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INTEGRATED ELECTRICAL SERVICES INC

Form 10-K/A

February 14, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A

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

FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2001

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 1-13783

INTEGRATED ELECTRICAL SERVICES, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State of other jurisdiction of
incorporation or organization)

76-0542208
(I.R.S. Employer
Identification No.)

1800 WEST LOOP SOUTH
SUITE 500
HOUSTON, TEXAS
(Address of principal executive offices)

77027
(Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (713) 860-1500

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS

NAME OF EACH EXCHANGE ON WHICH REGISTERED

Common Stock, par value \$.01 per share

New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: None

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such

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filing requirements for the past 90 days. Yes [X] No []

Indicate by checkmark if disclosure of delinquent filings pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes [] No [X]

As of December 10, 2001, there were outstanding 39,694,095 shares of common stock of the Registrant. The aggregate market value on such date of the voting stock of the Registrant held by non-affiliates was an estimated \$121.2 million.

DOCUMENT INCORPORATED BY REFERENCE

The information called for by Part III of this Form 10-K is incorporated by reference from the Proxy Statement for the Annual Meeting of Stockholders of the Company to be held February 6, 2002.

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Explanatory Note

This Amendment No. 1 to Form 10-K for the fiscal year ended September 30, 2001 is being filed to correct a typographical error that occurred in two places in the initial filing on December 14, 2001 due to a printer's error. The errors were both in the "Integrated Electrical Services, Inc. and Subsidiaries Consolidated Statements of Operations." The title "2000" referred to the results of operations for the year ended September 30, 1999 and the title "1999" referred to the results of operations for the year ended September 30, 2000. All other disclosure is unchanged.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Integrated Electrical Services, Inc.:

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We have audited the accompanying consolidated balance sheets of Integrated Electrical Services, Inc. (a Delaware corporation), and subsidiaries as of September 30, 2000 and 2001, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three fiscal years in the period ended September 30, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Integrated Electrical Services, Inc., and subsidiaries as of September 30, 2000 and 2001, and the consolidated results of their operations and their cash flows for each of the three fiscal years in the period ended September 30, 2001, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP

Houston, Texas
November 12, 2001

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	September 30,	
(In Thousands, Except Share Information)	2000	2001
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents.....	\$ 770	\$ 3,475
Accounts receivable:		
Trade, net of allowance of \$7,121 and \$5,206 respectively.....	300,038	275,922
Retainage.....	67,851	64,933
Related party.....	256	222
Costs and estimated earnings in excess of billings on uncompleted contracts.....	51,119	62,249
Inventories.....	16,861	21,855
Prepaid expenses and other current assets.....	8,857	23,858

Total current assets.....	445,752	452,514

PROPERTY AND EQUIPMENT, net.....	61,367	70,343

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GOODWILL, net.....	496,212	482,654
OTHER NONCURRENT ASSETS, net.....	16,659	27,992
	-----	-----
Total assets.....	\$1,019,990	\$1,033,503
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

Short-term debt and current maturities of long-term debt.....	\$ 93,903	\$ 679
Accounts payable and accrued expenses.....	202,047	164,272
Income taxes payable.....	1,166	700
Billings in excess of costs and estimated earnings on uncompleted contracts.....	56,993	50,234
	-----	-----
Total current liabilities.....	354,109	215,885

LONG-TERM BANK DEBT.....	--	12,000
OTHER LONG-TERM DEBT, net of current maturities.....	1,162	872
SENIOR SUBORDINATED NOTES, net.....	148,927	273,210
OTHER NONCURRENT LIABILITIES.....	8,043	2,892
	-----	-----
Total liabilities.....	512,241	504,859

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY:

Preferred stock, \$.01 par value, 10,000,000 authorized, none issued and outstanding.....	--	--
Common stock, \$.01 par value, 100,000,000 shares authorized, 38,099,079 and 38,331,672 shares issued, respectively.....	381	383
Restricted voting common stock, \$.01 par value, 2,655,709 and 2,605,709 shares issued, authorized and outstanding, respectively.....	27	26
Additional paid-in capital.....	427,332	428,640
Treasury stock, at cost, none and 1,245,879 shares, respectively.....	--	(9,181)
Retained earnings.....	80,009	108,719
Accumulated other comprehensive income.....	--	57
	-----	-----
Total stockholders' equity.....	507,749	528,644
	-----	-----
Total liabilities and stockholders' equity.....	\$1,019,990	\$1,033,503

The accompanying notes are an integral part of these consolidated financial statements.

INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended September 30,		
	-----	-----	-----
(In Thousands, Except Share Information)	1999	2000	2001

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REVENUES.....	\$1,035,888	\$1,672,288	\$1,693,211
COST OF SERVICES (including depreciation).....	816,715	1,372,537	1,385,581
Gross profit.....	219,173	299,751	307,622
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES.....	113,871	221,519	214,071
GOODWILL AMORTIZATION.....	9,305	13,211	12,981
Income from operations.....	95,997	65,021	80,561
OTHER INCOME (EXPENSE):			
Interest expense.....	(13,145)	(23,230)	(26,051)
Other, net.....	603	1,008	(13,145)
Other expense, net.....	(12,542)	(22,222)	(26,181)
INCOME BEFORE INCOME TAXES.....	83,455	42,799	54,381
PROVISION FOR INCOME TAXES.....	35,348	21,643	25,671
NET INCOME.....	\$ 48,107	\$ 21,156	\$ 28,711
EARNINGS PER SHARE:			
Basic.....	\$ 1.41	\$ 0.53	\$ 0.77
Diluted.....	\$ 1.39	\$ 0.52	\$ 0.77
SHARES USED IN THE COMPUTATION OF EARNINGS PER SHARE:			
Basic.....	34,200,532	40,207,940	40,402,531
Diluted.....	34,613,644	40,410,400	40,899,791

The accompanying notes are an integral part of these consolidated financial statements.

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In Thousands, Except Share Information)	Comprehensive Income	Common Stock		Restricted Voting Common Stock		Treasury S
		Shares	Amount	Shares	Amount	Shares
BALANCE, September 30, 1998.....		28,105,363	\$281	2,655,709	\$27	--
Issuance of stock for acquisitions.....		7,755,586	78	--	--	--
Exercise of stock options		124,889	1	--	--	--
Net income.....	\$ 48,107	--	--	--	--	--
Comprehensive income.....	\$ 48,107					
BALANCE, September 30, 1999.....		35,985,838	360	2,655,709	27	--

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Issuance of stock for acquisitions.....	1,737,522	17	--	--	--
Issuance of stock.....	375,499	4	--	--	--
Exercise of stock options	220	--	--	--	--
Net income.....	\$ 21,156	--	--	--	--

Comprehensive income.....	\$ 21,156				
	=====				

BALANCE, SEPTEMBER 30, 2000.....	38,099,079	381	2,655,709	27	--
ISSUANCE OF STOCK.....	225,424	2	(50,000)	(1)	--
PURCHASE OF TREASURY STOCK.....	--	--	--	--	(1,459,573)
ISSUANCE OF STOCK UNDER EMPLOYEE STOCK PURCHASE PLAN.....	--	--	--	--	207,642
EXERCISE OF STOCK OPTIONS.....	7,169	--	--	--	6,052
UNREALIZED HOLDING GAIN ON SECURITIES, NET OF TAX.....	\$ 57	--	--	--	--
NET INCOME.....	28,710	--	--	--	--

COMPREHENSIVE INCOME.....	\$ 28,767				
	=====				

BALANCE, SEPTEMBER 30, 2001.....	38,331,672	\$383	2,605,709	\$26	(1,245,879)

(In Thousands, Except Share Information)	Accumulated Other Comprehensive Income	Total Stockholders' Equity
-----	-----	-----
BALANCE, September 30, 1998.....	\$--	\$ 302,704
Issuance of stock for acquisitions.....	--	115,152
Exercise of stock options	--	1,203
Net income.....	--	48,107
Comprehensive income.....		

BALANCE, September 30, 1999.....	--	467,166
Issuance of stock for acquisitions.....	--	17,062
Issuance of stock.....	--	2,362
Exercise of stock options	--	3
Net income.....	--	21,156
Comprehensive income.....		

BALANCE, SEPTEMBER 30, 2000.....	--	507,749
ISSUANCE OF STOCK.....	--	1,038
PURCHASE OF TREASURY STOCK.....	--	(10,376)
ISSUANCE OF STOCK UNDER EMPLOYEE STOCK PURCHASE PLAN.....	--	980
EXERCISE OF STOCK		

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OPTIONS.....	--	486
UNREALIZED HOLDING GAIN ON SECURITIES, NET OF TAX.....	57	57
NET INCOME.....	--	28,710
COMPREHENSIVE INCOME.....		

BALANCE, SEPTEMBER 30, 2001.....	\$57	\$ 528,644

The accompanying notes are an integral part of these consolidated financial statements.

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)	Year Ended September 30,		
	1999	2000	2001

CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income.....	\$ 48,107	\$ 21,156	\$ 28,710
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Non-cash compensation charge.....	--	5,378	568
Depreciation and amortization.....	16,947	32,656	30,345
Allowance for doubtful accounts.....	871	1,768	912
Deferred income tax benefit.....	(2,788)	(177)	(4,938)
Gain on sale of property and equipment.....	(198)	(145)	(287)
Changes in operating assets and liabilities, net of non-cash transactions:			
(Increase) decrease in:			
Accounts receivable.....	(54,456)	(82,917)	26,163
Inventories.....	(472)	(2,900)	(4,979)
Costs and estimated earnings in excess of billings on uncompleted contracts.....	(12,656)	(11,489)	(10,785)
Prepaid expenses and other current assets.....	(2,333)	(1,096)	(15,640)
Increase (decrease) in:			
Accounts payable and accrued expenses.....	6,585	72,763	(37,831)
Billings in excess of costs and estimated earnings on uncompleted contracts.....	(1,575)	15,131	(6,414)
Income taxes payable and other current liabilities.....	(8,087)	(2,880)	(250)
Other, net.....	3,789	(4,034)	3,060

Net cash provided by (used in) operating activities.....	(6,266)	43,214	8,634

CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sale of property and equipment.....	753	2,742	1,467
Additions of property and equipment.....	(12,888)	(28,381)	(25,801)
Purchase of businesses, net of cash acquired.....	(106,476)	(33,225)	(233)
Investments in marketable securities and other.....	--	(1,670)	(5,599)
Additions to notes receivable from affiliate.....	--	--	(1,250)

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Net cash used in investing activities.....	(118,611)	(60,534)	(31,416)
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CASH FLOWS FROM FINANCING ACTIVITIES:			
Borrowings of debt.....	270,388	63,434	231,744
Repayments of debt.....	(152,070)	(48,278)	(192,811)
Purchase of treasury stock.....	--	--	(10,376)
Payments for debt issuance costs.....	(5,554)	--	(5,358)
Proceeds from exercise of stock options.....	461	3	270
Proceeds from issuance of stock.....	--	--	1,038
Proceeds from issuance of stock under employee stock purchase plan.....	--	--	980
<hr/>			
Net cash provided by financing activities.....	113,225	15,159	25,487
<hr/>			
NET INCREASE (DECREASE) IN CASH.....	(11,652)	(2,161)	2,705
CASH AND CASH EQUIVALENTS, beginning of period.....	14,583	2,931	770
<hr/>			
CASH AND CASH EQUIVALENTS, end of period.....	\$ 2,931	\$ 770	\$ 3,475
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SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest.....	\$ 11,432	\$ 23,151	\$ 23,793
Income taxes.....	38,214	24,832	30,667
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The accompanying notes are an integral part of these consolidated financial statements.

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS:

Integrated Electrical Services, Inc. (the "Company" or "IES"), a Delaware corporation, was founded in June 1997 to create a leading national provider of electrical services, focusing primarily on the commercial and industrial, residential, communications solutions and service and maintenance markets.

In the course of its operations, the Company is subject to certain risk factors, including but not limited to: exposure to downturns in the economy, risks related to its acquisition strategy, risks related to management of internal growth and execution of strategy, management of external growth, availability of qualified employees, competition, seasonality, risks associated with contracts, significant fluctuations in quarterly results, recoverability of goodwill, collectibility of receivables, dependence on key personnel and risks associated with the availability of capital and with debt service.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of IES, its wholly owned subsidiaries, and certain investments. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the prior year consolidated financial statements to conform with the presentation used in 2001.

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Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Inventories

Inventories consist of parts and supplies held for use in the ordinary course of business and are valued by the Company at the lower of cost or market generally using the first-in, first-out (FIFO) method.

Marketable Securities and Equity Investment

At September 30, 2001, the Company has a 20.6% equity interest in Energy Photovoltaics, Inc. (EPV) of \$4.9 million which is included in other noncurrent assets. The Company accounts for this investment under the equity method of accounting in accordance with Accounting Principles Board Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." In the year ended September 30, 2001, the Company recognized a \$0.4 million loss as its portion of this investment's losses. This amount is included as a component of other income/expense in the Company's consolidated statement of operations. None of the Company's investments qualified for accounting treatment under the equity method of accounting as of September 30, 2000. Additionally, the Company has notes receivable totaling approximately \$1.3 million with EPV at September 30, 2001. See Note 13 for further commitments.

The Company accounts for all other marketable securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Management determines the appropriate classification of marketable securities at the time of purchase and re-evaluates such designation at each balance sheet date. The Company has certain marketable securities that are categorized as "available for sale" and are carried at fair value and included in other noncurrent assets. Unrealized holding gains and losses, net of taxes, are reflected in accumulated other comprehensive income (loss) included in stockholders' equity until realized. During the year ended September 30, 2001, the Company disposed of one of its' available for sale investments for approximately \$0.3 million and realized a loss of \$0.7 million. Such loss is included as a component of other income/expense in the Company's consolidated statement of operations for the year ended September 30, 2001. At September 30, 2000 and 2001, the Company's investments in marketable securities have fair values of \$1.7 million and \$1.5 million (cost of \$1.7 million and \$1.4 million), respectively.

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Property and Equipment

Additions of property and equipment are stated at cost, and depreciation is computed using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are capitalized and amortized over the lesser of the life of the lease or the estimated useful life of the asset. Depreciation expense was approximately \$6,728,000, \$17,970,000 and \$15,757,000 for the years ended September 30, 1999, 2000 and 2001, respectively.

In accordance with its ongoing review of capitalized software, during 2000, the Company curtailed the development of a complex and proprietary information system. This comprehensive information system had been under development for

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approximately one year. After a period of field-testing, the Company determined that it was necessary to significantly alter the technological architecture of the system in order to reduce ongoing support, maintenance and communications costs. Accordingly, the Company recorded a pretax charge of approximately \$6.8 million, of which \$5.7 million was included in depreciation expense for the year, to write-off the carrying value of the software costs, development costs and certain hardware and network infrastructure costs.

Expenditures for repairs and maintenance are charged to expense when incurred. Expenditures for major renewals and betterments, which extend the useful lives of existing equipment, are capitalized and depreciated. Upon retirement or disposition of property and equipment, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in the statement of operations.

Goodwill

Goodwill represents the excess of the aggregate of purchase price paid by the Company in the acquisition of businesses accounted for as purchases over the estimated fair market value of the net assets acquired. Goodwill is amortized on a straight-line basis over 40 years. As of September 30, 2000 and 2001, accumulated amortization was approximately \$25,761,000 and \$38,744,000, respectively.

The Company periodically evaluates the recoverability of intangibles resulting from business acquisitions and measures the amount of impairment, if any, by assessing current and future levels of income and cash flows as well as other factors, such as business trends and prospects and market and economic conditions. If an evaluation is required, the estimated future undiscounted cash flows associated with the asset will be compared to the asset's carrying amount to determine if such an impairment exists.

Debt Issuance Costs

Debt issuance costs related to the Company's credit facility and the senior subordinated notes are included in other noncurrent assets and are amortized to interest expense over the scheduled maturity of the debt. As of September 30, 2000 and 2001, accumulated amortization of debt issuance costs were approximately \$2,458,000 and \$1,871,000, respectively. Debt issuance costs of \$1,918,000 associated with the Company's previous credit facility, as amended, were fully amortized during the year ended September 30, 2001. During the year ended September 30, 2001, the Company capitalized \$5.4 million of offering costs incurred in connection with the issuance of the senior subordinated notes and obtaining its new credit facility.

Revenue Recognition

The Company recognizes revenue when services are performed except when work is being performed under a construction contract. Such contracts generally provide that the customers accept completion of progress to date and compensate the Company for services rendered measured in terms of units installed, hours expended or some other measure of progress. Revenues from construction contracts are recognized on the percentage-of-completion method in accordance with the American Institute of Certified Public Accountants Statement of Position (SOP) 81-1 "Accounting for Performance of Construction-Type and Certain Production-Type Contracts." Percentage-of-completion for construction contracts is measured principally by the percentage of costs incurred and accrued to date for each contract to the estimated total costs for each contract at completion. The Company generally considers contracts to be substantially complete upon departure from the work site and acceptance by the customer. Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and

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depreciation costs. Changes in job performance, job conditions, estimated contract costs

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

and profitability and final contract settlements may result in revisions to costs and income and the effects of these revisions are recognized in the period in which the revisions are determined. Provisions for total estimated losses on uncompleted contracts are made in the period in which such losses are determined.

The balances billed but not paid by customers pursuant to retainage provisions in construction contracts will be due upon completion of the contracts and acceptance by the customer. Based on the Company's experience with similar contracts in recent years, the retention balance at each balance sheet date will be collected within the subsequent fiscal year.

The current asset, "Costs and estimated earnings in excess of billings on uncompleted contracts," represents revenues recognized in excess of amounts billed which management believes will be billed and collected within the subsequent year. The current liability, "Billings in excess of costs and estimated earnings on uncompleted contracts," represents billings in excess of revenues recognized.

Accounts Receivable and Provision for Doubtful Accounts

The Company provides an allowance for doubtful accounts for unknown collection issues in addition to reserves for specific accounts receivable where collection is considered doubtful.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes". Under this method, deferred income tax assets and liabilities are recorded for the future income tax consequences of temporary differences between the financial reporting and income tax bases of assets and liabilities, and are measured using enacted tax rates and laws.

The Company files a consolidated federal income tax return, which includes the operations of all acquired businesses for periods subsequent to their respective acquisition dates. The acquired businesses file "short period" federal income tax returns for the period from their last fiscal year through their respective acquisition dates.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates and assumptions by management in determining the reported amounts of assets and liabilities, disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates are used in the Company's revenue recognition of construction in progress, allowance for doubtful accounts and self insured claims liability.

Self-Insurance

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The Company retains the risk for worker's compensation, employer's liability, auto liability, general liability and employee group health claims, resulting from uninsured deductibles per accident or occurrence which are subject to annual aggregate limits. Losses up to the deductible amounts are accrued based upon the Company's known claims incurred and an estimate of claims incurred but not reported. The accruals are based upon known facts and historical trends and management believes such accruals to be adequate.

Realization of Long-Lived Assets

In accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", the Company evaluates the recoverability of property and equipment or other assets, if facts and circumstances indicate that any of those assets might be impaired. If an evaluation is required, the estimated future undiscounted cash flows associated with the asset are compared to the asset's carrying amount to determine if an impairment of such property has occurred. The effect of any impairment would be to expense the difference between the fair value of such property and its carrying value. To date, the Company has not recorded any such impairments.

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Risk Concentration

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash deposits and trade accounts receivable. The Company grants credit, generally without collateral, to its customers, which are generally contractors and homebuilders throughout the United States. Consequently, the Company is subject to potential credit risk related to changes in business and economic factors throughout the United States within the construction and home-building market. However, the Company generally is entitled to payment for work performed and has certain lien rights in that work. Further, management believes that its contract acceptance, billing and collection policies are adequate to manage potential credit risk. The Company routinely maintains cash balances in financial institutions in excess of federally insured limits.

The Company had no single customer accounting for more than 5% of its revenues for the year ended September 30, 2001. During the year ended September 30, 2000, the Company had one customer that represented 11% of its revenues. Excluding that customer, the Company had no single customer accounting for more than 5% of its revenues. During the year ended September 30, 1999, the Company had no single customer accounting for more than 5% of its revenues.

Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, receivables from related parties, retainage receivables, notes receivable, accounts payable, a line of credit, notes and bonds payable, long-term debt and an interest rate swap agreement. The Company's senior subordinated notes had a carrying value, excluding unamortized discount, at September 30, 2000 and 2001 of \$150.0 million and \$275.0 million, respectively. The fair value of the Company's senior subordinated notes at September 30, 2000 and 2001 was \$132.4 million and \$242.1 million, respectively. The fair value of the Company's interest rate swap at September 30, 2001 was \$3.2 million. Other than the senior subordinated notes and the interest rate swap agreement, the Company believes that the carrying value of financial instruments on the accompanying consolidated balance sheets approximates their fair value.

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Subsidiary Guaranties

All of the Company's operating income and cash flows are generated by its wholly owned subsidiaries, which are the subsidiary guarantors of the Company's outstanding 9 3/8% Senior Subordinated Notes due 2009 (the "Senior Subordinated Notes"). The Company is structured as a holding company and substantially all of its assets and operations are held by its subsidiaries. There are currently no significant restrictions on the Company's ability to obtain funds from its subsidiaries by dividend or loan. The separate financial statements of the subsidiary guarantors are not included herein because (i) the subsidiary guarantors are all of the direct and indirect subsidiaries of the Company; (ii) the subsidiary guarantors have fully and unconditionally, jointly and severally guaranteed the Senior Subordinated Notes; and (iii) the aggregate assets, liabilities, earnings, and equity of the subsidiary guarantors is substantially equivalent to the assets, liabilities, earnings and equity of the Company on a consolidated basis. As a result, the presentation of separate financial statements and other disclosures concerning the subsidiary guarantors is not deemed material.

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Earnings per Share

The following table reconciles the components of the basic and diluted earnings per share for the three years ended September 30, 1999, 2000 and 2001 (in thousands, except share information):

	Year Ended September 30,		
	1999	2000	2001
<hr style="border-top: 1px dashed black;"/>			
Numerator:			
Net income.....	\$ 48,107	\$ 21,156	\$ 28,107
<hr style="border-top: 1px dashed black;"/>			
Denominator:			
Weighted average common shares outstanding -- basic.....	34,200,532	40,207,940	40,402,402
Effect of dilutive stock options.....	413,112	202,460	497
<hr style="border-top: 1px dashed black;"/>			
Weighted average common and common equivalent shares outstanding -- diluted.....	34,613,644	40,410,400	40,899,899
<hr style="border-top: 1px dashed black;"/>			
Earnings per share:			
Basic.....	\$ 1.41	\$ 0.53	\$ 0.70
Diluted.....	\$ 1.39	\$ 0.52	\$ 0.69
<hr style="border-top: 1px dashed black;"/>			

For the years ended September 30, 1999, 2000 and 2001, exercisable stock options of 1.0 million, 4.4 million and 4.4 million, respectively, were excluded from the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the Company's common stock.

New Accounting Pronouncements

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In December 1999, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 101 (SAB 101). SAB 101 reflects the basic principles of revenue recognition in existing accounting principles generally accepted in the United States. SAB 101 does not supersede any existing authoritative literature. The Company recognizes revenue from construction contracts on the percentage-of-completion method in accordance with the American Institute of Certified Public Accountants Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts". The adoption of SAB 101 did not have an impact on the results of operations of the Company.

Statement of Financial Accounting Standards (SFAS) 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS Nos. 137 and 138, was effective for the Company on October 1, 2000. These statements require that all derivative instruments (such as an interest rate swap contract), be recorded as either assets or liabilities measured at fair value. Changes in the derivative's fair value are to be recognized currently in earnings unless specific hedge accounting criteria are met. The criteria for cash flow and fair value hedges require that hedging relationships must be designated and documented upon inception. The documentation must include the consideration of the hedged item, the specific risk being hedged, identification of the hedging instrument, the Company's risk management strategy, and how effectiveness will be assessed. The effectiveness assessment must have a historical basis that supports the assertion that the hedge will be effective prospectively. At the date of adoption, there was no financial impact on the Company's consolidated financial statements as the Company was not a party to any derivative instruments. In August 2001, the Company entered into an interest rate swap contract to manage specific interest rate risks. See Note 6.

In June 2001, the FASB issued SFAS No. 141, "Business Combinations". SFAS No. 141 establishes new standards for accounting and reporting requirements for business combinations and requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS No. 141 also requires that acquired intangible assets be recognized as assets apart from goodwill if they meet one of two specified criteria. Additionally, the statement adds certain disclosure requirements to those required by APB 16, including disclosure of the primary reasons for the business combination and the allocation of the purchase price paid to the assets acquired and liabilities assumed by major balance sheet caption. This statement is required to be applied to all business combinations initiated after June 30, 2001 and to all business combinations accounted for using the purchase method

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

for which the date of acquisition is July 1, 2001 or later. Use of the pooling-of-interests method is prohibited. The adoption of SFAS No. 141 did not have an impact on the Company's financial condition or results of operations.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 142, which must be applied to fiscal years beginning after December 15, 2001, modifies the accounting and reporting of goodwill and intangible assets. The pronouncement requires entities to discontinue the amortization of goodwill, reallocate all existing goodwill among its reporting segments based on criteria set by SFAS No. 142 and perform initial impairment tests by applying a fair-value-based analysis on the goodwill in each reporting segment. Any impairment at the initial adoption date shall be recognized as the effect of a change in accounting principle. Subsequent to the initial adoption, goodwill shall be tested for impairment annually or more frequently if

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circumstances indicate a possible impairment.

Under SFAS No. 142, entities are required to determine the useful life of other intangible assets and amortize the value over the useful life. If the useful life is determined to be indefinite, no amortization will be recorded. For intangible assets recognized prior to the adoption of SFAS No. 142, the useful life should be reassessed. Other intangible assets are required to be tested for impairment in a manner similar to goodwill. At September 30, 2001, the Company's net goodwill was approximately \$482.7 million, and annual amortization of such goodwill was approximately \$13.0 million. The Company expects to adopt SFAS No. 142 during its first fiscal quarter of 2002. The Company believes the impairment charge upon adoption will be material, and based on current market capitalization could equate to a substantial amount of its recorded goodwill. The Company does not believe this adoption will impact its free cash flows, its operating income or compliance with its debt instruments.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of". SFAS No. 144 establishes a single accounting model for long-lived assets to be disposed of by sale and requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. The Company is in the process of assessing the impact that the adoption of this standard will have on its financial position and results of operations.

3. BUSINESS COMBINATIONS:

Purchases

Subsequent to the IPO, and through September 30, 2001, IES has acquired 70 businesses in transactions accounted for as purchases. The total consideration paid in these transactions was approximately \$232.9 million in cash and 14.7 million shares of common stock.

In connection with the acquisitions discussed above, goodwill was determined as follows for each of the years ending September 30, 1999, 2000 and 2001 (in thousands):

	1999	2000	2001
Fair value of assets acquired, net of cash acquired.....	\$115,645	\$ 23,726	\$ 239
Liabilities assumed.....	(77,641)	(15,477)	(159)
Net assets acquired, net of cash.....	38,004	8,249	80
Cash paid, net of cash acquired.....	106,476	33,225	233
Issuance of common stock.....	115,152	17,062	--
Total consideration paid.....	221,628	50,287	233
Goodwill.....	\$183,624	\$ 42,038	\$ 153

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Pro Forma Presentation

The unaudited pro forma data presented below reflect the results of operations of IES and the businesses acquired during fiscal 1999 and 2000 assuming the transactions were completed on October 1, 1998 (in thousands):

(Unaudited)	Year Ended September 30,	
	1999	2000
Revenues.....	\$1,376,763	\$1,687,650
Net income.....	\$ 65,164	\$ 22,440
Basic earnings per share.....	\$ 1.91	\$ 0.57
Diluted earnings per share.....	\$ 1.88	\$ 0.56

The unaudited pro forma data summarized above also reflects pro forma adjustments primarily related to: reductions in general and administrative expenses for contractually agreed reductions in owners' compensation, estimated goodwill amortization for the excess of consideration paid over the net assets acquired assuming a 40-year amortization period, interest expense on borrowings incurred to fund acquisitions, elimination of interest income, and additional income tax expense based on the Company's effective income tax rate. The unaudited pro forma financial data does not purport to represent what the Company's combined results of operations would actually have been if such transactions had in fact occurred on October 1, 1998, and are not necessarily representative of the Company's results of operations for any future period.

4. PROPERTY AND EQUIPMENT:

Property and equipment consists of the following (in thousands):

	Estimated Useful Lives in Years	September 30,	
		2000	2001
Land.....	N/A	\$ 1,621	\$ 1,621
Buildings.....	5-32	6,876	7,153
Transportation equipment.....	3-5	30,119	33,109
Machinery and equipment.....	3-10	33,442	46,985
Leasehold improvements.....	5-32	8,231	12,992
Furniture and fixtures.....	5-7	7,390	9,182
		87,679	111,042
Less -- Accumulated depreciation and amortization.....		(26,312)	(40,699)
Property and equipment, net.....		\$ 61,367	\$ 70,343

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5. DETAIL OF CERTAIN BALANCE SHEET ACCOUNTS:

Activity in the Company's allowance for doubtful accounts receivable consists of the following (in thousands):

	September 30,	
	2000	2001
Balance at beginning of period.....	\$ 5,709	\$ 7,121
Additions from acquisitions.....	948	--
Additions to costs and expenses.....	1,768	912
Deductions for uncollectible receivables written off, net of recoveries.....	(1,304)	(2,827)
Balance at end of period.....	\$ 7,121	\$ 5,206

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Accounts payable and accrued liabilities consist of the following (in thousands):

	September 30,	
	2000	2001
Accounts payable, trade.....	\$105,814	\$ 78,948
Accrued compensation and benefits.....	57,561	53,057
Other accrued liabilities.....	38,672	32,267
	\$202,047	\$164,272

Contracts in progress are as follows (in thousands):

	September 30,	
	2000	2001
Costs incurred on contracts in progress.....	\$ 1,163,463	\$ 1,297,850
Estimated earnings.....	220,411	254,981
	1,383,874	1,552,831

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Less -- Billings to date.....	(1,389,748)	(1,540,816)
	-----	-----
	\$ (5,874)	\$ 12,015
	=====	=====
Costs and estimated earnings in excess of billings on uncompleted contracts.....	\$ 51,119	\$ 62,249
Less -- Billings in excess of costs and estimated earnings on uncompleted contracts.....	(56,993)	(50,234)
	-----	-----
	\$ (5,874)	\$ 12,015
	-----	-----

6. DEBT:

Debt consists of the following (in thousands):

	September 30,	
	2000	2001
	-----	-----
Secured credit facility with a bank group, due July 30, 2001, at a weighted average interest rate of 8.00%.....	\$ 93,000	\$ --
Secured credit facility with a group of lending institutions, due May 22, 2004, at a weighted average interest rate of 7.56%.....	--	12,000
Senior Subordinated Notes, due February 1, 2009, bearing interest at 9.375% with an effective interest rate of 9.50%.....	150,000	150,000
Senior Subordinated Notes, due February 1, 2009, bearing interest at 9.375% with an effective interest rate of 10.00%.....	--	125,000
Other.....	2,065	1,551
	-----	-----
	245,065	288,551
Less -- short-term debt and current maturities of long-term debt.....	(93,903)	(679)
Less -- unamortized discount on Senior Subordinated Notes...	(1,073)	(4,949)
	-----	-----
Total long-term debt.....	\$150,089	\$282,923
	-----	-----

Future payments due on debt at September 30, 2001 are as follows (in thousands):

2002.....	\$ 679
2003.....	614
2004.....	12,170
2005.....	73
2006.....	15
Thereafter.....	275,000

Total.....	\$288,551

INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Credit Facility

On May 22, 2001, the Company replaced its \$175.0 million credit facility with a bank group, with a new \$150.0 million revolving credit facility with a group of lending institutions to be used for working capital, capital expenditure, acquisitions and other corporate purposes, that matures May 22, 2004 (the "Credit Facility"). Amounts borrowed under the Credit Facility bear interest at an annual rate equal to either (a) the London interbank offered rate (LIBOR) plus 1.75 percent to 2.75 percent, as determined by the ratio of the Company's total funded debt to EBITDA (as defined in the Credit Facility) or (b) the higher of (i) the bank's prime rate or (ii) the Federal funds rate plus 0.50 percent plus an additional 0.25 percent to 1.25 percent, as determined by the ratio of the Company's total funded debt to EBITDA. Commitment fees of 0.50 percent are assessed on any unused borrowing capacity under the Credit Facility. The Company's existing and future subsidiaries guarantee the repayment of all amounts due under the facility, and the facility is secured by the capital stock of those subsidiaries and the accounts receivable of the Company and those subsidiaries. Borrowings under the Credit Facility are limited to 66 2/3% of outstanding receivables (as defined in the Agreement). The Credit Facility requires the consent of the lenders for acquisitions exceeding a certain level of cash consideration, prohibits the payment of cash dividends on the common stock, restricts the ability of the Company to repurchase shares of common stock, to incur other indebtedness and requires the Company to comply with various affirmative and negative covenants including certain financial covenants. Among other restrictions, the financial covenants include minimum net worth requirements, a maximum total consolidated funded debt to EBITDA ratio, a maximum senior consolidated debt to EBITDA ratio, and a minimum interest coverage ratio. The Company was in compliance with the financial covenants at September 30, 2001. As of September 30, 2001, the Company had borrowings outstanding under its Credit Facility of \$12.0 million, letters of credit outstanding under its Credit Facility of \$0.9 million, \$1.6 million of other borrowings and available borrowing capacity under its Credit Facility of \$137.1 million.

Senior Subordinated Notes

On January 25, 1999 and May 29, 2001, the Company completed offerings of \$150.0 million and \$125.0 million Senior Subordinated Notes, respectively. The offering completed on May 29, 2001, yielded \$117.0 million in proceeds to the Company, net of a \$4.2 million discount and \$3.8 million in offering costs. The proceeds from the May 29, 2001, offering were used primarily to repay amounts outstanding under the Credit Facility. The Senior Subordinated Notes bear interest at 9 3/8% and mature on February 1, 2009. The Company pays interest on the Senior Subordinated Notes on February 1 and August 1 of each year. The Senior Subordinated Notes are unsecured obligations and are subordinated to all existing and future senior indebtedness. The Senior Subordinated Notes are guaranteed on a senior subordinated basis by all of the Company's subsidiaries. Under the terms of the Senior Subordinated Notes, the Company is required to comply with various affirmative and negative covenants including: (i) restrictions on additional indebtedness, and (ii) restrictions on liens, guarantees and dividends.

Interest Rate Swap

The Company entered into an interest rate swap agreement in August 2001, designated as a fair value hedge, in order to minimize the risks and cost

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associated with its financing activities. The interest rate swap agreement has a notional amount of \$100.0 million and was established to manage the interest rate risk of the senior subordinated note obligations. Under the swap agreement, the Company pays the counterparty variable rate interest (3-month LIBOR plus 3.49%) and the counterparty pays the Company fixed rate interest of 9.375% on a semiannual basis over the life of the instrument. Pursuant to SFAS No. 133, as amended, such interest rate swap contract is reflected at fair value on the Company's consolidated balance sheet and the related portion of fixed-rate debt being hedged is reflected at an amount equal to the sum of its carrying value plus an adjustment representing the change in fair value of the debt obligation attributable to the interest rate being hedged. The net effect of this accounting on the Company's operating results is that interest expense on the portion of fixed-rate debt being hedged is generally recorded based on variable interest rates. The interest rate swap is considered to be perfectly effective because it qualifies for the "short-cut" method under SFAS No. 133 and therefore there is no net change in fair value to be recognized in income. At September 30, 2001, the interest rate swap had a notional value of \$100.0 million and a fair value of \$3.2 million.

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The fair value of this contract is included in the balance sheet in other noncurrent assets. The following table presents the balance sheet effect on the Senior Subordinated Notes (in thousands):

	September 30,	
	2000	2001
Senior Subordinated Notes, due February 1, 2009.....	\$150,000	\$275,000
Less-unamortized discount on Senior Subordinated Notes.....	(1,073)	(4,949)
Add: Fair value of interest rate hedge.....	--	3,159
	\$148,927	\$273,210

7. LEASES:

The Company leases various facilities under noncancelable operating leases. For a discussion of leases with certain related parties see Note 11. Rental expense for the years ended September 30, 1999, 2000 and 2001 was approximately \$4,849,000, \$7,543,000 and \$9,724,000, respectively. Future minimum lease payments under these noncancelable operating leases with terms in excess of one year are as follows (in thousands):

YEAR ENDED SEPTEMBER 30

2002.....	\$10,385
2003.....	7,871
2004.....	6,196
2005.....	4,015
2006.....	1,793

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Thereafter.....	2,830

Total.....	\$33,090

8. INCOME TAXES:

Federal and state income tax provisions are as follows (in thousands):

	Year Ended September 30,		
	1999	2000	2001

Federal:			
Current.....	\$33,317	\$19,345	\$24,592
Deferred.....	(2,558)	(157)	(2,025)
State:			
Current.....	4,819	2,475	6,017
Deferred.....	(230)	(20)	(2,913)
	-----	-----	-----
	\$35,348	\$21,643	\$25,671

Actual income tax expense differs from income tax expense computed by applying the U.S. federal statutory corporate rate of 35 percent to income before provision for income taxes as follows (in thousands):

	Year Ended September 30,		
	1999	2000	2001

Provision at the statutory rate.....	\$29,209	\$14,980	\$19,033
Increase resulting from:			
Non-cash restricted stock compensation charge.....	--	611	88
Non-deductible goodwill.....	2,838	4,070	4,208
State income taxes, net of benefit for federal deduction.....	2,983	1,596	2,018
Non-deductible expenses.....	318	386	324
	-----	-----	-----
	\$35,348	\$21,643	\$25,671

INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Deferred income tax provisions result from temporary differences in the recognition of income and expenses for financial reporting purposes and for income tax purposes. The income tax effects of these temporary differences, representing deferred income tax assets and liabilities, result principally from the following (in thousands):

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	Year Ended September 30,	
	2000	2001

Deferred income tax assets:		
Allowance for doubtful accounts.....	\$ 2,492	\$ 2,010
Accrued expenses.....	9,507	6,805
Other.....	2,626	2,824

Total deferred income tax assets.....	14,625	11,639

Deferred income tax liabilities:		
Property, equipment and goodwill.....	(8,559)	(3,562)
Deferred contract revenue and other.....	(5,618)	(2,691)

Total deferred income tax liabilities.....	(14,177)	(6,253)

Net deferred income tax assets.....	\$ 448	\$ 5,386

The Company does not believe that a valuation allowance against the deferred income tax assets is necessary as it believes the assets will be fully realized.

The net deferred income tax assets and liabilities are comprised of the following (in thousands):

	September 30,	
	2000	2001

Current deferred income taxes:		
Assets.....	\$13,567	\$ 9,075
Liabilities.....	(5,664)	(1,960)

	7,903	7,115

Long-term deferred income taxes:		
Assets.....	\$ 1,059	\$ 2,564
Liabilities.....	(8,514)	(4,293)

	(7,455)	(1,729)

Net deferred income tax assets.....	\$ 448	\$ 5,386

9. OPERATING SEGMENTS

The Company follows SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." Certain information is disclosed, per SFAS No. 131, based on the way management organizes financial information for making operating decisions and assessing performance. The Company's reportable segments

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are strategic business units that offer products and services to four distinct customer groups. They are managed separately because each business requires different operating and marketing strategies.

Prior to October 1, 2000, the Company was organized in a single segment. During fiscal 2000, the Company aligned its operations among two complementary core businesses: electrical contracting and communications solutions. Within the electrical contracting business, the Company has three reportable segments: commercial/industrial, residential and service and maintenance markets. The commercial/industrial segment provides installations, renovations and upgrades and replacement services in office buildings, high-rise apartments and condominiums, theaters, restaurants, hotels, hospitals and critical-care facilities, school districts, manufacturing and processing facilities, military installations, airports, refineries and petrochemical and power plants. The residential segment consists of installations, replacements and renovation services in single family and low-rise multifamily housing units. The service and maintenance segment provides maintenance and replacement services from service calls and routine

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

maintenance contracts. The communications solutions business provides installation, service and maintenance, design, engineering and support services to infrastructure services customers.

The accounting policies of these reportable segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on income from operations of the respective business units prior to unallocated home office expenses. No significant transactions have occurred between the Company's business segments. Management intends to continue to focus on its internal allocation methods for allocating results to business segments.

Segment information for the years ended September 30, 1999, 2000 and 2001 are as follows (in thousands):

	Fiscal Year Ended September 30, 1999				
	Electrical Contracting				
	Commercial/ Industrial	Residential	Service And Maintenance	Subtotal	Communications Solutions
Revenues.....	\$ 716,340	\$175,978	\$ 69,370	\$ 961,688	\$ 74,200
Cost of services.....	583,440	134,938	45,967	764,345	52,370
Gross profit.....	132,900	41,040	23,403	197,343	21,830
Selling, general and administrative.....	68,335	16,524	6,617	91,476	10,388
Goodwill amortization.....	6,993	1,056	677	8,726	579
Operating Income.....	\$ 57,572	\$ 23,460	\$ 16,109	\$ 97,141	\$ 10,863

Other Data:

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Depreciation expense.....	\$ 4,419	\$ 493	\$ 428	\$ 5,340	\$ 1,187
Capital expenditures.....	7,089	880	687	8,656	2,456
Total assets.....	518,157	101,610	33,725	653,492	51,718

Fiscal Year Ended September 30, 2000

	Electrical Contracting				
	Commercial/ Industrial	Residential	Service And Maintenance	Subtotal	Communications Solutions
Revenues.....	\$1,126,792	\$250,877	\$132,167	\$1,509,836	\$162,452
Cost of services.....	950,131	195,913	102,849	1,248,893	123,644
Gross profit.....	176,661	54,964	29,318	260,943	38,808
Selling, general and administrative.....	107,859	23,557	12,651	144,067	22,743
Goodwill amortization.....	9,343	1,505	1,096	11,944	1,267
Operating Income.....	\$ 59,459	\$ 29,902	\$ 15,571	\$ 104,932	\$ 14,798
Other Data:					
Depreciation expense.....	\$ 7,613	\$ 702	\$ 893	\$ 9,208	\$ 2,599
Capital expenditures.....	13,337	1,254	1,564	16,155	5,377
Total assets.....	663,810	144,856	61,102	869,768	113,229

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Fiscal Year Ended September 30, 2001

	Electrical Contracting				
	Commercial/ Industrial	Residential	Service And Maintenance	Subtotal	Communications Solutions
Revenues.....	\$1,120,341	\$257,440	\$135,594	\$1,513,375	\$179,838
Cost of services.....	936,880	198,908	104,507	1,240,295	145,294
Gross profit.....	183,461	58,532	31,087	273,080	34,544
Selling, general and administrative.....	104,199	30,977	13,064	148,240	20,488
Goodwill amortization.....	9,115	1,505	1,096	11,716	1,267
Operating Income.....	\$ 70,147	\$ 26,050	\$ 16,927	\$ 113,124	\$ 12,789
Other Data:					

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Depreciation expense.....	\$ 9,558	\$ 1,745	\$ 994	\$ 12,297	\$ 2,529
Capital expenditures.....	8,471	1,936	3,587	13,994	4,796
Total assets.....	673,992	112,779	81,573	868,344	94,617

The Company does not have significant operations or long-lived assets in countries outside of the United States.

10. STOCKHOLDERS' EQUITY:

Restricted Voting Common Stock

The shares of restricted voting common stock have rights similar to shares of common stock except that such shares are entitled to elect one member of the board of directors and to not otherwise vote with respect to the election of directors and are entitled to one-half of one vote for each share held on all other matters. Each share of restricted voting common stock will convert into common stock upon disposition by the holder of such shares.

1997 Stock Plan

In September 1997, the Company's board of directors and stockholders approved the Company's 1997 Stock Plan (the "Plan"), which provides for the granting or awarding of incentive or nonqualified stock options, stock appreciation rights, restricted or phantom stock and other incentive awards to directors, officers, key employees and consultants of the Company. The number of shares authorized and reserved for issuance under the Plan is 15 percent of the aggregate number of shares of common stock outstanding. The terms of the option awards will be established by the compensation committee of the Company's board of directors. Options generally expire 10 years from the date of grant, one year following termination of employment due to death or disability, or three months following termination of employment by means other than death or disability.

Directors' Stock Plan

In September 1997, the Company's board of directors and stockholders approved the 1997 Directors' Stock Plan (the "Directors' Plan"), which provides for the granting or awarding of stock options to nonemployee directors. In May 2000, the Company's board of directors amended the Directors' Plan. The number of shares authorized and reserved for issuance under the Directors' Plan is 250,000 shares. Each nonemployee director is granted options to purchase 3,000 shares at the time of an initial election of such director. In addition, each director will be automatically granted options to purchase 3,000 shares annually at each September 30 on which such director remains a director. All options have an exercise price based on the fair market value at the date of grant and vesting terms similar to options granted under the Directors' Plan discussed above.

1999 Incentive Compensation Plan

In November 1999, the Board of Directors adopted the 1999 Incentive Compensation Plan (the "1999 Plan"). The 1999 Plan, as amended, authorizes the Compensation Committee of the Board of Directors or the Board of Directors

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stock appreciation rights, restricted stock or other stock based awards. The Company has up to 5.5 million shares of common stock authorized for issuance under the 1999 Plan.

In December 1999 and March 2000, the Company granted restricted stock awards of 609,306 and 400,000, respectively, under its stock plans to certain employees. The December 1999 awards vested in equal installments on May 31, 2000 and August 31, 2000, provided the recipient was still employed by the Company. The March 2000 award vests in equal installments on March 20th of each year through 2004, provided the recipient is still employed by the Company. The market value of the underlying stock on the date of grant for the December 1999 and March 2000 awards was \$5.2 million and \$2.3 million, respectively, which is being recognized as compensation expense over the related vesting periods. During the years ended September 30, 2000 and 2001, the Company amortized \$5.4 million and \$0.6 million, respectively, to expense in connection with these awards. Through September 30, 2001, 678,269 shares of these common stock awards vested and 31,037 shares of common stock were forfeited. To fund employee tax liabilities, 234,234 of these awards were cancelled and 444,035 of these shares were issued and are currently outstanding. At September 30, 2001, there were 300,000 shares of unvested common stock awards outstanding.

The following table summarizes activity under the Company's stock option and incentive compensation plans:

	Shares	Weighted Average Exercise Price

Outstanding, September 30, 1998.....	3,238,951	13.48

Options Granted.....	1,248,125	16.93
Exercised.....	(316,312)	9.55
Forfeited.....	(420,307)	15.20

Outstanding, September 30, 1999.....	3,750,457	\$14.81

Options Granted.....	1,987,482	10.18
Restricted Stock Granted.....	1,009,306	0.00
Exercised.....	(579,839)	0.00
Forfeited and Cancelled.....	(721,111)	13.92

Outstanding, September 30, 2000.....	5,446,295	\$12.02
=====		
Options Granted.....	2,251,199	5.76
Restricted Stock Granted.....	43,783	0.00
Exercised.....	(157,004)	0.47
Forfeited and Cancelled.....	(655,152)	13.04

Outstanding, September 30, 2001.....	6,929,121	\$10.06
=====		
Exercisable, September 30, 1999.....	\$ 759,656	\$14.17
=====		
Exercisable, September 30, 2000.....	\$ 1,536,995	\$13.74
=====		
Exercisable, September 30, 2001.....	\$ 2,626,988	\$12.23

Unexercised options expire at various dates from January 27, 2008 through September 30, 2011.

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The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following subjective assumptions:

	1999	2000	2001
Expected dividend yield.....	0.00%	0.00%	0.00%
Expected stock price volatility.....	52.23%	94.42%	60.99%
Weighted average risk free interest rate.....	5.24%	6.35%	5.15%
Expected life of options.....	6 years	6 years	6 YEARS

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The tables below summarizes options outstanding and exercisable at September 30, 2001:

Range of Exercise Prices	Outstanding as of September 30, 2001	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Exercisable as September 30, 2001
\$0.0000 -- \$4.6240	300,000	8.5	\$ 0.0000	--
\$4.6250 -- \$7.8000	3,077,023	8.5	\$ 9.4661	729,364
\$7.8100 -- \$10.5000	64,667	7.1	\$ 9.4661	12,793
\$10.5100 -- \$15.5000	2,640,599	6.7	\$13.7335	1,384,142
\$15.5100 -- \$22.1250	846,832	6.6	\$18.1641	500,689
	6,929,121	7.5	\$10.0645	2,626,988

Options exercisable at September 30, 1999, 2000 and 2001 had weighted average fair values per option of \$9.45, \$8.10 and \$3.55, respectively.

Employee Stock Purchase Plan

In February 2000, the Company's stockholders approved the Company's Employee Stock Purchase Plan (the "ESPP"), which provides for the sale of common stock to participants as defined at a price equal to the lower of 85% of the Company's closing stock price at the beginning or end of the option period, as defined. The number of shares of common stock authorized and reserved for issuance under the ESPP is 1.0 million shares. The purpose of the ESPP is to provide an incentive for employees of the Company to acquire a proprietary interest in the Company through the purchase of shares of the Company's common stock. The ESPP is intended to qualify as an "Employee Stock Purchase Plan" under Section 423 of the Internal Revenue Code of 1986, as amended (the "Code"). The provisions of the ESPP are construed in a manner to be consistent with the requirements of that section of the Code. As of September 30, 2000, there were no shares purchased under the ESPP. During the year ended September 30, 2001, the Company issued 207,642 shares pursuant to the ESPP. For purposes of SFAS No.

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123, "Accounting for Stock-Based Compensation," estimated compensation cost as it relates to the ESPP was computed for the fair value of the employees' purchase rights using the Black-Scholes option pricing model with the following assumptions for 2001: expected dividend yield of 0.00%, expected stock price volatility of 60.99%, weighted average risk free interest rate of 5.15% and an expected life of 0.5 years. The weighted average fair value per share of these purchase rights granted in 2001 was approximately \$1.52.

The Company follows Accounting Principles Board ("APB") Opinion No. 25 in accounting for its stock-based compensation. Under APB Opinion No. 25, no compensation expense is recognized in the consolidated statements of operations if no intrinsic value exists at the date of grant. SFAS No. 123 requires that if a company does not record compensation expense for stock options issued to employees pursuant to APB Opinion No. 25, the company must also disclose the effects on its results of operations as if the Company has adopted SFAS 123. Had compensation costs for the Company's stock option plans, restricted stock awards granted and the ESPP been determined consistent with SFAS No. 123, the Company's net income and earnings per share would have been reduced to the following pro forma amounts (in thousands, except per share information):

	1999	2000	2001

Net income			
As reported.....	\$48,107	\$21,156	\$28,710
Pro forma for SFAS No. 123.....	\$42,720	\$12,510	\$21,630
Basic earnings per share			
As reported.....	\$ 1.41	\$ 0.53	\$ 0.71
Pro forma for SFAS No. 123.....	\$ 1.25	\$ 0.31	\$ 0.54
Diluted earnings per share			
As reported.....	\$ 1.39	\$ 0.52	\$ 0.70
Pro forma for SFAS No. 123.....	\$ 1.23	\$ 0.31	\$ 0.53

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The effects of applying SFAS No. 123 in the pro forma disclosure may not be indicative of future amounts as additional awards in future years are anticipated and because the Black-Scholes option-pricing model involves subjective assumptions which may be materially different than actual amounts.

11. RELATED-PARTY TRANSACTIONS:

The Company has transactions in the normal course of business with certain affiliated companies. Amounts due from related parties at September 30, 2000 and 2001 were \$256,000 and \$222,000, respectively. In connection with certain of the acquisitions, subsidiaries of the Company have entered into a number of related party lease arrangements for facilities. These lease agreements are for periods generally ranging from three to five years. Related party lease expense for the years ended September 30, 1999, 2000 and 2001 were \$2,850,000, \$4,180,000 and \$4,335,000, respectively. Future commitments with respect to these leases are included in the schedule of minimum lease payments in Note 7.

12. EMPLOYEE BENEFIT PLANS:

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In November 1998, the Company established the Integrated Electrical Services, Inc. 401(k) Retirement Savings Plan (the "401(k) Plan"). All IES employees are eligible to participate subsequent to completing six months of service and attaining age twenty-one. Participants become vested in Company matching contributions following three years of service.

Certain subsidiaries of the Company do not participate in the 401(k) Plan, but instead provide various defined contribution savings plans for their employees (the "Plans"). The Plans cover substantially all full-time employees of such subsidiaries. Participants vest at varying rates ranging from full vesting upon participation to those that provide for vesting to begin after three years of service and are fully vested after eight years. Certain plans provide for a deferral option that allows employees to elect to contribute a portion of their pay into the plan and provide for a discretionary profit sharing contribution by the individual subsidiary. Generally the subsidiaries match a portion of the amount deferred by participating employees. Contributions for the profit sharing portion of the Plans are generally at the discretion of the individual subsidiary. The aggregate contributions by the Company to the 401(k) Plan and the Plans were \$1,460,000, \$2,106,000 and \$3,380,000 for the years ended September 30, 1999, 2000 and 2001, respectively.

13. COMMITMENTS AND CONTINGENCIES:

Subsidiaries of the Company are involved in various legal proceedings that have arisen in the ordinary course of business. While it is not possible to predict the outcome of such proceedings with certainty and it is possible that the results of legal proceedings may materially adversely affect us, in the opinion of the Company, all such proceedings are either adequately covered by insurance or, if not so covered, should not ultimately result in any liability which would have a material adverse effect on the financial position, liquidity or results of operations of the Company. The Company expenses routine legal costs related to such proceedings as incurred.

The Company has committed to invest up to \$5.0 million in EnerTech Capital Partners II L.P. ("EnerTech"). EnerTech is a private equity firm specializing in investment opportunities emerging from the deregulation and resulting convergence of the energy, utility and telecommunications industries. Through September 30, 2001, the Company had invested \$1.5 million under its commitment to EnerTech.

The Company has committed to advance EPV, an affiliate, up to \$1.8 million in the form of notes receivable. At September 30, 2001, the Company had notes receivable totaling approximately \$1.3 million. Subsequent to September 30, 2001, EPV was advanced the remaining \$0.5 million under the Company's commitment.

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INTEGRATED ELECTRICAL SERVICES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

14. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED):

Quarterly financial information for the years ended September 30, 2000 and 2001 are summarized as follows (in thousands, except per share data):

Fiscal Year Ended September 30, 2			
First	Second	Third	F

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	Quarter	Quarter	Quarter	Qu
Revenues.....	\$335,191	\$370,327	\$452,149	\$5
Gross profit.....	\$ 59,620	\$ 62,860	\$ 78,048	\$
Net income.....	\$ 2,603	\$ (2,475)	\$ 10,084	\$
Earnings per share:				
Basic.....	\$ 0.07	\$ (0.06)	\$ 0.25	\$
Diluted.....	\$ 0.07	\$ (0.06)	\$ 0.25	\$

	FISCAL YEAR ENDED SEPTEMBER 30, 2			
	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER	F QU
Revenues.....	\$427,030	\$418,557	\$423,988	\$4
Gross profit.....	\$ 74,541	\$ 76,749	\$ 81,755	\$
Net income.....	\$ 7,008	\$ 8,075	\$ 10,533	\$
Earnings per share:				
Basic.....	\$ 0.17	\$ 0.20	\$ 0.26	\$
Diluted.....	\$ 0.17	\$ 0.20	\$ 0.26	\$

The sum of the individual quarterly earnings per share amounts may not agree with year-to-date earnings per share as each period's computation is based on the weighted average number of shares outstanding during the period.

15. EVENT SUBSEQUENT TO DATE OF AUDITORS' REPORT (UNAUDITED):

During the first fiscal quarter of 2002, the Company implemented cost reduction procedures and terminated certain positions at the corporate office and field locations. The Company expects to incur approximately \$4.0 million to \$4.5 million in associated costs.

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PART IV

Item 14. Exhibits

23.1 Consent of Arthur Andersen LLP

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 on February 14th, 2002.

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INTEGRATED ELECTRICAL SERVICES, INC.

By: /s/ WILLIAM W. REYNOLDS

William W. Reynolds
Executive Vice President and
Chief Financial Officer

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INDEX TO EXHIBITS

23.1 Consent of Arthur Andersen LLP