ENGLOBAL CORP
Form 10-Q
May 11, 2017

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 April 1, 2017

[ ] **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	**77060-5914**
(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No [ ]

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

Large Accelerated Filer	[ ]		Accelerated Filer	[ ]
Non-Accelerated Filer	[ ]	(Do not check if a smaller reporting company)	Smaller Reporting Company	[X]
Emerging growth company	[ ]			

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

Indicate by check mark whether the registrant is a shell company (as defined in 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 on May 9, 2017.

$0.001 Par Value Common Stock 27,138,657 shares

QUARTERLY REPORT ON FORM 10-Q

FOR THE PERIOD ENDED April 1, 2017

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ENGlobal Corporation

Condensed Consolidated Statements of Operations

(Unaudited)

(amounts in thousands, except per share data)

	For the Three Months Ended	
	April 1, 2017	**March 26, 2016**
Operating revenues	$12,473	$14,812
Operating costs	10,742	13,139
Gross profit	1,731	1,673
Selling, general and administrative expenses	3,406	3,390
Operating loss	(1,675)	(1,717)
Other income (expense):		
Other income (expense), net	3	6
Interest expense, net	(65)	(36)
Loss from operations before income taxes	(1,737)	(1,747)
Benefit for federal and state income taxes	(859)	(998)
Net loss	$(878)	$(749)
Basic and diluted loss per common share:	$(0.03)	$(0.03)
Basic and diluted weighted average shares used in computing earnings per share:	27,188	27,950

See accompanying notes to unaudited interim condensed consolidated financial statements.

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ENGlobal Corporation

Condensed Consolidated Balance Sheets

(Unaudited)

(amounts in thousands, except share amounts)

	April 1, 2017	**December 31, 2016**
ASSETS		
Current Assets:		
Cash, cash equivalents and restricted cash	$14,373	$ 15,687
Trade receivables, net of allowances of $302 and $422	7,981	10,455
Prepaid expenses and other current assets	989	1,240
Costs and estimated earnings in excess of billings on uncompleted contracts	3,429	2,434
Total Current Assets	26,772	29,816
Property and equipment, net	1,363	1,194
Goodwill	2,806	2,806
Deferred tax asset	11,056	10,208
Other assets	345	412
Total Assets	$42,342	$ 44,436
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$1,900	$ 2,876
Accrued compensation and benefits	1,840	2,099
Billings in excess of costs and estimated earnings on uncompleted contracts	1,473	1,371
Other current liabilities	1,097	1,270
Total Current Liabilities	6,310	7,616
Long Term Leases	29	14
Total Liabilities	6,339	7,630
Commitments and Contingencies (Note 8)		
Stockholders' Equity:		
Common stock - $0.001 par value; *75,000,000 shares authorized; 27,149,582 and 27,190,082 shares issued and outstanding at April 1, 2017 and December 31, 2016, respectively*	27	27
Additional paid-in capital	36,397	36,322
Accumulated (deficit)/earnings	(421)	457
Total Stockholders' Equity	36,003	36,806
Total Liabilities and Stockholders' Equity	$42,342	$ 44,436

See accompanying notes to unaudited interim condensed consolidated financial statements.

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ENGlobal Corporation

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(amounts in thousands)

	For the Three Months Ended	
	April 1, 2017	**March 26, 2016**
Cash Flows from Operating Activities:		
Net loss	$(878)	$(749)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	269	321
Share-based compensation expense	75	121
Loss on disposal of fixed assets	-	1
Deferred tax asset	(848)	(1,044)
Changes in current assets and liabilities:		
Trade accounts receivable	2,474	4,771
Costs and estimated earnings in excess of billings on uncompleted contracts	(995)	542
Other current assets	176	326
Accounts payable	(976)	(236)
Accrued compensation and benefits	(259)	335
Billings in excess of costs and estimated earnings on uncompleted contracts	102	36
Income taxes payable	96	25
Other current liabilities, net	(109)	(77)
Net cash provided by (used in) operating activities	$(873)	$4,372
Cash Flows from Investing Activities:		
Proceeds from notes receivable	10	-
Property and equipment acquired	(408)	(45)
Net cash used in investing activities	$(398)	$(45)
Cash Flows from Financing Activities:		
Purchase of treasury stock	-	(253)
Payments on capitalized leases	(43)	(95)
Net cash used in financing activities	$(43)	$(348)
Net change in cash, cash equivalents and restricted cash	(1,314)	3,979
Cash, cash equivalents and restricted cash, at beginning of period	15,687	7,806
Cash, cash equivalents and restricted cash, at end of period	$14,373	$11,785
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$65	$38

Cash paid during the period for income taxes (net of refunds)	$(107)	$20

See accompanying notes to unaudited interim condensed consolidated financial statements.

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ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of ENGlobal Corporation (which may be referred to as “ENGlobal,” the “Company,” “we,” “us,” or “our”) were prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and the rules and regulations of the Securities and Exchange Commission. Accordingly, these condensed financial statements do not include all of the information or note disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP. These condensed financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2016, included in the Company’s 2016 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

The condensed financial statements included herein are unaudited for the three month periods ended April 1, 2017 and March 26, 2016, and in the case of the condensed balance sheet as of December 31, 2016, have been derived from the audited financial statements of the Company. 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.

The Company has assessed subsequent events through the date of filing of these condensed financial statements with the Securities and Exchange Commission and believes that the disclosures made herein are adequate to make the information presented herein not misleading.

We had no items of other comprehensive income in any period presented; therefore, no other components of comprehensive income or comprehensive income are presented.

Each of our quarters is comprised of 13 weeks.

Changes in Accounting

In March 2016, the Financial Statements Accounting Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*, to change several aspects of accounting for share-based payment transactions, including a requirement to recognize all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This pronouncement is effective for interim and annual reporting periods beginning after December 31, 2016, with early adoption permitted. Varying transition methods (modified retrospective, retrospective or prospective) are applied to different provisions of the standard. We have adopted this pronouncement in the first quarter of 2017 by electing to account for forfeitures in compensation costs as they occur and reflecting this change in accounting policy on a modified retrospective basis through a non-material, cumulative-effect adjustment reducing accumulated earnings as of the beginning of 2017. We recognized a benefit in stock compensation related to forfeitures of $.01 million in the three months ended April 1, 2017.

In November 2016, the FASB Issued Update 2016-18, *Statement of Cash flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)*. This update addresses the presentation of restricted cash or restricted cash equivalents in the statement of cash flows. This pronouncement is effective for interim and annual reporting periods beginning after December 15, 2017, with early application permitted. We have adopted this pronouncement in the first quarter of 2017 and have reported restricted cash as a component of ending cash, cash equivalents and restricted cash on the Statements of Cash Flows.

New Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB issued ASU No. 2014-09*, Revenue From Contracts with Customers (Topic 606)*, that will supersede most of the existing revenue recognition requirements in U.S. GAAP and will require entities to recognize revenue at an amount that reflects the consideration to which we expect to be entitled in exchange for transferring goods or services to a customer. This new standard also requires significantly expanded disclosures regarding the qualitative and quantitative information of an entity's nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In May 2016, the FASB issued ASU No. 2016-12 to clarify certain narrow aspects of Topic 606 such as assessing the collectability criterion, presentation of sales taxes and other similar taxes collected from customers, non-cash consideration, contract modifications at transition, completed contracts at transition, and other technical corrections. This new accounting standard, as updated, is effective for interim and annual reporting periods beginning after December 15, 2017. We have begun the process of evaluating the principles in the new standard following the five step approach and we are assessing its potential impact on our financial position, results of operations, cash flows and related disclosures. Through our initial evaluation, we believe the impact to our financial statements will be immaterial and we do not believe the implementation will have a material impact on our business practices.

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NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, that will amend the accounting standards for leases. This new standard retains a distinction between finance leases and operating leases but the primary change is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases on the lessee's balance sheet and certain aspects of lease accounting have been simplified. This new standard requires additional qualitative and quantitative disclosures along with specific quantitative disclosures required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. This pronouncement is effective for interim and annual reporting periods beginning after December 15, 2018, with early application permitted. We are currently evaluating the provisions of this pronouncement and are assessing its potential impact on our financial position, results of operations, cash flows and related disclosures. However we are currently unable to reasonably estimate the impact this pronouncement will have on our financial statements and related disclosures.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.* This amendment addresses how certain specified cash receipts and cash payments are presented in the statement of cash flows. This guidance becomes effective for interim and annual reporting periods beginning after December 15, 2017. We are currently evaluating the provisions of this pronouncement and are assessing its potential impact on our financial position, results of operations, cash flows and related disclosures.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. This amendment removes the second step of the two-step goodwill impairment test. When adopted, an entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. This pronouncement is effective for the Company's annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019, with early adoption permitted. We are currently evaluating the provisions of this pronouncement and are assessing its potential impact on our financial position, results of operations, cash flows and related disclosures.

NOTE 2 – CASH, CASH EQUIVALENTS AND RESTRICTED CASH

The following table provides a reconciliation of Cash, cash equivalents and restricted cash reported within the consolidated financial statements:

	April 1, 2017	December 31, 2016
	(dollars in thousands)	
Cash and cash equivalents	$13,713	$ 15,687
Restricted cash	660	—
Total cash, cash equivalents and restricted cash	$14,373	$ 15,687

Amounts included in restricted cash represent those required to be set aside to collateralize a letter of credit required by a customer.

NOTE 3 - CONTRACTS

Costs, estimated earnings and billings on uncompleted contracts consisted of the following at April 1, 2017 and December 31, 2016:

	April 1, 2017	December 31, 2016
	(dollars in thousands)	
Costs incurred on uncompleted contracts	$59,101	$ 58,933
Estimated earnings on uncompleted contracts	24,534	24,694
Earned revenues	83,635	83,627
Less: billings to date	81,679	82,564
Net costs and estimated earnings in excess of billings on uncompleted contracts	$1,956	$ 1,063
Costs and estimated earnings in excess of billings on uncompleted contracts	$3,429	$ 2,434
Billings in excess of costs and estimated earnings on uncompleted contracts	(1,473)	(1,371)
Net costs and estimated earnings in excess of billings on uncompleted contracts	$1,956	$ 1,063

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NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Revenue on fixed-price contracts is recorded primarily using the percentage-of-completion (cost-to-cost) method. 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. To manage unknown risks, management may use contingency amounts to increase the estimated costs, therefore, lowering the earned revenues until the risks are better identified and quantified or have been mitigated. We currently have $0.5 million in contingency amounts as of April 1, 2017 compared to $0.9 million as of December 31, 2016. Losses on contracts are recorded in full as they are identified. Fixed price contracts generally include retainage provisions under which a percentage of the contract price is withheld until the project is complete and has been accepted by our customer. We currently have $1.0 million in retainage as of April 1, 2017 compared to $1.4 million as of December 31, 2016.

We recognize service revenue as soon as the services are performed. For clients that we consider higher risk, due to past payment history or history of not providing written work authorizations, we have deferred revenue recognition until we receive either a written authorization or a payment. We currently have $0.4 million in deferred revenue recognition as of April 1, 2017 compared to $0.1 million as of December 31, 2016. This deferred revenue represents work on not–to-exceed contracts that has been performed but has not been billed or booked as revenue due to our revenue recognition policies as the work was performed outside the contracted amount without obtaining proper work order changes. It is uncertain as to whether these revenues will eventually be recognized by us or the proceeds collected. The costs associated with these billings have been expensed as incurred.

NOTE 4 – LINE OF CREDIT AND LETTER OF CREDIT FACILITIES

Line of Credit Facility

On March 31, 2017, the Company terminated its credit facility with Regions Bank. There were no loans outstanding under that facility on that date. See “Note 6 - Credit Facilities” to our financial statements included in our 2016 Annual Report on Form 10-K for a description of the material terms of the Regions Bank credit facility. The facility was terminated because the Company believes that its cash on hand, internally generated funds and other working capital are sufficient to fund its current operations and near term growth. In addition, the elimination of the facility, which was scheduled to expire in September 2017, will significantly reduce costs to the Company.

NOTE 5 – SEGMENT INFORMATION

The Engineering, Procurement and Construction Management ("EPCM") segment provides services relating to the development, management and execution of projects requiring professional engineering and related project services primarily to the energy industry throughout the United States. The EPCM segment includes the government services group, which provides engineering, design, installation and operation and maintenance of various government, public sector and international facilities. The Automation segment provides services related to the design, fabrication and implementation of process distributed control and analyzer systems, advanced automation, information technology and electrical projects primarily to the upstream and downstream sectors throughout the United States as well as a specific project in Central Asia.

Revenues, operating income, and identifiable assets for each segment are set forth in the following table. The amount identified as Corporate includes those activities that are not allocated to the operating segments and includes costs related to business development, executive functions, finance, accounting, safety, human resources and information technology that are not specifically identifiable with the segments.

Segment information for the three months ended April 1, 2017 and March 26, 2016 is as follows (dollars in thousands):

For the three months ended April 1, 2017:	EPCM	Automation	Corporate	Consolidated
Revenue	$8,165	$ 4,308	$ -	$ 12,473
Gross profit	942	789	-	1,731
SG&A	917	607	1,882	3,406
Operating income (loss)	25	182	(1,882)	(1,675)
Other income				3
Interest expense, net				(65)
Tax benefit				859
Net loss				$ (878)

For the three months ended March 26, 2016:	EPCM	Automation	Corporate	Consolidated
Revenue	$8,527	$ 6,285	$ -	$ 14,812
Gross profit	634	1,039	-	1,673
SG&A	769	743	1,878	3,390
Operating income (loss)	(135)	296	(1,878)	(1,717)
Other income				6
Interest expense, net				(36)
Tax benefit				998
Net loss				$ (749)

Total Assets by Segment	**As of**	**As of**

	April 1, 2017	December 31, 2016
	(dollars in thousands)	
EPCM	$7,084	$ 6,530
Automation	8,578	10,296
Corporate	26,680	27,610
Consolidated	$42,342	$ 44,436

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ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 – FEDERAL AND STATE INCOME TAXES

The Company accounts for income taxes in accordance with FASB Accounting Standards Codification 740, "Income Taxes" ("ASC 740"). Under ASC 740, we estimate an annual effective tax rate based on year-to-date operating results and our projection of operating results for the remainder of the year. We apply this annual effective tax rate to the year-to-date operating results. If our actual results differ from the estimated annual projection, our estimated annual effective tax rate can change affecting the tax expense for successive interim results as well as the estimated annual tax expense results. Certain states are not included in the calculation of the estimated annual effective tax rate because the underlying basis for the tax is related to revenues and not taxable income. Amounts for Texas margin taxes are reported as income tax expense. The Company applies a more likely than not recognition threshold for all tax uncertainties. The FASB guidance for uncertain tax positions only allows the recognition of those tax benefits, based on their technical merits that have a greater than 50 percent likelihood of being sustained upon examination by the taxing authorities. Management has reviewed the Company's tax positions and determined there are no uncertain tax positions requiring recognition in the financial statements. U.S. federal tax returns prior to 2013 and Texas margins tax returns prior to 2013 are closed. Generally, the applicable statues of limitations are three to four years from their filings. During the three months ended April 1, 2017, the Company recognized an income tax benefit of $0.9 million. The Company's effective tax rate was 49.6% for the three months ended April 1, 2017 as compared with 55.7% for the three months ended March 26, 2016. The effective tax rate for the three months ended April 1, 2017 differed from the federal statutory rate of 35% primarily due to state income taxes, adjustments of federal tax credits, adjustments of state tax NOLs, federal tax credits expected for the current year, permanently non-deductible items, the impact of foreign income taxes and the effect of applying the estimated effective tax rate for the year to the current quarter ended April 1, 2017. The effective tax rate for the three months ended March 26, 2016 differed from the federal statutory rate of 35% primarily due state income taxes and a partial valuation allowance on foreign tax credits.

NOTE 7 – STOCK REPURCHASE PROGRAM

On April 21, 2015, the Company announced that its Board of Directors authorized the repurchase of up to $2 million of the Company's common stock from time to time through open market or privately negotiated transactions, based on prevailing market conditions. The Company is not obligated to repurchase any dollar amount or specific number of shares of common stock under the repurchase program, which may be suspended or discontinued at any time. As of April 1, 2017, the Company had purchased and retired 1,127,894 shares for $1.4 million under this program. No shares were purchased in the three months ended April 1, 2017.

NOTE 8 – COMMITMENTS AND CONTINGENCIES

From time to time, ENGlobal or one or more of its subsidiaries is involved in various legal proceedings or is subject to claims that arise in the ordinary course of business alleging, among other things, claims of breach of contract or negligence in connection with the performance or delivery of goods and/or services. The outcome of any such claims or proceedings cannot be predicted with certainty. Management is not aware of any pending or threatened lawsuits or proceedings that are expected to have a material effect on our financial position, results of operations or liquidity.

We carry 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, all with standard self-insured retentions/deductibles. We also provide health insurance to our employees (including vision and dental), and are partially self-funded for these claims. Provisions for expected future payments are accrued based on our experience, and specific stop loss levels provide protection for the Company. We believe we have adequate reserves for the self-funded portion of our insurance policies. We are not aware of any material litigation or claims that are not covered by these policies or which are likely to materially exceed the Company's insurance limits.

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ENGLOBAL CORPORATION AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 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,