 due quarterly, maturing in October 2009	3
A.T.I. Inc. - Note payable, interest at 6%, principal payments in installments of \$30,422 including interest due monthly, maturing in January 2009	1
Michael Lee - Note payable, interest at 5%, principal payments in installments of \$150,000 plus interest due quarterly, maturing in July 2010	1,0
Watco Management, Inc. - Note payable, interest at 4%, principal payments in installments of \$137,745 including interest due annually, maturing in	

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October 2010	3
Frank H McIlwain, PC; James A Walters, PC; William M Bosarge, PC; Matthew R Burton, PC - Notes payable, discounted at 2.38% interest, payments in installments of \$666,667 including interest due annually, maturing in December 2010.	1,9 -----
Total long-term debt	34,0
Less: current maturities of long-term debt	(1,9 -----
Long-term debt, net of current portion	\$ 32,1
Borrowings under capital lease	4
Less: current maturities of capital lease	(1 -----
Total	\$ 32,4 =====

8

Notes to Condensed Consolidated Financial Statements

The Company plans additional borrowings of approximately \$500,000 under capital leases during the remainder of 2008.

NOTE 6 - SEGMENT INFORMATION

ENGlobal has four reportable segments: Engineering, Construction, Automation and Land. Our segments are strategic business units that offer different services and products and therefore require different marketing and management strategies. Our segments have grown through strategic acquisitions, which have also served to augment management expertise.

The Engineering segment provides consulting services relating to the development, management and execution of projects requiring professional engineering and related project services. Services provided by the Engineering segment include feasibility studies, engineering, design, procurement, and construction management. The Construction segment provides construction management personnel and services in the areas of inspection, mechanical integrity, vendor and turnaround surveillance, field support, construction, quality assurance and plant asset management. The Automation segment provides services related to the design, fabrication, and implementation of process distributed control and analyzer systems, advanced automation, and information technology projects. The Land segment provides land management, right-of-way, environmental compliance, and governmental regulatory compliance services primarily to pipeline, utility and telecom companies and other owner/operators of infrastructure facilities throughout the United States and Canada.

The accounting policies of each of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on profit or loss from operations before interest, income taxes and other income or loss, but after selling, general and administrative expenses attributable to the reportable segments. Transactions between reportable segments are at market rates comparable to terms available from unrelated parties.

(Dollars in Thousands)	Engineering	Construction	Automation	Land	All
For the three months ended	-----	-----	-----	----	----
September 30, 2008					

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Revenue before eliminations	\$ 63,170	\$ 44,481	\$ 7,912	\$ 11,251	\$
Inter-segment eliminations	\$ (60)	(3,571)	(16)	--	
	-----	-----	-----	-----	-----
Revenue	\$ 63,110	40,910	7,896	11,251	
Gross profit	\$ 8,864	2,765	154	1,851	
SG&A	\$ 1,446	794	720	660	
	-----	-----	-----	-----	-----
Operating income	\$ 7,418	\$ 1,971	\$ (566)	\$ 1,191	\$
	-----	-----	-----	-----	-----
Other income (expense)					
Tax provision					
Net income					

(Dollars in Thousands)
For the three months ended
September 30, 2007

Revenue before eliminations	\$ 61,687	\$ 26,402	\$ 8,853	\$ 7,620	\$
Inter-segment eliminations	\$ (7)	(7,403)	(327)	--	
	-----	-----	-----	-----	-----
Revenue	\$ 61,680	18,999	8,526	7,620	
Gross profit	\$ 10,801	3,678	774	1,086	
SG&A	\$ 2,741	791	688	562	
	-----	-----	-----	-----	-----
Operating income	\$ 8,060	\$ 2,887	\$ 86	\$ 524	\$
	-----	-----	-----	-----	-----
Other income (expense)					
Tax provision					
Net income					

9

Notes to Condensed Consolidated Financial Statements

NOTE 6 - SEGMENT INFORMATION (continued)

(Dollars in Thousands)					
For the nine months ended					
September 30, 2008					

Revenue before eliminations	\$ 192,685	\$ 110,356	\$ 29,880	\$ 31,928	\$
Inter-segment eliminations	\$ (67)	(6,892)	(546)	--	
	-----	-----	-----	-----	-----
Revenue	\$ 192,618	103,464	29,334	31,928	
Gross profit	\$ 31,525	8,781	2,560	5,415	
SG&A	\$ 5,003	2,255	2,101	2,219	
	-----	-----	-----	-----	-----
Operating income	\$ 26,522	\$ 6,526	\$ 459	\$ 3,196	\$
	-----	-----	-----	-----	-----
Other income (expense)					
Tax provision					

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Net income

(Dollars in Thousands)
For the nine months ended
September 30, 2007

Revenue before eliminations	\$ 170,103	\$ 60,069	\$ 28,618	\$ 21,611
Inter-segment eliminations	\$ (8)	(11,297)	(1,036)	--
	-----	-----	-----	-----
Revenue	\$ 170,095	48,772	27,582	21,611
Gross profit	\$ 29,549	8,406	2,667	3,213
SG&A	\$ 6,339	2,084	2,306	1,719
	-----	-----	-----	-----
Operating income	\$ 23,210	\$ 6,322	\$ 361	\$ 1,494
	-----	-----	-----	-----
Other income (expense)				
Tax provision				
Net income				

Financial information about geographic areas

Revenue from the Company's non-U.S. operations is not material. Long-lived assets (principally leasehold improvements and computer equipment) located in Canada were valued at \$57,000 as of September 30, 2008, net of accumulated depreciation, stated in U.S. dollars.

NOTE 7 - FEDERAL AND STATE INCOME TAXES

The components of income tax expense (benefit) for the three months and nine months ended September 30, 2008 and 2007 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	-----	-----	-----	-----
	(Dollars in thousands)		(Dollars in thousands)	
Current	\$ 2,403	\$ 3,110	\$ 9,787	\$ 7,927
Deferred	(24)	(38)	(204)	(205)
	-----	-----	-----	-----
Total tax provision	\$ 2,379	\$ 3,072	\$ 9,583	\$ 7,722
	=====	=====	=====	=====
Effective tax rate	40.5%	42.0%	40.3%	39.7%
	-----	-----	-----	-----

The estimated effective tax rates are based on estimates using historical rates adjusted by recurring and non-recurring book to tax differences. Estimates at September 30, 2008, are based on results of the 2007 year end and adjusted for estimates of non-recurring differences from the prior year, as well as anticipated book to tax differences for 2008.

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NOTE 8 - EARNINGS PER SHARE

The following table reconciles the number of shares used to compute basic earnings per share to the number of shares used to compute diluted earnings per share ("EPS").

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(Shares in thousands)		(Shares in thousands)	
Weighted average shares outstanding used to compute basic EPS	27,272	26,953	27,143	26,877
Effect of share-based plan	684	464	561	401
	27,956	27,417	27,704	27,278
	=====	=====	=====	=====

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Employment Agreements

The Company has employment agreements with certain of its executive officers and other officers. Such agreements provide for minimum salary levels. Generally, if the Company terminates the employment of the employee for any reason other than (1) for cause, as defined in the employment agreement, (2) voluntary resignation, or (3) the employee's death, the Company is obligated to provide a severance benefit equal to six months of the employee's salary, and, at its option, an additional six months at 50% to 100% of the employee's salary in exchange for an extension of the employee's agreement not to engage in certain competitive activities. These agreements are renewable for one year at the Company's option.

Long-term Note Receivable

In the first quarter of 2007, ENGlobal Engineering, Inc. ("EEI") and South Louisiana Ethanol, LLC ("SLE") executed an agreement for engineering, procurement and construction (EPC) services relating to the retro-fit of an ethanol plant in southern Louisiana. The history of the SLE project (the "SLE Project") is described in Note 12 to the Company's condensed consolidated financial statements included in its Quarterly Report on Form 10-Q for the quarter ended September 30, 2007, and is discussed further in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, under Litigation, below, and in Part II, "Item 1 - Legal Proceedings" of this Quarterly Report on Form 10-Q.

Accounts Receivable

Note 10 to the Company's condensed consolidated financial statements ("Subsequent Events") included in its Quarterly Report on Form 10-Q for the quarter ended June 30, 2008, discussed the petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code filed by the parent of ENGlobal client SemCrude, L.P. This client has continued to be current on payments due to the Company throughout the third quarter.

Litigation

Due to SLE's continued failure to obtain permanent financing, on May 30, 2008, the Company filed suit in the United States District Court for the Eastern District of Louisiana, Cause Number 08-3601, seeking damages of

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\$15.8 million. An independent appraisal, dated March 17, 2008, from the bridge lending bank's appraiser, Revpro and Associates, indicates a fair market value of SLE's assets of \$35.8 million, an orderly liquidation value of \$25.3 million, and a forced liquidation value of \$20.0 million. While the Company believes that in the event the collateral is liquidated, SLE's obligations to the Company would be paid in full pursuant to the Collateral Mortgage in favor of the Company, collectability is not assured at this time. However, at this time the Company believes that the ultimate disposition of the SLE collateral will not materially adversely affect our liquidity or overall financial position.

11

Notes to Condensed Consolidated Financial Statements

From time to time, the Company is involved in various legal proceedings arising in the ordinary course of business alleging, among other things, breach of contract or tort in connection with the performance of professional services, the outcome of which cannot be predicted with certainty. As of the date of this filing, we are party to several legal proceedings that we believe have been reserved for or are covered by insurance, or that, if determined adversely to us individually or in the aggregate, would not have a material adverse effect on our results of operations or financial position.

Insurance

The Company carries a broad range of insurance coverage, including general and business automobile liability, commercial property, professional errors and omissions, workers' compensation insurance, directors and officers liability insurance and a general umbrella policy. The Company is not aware of any claims in excess of insurance recoveries. ENGlobal is partially self-funded for health insurance claims. Provisions for expected future payments are accrued based on the Company's experience.

Building Lease Commitment

As discussed in Note 20 to the Company's consolidated financial statements included in its 2007 Annual Report on Form 10-K, on February 28, 2008, ENGlobal entered into a lease agreement with a third party relating to the construction of a new facility in Beaumont, Texas. Commencement of the lease agreement and construction of the facility was contingent on the sale of property to the developer/lessor. During May 2008, the Company completed the sale of property to the developer/lessor. Construction has commenced on the new facility and is expected to continue throughout 2008.

Restricted Stock Units

As discussed at the end of Note 3, on August 8, 2008, the Company granted compensation to each of its three non-employee directors via restricted stock unit awards equivalent to 6,420 shares of common stock. The fair value of the award was \$93,411 per director based on the market price of \$14.55 per share of the Company's stock on the date the award was granted. The total value of the grant was \$280,000. Upon vesting, the RSUs will be convertible into cash or common stock. Settlement of the RSUs with the non-employee directors is at the discretion of the Compensation Committee, subject to the requirement for stockholder approval to settle in common stock. One-fourth, \$70,000, of the compensation related to the restricted stock unit awards vested in the third quarter of 2008. Because it has not

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yet been determined whether this award will be settled in cash or stock, the award has not been classified as a liability. If settlement is ultimately made in cash, the transaction will be reclassified from additional paid in capital to a liability. The amount of compensation that was unrecognized at September 30, 2008, totals \$210,000.

Retention Bonus

On September 29, 2008, the Company acquired 100% of the membership interests of Advanced Control Engineering, LLC ("Advanced Control Engineering") as discussed in Note 10 below. Per Section 6.10 of the Purchase Agreement between ENGlobal and Advanced Control Engineering (which is attached as an exhibit to this Quarterly Report on Form 10-Q), one of the conditions to the transaction's closing was the agreement to pay employee retention bonuses. The retention bonuses are payable to employees of Advanced Control Engineering, contingent on their continued employment with ENGlobal, and, as such, will be recognized as compensation expense in the period in which they become due.

12

Notes to Condensed Consolidated Financial Statements

NOTE 10 - ACQUISITIONS

EMC Design & Consulting, Inc.

On September 4, 2008, the Company acquired the net assets of EMC Design & Consulting, Inc. for a cash payment of \$350,000. The property, plant and equipment was valued at \$206,000 net of depreciation. The remaining \$144,000 is included in other intangible assets and is being amortized over 24 months.

Advanced Control Engineering

On September 29, 2008, the Company acquired 100% of the membership interests of Advanced Control Engineering, LLC ("Advanced Control Engineering"). Advanced Control Engineering provides control system and related technical services to a variety of industries. Advanced Control Engineering complements the business of the Company's Automation segment and is situated geographically to expand the Automation segment's service territory. At the closing of the acquisition, the aggregate purchase price was \$4.4 million, including a cash payment of \$2.5 million to the principals of Advanced Control Engineering, and promissory notes issued to such principals (described in Note 5) in the face amount of \$2.0 million, discounted for interest to \$1.9 million, using guidance from the Internal Revenue Service on discounting non-interest bearing notes. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. ENGlobal is in the process of obtaining third-party valuations of certain intangible assets. Therefore, the allocation of the purchase price is subject to change.

Advanced Control Engineering, LLC

At September 30, 2008

(Dollars in thousands)

Cash and other current assets	\$ 75
Accounts receivable	1,913
Property, plant and equipment	244

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Goodwill	2,910
Less liabilities assumed	(700)

Net assets acquired	\$ 4,442
	=====
Net purchase price	\$ 4,442

The Company is expecting to account for this transaction as a purchase under SFAS No. 141, Business Combinations.

Because the transaction closing date was September 29, 2008, no results of operations of Advanced Control Engineering are reflected in the Company's condensed consolidated statements of income in this Quarterly Report on Form 10-Q. The results of operations of Advanced Control Engineering are summarized as follows:

Advanced Control Engineering, LLC	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2008
	-----	-----
	(Dollars in thousands)	(Dollars in thousands)
Total Revenue	\$2,330	\$7,059
	-----	-----
Net Income	\$ 85	\$ 624
	=====	=====

NOTE 11 - SUBSEQUENT EVENTS

On or about November 4, 2008, EcoProduct Solutions, L.P. ("EcoProduct") served ENGlobal Engineering, Inc. ("EEI") with an arbitration demand in connection with a previously initiated arbitration proceeding against defendant Swenson Technology, Inc. ("Swenson") pending before the American Arbitration Association. According to the first amended statement of claims, the claimant has made various allegations, including professional negligence, breach of contract, and violation of Texas consumer protection laws, against primary defendant Swenson Technology, Inc., and now, also against EEI in connection with an engineering project on which EEI's work was completed in 2005. EcoProduct is seeking approximately \$45 million in damages. Due to the recentness of the filing, we have not yet had a chance to review the claims thoroughly. However, it is our current understanding that the suit is substantially without merit, and we intend to vigorously defend against it.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

Certain information contained in this Quarterly Report on Form 10-Q, the Company's Annual Report on Form 10-K, as well as other written and oral statements made or incorporated by reference from time to time by the Company and its representatives in other reports, filings with the Securities and Exchange Commission, press releases, conferences, or otherwise, may be deemed to be forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. This information includes, without limitation, statements concerning the

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Company's future financial position and results of operations; planned capital expenditures; business strategy and other plans for future operations; the future mix of revenues and business; customer retention; project reversals; commitments and contingent liabilities; and future demand and industry conditions. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Generally, the words "anticipate," "believe," "estimate," "expect," "may," and similar expressions, identify forward-looking statements, which generally are not historical in nature. Actual results could differ materially from the results described in the forward-looking statements due to the risks and uncertainties set forth in this Quarterly Report on Form 10-Q, the specific risk factors identified in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, and those described from time to time in our future reports filed with the Securities and Exchange Commission.

The following discussion is qualified in its entirety by, and should be read in conjunction with, the Company's condensed consolidated financial statements, including the notes thereto, included in this Quarterly Report on Form 10-Q and the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

MD&A Overview

The following list sets forth a general overview of certain significant changes in the Company's financial condition and results of operations for the three months and nine months ended September 30, 2008, compared to the corresponding periods in 2007.

	During the three months ended September 30, 2008	During the nine months ended September 30, 2008
	-----	-----
Revenues	Increased 27.3%	Increased 33.3%
Gross profit	Decreased 16.6%	Increased 10.3%
Operating income	Decreased 19.5%	Increased 23.3%
SG&A expense	Decreased 14.0%	Decreased 0.8%
Net income	Decreased 12.5%	Increased 29.1%

Management's Discussion and Analysis (continued)

	As of September 30, 2008	As of December 31, 2007	As of September 30, 2007
Selected Balance Sheet Comparisons	-----	-----	-----
	(Dollars in Thousands)		
	-----	-----	-----

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Working capital	\$ 61,516	\$ 42,915	\$ 48,924
Total assets	\$140,191	\$119,590	\$126,790
Long-term debt, net of current portion	\$ 32,115	\$ 29,318	\$ 37,795
Stockholders' equity	\$ 72,312	\$ 55,797	\$ 53,531

Long-term debt, net of current portion, increased 9.6%, or \$2.8 million, from \$29.3 million at December 31, 2007 to \$32.1 million at September 30, 2008. As a percentage of stockholders' equity, long-term debt decreased to 44.4% from 52.5% at these dates. The increase in long-term debt primarily relates to \$1.9 million in notes payable issued as a part of the consideration paid for the acquisition of Advanced Control Engineering and a \$2.3 million increase in the amount drawn on our line of credit, offset by note payments. On average, our days sales outstanding remained 61 days for the three-month period ended September 30, 2008, equal to 61 days for the twelve-month period ended December 31, 2007, but lower than the 66 days for the three-month period ended September 30, 2007. The Company continues to work toward improving its billing and client collection processes.

Total stockholders' equity increased 29.6%, or \$16.5 million, from \$55.8 million as of December 31, 2007 to \$72.3 million as of September 30, 2008.

Management's Discussion and Analysis (continued)

Consolidated Results of Operations for the Three Months
Ended September 30, 2008 and 2007
(Unaudited)

For the three months ended
September 30, 2008
(Dollars in Thousands)

	Engineering	Construction	Automation	Land	AL
Revenue before eliminations	\$ 63,170	\$ 44,481	\$ 7,912	\$ 11,251	\$
Inter-segment eliminations	(60)	(3,571)	(16)	--	

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Revenue	\$ 63,110	\$ 40,910	\$ 7.896	\$ 11,251	\$
	-----	-----	-----	-----	-----
Gross profit	\$ 8,864	\$ 2,765	\$ 154	\$ 1,851	\$
SG&A	1,446	794	720	660	
	-----	-----	-----	-----	-----
Operating income	\$ 7,418	\$ 1,971	\$ (566)	\$ 1,191	\$
	-----	-----	-----	-----	-----
Other income (expense)					
Tax provision					
Net income					

For the three months ended
September 30, 2007
(Dollars in Thousands)

Revenue before eliminations	\$ 61,687	\$ 26,402	\$ 8,853	\$ 7,620	\$
Inter-segment eliminations	(7)	(7,703)	(327)	--	
	-----	-----	-----	-----	-----
Revenue	\$ 61,680	\$ 18,999	\$ 8,526	\$ 7,620	\$
	-----	-----	-----	-----	-----
Gross profit	\$ 10,801	\$ 3,678	\$ 774	\$ 1,086	\$
SG&A	2,741	791	688	562	
	-----	-----	-----	-----	-----
Operating income	\$ 8,060	\$ 2,887	\$ 86	\$ 524	\$
	-----	-----	-----	-----	-----
Other income (expense)					
Tax provision					
Net income					

16

Management's Discussion and Analysis (continued)

Consolidated Results of Operations for the Nine Months
Ended September 30, 2008 and 2007
(Unaudited)

For the nine months ended
September 30, 2008
(Dollars in Thousands)

	Engineering	Construction	Automation	Land	AL
	-----	-----	-----	-----	-----
Revenue before eliminations	\$ 192,685	\$ 110,356	\$ 29,880	\$ 31,928	\$
Inter-segment eliminations	(67)	(6,892)	(546)	--	
	-----	-----	-----	-----	-----
Revenue	\$ 192,618	\$ 103,464	\$ 29,334	\$ 31,928	\$
	-----	-----	-----	-----	-----
Gross profit	\$ 31,525	\$ 8,781	\$ 2,560	\$ 5,415	\$
SG&A	5,003	2,255	2,101	2,219	
	-----	-----	-----	-----	-----
Operating income	\$ 26,522	\$ 6,526	\$ 459	\$ 3,196	\$
	-----	-----	-----	-----	-----
Other income (expense)					
Tax provision					

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Net income

For the nine months ended
September 30, 2007
(Dollars in Thousands
-----)

Revenue before eliminations	\$ 170,103	\$ 60,069	\$ 28,618	\$ 21,611	\$
Inter-segment eliminations	(8)	(11,297)	(1,036)	--	
	-----	-----	-----	-----	-----
Revenue	\$ 170,095	\$ 48,772	\$ 27,582	\$ 21,611	\$
	-----	-----	-----	-----	-----
Gross profit	\$ 29,549	\$ 8,406	\$ 2,667	\$ 3,213	\$
SG&A	6,339	2,084	2,306	1,719	
	-----	-----	-----	-----	-----
Operating income	\$ 23,210	\$ 6,322	\$ 361	\$ 1,494	\$
	-----	-----	-----	-----	-----
Other income (expense)					
Tax provision					
Net income					

17

Management's Discussion and Analysis (continued)

We recorded net income of \$3.5 million, or \$0.13 per diluted share, for the three months ended September 30, 2008, compared to net income of \$4.0 million, or \$0.14 per diluted share, for the corresponding period last year. We recorded net income of \$14.2 million, or \$0.51 per diluted share, for the nine months ended September 30, 2008, compared to net income of \$11.0 million, or \$0.40 per diluted share, for the corresponding period in 2007.

The decline in net income during the three months ended September 30, 2008 was due in part to the impacts of Hurricane Gustav and Hurricane Ike. The Company's operations in Baton Rouge, Louisiana were impacted by the landfall of Hurricane Gustav on September 1, 2008. Hurricane Ike's landfall on September 13, 2008 impacted approximately one-third of the Company's operations. Ike was particularly devastating to our Beaumont, Texas operations, with evacuations spanning from September 11 to September 20 and power outages affecting certain of the Company's offices throughout this

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period as the infrastructures of the affected areas were repaired. Nonetheless, our Company and employees displayed resilience during this time by returning to work when possible, utilizing weekends to make up lost time, and seeking additional opportunities to assist our clients with the restoration of their facilities.

The Company recognizes service revenue as soon as the services are performed. The majority of the Company's service revenue has historically been provided through cost-plus contracts, whereas a majority of our fabrication and turnkey EPC projects revenue has been earned on fixed-price contracts.

Revenue on fixed-price contracts is recorded primarily using the percentage-of-completion (cost-to-cost) method. Under this method, revenue on long-term contracts is recognized in the ratio that contract costs incurred bear to total estimated contract costs. Revenue and gross margin on fixed-price contracts are subject to revision throughout the lives of the contracts and any required adjustments are made in the period in which the revisions become known. Losses on contracts are recorded in full as they are identified.

In the course of providing our services, we routinely provide engineering, materials, and equipment and may provide construction services on a direct hire or subcontractor basis. Generally, the materials, equipment and subcontractor costs are passed through to our clients and reimbursed, along with fees, which in total are at margins lower than those of our normal core business. In accordance with industry practice and generally accepted accounting principles, all such costs and fees are included in reported revenue. The use of subcontractor services can change significantly from project to project; therefore, changes in revenue and gross profit, SG&A expense and operating income as a percent of revenue may not be indicative of the Company's core business trends.

Operating SG&A expense includes management and staff compensation, office costs such as rents and utilities, depreciation, amortization, travel and other expenses generally unrelated to specific contracts, but directly related to the support of a segment's operations.

All other SG&A expense is comprised primarily of business development costs, as well as costs related to the executive, investor relations/governance, finance, accounting, safety, human resources, project controls, legal and information technology departments, and other costs generally unrelated to specific projects, but which are incurred to support corporate activities and initiatives.

Industry Overview:

Due to the increasing global demand for, and limited supply of, both crude oil and refined products, and the resulting increased spending on necessary energy infrastructure improvements in North America, we believe each of ENGlobal's business segments is well positioned within the industry.

Many ENGlobal offices have benefited from significant capital projects in the downstream refinery market, primarily related to increasing capacity, utilizing heavy or sour crude oil, and rebuilding facilities damaged by accidents or natural disasters. While many of such projects are currently underway, some refiners may choose to defer significant new spending given the recent tightening of refining margins. The Company expects a continuation of compliance-driven refining projects, such as EPA environmental initiatives, DOT pipeline integrity requirements, and OSHA safety-related projects, which may result from increased audits of U.S.-based refineries. Also, the Company is seeing opportunities to upgrade

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obsolete automation and control systems at existing refineries and to plan and manage turnaround projects.

18

Management's Discussion and Analysis (continued)

The downstream petrochemical industry has historically been a good source of projects for ENGlobal. While not currently as robust as the refining market, we have seen a steady level of both maintenance and capital spending in this industry. We believe that major grassroots petrochemical projects will continue to be undertaken overseas, either closer to product demand in emerging economies, or located closer to less expensive feed stocks. We expect that future petrochemical work undertaken in the U.S. primarily will consist of smaller capital projects or will be maintenance related.

Despite past downturns in the industry, pipeline projects have remained fairly constant and we have recently seen a significant increase in project activity. Although pipeline projects tend to require fewer engineering man hours than similarly sized downstream projects, ENGlobal may also provide a pipeline client with several additional services, such as right-of-way acquisition, regulatory permitting, inspection, and construction management. The drivers we see behind growth in domestic pipeline activity include: (1) natural gas transportation away from the Rocky Mountain area and new gas fields in other parts of the country, (2) natural gas transportation related to LNG import facilities, (3) movement of heavy Canadian crude oil into the United States, and (4) movement of refined products from Gulf Coast refineries to the Midwest and Northeast.

The country's focus on alternative energy has presented the Company with many new project opportunities. The North American Industrial Project Spending Index has recently indicated that capital spending for all alternative energy projects exceeds that for refining and pipeline. To date, ENGlobal has mainly focused its efforts on biomass processes, such as those related to coal-to-liquids projects, the production of ethanol and biodiesel, and the utilization of refinery petroleum coke as an energy source (e.g. ammonia to feed a fertilizer plant). In addition, the Company predicts possible opportunities related to solar energy in future years, including the opportunity to perform project services on solar collector and polysilicon (used in photovoltaic cells) production facilities. Most of our alternative energy projects are awarded from smaller developers rather than our larger, traditional clients.

Tightening credit markets have resulted in a worldwide credit crisis that has triggered substantial uncertainty with respect to the funding of capital expenditures by our customers, and oil and natural gas prices have fallen substantially from their highs in summer 2008. These changes have impacted general business conditions and may reduce demand for certain of our products and services. As mentioned above, some refiners may choose to defer significant new spending given the recent tightening of refining margins. Although we are not immune to the current financial and economic events, we believe each of ENGlobal's business segments is well positioned within the industry, as further discussed in the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 29, 2008, and as follows:

ENGlobal has served many of our valued clients over a long period of time, and these strong alliance relationships are the foundation of our business.

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Our business relies on small to mid-sized projects, many of which fall into the "run and maintain" category. We are not nearly as dependent on huge grass roots capital projects as most others in our industry.

A significant part of our Automation segment's work is driven by our clients' need to replace aging and obsolete distributed control system (DCS) and analytical equipment. While at times these expenditures can be deferred, the need to replace DCS and other equipment has provided a reliable and recurring source of projects. We are focusing our efforts on improving operational efficiencies that will allow us to fully capitalize on these opportunities.

About half of the states in the U.S. have enacted Renewable Portfolio Standards, which mandate a timeline and percentage for electricity generation from renewable sources such as wind, solar, geothermal, and biomass. Also, the Investment Tax Credit for these renewable energy projects was due to expire on December 31, 2008, but was extended as part of the recent "bailout" legislation. We believe these two factors working together, will serve to drive demand for alternative energy projects in the future.

Facilities in the energy industry, as well as in many other industries, are aging. No grassroots refinery has been built in the U.S. since 1976, and many of the country's large pipelines were installed over 50 years ago. We anticipate that maintaining and rebuilding this aging infrastructure - an ENGlobal core competency - will benefit our Company.

Note: The segment information contains further detail regarding the reasons for changes from period to period.

Revenue:

Revenue increased \$26.4 million, or 27.3%, to \$123.2 million for the three months ended September 30, 2008, from \$96.8 million for the comparable prior-year period. Of the increase, approximately \$1.4 million is attributable to our Engineering segment, \$21.9 million to our Construction segment, and \$3.7 million to our Land segment, while our Automation segment decreased \$0.6 million. The most significant increase in revenue for the three months ended September 30, 2008, was in the Construction segment, as inspection services rose by \$22.2 million, an increase of 133.7% over the comparable prior-year period.

Revenue increased \$89.2 million, or 33.3%, to \$357.3 million for the nine months ended September 30, 2008, from \$268.1 million for the comparable prior-year period. Of the increase, approximately \$22.5 million is attributable to our Engineering segment, \$54.7 million to our Construction segment, \$1.7 million to our Automation segment, and \$10.3 million to our Land segment. The most significant increase in revenue for the nine months ended September 30, 2008, was in the Construction segment, as inspection services rose by \$53.8 million, an increase of 136.5% over the comparable prior-year period. The next most significant increase in revenue was in the Engineering segment as detail-design services rose by \$28.4 million, an increase of 28.7% over the comparable prior-year period.

Gross Profit:

Gross profit decreased \$2.7 million, or 16.6%, to \$13.6 million for the three months ended September 30, 2008, from \$16.3 million for the comparable prior-year period. The \$2.7 million decrease in gross profit is attributable to approximately \$7.1 million in higher costs and increased procurement and inspection services, where higher employee-related costs and competitive pressure on bill rates resulted in lower margins. This is

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offset by the \$4.4 million increase in revenue related to the increase in inspection services and more competitive margins on the detail-design services related to a single refinery rebuild project.

19

Management's Discussion and Analysis (continued)

As a percentage of revenue, gross profit decreased 5.8% from 16.8% for the three months ended September 30, 2007, to 11.0% for the three months ended September 30, 2008. The decrease in gross profit margin as a percentage of revenue primarily relates to a shift in revenue mix quarter-over-quarter. Revenues in the Construction segment for the three months ended September 30, 2008, included \$38.8 million in inspection services compared to \$16.6 million for the three months ended September 30, 2007. While this portion of our revenue added \$22.2 million to our overall revenue growth, this type of service has typically been performed at lower margins, thereby resulting in an average reduction of 2.8% in our overall gross margin. Increased costs on fixed-price work and increased non-reimbursable costs in our Automation segment also contributed to the lower margins.

Gross profit increased \$4.5 million, or 10.3%, to \$48.3 million for the nine months ended September 30, 2008, from \$43.8 million for the comparable prior-year period. The \$4.5 million increase in gross profit is attributable to a \$14.6 million increase in revenue, which was offset by approximately \$10.1 million in higher costs and lower margins.

As a percentage of revenue, gross profit decreased 2.9% from 16.4% for the nine months ended September 30, 2007, to 13.5% for the quarter ended September 30, 2008. Revenues in the Engineering segment for the nine months ended September 30, 2008, included \$25.1 million in procurement services compared to \$16.2 million for the nine months ended September 30, 2007. Revenues in the Construction segment for the nine months ended September 30, 2008, included \$93.2 million in inspection services compared to \$39.4 million for the nine months ended September 30, 2007. While these two portions of our revenue added \$62.7 million to our overall revenue growth, these pass-through type services have typically been performed at lower margins, thereby resulting in an average reduction of 2.9% in our overall gross margin.

Selling, General, and Administrative:

As a percentage of revenue, total SG&A expense decreased 2.9% to 6.0% for the three months ended September 30, 2008, from 8.9% for the comparable period in 2007. Total expense for SG&A decreased \$1.2 million, or 14.0%, to \$7.4 million for the three months ended September 30, 2008, from \$8.6 million for the comparable prior-year period.

As a percentage of revenue, operating SG&A expense decreased 2.1% to 2.9% for the three months ended September 30, 2008, from 5.0% for the comparable prior-year period. Operating SG&A decreased \$1.2 million, or 25.0%, to \$3.6 million for the three months ended September 30, 2008, from \$4.8 million for the comparable prior-year period. Decreases in operating SG&A were primarily related to decreases in bad debt expense and identifying approximately \$0.3 million of certain associate expenses as direct costs rather than overhead. Operating SG&A is discussed in further detail in each of the segment sections.

As a percentage of revenue, all other SG&A expense decreased 0.8% to 3.1% for the three months ended September 30, 2008, from 3.9% for the comparable

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prior-year period. All other SG&A expense remained the same at \$3.8 million for both the three months ended September 30, 2008 and for the comparable prior-year period.

As a percentage of revenue, total SG&A expense decreased 2.3% to 6.5% for the nine months ended September 30, 2008, from 8.8% for the comparable period in 2007. Total expense for SG&A decreased \$0.2 million, or 0.8%, to \$23.4 million for the nine months ended September 30, 2008, from \$23.6 million for the comparable prior-year period.

As a percentage of revenue, operating SG&A expense decreased 1.4% to 3.2% for the nine months ended September 30, 2008, from 4.6% for the comparable prior-year period. Operating SG&A expense decreased approximately \$0.8 million to \$11.6 million for the nine months ended September 30, 2008, from \$12.4 million for the comparable prior-year period. Decreases in operating SG&A were primarily related to identifying approximately \$0.9 million of certain associate expenses as direct costs rather than overhead.

As a percentage of revenue, all other SG&A expense decreased 0.9% to 3.3% for the nine months ended September 30, 2008, from 4.2% for the comparable prior-year period. All other SG&A expense increased approximately \$0.6 million, or 5.4%, to \$11.8 million for the nine months ended September 30, 2008, from \$11.2 million for the comparable prior-year period. The increase over the prior year's all other SG&A was related to increases of approximately \$375,000 related to professional services, \$252,000 in depreciation and amortization expense, and \$97,000 in stock compensation expense.

20

Management's Discussion and Analysis (continued)

Operating Income:

Operating income decreased approximately \$1.5 million, or 19.5%, to \$6.2 million for the three months ended September 30, 2008, from \$7.7 million for the same period in 2007. As a percentage of revenue, operating income decreased 3.0% to 5.0% for the three months ended September 30, 2008, from 8.0% for the comparable prior-year period.

Operating income increased approximately \$4.7 million, or 23.3%, to \$24.9 million for the nine months ended September 30, 2008, from \$20.2 million for the comparable period in 2007. As a percentage of revenue, operating income decreased 0.5% to 7.0% for the three months ended September 30, 2008, from 7.5% for the comparable prior-year period.

Other Expense, net:

Other expense decreased \$0.3 million, to \$0.3 million for the three months ended September 30, 2008, from \$0.6 million for the comparable prior-year period.

Other expense decreased \$0.3 million, to \$1.1 million for the nine months ended September 30, 2008, from \$1.4 million for the comparable prior-year period.

Tax Provision:

Income tax expense decreased \$0.7 million, or 22.6%, to \$2.4 million for the three months ended September 30, 2008, from \$3.1 million for the

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comparable prior-year period. The estimated effective tax rate was 40.5% for the three months ended September 30, 2008, compared to 42.0% for the comparable prior-year period.

Income tax expense increased \$1.9 million, or 24.7%, to \$9.6 million for the nine months ended September 30, 2008, from \$7.7 million for the comparable prior-year period. The estimated effective tax rate was 40.3% for the nine months ended September 30, 2008, compared to 39.7% for the comparable prior-year period and for the twelve-month period ended December 31, 2007.

The estimated effective tax rates are based on estimates using historical rates adjusted by recurring and non-recurring book to tax differences. Estimates at September 30, 2008, are based on results of the 2007 year end and adjusted for estimates of non-recurring differences from the prior year, as well as anticipated book to tax differences for 2008.

Net Income:

Net income for the three months ended September 30, 2008 decreased \$0.5 million, or 12.5%, to \$3.5 million from \$4.0 million for the comparable prior-year period. As a percentage of revenue, net income decreased 1.3% to 2.8% for the three months ended September 30, 2008, from 4.1% for the three months ended September 30, 2007.

Net income for the nine months ended September 30, 2008 increased \$3.2 million, or 29.1%, to \$14.2 million from \$11.0 million for the comparable prior-year period. As a percentage of revenue, net income decreased 0.1% to 4.0% for the nine months ended September 30, 2008, from 4.1% for the nine months ended September 30, 2007.

Liquidity and Capital Resources

Overview

The Company defines liquidity as its ability to pay liabilities as they become due, fund our operations and meet monetary contractual obligations. Our primary source of funds to meet liquidity needs during the period ended September 30, 2008 was borrowings under our senior revolving credit facility. Cash on hand at September 30, 2008 totaled \$1.4 million and availability under the credit facility totaled \$19.6 million, resulting in cash and previously arranged borrowing capacity to meet additional liquidity needs of \$21.0 million. As of September 30, 2008, management believes the Company is positioned to meet its liquidity requirements for the next 12 months.

21

Management's Discussion and Analysis (continued)

At September 30, 2008, the amount outstanding on the Company's line of credit was \$30.1 million compared to \$25.5 million at June 30, 2008. This increase in debt is primarily related to \$2.5 million borrowed on September 29, 2008, for the acquisition of Advanced Control Engineering.

We are a growth company and we manage our business to achieve reasonable growth objectives that are commensurate with profitable operations given existing and anticipated economic conditions. The outlook for our continued organic growth is generally favorable. We also expect opportunities to make

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strategic acquisitions. We intend to continue to meet our incremental liquidity needs through internally generated profits and existing borrowing arrangements. In 2008, we began to utilize capital lease arrangements for a significant upgrade in our computing equipment. We expect that the capital lease commitment will be approximately \$1.0 million when completed by the end of 2008.

The competitive contracting environment exposes us to situations where our clients may become unable or unwilling to complete a contract and meet their obligations to us in the normal course of business. These situations cause unexpected liquidity requirements, lower than expected profits and even losses. We currently are financing more than \$9.2 million relating to such a situation, described more fully in Note 9 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q. While this situation has caused the Company to incur higher interest costs than would otherwise have been incurred, our liquidity remains sufficient to meet our objectives.

However, cash and the availability of cash could be materially restricted if:

- (1) circumstances prevent the timely internal processing of invoices,
- (2) amounts billed are not collected or are not collected in a timely manner,
- (3) project mix shifts from cost-reimbursable to fixed-price contracts during periods of growth,
- (4) the Company loses one or more of its major customers,
- (5) the Company experiences material cost overruns on fixed-price contracts,
- (6) our client mix shifts from our historical owner-operator client base to more developer-based clients,
- (7) acquisitions are not accretive or are not integrated timely, or
- (8) we are unable to meet the covenants of the Credit Facility.

If any such event occurs, we would be forced to consider alternative financing options, if such options are available given current market conditions.

Cash Flows from Operating Activities:

Operations generated approximately \$1.0 million in net cash for the nine months ended September 30, 2008, compared with net cash used for operations of \$9.4 million during the same period in 2007. The \$9.4 million in cash used for operations during the nine-month period ended September 30, 2007 primarily related to funding amounts required for the SLE project. Operations used approximately \$3.5 million in net cash for the three months ended September 30, 2008, compared to the \$5.0 million used for the three months ended September 30, 2007. Although we are experiencing growth in our operations, this growth is reflected in increased working capital rather than a significant improvement in cash flows from operations. Our most significant working capital changes are discussed below. The primary changes in working capital accounts during the period were:

- o Increased Trade Receivables - The increase of \$19.6 million from December 31, 2007, was primarily the result of an overall increase in operating activity. Our collections on past due Accounts Receivable balances continue to improve and our days sales outstanding has decreased from 66 days as of the period ended September 30, 2007 to 61 days at the periods ended September 30, 2008 and December 31, 2007.

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Management's Discussion and Analysis (continued)

- o Increased Accounts Payable - The increase of \$1.0 million from December 31, 2007, was primarily the result of increases in vendor and sub-contractor charges due to increased operating activity in our Engineering segment during the three months ended September 30, 2008. A material portion of these obligations are scheduled to be met during the fourth quarter of 2008 and are expected to be funded through receipts from collections of Trade Receivables. Approximately \$440,000 in payments related to the SLE project were paid during the three month period ended September 30, 2008, and approximately \$858,000 in commitments remain outstanding. The SLE obligations are also expected to be satisfied during the fourth quarter of 2008.
- o Increased Accrued Compensation and Benefits - The increase was primarily due to timing of bi-weekly payroll and benefits payments at September 30, 2008.

Management's Discussion and Analysis (continued)

Engineering Segment Results

Three Months Ended September 30		Nin
2008	2007	2008
(Dollars in Thousands)		

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Revenue before eliminations	\$ 63,170		\$ 61,687		\$ 192,685	
Inter-segment eliminations	(60)		(7)		(67)	
	-----		-----		-----	
Total revenue	\$ 63,110		\$ 61,680		\$ 192,618	
	=====		=====		=====	
Detailed revenue:						
Detail-design	\$ 43,236	68.5 %	\$ 32,504	52.7 %	\$ 127,212	66
Field services	12,055	19.1 %	13,923	22.6 %	38,112	19
Procurement services	7,607	12.1 %	9,439	15.3 %	25,107	13
Fixed-price	212	0.3 %	5,814	9.4 %	2,187	1
	-----		-----		-----	
Total revenue:	\$ 63,110	100.0 %	\$ 61,680	100.0 %	\$ 192,618	100
Gross profit:	\$ 8,864	14.0 %	\$ 10,801	17.5 %	\$ 31,525	16
Operating SG&A expense:	\$ 1,446	2.3 %	\$ 2,741	4.4 %	\$ 5,003	2
	-----		-----		-----	
Operating income:	\$ 7,418	11.7 %	\$ 8,060	13.1 %	\$ 26,522	13
	=====		=====		=====	

Overview of Engineering Segment:

Our Engineering segment continues to benefit from a large project load generated primarily by both its downstream and midstream clients. The industry's refining and pipeline segments continue to be very active, supplying a large percentage of the Company's backlog. ENGlobal is benefiting from the renewed interest of maintenance and small capital projects as product margins improve.

Revenue:

Engineering segment revenue increased \$1.4 million, or 2.3%, to \$63.1 million for the three months ended September 30, 2008, from \$61.7 million for the comparable prior-year period.

Engineering segment revenue increased \$22.5 million, or 13.2%, to \$192.6 million for the nine months ended September 30, 2008, from \$170.1 million for the comparable prior-year period.

The increase in Engineering segment revenue resulted primarily from increased activity in the engineering and construction markets. Refining-related activity has been particularly strong, and includes projects to expand existing facilities and utilize heavier sour crude. Capital spending in the pipeline area is also trending higher, with numerous projects in North America currently underway to deliver crude oil, natural gas, petrochemicals and refined products. Renewable energy appears to be an emerging area of activity and potential growth, with the Company currently performing a variety of services for biodiesel, coal-to-liquids, petroleum coke to ammonia, and other biomass processes.

The increase in detail-design services for the three months and nine months ended September 30, 2008, and the increase in procurement services for the nine months ended September 30, 2008, are directly related to rebuilding a single refinery. Procurement services include subcontractor placements, equipment purchases, and other procurement activities necessary to rebuild the damaged facilities. Although most of the services rendered during the current fiscal year to date occurred in the second quarter of 2008, we

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continued providing services during the third quarter, impacting both the three months and nine months ended September 30, 2008.

24

Management's Discussion and Analysis (continued)

Our detail-design services proved strong with revenue increasing 32.9%, or \$10.7 million, to \$43.2 million for the three months ended September 30, 2008, from \$32.5 million for the comparable period in 2007. As a percentage of the total Engineering segment revenue during these periods, detail-design revenue increased 15.8% to 68.5% in 2008 from 52.7% in 2007. The increase is related to the refinery rebuild project described above.

Revenue from detail-design services increased 28.7%, or \$28.4 million, to \$127.2 million for the nine months ended September 30, 2008, from \$98.8 million for the comparable period in 2007. As a percentage of the total Engineering segment revenue during these periods, detail-design revenue increased 8.0% to 66.1% in 2008 from 58.1% in 2007. The increase is related to the refinery rebuild project described above.

Our field services revenues decreased 12.9%, or \$1.8 million, to \$12.1 million for the three months ended September 30, 2008, from \$13.9 million for the comparable period in 2007. As a percentage of the total Engineering segment revenue during these periods, field services revenue decreased 3.5% to 19.1% in 2008 from 22.6% in 2007.

Our field services revenues decreased 8.6%, or \$3.6 million, to \$38.1 million for the nine months ended September 30, 2008, from \$41.7 million for the comparable period in 2007. As a percentage of the total Engineering segment revenue during these periods, field services revenue decreased 4.7% to 19.8% in 2008 from 24.5% in 2007.

Revenue from procurement services decreased 19.1%, or \$1.8 million, to \$7.6 million for the three months ended September 30, 2008, from \$9.4 million for the comparable period in 2007. As a percentage of the total Engineering segment revenue, procurement services revenue decreased 3.2% to 12.1% for the three months ended September 30, 2008, from 15.3% for the comparable period in 2007. Much of this decrease is attributable to the peaking in the second quarter of 2008 of the procurement activities related to the refinery rebuild project described above.

Revenue from procurement services increased 54.9%, or \$8.9 million, to \$25.1 million for the nine months ended September 30, 2008, from \$16.2 million for the comparable period in 2007. As a percentage of the total Engineering segment revenue, procurement services revenue increased 3.5% to 13.0% for the nine months ended September 30, 2008, from 9.5% for the comparable period in 2007. Much of this increase is related to the refinery rebuild project described above. The level of procurement services is project dependent and varies over time depending on the volume of procurement activity our customers choose to do themselves as opposed to using our services.

Fixed-price revenue decreased 96.6%, or \$5.6 million, to \$0.2 million for the three months ended September 30, 2008, from \$5.8 million for the comparable period in 2007. As a percentage of the total Engineering segment revenue, fixed-price revenue decreased 9.1% to 0.3% for the three months ended September 30, 2008, from 9.4% for the comparable period in 2007 as the Company neared completion of certain EPC contracts. We are focusing on accepting new projects on a cost-plus basis rather than fixed-price due to

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the economic conditions discussed earlier.

Fixed-price revenue decreased 83.5%, or \$11.1 million, to \$2.2 million for the nine months ended September 30, 2008, from \$13.3 million for the comparable period in 2007. As a percentage of the total Engineering segment revenue, fixed-price revenue decreased 6.8% to 1.1% for the nine months ended September 30, 2008, from 7.9% for the comparable period in 2007 as the Company neared completion of certain EPC contracts. We are focusing on accepting new projects on a cost-plus basis rather than fixed-price due to the economic conditions discussed earlier.

25

Management's Discussion and Analysis (continued)

Gross Profit:

Our Engineering segment's gross profit decreased \$1.9 million, or 17.6%, to \$8.9 million for the three months ended September 30, 2008, from \$10.8 million for the comparable period in 2007. As a percentage of the total Engineering segment revenue, gross profit decreased by 3.5% to 14.0% from 17.5% for the three months ended September 30, 2008 and 2007, respectively. The overall \$1.9 million decrease in gross profit was attributable to the overall lower margins in the detail-design services. While the refinery rebuild project was the primary source of the \$10.7 million of increased detail-design services revenues, the project was performed at a more competitive margin.

Our Engineering segment's gross profit increased \$2.0 million, or 6.8%, to \$31.5 million for the nine months ended September 30, 2008, from \$29.5 million for the comparable period in 2007. As a percentage of the total Engineering segment revenue, gross profit decreased by 1.0% to 16.4% from 17.4% for the nine months ended September 30, 2008 and 2007, respectively. The overall \$2.0 million increase in gross profit was attributable to the overall \$22.5 million increase in Engineering segment revenues, offset by \$20.5 million in overall increased direct costs as work was performed at more competitive margins. The decrease in margins is attributable to higher activity in low margin/high dollar procurement projects and the refinery rebuild project.

Selling, General, and Administrative:

Our Engineering segment's SG&A expense decreased \$1.3 million, or 48.1%, to \$1.4 million for the three months ended September 30, 2008, from \$2.7 million for the comparable period in 2007. The decrease in the Engineering segment's SG&A expense is attributable to approximately \$0.9 million in lower bad debt expense and approximately \$0.3 million in employee and associated costs reclassified to direct expense. As a percentage of the total Engineering segment revenue, the segment's SG&A costs decreased by 2.1% to 2.3% from 4.4% for the three months ended September 30, 2008 and 2007, respectively.

Our Engineering segment's SG&A expense decreased \$1.3 million, or 20.6% to \$5.0 million for the nine months ended September 30, 2008, from \$6.3 million for the comparable period in 2007. The differences in the Engineering segment's SG&A expense are attributable to approximately \$0.9 million in lower employee and associated costs re-classified to direct expense in 2008, a \$0.2 decrease in bad debt expense and a \$0.2 million

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decrease in depreciation and amortization. As a percentage of the total Engineering segment revenue, the segment's SG&A costs decreased by 1.1% to 2.6% from 3.7% for the nine months ended September 30, 2008 and 2007, respectively.

Operating Income:

Operating income for the Engineering segment decreased \$0.7 million, or 8.6%, to \$7.4 million for the three months ended September 30, 2008, from \$8.1 million for the comparable prior-year period. As a percentage of the total Engineering segment revenue, operating income decreased by 1.4% to 11.7% for the three months ended September 30, 2008, from 13.1% for the comparable prior-year period. The decrease in operating income for the three months ended September 30, 2008 and the comparable prior-year period is a result of the increase in lower margin procurement revenue discussed in the gross profit discussion.

Operating income for the Engineering segment increased \$3.3 million, or 14.2%, to \$26.5 million for the nine months ended September 30, 2008, from \$23.2 million for the comparable prior-year period. As a percentage of the total Engineering segment revenue, operating income increased by 0.1% to 13.8% for the nine months ended September 30, 2008, from 13.7% for the comparable prior-year period. The increase in operating income for the nine months ended September 30, 2008 and the comparable prior-year period is a result of the overall increases in total revenue discussed in the gross profit discussion.

26

Management's Discussion and Analysis (continued)

Construction Segment Results

	Three Months Ended September 30				Nine M Sep
	2008	2007			2008
	(Dollars in Thousands)				
Revenue before eliminations	\$ 44,481	\$ 26,402			\$ 110,356
Inter-segment eliminations	(3,571)	(7,403)			(6,892)
Total revenue	\$ 40,910	\$ 18,999			\$ 103,464
	=====	=====			=====
Detailed revenue:					
Inspection	38,800	16,625	94.8 %	87.5 %	93,220 90.1
Construction services	2,110	2,374	5.2 %	12.5 %	10,244 9.9
	-----	-----			-----
Total revenue:	\$ 40,910	\$ 18,999	100.0 %	100.0 %	\$ 103,464 100.0
Gross profit:	\$ 2,765	\$ 3,678	6.7 %	19.4 %	\$ 8,781 8.5
Operating SG&A expense:	\$ 794	\$ 791	1.9 %	4.2 %	2,255 2.2

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Operating income:	\$ 1,971	4.8 %	\$ 2,887	15.2 %	\$ 6,526	6.3
	=====		=====		=====	

Overview of Construction Segment:

The construction group provides construction management personnel and services in the areas of mechanical integrity, vendor and turnaround surveillance, field support, construction, inspection, and high-tech maintenance. Our construction management business provides project managers, instrument technicians, CADD operators, clerical staff, and inspectors.

Revenue:

Our Construction segment's revenue increased \$21.9 million, or 115.3%, to \$40.9 million for the three months ended September 30, 2008, from \$19.0 million for the comparable prior-year period.

We have experienced significant growth in our inspection related revenue due to increased capital spending primarily by our pipeline clients. While inspection related revenues increased \$22.2 million, or approximately 133.7%, to \$38.8 million for the three months ended September 30, 2008, from \$16.6 million for the comparable prior-year period, the contribution to gross profit was reduced. This was the result of our decision to seek to increase market share and remain competitive by accepting work at lower margins. Increased variable costs associated with labor to perform proposals, project controls and project management also contributed to the decrease in gross profit.

Construction services revenues decreased \$0.3 million, or 12.5%, to \$2.1 for the three months ended September 30, 2008, from \$2.4 million for the comparable period in 2007.

Our Construction segment's revenue increased \$54.7 million, or 112.1%, to \$103.5 million for the nine months ended September 30, 2008, from \$48.8 million for the comparable prior-year period.

While inspection related revenues increased \$53.8 million, or approximately 136.6%, to \$93.2 million for the nine months ended September 30, 2008, from \$39.4 million for the comparable prior-year period, the contribution to gross profit was reduced. The reduction resulted in part from increased variable costs associated with labor to perform proposals. In addition, project controls and project management also contributed to the decrease in gross profit. Increased market share has contributed to the increase in our construction services revenues. Construction services revenues increased \$0.8 million, or 8.5%, to \$10.2 for the nine months ended September 30, 2008, from \$9.4 million for the comparable period in 2007.

Management's Discussion and Analysis (continued)

Our Construction and Engineering segments are both providing services in connection with refinery rebuild projects, with many of those services being performed at tighter margins. The Construction segment has taken action to develop new business by adding new sales personnel.

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Gross profit:

Our Construction segment's gross profit decreased approximately \$0.9 million, or 24.3%, to \$2.8 million for the three months ended September 30, 2008, from \$3.7 million for the comparable prior-year period and, as a percentage of the total Construction segment revenue, gross profit decreased by 12.7% to 6.7% from 19.4% for the respective periods. The decrease in gross profit is primarily attributable to increased revenue related to our growth of inspection services, where higher employee-related costs and competitive pressure on bill rates resulted in lower margins.

Our Construction segment's gross profit increased approximately \$0.4 million, or 4.8%, to \$8.8 million for the nine months ended September 30, 2008, from \$8.4 million for the comparable prior-year period and, as a percentage of the total Construction segment revenue, gross profit decreased by 8.7% to 8.5% from 17.2% for the respective periods. The decrease in gross profit as a percentage of total Construction segment revenue is primarily attributable to increased revenue related to an increase in our provision of inspection services, where higher employee-related costs and competitive pressure on bill rates resulted in lower margins.

Selling, General, and Administrative:

Our Construction segment's SG&A expense remained steady at \$0.8 million for the three months ended September 30, 2008, and for the same period in 2007. As a percentage of the total Construction segment revenue, SG&A expense decreased by 2.3% to 1.9% from 4.2% for the respective periods.

Our Construction segment's SG&A expense increased approximately \$0.2 million, or 9.5%, to \$2.3 million for the nine months ended September 30, 2008, from \$2.1 million for the same period in 2007. As a percentage of the total Construction segment revenue, SG&A expense decreased by 2.0% to 2.2% from 4.2% for the respective periods. Increases of \$250,000 in salaries and \$137,000 in bad debt expense were offset by savings of \$121,000 in professional services.

Operating Income:

Our Construction segment's operating income decreased \$0.9 million, or 31.0%, to \$2.0 million for the three months ended September 30, 2008, from \$2.9 million for the comparable prior-year period. As a percentage of the total Construction segment revenue, operating income decreased by 10.4% to 4.8% for the three months ended September 30, 2008, from 15.2% for the comparable prior-year period. The decrease in operating income is primarily attributable to increased revenue related to an increase in our provision of inspection services, where higher employee-related costs and competitive pressure on bill rates resulted in lower margins as described in gross profit above.

Our Construction segment's operating income increased \$0.2 million, or 3.2%, to \$6.5 million for the nine months ended September 30, 2008, from \$6.3 million for the comparable prior-year period. As a percentage of the total Construction segment revenue, operating income decreased by 6.7% to 6.3% for the nine months ended September 30, 2008, from 13.0% for the comparable prior-year period. The increase in operating income is primarily attributable to holding SG&A expenses to nearly the same level, while total revenue more than doubled. The increase in total revenue was mostly in the inspection services, where higher employee-related costs and competitive pressure on bill rates resulted in lower margins as described in gross profit above.

Management's Discussion and Analysis (continued)

Automation Segment Results

	Three Months Ended September 30				2008	
	2008		2007			
(Dollars in Thousands)						
Revenue before eliminations	\$	7,912	\$	8,853	\$ 29,880	
Inter-segment eliminations		(16)		(327)	(546)	
Total revenue	\$	7,896	\$	8,526	\$ 29,334	
Detailed revenue:						
Fabrication		4,446	56.3%	4,528	53.1%	18,067
Non-Fabrication		3,450	43.7%	3,998	46.9%	11,267
Total revenue:	\$	7,896	100.0%	\$ 8,526	100.0%	\$ 29,334
Gross profit:	\$	154	1.9%	\$ 774	9.1%	\$ 2,560
Operating SG&A expense:	\$	720	9.1%	\$ 688	8.1%	2,101
Operating income:	\$	(566)	(7.2)%	\$ 86	1.0%	\$ 459

Overview of Automation Segment:

Our Automation group provides services relating to the implementation of process controls, advanced automation and information technology projects. We provide clients with a full range of services including front-end engineering feasibility studies and the execution of active engineering, procurement, and construction projects. By focusing on such large-scope projects, we intend to pursue Distributed Control Systems (DCS) conversion and new installation projects by utilizing our own resources as well as resources from our engineering and systems businesses. ENGlobal has proven capabilities for plant automation services and products to respond to an industry progression toward replacing obsolete technology with new open system architecture DCS.

Revenue:

Our Automation segment's revenue decreased approximately \$0.6 million, or 7.1%, to \$7.9 million for the three months ended September 30, 2008, from \$8.5 million for the comparable prior-year period due to slowed receipt of materials resulting from Hurricanes Gustav and Ike and the lag between

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consummation of sales and actual project start-up.

Our Automation segment's revenue increased approximately \$1.7 million, or 6.2%, to \$29.3 million for the nine months ended September 30, 2008, from \$27.6 million for the comparable prior-year period due to increased fabrication revenue in the first and second quarters of 2008.

The Automation segment aggressively pursued new business in the third quarter with the acquisition of Advanced Control Engineering, LLC ("Advanced Control Engineering") on September 29, 2008. The strategic location of this acquisition will allow the Company to pursue business in the Southeastern U.S. and expand the business of its Atlanta, Georgia, office. The plant expansions along the upper Texas Gulf Coast may provide a number of opportunities for remote instrument enclosures (RIEs) and analytical systems, which this segment is poised to provide. The Automation segment experienced a significant increase in its engineering services proposal activity during this period. The segment continues to evaluate potential acquisitions with the goal of complementing its current portfolio.

Gross profit:

The Automation segment's gross profit decreased approximately \$0.6 million, or 75.0%, to \$0.2 million for the three months ended September 30, 2008, from \$0.8 million for the comparable prior-year period. As a percentage of

29

Management's Discussion and Analysis (continued)

the total Automation segment revenue, gross profit decreased by 7.2% to 1.9%, from 9.1% for the three months ended September 30, 2008 and 2007, respectively. Increased costs on fixed-price work and increased non-reimbursable costs contributed to the lower margins.

The Automation segment's gross profit decreased approximately \$0.1 million, or 3.7%, to \$2.6 million for the nine months ended September 30, 2008, from \$2.7 million for the comparable prior-year period. As a percentage of the total Automation segment revenue, gross profit decreased by 1.0% to 8.7%, from 9.7% for the nine months ended September 30, 2008 and 2007, respectively. Increased costs on fixed-price work and increased non-reimbursable costs contributed to the lower margins.

Selling, General, and Administrative:

Our Automation segment's SG&A expense was \$0.7 million for the three months ended September 30, 2008 and September 30, 2007. As a percentage of the total Automation segment revenue, SG&A expense increased by 1.0% to 9.1%, from 8.1% for the three months ended September 30, 2008 and 2007, respectively.

Our Automation segment's SG&A expense decreased approximately \$0.2 million, or 8.7%, to \$2.1 million for the nine months ended September 30, 2008, from \$2.3 million for the same period in 2007. As a percentage of the total Automation segment revenue, SG&A expense decreased by 1.3% to 7.1%, from 8.4% for the nine months ended September 30, 2008 and 2007, respectively. The decrease in SG&A expense from September 30, 2008 to the comparable

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prior-year period is the result of overall cost controls in all SG&A categories.

Operating Income:

The Automation segment recorded an operating loss of \$0.6 million for the three months ended September 30, 2008, compared to near breakeven for the three months ended September 30, 2007. As a percentage of the total Automation segment revenue, operating income decreased by 8.2% to (7.2)% for the three months ended September 30, 2008, from 1.0% for the comparable prior-year period. Increased costs on fixed-price work and increased non-reimbursable costs contributed to the operating loss of the Automation segment during the three months ended September 30, 2008.

The Automation segment recorded an operating income of \$0.5 million for the nine months ended September 30, 2008, compared to operating income of \$0.4 million for the nine months ended September 30, 2007. As a percentage of the total Automation segment revenue, operating income increased by 0.3% to 1.6% for the nine months ended September 30, 2008, from 1.3% for the comparable prior-year period.

30

Management's Discussion and Analysis (continued)

Land Segment Results

	Three Months Ended September 30				2008
	2008		2007		
	(Dollars in Thousands)				
Revenue before eliminations	\$ 11,251		\$ 7,620		\$ 31,920
Inter-segment eliminations	-		-		-
Total revenue	\$ 11,251	100.0%	\$ 7,620	100.0%	\$ 31,920
Gross profit:	\$ 1,851	16.5%	\$ 1,086	14.3%	\$ 5,410
Operating SG&A expense:	\$ 660	5.9%	\$ 562	7.4%	2,210
Operating income:	\$ 1,191	10.6%	\$ 524	6.9%	\$ 3,190

Overview of Land Segment:

Our Land segment possesses a long, reputable history of land management expertise in title research, permitting and acquisition. We provide land and right of way consulting services and a broad menu of complementary

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solutions primarily to the energy, utility, transportation, telecommunications, power, mining and government sectors. We have successfully built a reputation for quality, budget management, focused objectives, ownership and responsibility for deliverables as long term alliance partnerships with clients.

The Land segment was formed out of our acquisition of WRC Corporation in May 2006, which was renamed ENGlobal Land, Inc. in January 2008. The Land segment provides services to a cross-section of clients in the energy markets. As the country attempts to shift its dependence on foreign energy to reliance on domestic sources, it is anticipated that the Land segment will have additional project opportunities.

Revenue:

The Land segment's revenue increased approximately \$3.7 million, or 48.7%, to \$11.3 million for the three months ended September 30, 2008, from \$7.6 million for the comparable prior-year period. This increase in Land segment revenue is primarily attributable to expanded market opportunities in the energy and alternative energy industries, as well as geographically with services being provided throughout the United States.

The Land segment's revenue increased approximately \$10.3 million, or 47.7%, to \$31.9 million for the nine months ended September 30, 2008, from \$21.6 million for the comparable prior-year period. This increase in Land segment revenue is primarily attributable to expanded market opportunities in the energy and alternative energy industries, as well as geographically with services being provided throughout the United States.

Gross profit:

The Land segment's gross profit increased approximately \$0.8 million, or 72.7%, to \$1.9 million for the three months ended September 30, 2008, from \$1.1 million for the comparable prior-year period. In 2008, we renegotiated billing rates on existing contracts to accommodate increased costs which has contributed to improved gross margins. Of the \$0.8 million increase in gross profit quarter-over-quarter, approximately \$0.5 million is attributable to the increase in revenue and approximately \$0.3 million is attributable to improved margins. As a percentage of the total Land segment revenue, gross profit increased by 2.2% to 16.5%, from 14.3% for the three months ended September 30, 2008 and 2007, respectively.

The Land segment's gross profit increased approximately \$2.2 million, or 68.8%, to \$5.4 million for the nine months ended September 30, 2008, from \$3.2 million for the comparable prior-year period. As a percentage of the total Land segment revenue, gross profit increased by 2.1% to 17.0%, from 14.9% for the nine months ended September 30, 2008 and 2007, respectively.

Management's Discussion and Analysis (continued)

Of the \$2.2 million increase in gross profit comparing year-to-date, approximately \$1.5 million is attributable to the increase in revenue and approximately \$0.7 million is attributable to improved margins.

In 2007, as we focused on growing this segment's business, we increased the number of its personnel. As a result, our gross profit margins decreased

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because we were not able to immediately pass through to clients the resulting increased costs of labor and expenses. As mentioned above, in 2008, we renegotiated billing rates on existing contracts to accommodate these increased costs, which has contributed to improved gross margins.

Selling, General, and Administrative:

The Land segment's SG&A expense increased approximately \$0.1 million, or 16.7%, to \$0.7 million for the three months ended September 30, 2008, from \$0.6 million for the same period in 2007. As a percentage of the total Land segment revenue, SG&A expense decreased by 1.5% to 5.9%, from 7.4% for the three months ended September 30, 2008 and 2007, respectively. Increases in SG&A costs for the three months ended September 30, 2008, were related to \$57,000 in higher salaries and associated expenses primarily associated with our growth, \$19,000 in increased marketing expenses and an increase in associate relations expense of \$17,000.

The Land segment's SG&A expense increased approximately \$0.5 million, or 29.4%, to \$2.2 million for the nine months ended September 30, 2008, from \$1.7 million for the same period in 2007. As a percentage of the total Land segment revenue, SG&A expense decreased by 1.0% to 7.0%, from 8.0% for the nine months ended September 30, 2008 and 2007, respectively. Most of the increases in SG&A costs for the nine months ended September 30, 2008, were related to \$216,000 in higher salaries and associated expenses primarily associated with our growth, an increase in marketing expense of \$58,000 and an increase in bad debt expense of \$163,000.

Operating Income:

The Land segment recorded an operating income of \$1.2 million for the three months ended September 30, 2008, compared to an operating income of \$0.5 million for the three months ended September 30, 2007, due to higher revenue and lower cost as a percentage of revenue. As a percentage of the total Land segment revenue, operating income increased 3.7% to 10.6% for the three months ended September 30, 2008, from 6.9% for the same period in 2007.

The Land segment recorded an operating income of \$3.2 million for the three months ended September 30, 2008, compared to an operating income of \$1.5 million for the three months ended September 30, 2007, due to higher revenue and lower cost as a percentage of revenue. As a percentage of the total Land segment revenue, operating income increased 3.1% to 10.0% for the three months ended September 30, 2008, from 6.9% for the same period in 2007.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our financial instruments include cash and cash equivalents, accounts receivable, accounts payable, notes and capital leases payable, and debt obligations. The book value of cash and cash equivalents, accounts receivable, accounts payable and short-term notes payable are considered to be representative of fair value because of the short maturity of these instruments.

We do not utilize financial instruments for trading purposes and we do not hold any derivative financial instruments that could expose us to significant market risk. In the normal course of business, our results of

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operations are exposed to risks associated with fluctuations in interest rates and currency exchange rates.

Our exposure to market risk for changes in interest rates relates primarily to our obligations under the Comerica Credit Facility (the "Credit Facility"). As of September 30, 2008, \$30.1 million had been borrowed under the Credit Facility, accruing interest at 4.75% per year, excluding amortization of prepaid financing costs. A 10% increase in the short-term borrowing rates on the Credit Facility outstanding as of September 30, 2008 would be 47.5 basis points. Such an increase in interest rates would increase our annual interest expense by approximately \$140,000, assuming the amount of debt outstanding remains constant.

In general, our exposure to fluctuating exchange rates relates to the effects of translating the financial statements of our Canadian subsidiary from the Canadian dollar to the U.S. dollar. We follow the provisions of SFAS No. 52 - "Foreign Currency Translation" in preparing our condensed consolidated financial statements. Currently, we do not engage in foreign currency hedging activities.

ITEM 4. CONTROLS AND PROCEDURES

a) Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures of a registrant designed to ensure that information required to be disclosed by the registrant in the reports that it files or submits under the Exchange Act is properly recorded, processed, summarized, and reported, within the time periods specified in the Securities and Exchange Commission's ("SEC") rules and forms. Disclosure controls and procedures include processes to accumulate and evaluate relevant information and communicate such information to a registrant's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosures.

We evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2008, as required by Rule 13a-15 of the Exchange Act. As described below, material weaknesses were identified in our internal control over financial reporting as of September 30, 2008. Based on the evaluation described above, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2008, our disclosure controls and procedures were not effective to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC's rules and forms.

Changes in Internal Control over Financial Reporting

In our Form 10-K for the year ended December 31, 2007, we disclosed certain material weaknesses in internal control over financial reporting, which are identified below. Neither material weakness has been remediated as of September 30, 2008.

Deficiencies in the Company's Control Environment and Accounting System Controls. We did not effectively and accurately close the general ledger in a timely manner and we did not provide complete and accurate disclosure in

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our notes to financial statements, as required by generally accepted accounting principles. Specifically, the Company lacks sufficient knowledge and expertise in financial reporting to adequately handle complex or non-routine accounting issues, resulting in the following:

- failure in a timely manner to properly evaluate goodwill for potential impairment in accordance with SFAS 142, "Goodwill and Other Intangible Assets";
- difficulty in obtaining timely resolution of SEC comments related to the above item, causing a delay in the Company's period-end closing process for its 2007 Form 10-K; and
- failure to effectively utilize third-party specialists in a timely manner to assist with complex or non-routine accounting issues.

As noted above, no change in our internal control over financial reporting occurred during the nine months ended September 30, 2008, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. However, the Company has engaged consultants to begin review of the goodwill impairment modeling for 2008. These consultants have reviewed certain non-routine accounting issues for the third quarter of 2008.

Remediation Initiatives

Management, with oversight from the Audit Committee of the Board of Directors, has been addressing the material weaknesses discussed above. While progress has been made, these remedial steps have not been completed; however, the Company has performed additional analysis and procedures in order to ensure that the condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q were prepared in accordance with generally accepted accounting principles in the United States. Although the Company's remediation efforts are underway, control weaknesses will not be considered remediated until new internal controls over financial reporting are implemented and operational for a sufficient period of time to allow for effective testing and are tested, and management and its independent registered certified public accounting firm conclude that these controls are operating effectively. Management, along with its outside consultants, and the Audit Committee of the Company's Board of Directors are working to determine the most effective way to implement the remedial measures listed below, and, if necessary, to develop additional remedial measures to address the internal control deficiencies identified above. The Company is monitoring the effectiveness of planned actions and will make any other changes and take such other actions as management or the Audit Committee determines to be appropriate. The Company's remediation efforts include:

- o engagement of various third-party consultants to assist us with specific technical accounting issues;
- o engagement of third-party consultants to provide valuation services in accordance with SFAS 142;
- o implementation of quarterly and annual disclosure checklists, which are utilized in connection with the completion of our quarterly financial statements;
- o provision of additional training to accounting staff on SFAS 142, SEC reporting principles, and GAAP; and
- o implementation of periodic accounting management meetings where our accounting processes and procedures are communicated and reinforced.

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The Company has been holding quarterly meetings of the accounting staff to facilitate quarterly closing procedures and review of quarterly checklists. Certain training needs have been addressed as a result. The Company has engaged a consulting firm to assist with the review of specific technical accounting issues and disclosure checklists to improve compliance.

34

PART II. - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On or about November 4, 2008, EcoProduct Solutions, L.P. ("EcoProduct") served ENGlobal Engineering, Inc. ("EEI") with an arbitration demand in connection with a previously initiated arbitration proceeding against defendant Swenson Technology, Inc. ("Swenson") pending before the American Arbitration Association. According to the first amended statement of claims, the claimant has made various allegations, including professional negligence, breach of contract, and violation of Texas consumer protection laws, against primary defendant Swenson Technology, Inc., and now, also against EEI in connection with an engineering project on which EEI's work was completed in 2005. EcoProduct is seeking approximately \$45 million in damages. Due to the recentness of the filing, we have not yet had a chance to review the claims thoroughly. However, it is our current understanding that the suit is substantially without merit, and we intend to vigorously defend against it.

As discussed in Note 9 above, in the first quarter of 2007 ENGlobal Engineering, Inc. and South Louisiana Ethanol, LLC ("SLE") executed an agreement for EPC services relating to the retro-fit of an ethanol plant in southern Louisiana. The history of the SLE Project is described in Note 12 to the Company's condensed consolidated financial statements included in its Quarterly Report on Form 10-Q for the quarter ended September 30, 2007, and is discussed further in the Company's Annual Report on Form 10-K for the year ended December 31, 2007. Due to the continued failure of SLE to obtain permanent financing, on May 30, 2008, the Company filed suit in the United States District Court for the Eastern District of Louisiana, Cause Number 08-3601. The Company is seeking damages of \$15.8 million.

From time to time, the Company and its subsidiaries become parties to various legal proceedings arising in the ordinary course of normal business activities. While we cannot predict the outcome of these proceedings, in our opinion and based on reports of counsel, any liability arising from such matters, individually or in the aggregate, is not expected to have a material effect upon the consolidated financial position or operations of the Company.

ITEM 1A. RISK FACTORS

If we are unable to collect our receivables, our results of operations and cash flows could be adversely affected.

Our business depends on our ability to successfully obtain payment from our clients of the amounts they owe us for work performed and materials supplied. We bear the risk that our clients will pay us late or not at all. Though we evaluate and attempt to monitor our clients' financial condition, there is no guarantee that we will accurately assess their creditworthiness. Financial difficulties or business failure experienced by one or more of our major

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customers could have a material adverse affect on both our ability to collect receivables and our results of operations.

As discussed further in Note 9 above, due to the continued failure of South Louisiana Ethanol, LLC ("SLE") to obtain permanent financing, the Company has filed suit against SLE seeking damages of \$15.8 million. While the Company believes that in the event that the collateral is liquidated, SLE's obligations to the Company would be paid in full pursuant to the Collateral Mortgage in favor of the Company, collectability is not assured at this time.

As discussed further in Note 9 above, we have potential exposure related to services provided by our Engineering and Construction segments to SemCrude, L.P. ("SemCrude"), an affiliate of SemGroup, L.P. ("SemGroup), in connection with construction of the White Cliffs Pipeline. While SemCrude's account was materially current as of November 6, 2008, the Company is closely monitoring this account.

Our business depends on domestic spending by the oil, natural gas, and other energy-related industries, and this spending and our business may be adversely affected by industry and financial market conditions that are beyond our control.

35

We depend on our clients' willingness to make operating and capital expenditures related to transportation, refining, and infrastructure improvements in the United States. Clients' expectations for lower market prices for oil and natural gas, as well as the availability of capital for operating and capital expenditures, may curtail spending thereby reducing demand for our products and services. Industry conditions are influenced by numerous factors over which we have no control, such as the supply of and demand for oil, natural gas and other energy sources; domestic and worldwide economic conditions; political instability in oil and natural gas producing countries; and merger and divestiture activity among energy producers. The volatility of the energy industry could result in a decline in the demand for our services and adversely affect the price of our services. Furthermore, recent adverse changes in capital markets may cause energy-related companies to announce reductions in capital budgets for future periods. Limitations on the availability of capital, or higher costs of capital, for financing expenditures may cause some of our smaller clients to make reductions to capital budgets.

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only additional risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial conditions or operating results.

36

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
None.

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

- 10.1 Purchase Agreement between ENGlobal and Advanced Control Engineering, LLC dated September 25, 2008
- 10.2 Note Payable between ENGlobal and Frank H McIlwain, PC
- 10.3 Note Payable between ENGlobal and James A Walters, PC
- 10.4 Note Payable between ENGlobal and William M Bosarge, PC
- 10.5 Note Payable between ENGlobal and Matthew R Burton, PC
- 31.1 Certifications Pursuant to Rule 13a - 14(a) of the Securities Exchange Act of 1934 for the Third Quarter 2008
- 31.2 Certifications Pursuant to Rule 13a - 14(a) of the Securities Exchange Act of 1934 for the Third Quarter 2008
- 32.0 Certification Pursuant to Rule 13a - 14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for the Third Quarter 2008

37

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ENGlobal Corporation

Dated: November 6, 2008

By: /s/ Robert W. Raiford

Robert W. Raiford
Chief Financial Officer and Treasurer