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ENGLOBAL CORP  
Form 10-K  
March 16, 2009

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

Form 10-K

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

For the fiscal year ended December 31, 2008

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 No. 001-14217

ENGlobal Corporation

(Exact name of registrant as specified in its charter)

Nevada

88-0322261

(State or other jurisdiction of  
incorporation or organization)

(I.R.S Employer Identification No.)

654 North Sam Houston Parkway East, Suite 400

77060-5914

(Address of principal executive offices)

(Zip code)

Registrant's telephone number, including area code: (281) 878-1000

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

| Title of each class             | Name of each exchange on which registered |
|---------------------------------|---|
| Common Stock, \$0.001 par value | NASDAQ                                    |

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act

Yes [ ] No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act

Yes [ ] No

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.

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Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes  No

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The aggregate market value of the registrant's common stock held by non-affiliates of the registrant on June 30, 2008 was \$172,024,967 (based upon the closing price for shares of common stock as reported by the NASDAQ on that date).

The number of shares outstanding of the registrant's common stock on March 10, 2009 is as follows:

|                                |                   |
|--------------------------------|-------------------|
| \$0.001 Par Value Common Stock | 27,294,852 shares |
|--------------------------------|-------------------|

## DOCUMENTS INCORPORATED BY REFERENCE

Responses to Items 10, 11, 12, 13 and 14 of Part III of this report are incorporated herein by reference to certain information contained in the Company's definitive proxy statement for its 2009 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission on or before April 20, 2009.

ENGlobal Corporation  
2008 ANNUAL REPORT ON FORM 10-K  
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## PART I

### CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K ("Report"), including "Management's Discussion and Analysis of Financial Condition and Results of Operations," as well as oral statements made by the Company and its officers, directors or employees, contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such forward-looking statements are based on Management's beliefs, current expectations, estimates and projections about the industries that the Company and its subsidiaries serve, the economy and the Company in general. The words "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate" and similar expressions are intended to identify such forward-looking statements; however, this Report also contains other forward-looking statements in addition to historical information. Although we believe that the expectations reflected in the forward-looking statements are reasonable, such forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to differ materially from historical results or from any results expressed or implied by such forward-looking statements. The Company cautions readers that the following important factors and the risks described in the section of this report entitled "Risk Factors," among others, could cause the Company's actual results to differ materially from the forward-looking statements contained in this Report: (i) the effect of changes in the business cycle and downturns in local, regional and national economy and our ability to respond appropriately to the current worldwide economic financial situation; (ii) our ability to collect accounts receivable in a timely manner; (iii) our ability to accurately estimate costs and fees on fixed-price contracts; (iv) the effect of changes in laws and regulations with which the Company must comply, and the associated costs of compliance with such laws and regulations, either currently or in the future, as applicable; (v) the effect of changes in accounting policies and practices as may be adopted by regulatory agencies, as well as by the Financial Accounting Standards Board; (vi) the effect of changes in the Company's organization, compensation and benefit plans; (vii) the effect on the Company's competitive position within its market area in view of, among other things, the increasing consolidation within its services industries, including the increased competition from larger regional and out-of-state engineering and professional service organizations; (viii) the effect of increases and decreases in oil prices; (ix) the availability of parts from vendors; (x) our ability to increase or renew our line of credit; (xi) our ability to identify attractive acquisition candidates, consummate acquisitions on terms that are favorable to the Company and integrate the acquired businesses into our operations; (xii) our ability to hire and retain qualified personnel; (xiii) our ability to retain existing customers and get new customers; (xiv) our

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ability to mitigate losses; (xv) our ability to achieve our business strategy while effectively managing costs and expenses; (xvi) our ability to estimate exact project completion dates; (xvii) our ability to effectively monitor business done outside of the United States; and (xviii) the performance of the energy sector. The Company cautions that the foregoing list of important factors is not exclusive. We are under no duty and have no plans to update any of the forward-looking statements after the date of this Report to conform such statements to actual results.

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### ITEM 1. BUSINESS

#### Overview

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ENGlobal Corporation (which may be referred to as "ENGlobal," the "Company," "we," "us" or "our"), incorporated in the State of Nevada in June 1994, is a leading provider of engineering and professional services principally to the energy sector. ENGlobal's net revenue from continuous operations has grown from \$89.1 million in 2002 to \$493.6 million in 2008, a compounded annual growth rate of approximately 33%. We have accomplished this growth by expanding our engineering and professional service capabilities and our geographic presence through internal growth, including new initiatives, and to a lesser extent, through a series of strategic acquisitions.

We now have more than 2,300 full-time equivalent employees in 22 offices and 419,600 square feet of office and manufacturing fabrication space strategically located in the following cities: Houston, Beaumont, Clear Lake and Freeport, Texas; Baton Rouge and Lake Charles, Louisiana; Tulsa, Cleveland and Blackwell, Oklahoma; Broomfield, Colorado; Mobile, Alabama; and Calgary, Alberta, Canada.

#### The Engineering Segment

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The Engineering segment provides consulting services relating to the development, management and execution of projects requiring professional engineering and related project services. Services provided by the Engineering segment include feasibility studies, engineering, design, procurement and construction management. The Engineering segment provides these services to the upstream, midstream and downstream segments of the oil and gas industry, utilities, alternative energy developers, and branches of the U.S. military. In some instances, it delivers its services via in-plant personnel assigned throughout the United States and internationally.

#### The Construction Segment

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The Construction segment provides personnel and services primarily in the areas of inspection, and also in the areas of construction and construction management, mechanical integrity, vendor and turnaround surveillance, field support, quality assurance and plant asset management. Its customers include the pipeline, refining, utility, chemical, petrochemical, alternative energy, and power industries throughout the United States. Construction segment personnel are typically assigned to client facilities throughout the United States.

#### The Automation Segment

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The Automation segment provides services related to the design, fabrication, and implementation of process distributed control and analyzer systems, advanced

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automation, information technology, and heat tracing projects. The Automation segment's customers include members of the domestic and foreign energy related industries. Automation segment personnel assist in on-site commissioning, start-up and training for the Company's specialized systems.

### The Land Segment

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The Land segment provides land management, right-of-way, environmental compliance, and governmental regulatory compliance services, primarily to pipeline, utility and telecom companies and other owner/operators of infrastructure facilities throughout the United States and Canada. Land segment personnel are typically assigned to client facilities throughout the United States.

### Available Information

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We are currently subject to the information reporting requirements of the Securities Exchange Act and we file annual, quarterly and special reports and other information with the SEC. Our SEC filings are available to the public over the Internet at the SEC's web site at <http://www.sec.gov>. Our SEC filings are also available at our website at <http://www.englobal.com>. You may also read and copy any document we file at the SEC's public reference room at

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### ITEM 1. BUSINESS (Continued)

100 F. Street, N.E., Washington, D.C. 20002. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room.

### ENGlobal Website

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You can find financial and other information about ENGlobal at the Company's website at the URL address [www.englobal.com](http://www.englobal.com). Copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are provided free of charge through the Company's website and are available as soon as reasonably practicable after filing electronically or otherwise furnishing reports to the SEC. Information relating to corporate governance at ENGlobal, including: (i) our Code of Business Conduct and Ethics for all of our employees, including our Chief Executive Officer and Chief Financial Officer; (ii) our Code of Ethics for our Chief Executive Officer and Senior Financial Officers; (iii) information concerning our Directors and our Board Committees, including Committee charters, and (iv) information concerning transactions in ENGlobal securities by Directors and officers, is available on our website under the Investor Relations link. Our website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K. We will provide any of the foregoing information, for a reasonable fee, upon written request to Investor Relations, ENGlobal Corporation, 654 North Sam Houston Parkway East, Suite 400, Houston, Texas 77060-5914.

### Business Segments

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ENGlobal has four reporting segments: Engineering, Construction, Automation and Land. Our segments are strategic business units that offer different services and products and therefore require different marketing and management

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strategies. In addition to internal growth, our segments have grown through strategic acquisitions, which have also served to augment management expertise.

| Segments     | Percentage of Revenue |        |        |
|--------------|-----------------------|--------|--------|
|              | 2008                  | 2007   | 2006   |
| Engineering  | 51.0%                 | 61.0%  | 71.1%  |
| Construction | 28.3%                 | 20.2%  | 11.9%  |
| Automation   | 12.1%                 | 10.4%  | 11.5%  |
| Land         | 8.6%                  | 8.4%   | 5.5%   |
|              | 100.0%                | 100.0% | 100.0% |
|              | =====                 | =====  | =====  |

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### ITEM 1. BUSINESS (Continued)

#### Engineering Segment

-----

|                  | Selected Financial Data |           |           |
|------------------|-------------------------|-----------|-----------|
|                  | 2008                    | 2007      | 2006      |
|                  | (amounts in thousands)  |           |           |
| Revenue          | \$251,702               | \$221,787 | \$215,306 |
| Operating profit | \$ 31,786               | \$ 28,301 | \$ 6,195  |
| Total assets     | \$ 71,954               | \$ 63,265 | \$ 57,995 |

#### General

-----

The Engineering segment provides consulting services relating to the development, management and execution of projects requiring professional engineering and related project services. Our Engineering segment offers engineering consulting services primarily to clients in the petroleum refining, petrochemical, pipeline, production and alternative energy industries for the development and management of engineering projects throughout the United States.

The engineering staff has the capability of developing a project from the initial planning stages through detailed design and construction management. The engineering services include:

- o conceptual studies;
- o project definition;
- o cost estimating;
- o engineering design;
- o environmental compliance;
- o material procurement; and
- o project management.

The Engineering segment offers a wide range of services from a single source provider.

The Engineering segment currently operates through ENGlobal's wholly-owned subsidiary, ENGlobal Engineering, Inc. ("EEI"), and EEI's wholly-owned

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subsidiary, ENGlobal Technical Services, Inc. ("ETS"). EEI focuses primarily on providing its services to the upstream, midstream and downstream segments of the oil and gas industry, utilities and alternative energy developers. In some instances, it delivers its services via in-plant personnel assigned throughout the United States. ETS primarily provides automated fuel handling systems and services to branches of the U.S. military and public sector entities. The Engineering segment derives revenue primarily from cost-plus fees charged for professional and technical services. We also enter into contracts providing for the execution of projects on a fixed-price basis, whereby some or all of the project activities related to engineering, material procurement and construction (EPC) are performed for a fixed-price amount. As a service-based business, the Engineering segment is more labor than capital intensive. Our results primarily depend on our ability to generate revenue and collect cash under cost-plus contracts in excess of any cost for employees and benefits, material, equipment and subcontracts, plus our selling, general and administrative (SG&A) expenses.

Our domestic base of energy related clients, until late 2008, was generally less impacted by the downturn in the economy than most industries, with a high level of spending for both capital and maintenance projects. However, given dramatic decreases in prices for energy commodities, lower profit spreads for downstream operators and a more difficult financing environment, we expect all except possibly the largest of our clients to lower their spending plans for 2009. Currently the most active project areas are in the pipeline and alternative energy industries. Our clients' plans for larger capital projects in the refining and petrochemical industries have been most impacted by the economic downturn, with much of our work in this area now consisting of maintenance, small capital retrofit, and regulatory and compliance driven work. For the most part, clients are choosing to defer project activity into future years, as opposed to canceling projects outright.

As of December 31, 2008, the Engineering segment had more than 100 existing blanket service contracts under which it provides clients either with services on a time-and-materials basis or with services on a fixed-price basis. The

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### ITEM 1. BUSINESS (Continued)

Company strives to establish longer term alliance relationships with our clients that can be expected to provide a steadier stream of work. In addition, the Company has found that the outsourcing of its personnel to client facilities currently contributes to a stable business mix. Our Engineering segment operates out of offices in Baton Rouge and Lake Charles, Louisiana; Beaumont, Houston, and Freeport, Texas; Tulsa, Oklahoma; and Broomfield, Colorado. In the first quarter of 2007, our Dallas office was closed, the majority of its assets were sold, a major portion of the office lease obligations were assumed by others, and its operations were transferred to other Engineering offices.

#### Competition

-----

Our Engineering segment competes with a large number of public and private firms of various sizes, ranging from the industry's largest firms, which operate on a worldwide basis, to much smaller regional and local firms. Many of our competitors are larger than we are and have significantly greater financial and other resources available to them than we do. However, the largest firms in our industry are sometimes our clients, as they perform as program managers for very large scale projects and then subcontract a portion of their work to ENGlobal.

Competition is primarily centered on performance and the ability to provide the engineering, planning and project execution skills required for completing



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projects in a timely and cost-efficient manner. The technical expertise of our management team and technical personnel and the timeliness and quality of our support services are key competitive factors. Larger projects, especially international work, typically include pricing alternatives designed to shift risk to the service provider, or at least to cause the service provider to share a portion of the risks associated with cost overruns in service delivery. These alternatives include fixed-price, guaranteed maximum price, not-to-exceed, incentive fee, competitive bidding and other "value based" pricing arrangements.

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### ITEM 1. BUSINESS (Continued)

#### Construction Segment

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|                  | Selected Financial Data |           |           |
|------------------|-------------------------|-----------|-----------|
|                  | 2008                    | 2007      | 2006      |
|                  | -----                   |           |           |
|                  | (amounts in thousands)  |           |           |
|                  | -----                   |           |           |
| Revenue          | \$139,360               | \$ 73,210 | \$ 36,128 |
| Operating profit | \$ 7,459                | \$ 7,133  | \$ 1,579  |
| Total assets     | \$ 23,581               | \$ 17,226 | \$ 11,287 |

#### General

-----

Our Construction segment focuses on energy infrastructure projects in the United States by offering personnel and services primarily in the area of inspection but also in the areas of construction and construction management, mechanical integrity, vendor and turnaround management, field support, quality assurance and plant asset management. Our Construction segment's clients include operators and developers of pipeline, refining, utility, chemical, petrochemical, alternative energy and power facilities throughout the United States. The Construction segment operates through our wholly-owned subsidiary ENGlobal Construction Resources, Inc. ("ECR"). The Construction segment primarily derives revenue from cost-plus fees charged for professional and technical services. As a service business, the construction segment is more labor than capital intensive. We also enter into contracts providing for the execution of projects on a fixed-price basis, whereby some, or all, of the project activities related to EPC are performed for a fixed-price amount. Accordingly, our results primarily depend on our ability to generate revenue and collect cash under cost-plus or fixed price contracts in excess of any cost for employees and benefits, material, equipment and subcontracts, plus our SG&A expenses.

Our Construction segment operates out of offices in Baton Rouge and Lake

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Charles, Louisiana; Beaumont, Clear Lake and Freeport, Texas; and Cleveland, Blackwell and Tulsa, Oklahoma.

### Competition

Our Construction segment competes with a range of mostly private small and midsize inspection and construction management and alternative energy service companies. The principal elements of competition among these types of companies are rates, terms of service and flexibility and reliability of services. The inspection and construction management business is affected by industry pressure on costs, fueled by intense competition for contracts. Our Construction segment believes that its recent alliances with technology providers, especially in the area of alternative energy, may enhance its competitive position in the construction management business.

Competition is primarily centered on performance and the ability to provide the services in a timely and cost-efficient manner. The technical expertise of our personnel is a key competitive factor. Inspection specialists must have a thorough understanding of governmental and public regulatory factors. The Company strives to establish longer term alliance relationships with our clients that can be expected to provide a steadier stream of work. In addition, the Company has found that the inspection of pipelines and client facilities has also provided for a stable business mix.

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## ITEM 1. BUSINESS (Continued)

### Automation Segment

|                         | Selected Financial Data |           |           |
|-------------------------|-------------------------|-----------|-----------|
|                         | 2008                    | 2007      | 2006      |
|                         | -----                   |           |           |
|                         | (amounts in thousands)  |           |           |
|                         | -----                   |           |           |
| Revenue                 | \$ 59,730               | \$ 37,766 | \$ 34,888 |
| Operating profit (loss) | \$ 3,744                | \$ (58)   | \$ 579    |
| Total assets            | \$ 36,553               | \$ 17,468 | \$ 18,841 |

### General

-----

The Automation segment provides services related to the design, fabrication, and implementation of process distributed control and analyzer systems, advanced automation, information technology projects and process piping heat tracing. This segment also designs, assembles, integrates and services control and instrumentation systems for specific applications in the energy and processing related industries. These services are offered to clients in the petroleum refining, petrochemical, pipeline, production, process and pulp and paper industries throughout the United States and Canada as well as the Middle East and the Caribbean. The Automation segment currently operates through ENGlobal Systems, Inc. ("ESI") and ENGlobal Automation Group, Inc. ("EAG"), both wholly-owned subsidiaries of ENGlobal, and EAG's wholly owned subsidiary, ENGlobal Canada ULC ("ECAN"). EAG and ECAN focus primarily on providing automation related design and engineering services, while ESI primarily provides fabrication, testing and integration services of automation related enclosures. The Automation segment derives revenue from both cost-plus fees and fees charged for professional and technical services on a fixed-price basis, whereby some or

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all of the project activities related to engineering, material procurement and fabrication are performed for a lump sum amount. The lump sum contracts performed by ESI tend to be smaller than those performed in our Engineering segment. Out of the number of our total fixed price projects, 60% have less than \$100,000 contract value, 32% have between \$100,000 and \$1,000,000 contract value and 8% have greater than \$1,000,000 contract value. As a service provider, our Automation segment is more labor than capital intensive. Our results primarily depend on our ability to generate revenue and collect cash under cost-plus contracts in excess of any cost for employees and benefits, material, equipment and subcontracts, plus our SG&A expenses.

Our Automation segment operates out of offices in Baton Rouge, Louisiana; Beaumont and Houston, Texas; Mobile, Alabama; and Calgary, Alberta.

In September 2008, EAG purchased Advanced Control Engineering, LLC ("ACE"), a Mobile, Alabama based engineering firm. ACE provides control system and related technical services to a variety of industries and its geographic location expands the Automation segment's service territory.

In January 2006, ESI acquired certain assets of Analyzer Technology International, Inc. ("ATI"), a Houston-based analyzer systems provider of online process analyzer systems, and ATI has relocated its operation to ESI's Houston facility. The addition of ATI has provided ESI with a greater presence in the process analyzer sector, especially for opportunities involving larger foreign downstream projects.

### Competition

Our Automation segment competes with a large number of public and private firms of various sizes, ranging from the industry's largest firms, which operate on a worldwide basis, to much smaller regional and local firms. Many of our competitors are larger than we are and have significantly greater financial and other resources available to them than we do.

Competition is primarily centered on performance and the ability to provide the engineering, assembly and integration required to complete projects in a timely and cost-efficient manner. The technical expertise of our management team and technical personnel and the timeliness and quality of our support services, are key competitive factors.

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## ITEM 1. BUSINESS (Continued)

### Land Segment

|                  | Selected Financial Data |           |           |
|------------------|-------------------------|-----------|-----------|
|                  | 2008                    | 2007      | 2006      |
|                  | -----                   |           |           |
|                  | (amounts in thousands)  |           |           |
|                  | -----                   |           |           |
| Revenue          | \$ 42,540               | \$ 30,464 | \$ 16,768 |
| Operating profit | \$ 4,114                | 2,105     | 716       |
| Total assets     | \$ 13,482               | \$ 15,096 | \$ 11,540 |

### General

Our Land segment provides land management, right-of-way, environmental

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compliance and governmental regulatory compliance services primarily to pipeline, utility and other owner/operators of infrastructure facilities throughout the United States and Canada. The need to transport new sources of energy is the primary driver that results in demand for our rights-of-way services (pipelines, electric power transmission lines and telecommunication cables). As examples, rights-of-way are required for pipelines that transport oil & gas from imported sources, and from newly developed basins in the U.S. Rights-of-way are also required for new electric power transmission lines, needed to decongest circuits near population centers, and to transport a growing amount of wind and solar power that is located in remote areas.

The Land segment operates through the Company's wholly-owned subsidiary, ENGlobal Land, Inc. ("ELI"), formerly known as WRC Corporation, and its wholly-owned subsidiary WRC Canada ("WRC Canada"). ELI provides land management, environmental compliance, and governmental regulatory services to pipeline, utility and telecom companies and other owner/operators of infrastructure facilities. WRC Canada provides land management and inspection services. The Land segment derives revenue from cost-plus fees charged for professional and technical services. As a service company, ELI is more labor than capital intensive. Our results primarily depend on our ability to generate revenue and collect cash under cost-plus contracts in excess of any cost for employees and benefits, material, equipment and subcontracts, plus our SG&A expenses.

Our Land segment operates out of offices in Houston, Texas, Broomfield, Colorado, and Calgary, Alberta, as well as other satellite offices across the United States.

### Competition

-----

The Land segment competes with a range of small and midsize firms that provide right-of-way mapping, title assistance, appraisals and landowner negotiations.

Competition is primarily centered on retaining experienced landmen and other qualified professionals. Land and right-of-way specialists must have a thorough understanding of governmental and public regulatory requirements. These professionals must consider socioeconomic and environmental factors and coordinate planning for the relocation of utilities, displaced persons and businesses. Also, they must often assist in developing replacement housing units, which may involve the expenditure of large sums, condemnation, damages, restriction of access, and similar complicating factors. Retaining these qualified, skilled professionals is crucial to the operation of our Land segment.

### Acquisitions and Sales

-----

We have grown our business over the past several years through both internal initiatives and through strategic mergers and acquisitions. These mergers and acquisitions have allowed us to (i) expand our client base and the range of services that we provide to our clients; (ii) add new technical capabilities that can be marketed to our existing client base, (iii) grow our business geographically, and (iv) capture more of each project's value. We expect to continue evaluating and assessing acquisition opportunities that will either complement our existing business base or that will provide ENGlobal with additional capabilities or geographical coverage. Given current market conditions, we believe that strategic acquisitions will enable us to more efficiently serve the technical needs of national and international clients and strengthen our financial performance. However, it is unclear how our acquisition

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### ITEM 1. BUSINESS (Continued)

strategy will be impacted by the world economic situation and we may focus less on acquisitions in 2009 than we have in prior years. The following table lists the businesses we have acquired during the four-year period ended December 31, 2008.

| Name/Location/Business Unit<br>-----  | Date Acquired<br>----- | Primary Services<br>-----   |
|---|------------------------|---|
| Analyzer Technology International, Inc.<br>Houston, TX<br>Operates as a part of ESI | January 2006           | Process Analyzer Systems  |
| WRC Corporation and<br>WRC Canada<br>Denver, CO<br>Operates as ELI, formerly WRC    | May 2006               | Integrated Land Management  |
| PEI Investments<br>Beaumont, TX   | May 2006               | Real Estate   |
| Watco Management, Inc.<br>Clearlake, TX<br>Operates as a Division of ECR            | October 2006           | Turnaround Planning<br>Asset Management<br>Project Commissioning<br>Construction Management |
| EMC Design & Consulting, Inc.<br>Houston, TX<br>Operates as a Division of EEI       | September 2008         | Product Terminals<br>Engineering and Design   |
| Advanced Control Engineering, LLC<br>Mobile, AL<br>Operates as a Division of EAG    | September 2008         | Control Systems Engineering<br>and Design   |

ENGlobal Corporation transitions acquisitions under the ENGlobal brand name as soon as feasible, given the size and scope of the acquisition, but typically within two years. This strengthens ENGlobal's market position as a diversified supplier of engineering and related services and focuses on the quality of the ENGlobal name. Smaller acquisitions are almost immediately identified as a division of an existing segment.

#### Business Strategy -----

Our objective is to strengthen the Company's position as a leading full-service provider of services to the energy industry by enhancing our overall range of capabilities in the areas of engineering, construction, automation, and land management services. To achieve this objective, we have developed a strategy comprised of the following key elements:

- o Maintain High-Quality Service. To maintain high-quality service, we focus on being responsive to our customers, working diligently and responsibly, and maintaining safety standards, schedules and budgets. ENGlobal has a quality control and assurance program to maintain standards and procedures for performance and documentation. To enhance these efforts, we have added an officer level position responsible for

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project auditing and monitoring compliance with these internal project procedures and quality standards.

- o Improve Utilization of Resources. We have developed a work-sharing program that gives our staff and our clients' access to technical resources located in any of our offices and allows for higher

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### ITEM 1. BUSINESS (Continued)

utilization of human and computer resources. We believe the work-sharing program helps to reduce employee turnover and provides for a more stable work environment. We believe our ongoing program to standardize all of our processes and procedures among our offices will enhance our work-sharing ability and provide our clients with more consistent and higher quality services.

- o Enhance and Strengthen Our Ability to Perform Engineering, Procurement and Construction Projects. We rely heavily on repeat business and referrals from existing customers, industry members, and other business representatives. One of our Company's goals is to increase revenue by developing and marketing its ability to perform full service projects, also called EPC (Engineering, Procurement and Construction Management), while pursuing a cost-plus contracting strategy. By applying the wide range of capabilities offered by our four operating segments to any given project, we are able to capture a greater percentage of the project's total installed cost.
- o Recruit and Retain Qualified Personnel. We believe recruiting and retaining qualified, skilled professionals is crucial to our success and growth. As a result, we have a dedicated recruiting staff focused on recruiting qualified personnel with experience in the energy industry. Competitive employee benefits, together with various incentive programs, have helped us to retain valued employees.
- o Expand and Enhance Technical Capabilities. We believe that it is important to develop and enhance our overall technical capabilities in the markets we serve. To achieve this objective in the area of advanced computer-aided process simulation, design and drafting, we utilize technical software from numerous suppliers. By being vendor neutral, ENGlobal is able to provide high-quality technology and platforms for the design of plant systems such as 3D modeling, process simulation and other technical applications. We find it beneficial to match the design tools we use with those being utilized by our clients, many of whom are currently utilizing these design platforms.
- o Growth Through Acquisitions. In the past, we followed a balanced growth strategy for our business, utilizing both external acquisitions as well as internal measures. Given economic uncertainty that is likely to affect our business as well as the business of potential acquisition targets, ENGlobal believes that an internal focus may be its primary mode of growth in the near term and we have already announced several new measures to enhance internal growth and profitability. The internal measures will continue to include an active business development program covering all of our business segments. Our external growth, if any, will likely come from relatively small acquisitions and mergers that allow us to (i) offer expanded engineering and professional services to a broad energy complex, (ii) add new technical capabilities that can be marketed to

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our existing client base, (iii) grow our business geographically, and (iv) capture more of a project's value.

- o Building our Brand. We intend to continue to present a more unified identification for the Company by building a cohesive brand and increasing ENGlobal's name recognition. We have redesigned our website to highlight our four businesses: Engineering, Construction, Automation and Land. Effective January 1, 2008, we decided to focus on the ENGlobal name for purposes of branding all of our businesses. Our new image presents ENGlobal as one company, wherein our four business segments can work together as a team to offer their many capabilities seamlessly, with one consistent message and a continued focus on better serving our clients.

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### ITEM 1. BUSINESS (Continued)

#### Sales and Marketing

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ENGlobal derives revenue primarily from three sources: (1) in-house direct sales, (2) alliance agreements with strategic clients, and (3) referrals from existing customers and industry members. We currently employ 29 full-time professional in-house marketers in our business development department. Our Senior Vice President of Business Development supervises our in-house sales managers who are assigned to industry segments, clients and territories within the United States. Management believes that this method of selling should result in increased account penetration and enhanced customer service, which should, in turn, create and maintain the foundation for long-term customer relationships. In addition, relationships can be nurtured by our geographic advantage of having office locations near our larger clients. By having clients in close proximity, we are able to provide single, dedicated points of contact. Our growth depends not only on the world economic situation but also, in large measure, on our ability to attract and retain qualified business development managers and business development personnel with a respected reputation in the energy industry. Management believes that in-house marketing allows for more accountability and control, thus increasing profitability.

Products and services are also promoted through trade advertising, participation in industry conferences and on-line Internet communication via our corporate home page at [www.englobal.com](http://www.englobal.com). The ENGlobal site provides information about our four operating segments and illustrates our Company's full range of services and capabilities. We use internal and external resources to maintain and update our website on an ongoing basis. Through the ENGlobal website, we seek to provide visitors with a single point of contact for obtaining information on ENGlobal's services.

Our business development department focuses on building long-term relationships with customers and providing our customers and potential clients with solutions throughout the life-cycle of their facilities. Additionally, we seek to capitalize on cross-selling opportunities among our various businesses - Engineering, Construction, Automation, and Land. Sales leads are often jointly developed and pursued by the sales personnel from these various businesses.

ENGlobal develops alliance agreements with clients in order to facilitate repeat business. The Company currently has 24 alliances with 20 customers. These alliance agreements, also known as master services agreements or umbrella agreements, are typically two to three years in length. Although the agreement is not a guarantee for work under a certain project, ENGlobal generally offers a slightly reduced billing structure to clients willing to commit to arrangements

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that are expected to provide a steady stream of work. With the terms of the contract settled, add-on projects with alliance customers are easier to negotiate. Management believes that alliance agreements can serve to stabilize project centered operations such as the engineering and construction industry. In 2008, services provided under ENGlobal's alliance agreements accounted for 27% of the Company's revenue.

Much of our business is repeat business and we are introduced to new customers in many cases by referrals from existing customers and industry members. Management believes referrals provide the opportunity for increased profitability because referrals do not involve direct selling, but instead, allow satisfied customers to sell our services and products on our behalf. ENGlobal strives to develop our clients' trust, and then benefits by word-of-mouth referrals.

Our past acquisition program has provided the benefit of expanding our existing customer base. Management believes that cross-selling among our businesses is an effective way to build client loyalty by solidifying the client relationship thereby reducing attrition and increasing the lifetime profitability of each client. The Company also believes that cross-selling can help to ensure a greater predictability of revenue and can be a cost effective way to grow.

### Customers

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Our customer base consists primarily of Fortune 500 companies in the energy industry. While we do not have continuing dependence on any single client or a limited group of clients, one or a few clients may contribute a substantial portion of our revenue in any given year or over a period of several consecutive years due to major projects. ENGlobal may work for many different subsidiaries or divisions of our clients, which involves multiple parties to material contracts. The loss of a single contract award would not likely have a material

### ITEM 1. BUSINESS (Continued)

impact on our financial statements. In 2009, the Company will continue to focus substantial attention on improving customer services in order to enhance satisfaction and increase customer retention.

In 2008, almost 75% of our revenue was generated through sources such as in-plant staffing and alliance relationships that we consider longer-term in nature and that are not typically limited to one project. For example, our Engineering segment provides outsourced technical and other personnel that are assigned to work at client locations. In the past, these assignments often span multiple projects and multiple years, and although these engagements involve a lower margin, they help to contribute to a steady stream of work.

A major long-term trend among our clients and their industry counterparts has been toward outsourcing of engineering services, and more recently, sole-sourcing. This trend has fostered the development of ongoing, longer-term alliance arrangements with clients, rather than one-time limited engagements. These arrangements vary in scope, duration and degree of commitment. While there is typically no guarantee of work that will result from these alliance agreements, often they form the basis for a longer-term relationship with our clients. Despite their variety, we believe that these partnering relationships have a stabilizing influence on our revenue. At December 31, 2008, we maintained some form of partnering or alliance arrangement with 20 major oil and chemical companies. Alliance engagements may provide for:



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- o a minimum number of work man-hours over a specified period;
- o the provision of at least a designated percentage of the client's requirements;
- o the designation of the Company as the client's sole or preferred source of engineering at specific locations; or
- o a non-binding preference or intent, or a general contractual framework, for what the parties expect will be an ongoing relationship.

Overall, our ten largest customers, who vary from one period to the next, accounted for 62% of our total revenue for 2008, 57% of total revenue for 2007, and 62% of total revenue for 2006. Most of our projects are specific in nature and we generally have multiple projects with the same clients. If we were to lose one or more of our significant clients and were unable to replace them with other customers or other projects, our business would be materially adversely affected. Our top three clients in 2008 were Spectra Energy, Alon USA and Gulf South Pipeline Company. Even though we frequently receive work from repeat clients, our client list may vary significantly from year to year. Our potential revenue in all segments is dependent on continuing relationships with our customers.

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### ITEM 1. BUSINESS (Continued)

#### Engineering Segment:

In the Engineering segment, our ten largest customers vary from one period to the next. These customers accounted for 77% of our total revenue for 2008, 74% of total revenue for 2007, and 83% of total revenue for 2006. Our top three clients in 2008 were Alon USA, Motiva and ConocoPhillips.

Though the Engineering segment frequently receives work from repeat clients, its client list may vary significantly from year to year. In order to generate revenue in future years, we must continue efforts to obtain new engineering projects. The majority of the revenue for the Engineering segment is generated through sources such as in-plant staffing and alliance relationships that we consider longer-term in nature and that are not typically limited to one project.

#### Construction Segment:

In the Construction segment, our ten largest customers vary from one period to the next. Our ten largest customers accounted for 91% of our total revenue for 2008, 82% of total revenue for 2007, and 75% of total revenue for 2006. Our top three clients in 2008 were Gulf South Pipeline Company, Spectra Energy and Magellan Midstream Partners, LP.

The revenue for the Construction segment is generated through sources such as providing inspection and construction related personnel at field locations. While we have ongoing business relationships with many of our clients in the Construction segment, this business tends to be more cyclical than our Engineering segment, as it is more project-driven and dependent on field construction activity.

#### Automation Segment:

In the Automation segment, our ten largest customers, who also vary from one period to the next, accounted for 66% of our total revenue for 2008, 73% of

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total revenue for 2007 and 62% of total revenue for 2006. Our top three clients in 2008 were ExxonMobil, E.I. Dupont and Yanbu National Petrochemical. Total foreign customers accounted for 14% of our Automation segment revenue for 2008 and 22% for both 2007 and 2006. During 2008, 4% of our revenue came from our Canadian operations compared to 3% in 2007 and 1% in 2006.

Though the Automation segment frequently receives work from repeat clients, its client list may vary significantly from year to year. The Automation Segment's clients are primarily in the downstream process industries, and driven by requirements to upgrade obsolete distributed control systems or process analytical equipment.

### Land Segment:

In the Land segment, our ten largest customers vary from one period to the next. These customers accounted for 72% of our total revenue for 2008, 70% of total revenue for 2007 and 83% of total revenue for 2006. Our top three clients in 2008 were Spectra Energy, TransCanada and El Paso Corporation. The Land segment's clients currently consist primarily of pipeline operators or electric utilities, with both types of clients having needs to acquire rights-of-way for pipelines or electric transmission.

Though the Land segment frequently receives work from repeat clients, its client list may vary significantly from year to year with outsourced right-of-way and other personnel assigned to work at project sites across the United States and Canada. Factors affecting our Land business that are beyond our control include regulatory requirements, title assistance, landowner negotiations and eminent domain-condemnation.

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### ITEM 1. BUSINESS (Continued)

#### Contracts

We generally enter into two principal types of contracts with our clients: time-and-materials contracts and fixed-price contracts. Our mix of net revenue between time-and-materials and fixed-price is shown in the table below. Our clients typically determine the type of contract to be utilized for a particular engagement, with the specific terms and conditions of a contract resulting from a negotiation process between the Company and our client.

|                        | Time-and-material | %    | Fixed-price | %   |
|------------------------|-------------------|------|-------------|-----|
| -----                  |                   |      |             |     |
| (revenue in thousands) |                   |      |             |     |
| -----                  |                   |      |             |     |
| Engineering            | \$248,764         |      | \$ 2,938    |     |
| Construction           | 139,352           |      | 8           |     |
| Automation             | 33,308            |      | 26,422      |     |
| Land                   | 42,521            |      | 19          |     |
| Total company          | \$463,945         | 94.0 | \$ 9,387    | 6.0 |

- o Time-and-Materials. Under our time-and-materials contracts, we are paid for labor at either negotiated hourly billing rates or we are reimbursed for allowable hourly rates and for other expenses. We are paid for material and contracted services at an agreed upon multiplier of our cost, and at times we pass non-labor costs for equipment, materials and sub-contractor services through with no profit. Profitability on these contracts is driven by billable headcount, the

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amount of non-labor related services and cost control. Some of these contracts may have upper limits, referred to as "not-to-exceed." If our scope is not defined under a "not-to-exceed" agreement we are not under any obligation to provide services beyond the limits of the contract, but if we generate costs and billings that exceed the contract ceiling or are not allowable, we will not be able to obtain reimbursement for any excess cost. Further, the continuation of each contract partially depends upon the customer's discretionary periodic assessment of our performance on that contract.

- o Fixed-Price. Under a fixed-price contract, sometimes referred to as "guaranteed maximum," we provide the customer a total project for an agreed-upon price, subject to project circumstances and changes in scope. Fixed-price projects vary in scope, including some engineering activities and related services, and responsibility for procurement of material and construction. Fixed-price contracts carry certain inherent risks, including risks of losses from underestimating costs, delays in project completion, problems with new technologies, the economy, as it may relate to demand, labor shortages, and inflation of equipment and materials costs, natural disasters, and other changes that may occur over the contract period. Another risk includes our ability to secure written change orders prior to commencing work on such orders, without which we may not receive payment for work performed. Consequently, the profitability of fixed-price contracts may vary substantially. We plan to limit the size and scope of EPC fixed-price contracts that we enter into in the future due to significant losses on two fixed-price contracts during 2006.

### Backlog

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Backlog represents gross revenue of all awarded contracts that have not been completed and will be recognized as revenue over the life of the project. Although backlog reflects business that we consider to be firm, cancellations or scope adjustments may occur. Further, most contracts with clients may be terminated at will, in which case the client would only be obligated to us for services provided through the termination date. We have adjusted backlog to reflect project cancellations, deferrals and revisions in scope and cost (both upward and downward) known at the reporting date; however, future contract modifications or cancellations may increase or reduce backlog and future revenue. As a result, no assurances can be given that the amounts included in backlog will ultimately be realized. In addition, it is not clear how our backlog will be impacted by the current economy.

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### ITEM 1. BUSINESS (Continued)

At December 31, 2008, our backlog was \$325.7 million compared to an estimated \$289.2 million at December 31, 2007. We expect a majority of the \$325.7 million in backlog to be completed during 2009.

The backlog at December 31, 2008 consists of \$314.9 million with commercial customers and \$10.8 million with the United States government. Backlog on federal programs includes only the portion of the contract award that has been funded. The backlog for each of our segments at December 31, 2008 was as follows:

|                      |          |         |
|----------------------|----------|---------|
| Engineering segment  | \$ 113.5 | million |
| Construction segment | 128.9    | million |
| Automation segment   | 43.2     | million |

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Land segment

40.1 million

Backlog includes gross revenue under two types of contracts: (1) contracts for which work authorizations have been received on a fixed-price basis or time-and-material projects that are well defined, and (2) time-and-material evergreen contracts at an assumed 12 month run-rate, under which we place employees at our clients' site to perform day-to-day project efforts. There is no assurance as to the percentage of backlog that will be recognized.

### Customer Service and Support

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We provide service and technical support to our customers in varying degrees depending upon the business line and on customer contractual arrangements. The Company's technical staff provides initial telephone support services for its customers. These services include isolating and verifying reported failures and authorizing repair services in support of customer requirements. We also provide on-site engineering support if a technical issue cannot be resolved over the telephone. On projects for which we have provided engineering systems, we provide on-site factory acceptance tests and worldwide start-up and commissioning services. We also provide the manufacturers' limited warranty coverage for products we re-sell.

### Dependence Upon Suppliers

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Our ability to provide clients with services and systems in a timely and competitive manner depends on the availability of products and parts from our suppliers at competitive prices and on reasonable terms. Our suppliers are not obligated to have products on hand for timely delivery nor can they guarantee product availability in sufficient quantities to meet our demands. There can be no assurance that we will be able to obtain necessary supplies at prices or on terms we find acceptable. However, in an effort to maximize availability and maintain quality control, we generally procure components from multiple distributors.

For example, all of the product components used by our Automation segment are fabricated using components and materials that are available from numerous domestic manufacturers and suppliers. There are approximately five principal suppliers of distributed control systems, each of which can be replaced by an equally viable competitor, and our clients typically direct the selection of their preferred supplier. No one manufacturer or vendor provides products that account for more than 2% of our revenue. Thus, we anticipate little or no difficulty in obtaining components in sufficient quantities and in a timely manner to support our manufacturing and assembly operations. Units produced through the Automation segment are normally not produced for inventory and component parts; rather, they are typically purchased on an as-needed basis. By being relatively vendor neutral, ENGlobal is able to provide quality technology and platforms for the design of plant systems such as 3D modeling, process simulation and other technical applications.

Despite the foregoing, some of our subsidiaries rely on certain suppliers for necessary components and there can be no assurance that these components will continue to be available on acceptable terms. If a subsidiary or one of its suppliers terminates a long-standing supply relationship, it may be difficult to obtain alternative sources of supply without a material disruption in our ability to provide products and services to our customers. While we do not believe that such a disruption is likely, if it did occur, it could have a material adverse effect on our financial condition and results of operations.

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### ITEM 1. BUSINESS (Continued)

#### Patents, Trademarks, Licenses

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Our success depends in part upon our ability to protect our proprietary technology, which we do primarily through protection of our trade secrets and confidentiality agreements. The U.S. Patent and Trademark Office registered our trademark application for the use of "ENGlobal"(R) with our products in September 2004 and the Company claims common law trademark rights for "ENGlobal"™ in connection with our services. The U.S. Patent and Trademark Office registered our "Integrated Rack"™ application in 2008. We have pending trademark applications for "Engineered for Growth"™. ENGlobal claims common law trademark rights for "Global Thinking...Global Solutions"™, "CARES - Communicating Appropriate Responses in Emergency Situations"™, "Flare-Mon"™, "Purchased Data"™ and "viMAC."™

There can be no assurance that the protective measures we currently employ will be adequate to prevent the unauthorized use or disclosure of our technology, or the independent third party development of the same or similar technology. Although our competitive position to some extent depends on our ability to protect our proprietary and trade secret information, we believe that other factors, such as the technical expertise and knowledge base of our management and technical personnel, as well as the timeliness and quality of the support services we provide, will also help us to maintain our competitive position.

#### Government Regulations

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ENGlobal and certain of our subsidiaries are subject to various foreign, federal, state, and local laws and regulations relating to our business and operations, and various health and safety regulations as established by the Occupational Safety and Health Administration. The Company and our professional staff are subject to a variety of state, local and foreign licensing, registration and other regulatory requirements governing the practice of engineering and other professional disciplines. Currently, we are not aware of any situation or condition relating to the regulation of the Company, its subsidiaries, or personnel that we believe is likely to have a material adverse effect on our results of operations or financial condition.

#### Employees

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As of December 31, 2008, the Company and its subsidiaries employed 2,302 individuals. Of these employees, 1,247 were employed in engineering and related positions; 430 were employed as inspectors; 295 were employed as project support staff; 218 were employed in technical production positions; 83 were employed in administration, finance and management information systems and 29 were employed in sales and marketing. We believe that our ability to recruit and retain highly skilled and experienced technical, sales and management personnel has been and will continue to be critical to our ability to execute our business plan. None of our employees is represented by a labor union or is subject to a collective bargaining agreement. We believe that relations with our employees are good.

#### Benefit Plans

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ENGlobal sponsors a 401(k) profit sharing plan for its employees. The Company makes mandatory matching contributions equal to 66.66% of employee contributions up to 6% of employee compensation for regular (as distinguished from project or contract) employees. All other employees except our pipeline inspectors are

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matched at 50% of employee contribution up to 6% of compensation, as defined by the plan. The Company, at the direction of the Board of Directors, may make other discretionary contributions. Our employees may elect to make contributions pursuant to a salary reduction agreement upon meeting age and length-of-service requirements. The Company made contributions of approximately \$3,049,000, \$2,147,000, and \$1,310,000, respectively, for the years ended December 31, 2008, 2007, and 2006. On January 1, 2009, due to the current economic conditions, the Company elected to reduce its match on regular employees to 50% and all other employees except our pipeline inspectors, to 33.33% of employee contributions up to 6% of employee compensation.

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### ITEM 1. BUSINESS (Continued)

#### Geographic Areas

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In 2005, the Company formed ENGlobal Canada ULC, located in Calgary, Alberta to expand our Automation segment into Canada. In 2006, we acquired WRC Corporation and its subsidiary, WRC Canada, to expand our Land segment into Canada. While this gives us opportunities for expansion, our Canadian operations are small in comparison to the Company as a whole and have declined in size since their inception.

|                             | 2008                   | 2007      | 2006      |
|-----------------------------|------------------------|-----------|-----------|
|                             | -----                  | -----     | -----     |
|                             | (dollars in thousands) |           |           |
|                             | -----                  | -----     | -----     |
| US operations revenue       | \$490,584              | \$360,309 | \$299,333 |
| Canadian operations revenue | 2,748                  | 2,918     | 3,757     |
|                             | -----                  | -----     | -----     |
| Total revenue               | \$493,332              | \$363,227 | \$303,090 |

Long-lived assets consist of property, plant and equipment, net of depreciation ("PPE").

|                         | 2008                   | 2007    | 2006    |
|-------------------------|------------------------|---------|---------|
|                         | -----                  | -----   | -----   |
|                         | (dollars in thousands) |         |         |
|                         | -----                  | -----   | -----   |
| US operations PPE       | \$5,703                | \$6,378 | \$8,642 |
| Canadian operations PPE | 41                     | 94      | 83      |
|                         | -----                  | -----   | -----   |
| Total PPE               | \$5,744                | \$6,472 | \$8,725 |

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### ITEM 1A. RISK FACTORS

Set forth below and elsewhere in this Report and in other documents that we file with the SEC are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking

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statements contained in this Report. You should be aware that the occurrence of any of the events described in these risk factors and elsewhere in this Report could have a material adverse effect on our business, financial condition and results of operations and that upon the occurrence of any of these events, the trading price of our common stock could decline.

Our future revenue depends on our ability to consistently bid and win new contracts and to maintain and renew existing contracts. Our failure to effectively obtain future contracts could adversely affect our profitability.

Our future revenue and overall results of operations require us to successfully bid on new contracts and renew existing contracts. Contract proposals and negotiations are complex and frequently involve a lengthy bidding and selection process, which is affected by a number of factors, such as market conditions, financing arrangements and required governmental approvals. For example, a client may require us to provide a bond or letter of credit to protect the client should we fail to perform under the terms of the contract. If negative market conditions arise, or if we fail to secure adequate financial arrangements or the required governmental approval, we may not be able to pursue particular projects, which could adversely affect our profitability.

Economic downturns could have a negative impact on our businesses.

Demand for the services offered by us has been and is expected to continue to be, subject to significant fluctuations due to a variety of factors beyond our control, including demand for engineering services in the petroleum refining, petroleum chemical and pipeline industries and in other industries that we provide services to. During economic downturns in these industries, our customers' need to engage us may decline significantly and projects may be delayed or cancelled. We cannot predict how long the current economic downturn will last or the price of oil will be relatively low. However, these factors can cause our profitability to decline significantly.

We are engaged in highly competitive businesses and must typically bid against competitors to obtain engineering and service contracts.

We are engaged in highly competitive businesses in which customer contracts are typically awarded through competitive bidding processes. We compete with other general and specialty contractors, both foreign and domestic, including large international contractors and small local contractors. Some competitors have greater financial and other resources than we do, which, in some instances, gives them a competitive advantage over us.

The failure to attract and retain key professional personnel could adversely affect the Company.

Our success depends on attracting and retaining qualified personnel in a competitive environment. We are dependent upon our ability to attract and retain highly qualified managerial, technical and business development personnel. Competition for key personnel is intense. We cannot be certain that we will retain our key managerial, technical and business development personnel or that we will attract or assimilate key personnel in the future. Failure to attract and retain such personnel would materially adversely affect our businesses, financial position, results of operations and cash flows. This is a major risk factor that could materially impact our operating results.

If we are not able to successfully manage our growth strategy, our business and results of operations may be adversely affected.

We have grown rapidly over the last several years. Our growth presents numerous managerial, administrative, operational and other challenges. Our ability to manage the growth of our operations will require us to continue to improve our

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management information systems and maintain discipline in our internal systems and controls. Industry trends and our ability to manage and measure project performance will require us to strengthen our internal project and cost control systems within operations that have traditionally operated in a cost-plus environment. In addition, our growth will increase our need to attract, develop, motivate and retain both our management and professional employees. The inability of our management to effectively manage our growth or the inability of our employees to achieve anticipated performance could have a material adverse effect on our business.

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

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Our business depends on our ability to successfully obtain payment from our clients of the amounts they owe us for work performed and materials supplied. We bear the risk that our clients will pay us late or not at all. Though we

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### ITEM 1A. RISK FACTORS (Continued)

evaluate and attempt to monitor our clients' financial condition, there is no guarantee that we will accurately assess their creditworthiness. Financial difficulties or business failure experienced by one or more of our major customers could have a material adverse effect on both our ability to collect receivables and our results of operations.

Our backlog is subject to unexpected adjustments and cancellations and is, therefore, an uncertain indicator of our future revenue or earnings, particularly in light of the current economy.

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As of December 31, 2008, our backlog was approximately \$325.7 million. We cannot assure investors that the revenue projected in our backlog will be realized or, if realized, will result in profits. Projects may remain in our backlog for an extended period of time prior to project execution and, once project execution begins, it may occur unevenly over the current and multiple future periods. In addition, project terminations, suspensions or reductions in scope may occur from time to time with respect to contracts reflected in our backlog, reducing the revenue and profit we actually receive from contracts reflected in our backlog. Future project cancellations and scope adjustments could further reduce the dollar amount of our backlog and the revenue and profits that we actually earn. These adjustments may be exacerbated by current economic conditions.

Our dependence on one or a few customers could adversely affect us.

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One or a few clients have in the past and may in the future contribute a significant portion of our consolidated revenue in any one year or over a period of several consecutive years. In 2008, three of our clients each accounted for approximately 10% of our revenue was from Spectra Energy, approximately 10% of our revenue was from Alon USA and another 9% was from Gulf South Pipeline. As our backlog frequently reflects multiple projects for individual clients, one major customer may comprise a significant percentage of our backlog at any point in time. Because these significant customers generally contract with us for specific projects, we may lose them in other years as their projects with us are completed. If we do not replace them with other customers or other projects, our business could be materially adversely affected. Also, the majority of our contracts can be terminated at will. Additionally, we have long-standing relationships with many of our significant customers. Our contracts with these customers, however, are on a project-by-project basis and the customers may unilaterally reduce or discontinue their purchases at any time. The loss of business from any one of such customers could have a material adverse effect on



our business or results of operations.

If we are not able to successfully manage internal growth initiatives, our business and results of operations may be adversely affected.

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Our growth strategy is to use our technical expertise in conjunction with industry trends. To support this strategy, the Company may elect to fund internal growth initiatives targeted at markets that the Company believes may have significant potential needs for the Company's services. The downside risks are that such initiatives could have a negative effect on current earnings until they reach critical mass, that industry trends have been misread or delayed or that the Company is unable to successfully execute on these initiatives. In these cases, continued funding could have a negative impact on long term earnings.

The terms of our contracts could expose us to unforeseen costs and costs not within our control, which may not be recoverable and could adversely affect our results of operations and financial condition.

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Under fixed-price contracts, we agree to perform the contract for a fixed price and, as a result, can improve our expected profit by superior contract performance, productivity, worker safety and other factors resulting in cost savings. However, we could incur cost overruns above the approved contract price, which may not be recoverable. Under certain incentive fixed-price contracts, we may agree to share with a customer a portion of any savings we are able to generate while the customer agrees to bear a portion of any increased costs we may incur up to a negotiated ceiling. To the extent costs exceed the negotiated ceiling price, we may be required to absorb some or all of the cost overruns.

Fixed-price contract prices are established based largely upon estimates and assumptions relating to project scope and specifications, personnel and material needs. These estimates and assumptions may be inaccurate or conditions may change due to factors out of our control, resulting in cost overruns which we may be required to absorb. This could have a material adverse effect on our business, financial condition and results of operations. In addition, our profits from these contracts could decrease and we could experience losses if we incur difficulties in performing the contracts or are unable to secure fixed-pricing commitments from our manufacturers, suppliers and subcontractors at the time we enter into fixed-price contracts with our customers. In 2006, we

ITEM 1A. RISK FACTORS (Continued)

suffered significant losses as a result of two fixed-price contracts. Consequently, we plan to limit the size and scope of EPC fixed-price contracts that we enter into in the future.

Under cost-plus contracts, we perform our services in return for payment of our agreed upon reimbursable costs plus a profit. The profit component is typically expressed in the contract either as a percentage of the reimbursable costs we actually incur or is factored into the rates we charge for labor or for the cost of equipment and materials, if any, we are required to provide. Some cost-plus contracts provide for the customer's review of the accounting and cost control systems used by us to calculate these labor rates and to verify the accuracy of the reimbursable costs invoiced. These reviews could result in reductions in amounts previously billed to the customer and in an adjustment to amounts previously reported by us as our profit on the contract.

Many of our fixed-price or cost-plus contracts require us to satisfy specified

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progress milestones or performance standards in order to receive a payment. Under these types of arrangements, we may incur significant costs for labor, equipment and supplies prior to receipt of payment. If the customer fails or refuses to pay us for any reason, there is no assurance that we will be able to collect amounts due to us for costs previously incurred. In some cases, we may find it necessary to terminate. In certain cases, we may attempt to recoup some or all of the cost overruns by entering into a claims recovery process. We may even retain a third party consultant to assist us with necessary due diligence. However, there can be no assurance that we would be able to recover some or all of the cost overruns through the claims recovery process or on terms favorable to the Company.

We may incur significant costs in providing services in excess of original project scope without having an approved change order.

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After commencement of a contract, we may perform, without the benefit of an approved change order from the customer, additional services requested by the customer that were not contemplated in our contract price due to customer changes or to incomplete or inaccurate engineering, project specifications and other similar information provided to us by the customer. Our construction contracts generally require the customer to compensate us for additional work or expenses incurred under these circumstances.

A failure to obtain adequate compensation for these matters could require us to record in the current period an adjustment to revenue and profit recognized in prior periods under the percentage-of-completion accounting method. Any such adjustments, if substantial, could have a material adverse effect on our results of operations and financial condition, particularly for the period in which such adjustments are made. We cannot assure you that we will be successful in obtaining, through negotiation, arbitration, litigation or otherwise, approved change orders in an amount adequate to compensate us for our additional work or expenses.

Liability claims could result in losses.

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Providing engineering and design services involves the risk of contract, professional errors and omissions and other liability claims, as well as adverse publicity. Further, many of our contracts will require us to indemnify our clients not only for our negligence, if any, but also for the concurrent negligence and, in some cases, sole negligence of our clients. We currently maintain liability insurance coverage, including coverage for professional errors and omissions. However, claims outside of or exceeding our insurance coverage may be made. A significant claim could result in unexpected liabilities, take management time away from operations, and have a material adverse impact on our cash flow.

Failure to maintain adequate internal controls could adversely affect us.

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Failure to achieve and maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act could have a material adverse effect on our business and stock price. Our internal controls over financial reporting may not be adequate and our independent auditors may not be able to certify as to their adequacy, which could have a significant adverse effect on our business and reputation.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud. If we identify deficiencies in our internal control over financial reporting, our business and our stock price could be adversely affected. We have, in the past, identified material weaknesses in our internal controls, and while these have been cured, if we determine that we have further material weaknesses, it could affect

ITEM 1A. RISK FACTORS (Continued)

our ability to ensure timely and reliable financial reports and the ability of our auditors to attest to the effectiveness of our internal controls.

Our indebtedness could limit our ability to finance future operations or engage in other business activities.

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As of December 31, 2008, we had \$27.8 million of total outstanding indebtedness against our revolving line of credit, which is currently limited to \$50 million, subject to limitations based on the amount of our accounts receivable. Significant factors that could increase our indebtedness and/or limit our ability to finance future operations include:

- o our inability to collect accounts receivable within contractual terms;
- o client demands for extending contractual payment terms;
- o material losses and/or negative cash flows on significant projects;
- o clients' inability to pay our invoices due to economic conditions or otherwise; and
- o our ability to meet current credit facility financial ratios and covenants.

Although we are in compliance with all current credit facility covenants, our indebtedness could limit our ability to finance future operations or engage in other business activities.

Force majeure events such as natural disasters have negatively impacted and could further negatively impact the economy and the industries we service, which may negatively affect our financial condition, results of operations and cash flows.

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Force majeure events such as hurricanes could negatively impact the economies of the areas in which we operate. For example, during 2008, Hurricanes Gustav and Ike caused considerable damage along the Gulf Coast not only to the refining and petrochemical industry, but also the commercial segment which competes for labor, materials and equipment resources needed throughout the entire United States. In some cases, we remain obligated to perform our services after such a natural disaster even though our contracts may contain force majeure clauses. If we are not able to react quickly and/or negotiate contractual relief under a force majeure event, our operations may be affected significantly, which would have a negative impact on our financial condition, results of operations and cash flows.

Unsatisfactory safety performance can affect customer relationships, result in higher operating costs and result in high employee turnover.

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Our workers are subject to the normal hazards associated with providing services on constructions sites and industrial facilities. Even with proper safety precautions, these hazards can lead to personal injury, loss of life, damage to, or destruction, of property, plant and equipment, and environmental damage. We are intensely focused on maintaining a safe environment and reducing the risk of accidents. However, poor safety performance may limit or eliminate potential revenue streams from many of our largest customers and may materially increase our future insurance and other operating costs.

Our growth strategy requires that we increase the size of our workforce. While we normally target experienced personnel for employment, we also hire inexperienced employees. Even with thorough safety training, inexperienced employees have a higher likelihood of injury which could lead to higher

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operating costs and insurance rates.

Our business and operating results could be adversely affected by our inability to accurately estimate the overall risks, revenue or costs on a contract.

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We generally enter into two principal types of contracts with our clients: time-and-materials contracts and fixed-price contracts. Under our fixed-price contracts, we receive a fixed-price irrespective of the actual costs we incur and, consequently, we are exposed to a number of risks. These risks include underestimation of costs, problems with new technologies, unforeseen expenditures or difficulties, delays beyond our control and economic and other changes that may occur during the contract period. Our ability to secure change orders on scope changes and our ability to invoice for such changes poses an additional risk. In 2006, we suffered significant losses as a result of two fixed-price contracts. In fiscal 2008, approximately 6.0% of our net revenue was derived from fixed-price contracts, as compared with 10.9% in 2007. It is possible that we will enter into a greater number of fixed-price contracts in the future as customers shift more risk to their suppliers, given the economic downturn.

Under our time-and-materials contracts, we are paid for labor at negotiated hourly billing rates or reimbursement at specified mark-up hourly rates and negotiated rates for other expenses. Profitability on these contracts is driven

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### ITEM 1A. RISK FACTORS (Continued)

by billable headcount and cost control. Some time-and-materials contracts are subject to contract ceiling amounts, which may be fixed or performance-based. If our costs generate billings that exceed the contract ceiling or are not allowable under the provisions of the contract or any applicable regulations, we may not be able to obtain reimbursement for all of our costs.

Revenue recognition for a contract requires judgment relative to assessing the contract's estimated risks, revenue and costs, and technical issues. Due to the size and nature of many of our contracts, the estimation of overall risk, revenue and cost at completion is complicated and subject to many variables. Changes in underlying assumptions, circumstances or estimates may also adversely affect future period financial performance. This is a major risk factor that could materially impact our operating results.

If the operating result of any segment is adversely affected, an impairment of goodwill could result in a write down.

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Based on factors and circumstances impacting ENGlobal and the business climate in which it operates, the Company may determine that it is necessary to re-evaluate the carrying value of its goodwill by conducting an impairment test in accordance with Statement on Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, ("SFAS No. 142"). The Company has assigned goodwill to its segments based on estimates of the relative fair value of each segment. If changes in the industry, market conditions, or government regulation negatively impact any of the Company's segments resulting in lower operating income, if assets are damaged, if anticipated synergies or cost savings are not realized with newly acquired entities are not realized, or if any circumstance occurs which results in the fair value of any segment declining below its carrying value, an impairment to goodwill would be created. In accordance with SFAS No. 142, the Company would be required to write down the carrying value of goodwill. In 2007, the Company determined that goodwill within the Automation segment was impaired in the amount of \$432,000.

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Our dependence on subcontractors and equipment manufacturers could adversely affect us.

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We rely on third party subcontractors as well as third party suppliers and manufacturers to complete our projects. To the extent that we cannot engage subcontractors or acquire supplies or materials, our ability to complete a project in a timely fashion or at a profit may be impaired. If the amount we are required to pay for these goods and services exceeds the amount we have estimated in bidding for fixed-price or cost-plus contracts, we could experience losses in the performance of these contracts. In addition, if a subcontractor or supplier is unable to deliver its services or materials according to the negotiated terms for any reason, including the deterioration of its financial condition or over-commitment of its resources, we may be required to purchase the services or materials from another source at a higher price. This may reduce the profit to be realized or result in a loss on a project for which the services or materials were needed.

Additional acquisitions may adversely affect our ability to manage our business.

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Acquisitions have contributed to our growth in the past and, although we plan to reduce the size and number of our acquisitions, we plan to continue making some acquisitions on terms management considers favorable to us. The successful acquisition of other companies involves an assessment of future revenue opportunities, operating costs, economies and earnings after the acquisition is complete, and potential industry and business risks and liabilities beyond our control. This assessment is necessarily inexact and its accuracy is inherently uncertain. In connection with our assessments, we perform reviews of the acquisition target that we believe to be generally consistent with industry practices. These reviews, however, may not reveal all existing or potential problems, nor will they permit a buyer to become sufficiently familiar with the target companies to assess fully their deficiencies and capabilities. We cannot assure you that we will identify, finance and complete additional suitable acquisitions on acceptable terms. We may not successfully integrate future acquisitions. Any acquisition may require substantial attention from our management, which may limit the amount of time that management can devote to day-to-day operations. Our inability to find additional attractive acquisition candidates or to effectively manage the integration of any businesses acquired in the future could adversely affect our ability to grow profitably or at all.

Seasonality of our industry may cause our revenue to fluctuate.

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Holidays and employee vacations during our fourth quarter exert downward pressure on revenue for that quarter, which is only partially offset by the year-end efforts on the part of many clients to spend any remaining funds budgeted for services and capital expenditures during the year. The annual budgeting and approval process under which these clients operate is normally not completed until after the beginning of each new year, which can depress results

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### ITEM 1A. RISK FACTORS (Continued)

for the first quarter. Principally due to these factors, our first and fourth quarters may be less robust than our second and third quarters.

Our Board of Directors may authorize future sales of ENGlobal common stock, which could result in a decrease in value to existing stockholders of the shares they hold.

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Our Articles of Incorporation authorize our board of directors to issue up to an additional 47,705,148 shares of common stock and an additional 2,000,000 shares

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of blank check preferred stock as of the date of filing. These shares may be issued without stockholder approval unless the issuance is 20% or more of our outstanding common stock, in which case the NASDAQ requires stockholder approval. We may issue shares of stock in the future in connection with acquisitions or financings. In addition, we may issue options as incentives under an equity incentive plan. Future issuances of substantial amounts of common stock, or the perception that these sales could occur, may affect the market price of our common stock. In addition, the ability of the board of directors to issue additional stock may discourage transactions involving actual or potential changes of control of the Company, including transactions that otherwise could involve payment of a premium over prevailing market prices to holders of our common stock.

### ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

### ITEM 2. PROPERTIES

#### Facilities

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We lease space in 23 buildings in the U.S. and Canada totaling approximately 419,600 square feet. The leases have remaining terms ranging from monthly to five years and are on terms that we consider commercially reasonable. ENGlobal has no major encumbrances related to these properties. A discussion of the locations of the various segments is included in Item 7. On May 26, 2006, the Company entered into an exclusive agreement with a third party, national real estate firm for tenant representation services that covers most of our facilities.

Our principal office locations are in Houston and Beaumont, Texas; and Tulsa, Oklahoma. We have other offices in Clear Lake and Freeport, Texas; Baton Rouge and Lake Charles, Louisiana; Cleveland and Blackwell, Oklahoma; Broomfield, Colorado; Mobile, Alabama; and Calgary, Alberta Canada. Approximately 372,000 square feet of our total office space is designated for our professional, technical and administrative personnel. We believe that our office and other facilities are well maintained and adequate for existing and planned operations at each operating location.

Our Automation segment performs fabrication assembly in two shop facilities. One facility is in Houston, Texas with approximately 62,600 square feet of space and a second facility is in Beaumont, Texas with approximately 30,000 square feet of space. In March 2009, the Houston facility is being moved from the 63,000 square foot location to an 81,000 square foot location near its existing facility.

On May 25, 2006, the Company, through its wholly-owned subsidiary ENGlobal Corporate Services, Inc., purchased a one-third partnership interest in PEI Investments, A Texas Joint Venture ("PEI"), from Michael L. Burrow, the Company's then President and CEO, and another one-third interest from a stockholder who owns less than 1% of the Company's common stock. The partnership interests were purchased for a total of \$69,000. The remaining one-third interest was already held by the Company through its wholly-owned subsidiary EEI. PEI owned the land on which our Beaumont, Texas office building, destroyed by Hurricane Rita in September 2005, was located. The remains of the building were razed in July 2006. In September 2006, the Company acquired approximately 1.2 acres immediately adjacent to the former facility. In May 2008, the Company sold the land to a third party developer and entered into a build-to-suit lease agreement for a new office building. In February 2009, the Company occupied the new 50,000 square foot facility.

ITEM 2. PROPERTIES (Continued)

On March 2, 2007, the Company, through its wholly-owned subsidiary, ENGlobal Automation Group, Inc. ("EAG"), entered into a 39-month lease agreement for approximately 4,500 square feet of office space in Alpharetta, Georgia, a suburb of Atlanta. On January 27, 2009, EAG closed this operation and subleased the space for the remaining term to a third party tenant.

On June 28, 2007, the Company, through its wholly-owned subsidiary, RPM Engineering, Inc. ("RPM"), sold the Company's property located in Baton Rouge, Louisiana. The purchase price was approximately \$1.9 million with 20% of the purchase price being paid at closing and the balance self-financed for a period of 60 months, amortized over 180 months, payable in equal monthly installments and one irregular installment consisting of the interest and principal due at the end of the 60 months. The financed portion of the purchase price was secured by a first mortgage on the property. The Company's basis in the property, together with the building and all improvements, was approximately \$1.4 million. On July 24, 2008 the purchaser of the Baton Rouge building paid all outstanding principal owed on the note. The Company has leased approximately 31,900 square feet of space in two separate facilities to house its Engineering and Automation operations in Baton Rouge.

ITEM 3. LEGAL PROCEEDINGS

From time to time, one or more of ENGlobal's individual subsidiary business entities are involved in various legal proceedings or are 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, and the outcome of any such claims or proceedings cannot be predicted with certainty. As of the date of this filing, all such active proceedings and claims of substance that have been raised against any subsidiary business entity have been adequately reserved for, or are covered by insurance, such that, if determined adversely to those entities, individually or in the aggregate, they would not have a material adverse effect on our results of operations or financial position.

In June 2008, ENGlobal filed an action in the United States District Court for the Eastern District of Louisiana, Cause No. 08-3601, against South Louisiana Ethanol LLC entitled ENGlobal Engineering, Inc. and ENGlobal Construction Resources, Inc. v. South Louisiana Ethanol, LLC. The lawsuit seeks to enforce collection of \$15.8 million owed to ENGlobal and its affiliates for services performed on an ethanol plant in Louisiana. This lawsuit was consolidated with Cause No. 56-225, Griner Drilling Service, Inc. v. ENGlobal Construction Resources, Inc., ENGlobal Engineering, Inc. and South Louisiana Ethanol, LLC, originally filed in the 25th Judicial District Court of Plaquemines Parish, Louisiana and seeking a judgment for work allegedly performed at the SLE facility. Related lawsuits are (i) Cause No. B-183,211, Brand Scaffold Builders v. ENGlobal Construction Resources, Inc. in the 60th Judicial District Court of Jefferson County, Texas, seeking payment for or a return of scaffolding equipment; (ii) Cause No. 56-344, J&C Welding and Fabrication, Inc. v. ENGlobal Construction Resources, Inc., ENGlobal Engineering, Inc. and South Louisiana Ethanol, LLC, filed in the 25th Judicial District Court of Plaquemines Parish, Louisiana; seeking payment allegedly due for work performed on the SLE project; and (v) Civil Action No. 08-4008, Industrial Process Technology, Inc. v. J&C Welding & Fabrication, Inc. v. South Louisiana Ethanol, LLC and HPS Development, LLC seeking enforcement of alleged liens.

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

No matters were submitted to a vote of stockholders during the quarter ended December 31, 2008.

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### PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

#### Market Information and Holders

The Company's common stock has been quoted on the NASDAQ Global Stock Market (NASDAQ) since December 18, 2007, and is traded under the symbol "ENG". From June 16, 1998 to December 18, 2007, the Company's stock was traded on the American Stock Exchange. Newspaper stock listings identify us as "ENGlobal."

The following table sets forth the high and low sales prices of our common stock for the periods indicated.

|                | Fiscal Year Ended December 31 |         |         |         |
|----------------|-------------------------------|---------|---------|---------|
|                | 2008                          |         | 2007    |         |
|                | High                          | Low     | High    | Low     |
| First quarter  | \$ 10.61                      | \$ 8.35 | \$ 7.18 | \$ 5.05 |
| Second quarter | 14.24                         | 8.74    | 12.73   | 5.66    |
| Third quarter  | 17.85                         | 11.58   | 12.90   | 8.87    |
| Fourth quarter | 12.30                         | 2.35    | 14.81   | 9.78    |

The foregoing figures, based on information published by NASDAQ, do not reflect retail mark-ups or markdowns and may not represent actual trades.

As of December 31, 2008, approximately 238 stockholders of record held the Company's common stock. We do not have current information regarding the number of holders of beneficial interest holding our common stock.

A new class of capital stock of ENGlobal, consisting of 2,000,000 shares of Preferred Stock, par value \$0.001 per share (the "Preferred Stock") was approved by the Company's stockholders at its June 2006 meeting. The Board of Directors has the authority to approve the issuance of all or any of these shares of Preferred Stock in one or more series, to determine the number of shares constituting any series and to determine any voting powers, conversion rights, dividend rights, and other designations, preferences, limitations, restrictions and rights relating to such shares without any further action by the stockholders. The designations, preferences, limitations, restrictions and rights of any series of Preferred Stock designated by the Board of Directors will be set forth in an amendment to the Amended and Restated Articles of Incorporation ("Amended Articles") filed in accordance with Nevada law.

The Preferred Stock is referred to as a "blank check" because the Board of Directors, in its discretion, is authorized to provide for the issuance of all or any shares of the stock in one or more classes or series, specifying the terms of the shares, subject to the limitations of Nevada law. The Board of Directors would make a determination as to whether to approve the terms and issuance of any shares of Preferred Stock based on its judgment as to the best



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interests of the Company and its stockholders.

The reason for authorizing blank check Preferred Stock is to provide the Company with flexibility in connection with its future growth. Although the Company presently has no intentions of issuing shares of Preferred Stock, opportunities may arise that require the Board to act quickly, such as businesses becoming available for acquisition or favorable market conditions for the sale of a particular type of Preferred Stock. The Board believes that the authorization to issue Preferred Stock is advisable in order to enhance the Company's ability to respond to these and similar opportunities.

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### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES (Continued)

#### Performance Graph

The following graph compares the percentage change in (i) the cumulative total stockholder return on the Company's Common Stock for the five-year period ended December 31, 2008 with (ii) the cumulative total return on (a) the S&P SmallCap 600 Index, (b) the NASDAQ Market Index (US), and (c) self-instructed peer group, consisting of the following companies: Fermanite Corporation (formerly Xanser Corporation), Michael Baker Corporation, Matrix Service Company, Tetra Tech, Inc., Willbros Group, and VSE Corporation.

The comparison assumes (i) an investment of \$100 on December 31, 2003 in each of the foregoing indices and (ii) reinvestment of dividends, if any.

THE STOCK PRICE PERFORMANCE SHOWN ON THE GRAPH BELOW REPRESENTS HISTORICAL PRICE PERFORMANCE AND IS NOT NECESSARILY INDICATIVE OF ANY FUTURE STOCK PRICE PERFORMANCE.

#### COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN AMONG ENGLOBAL, NASDAQ MARKET INDEX (U.S.) AND PEER GROUP INDEX

[GRAPHIC ON FILE]

|                            | 2003   | 2004   | 2005   | 2006   | 2007   | 2008   |
|----------------------------|--------|--------|--------|--------|--------|--------|
| ENGLOBAL CORP.             | 100.00 | 157.36 | 426.40 | 326.40 | 576.65 | 164.97 |
| PEER GROUP INDEX           | 100.00 | 87.30  | 81.88  | 98.50  | 155.77 | 108.47 |
| NASDAQ MARKET INDEX (U.S.) | 100.00 | 109.04 | 112.97 | 126.73 | 138.98 | 81.17  |

ASSUMES \$100 INVESTED ON DECEMBER 31, 2003  
ASSUMES DIVIDEND REINVESTED  
FISCAL YEAR ENDING DECEMBER 31, 2008

Notwithstanding anything to the contrary set forth in any of ENGlobal's previous filings under the Securities Act of 1933, as amended, or the Exchange Act, which might incorporate future filings made by the Company under those statutes, the Company's Stock Performance Graph will not be incorporated by reference into any of those prior filings, nor will such report or graph be incorporated by reference into any future filings made by ENGlobal under those Acts.

#### Equity Compensation Plan Information

The following table sets forth certain information concerning the Company's only equity compensation plan as of December 31, 2008. See Note 13 in the attached

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financial statements.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES (Continued)

|   | Number of Securities to<br>be Issued Upon Exercise<br>of Outstanding Options,<br>Warrants and Rights (a) | Weighted-Average<br>Exercise Price of<br>Outstanding Options,<br>Warrants and Rights (b) | Number of<br>Remaining Av<br>Future Issu<br>Equity Compen<br>[Excluding S<br>Column ( |
|---|--|--|---|
|   | -----  | -----  | -----   |
| Equity compensation plan approved by security holders | 1,173,206  | (1) \$6.82   | 0   |

The Company's 1998 Incentive Plan expired in June 2008, and, as of December 31, 2008, it has not been replaced by a new plan. The Board of Directors has approved the ENGlobal Inc. 2009 Incentive Plan and currently intends to request that its' stockholders approve this plan at the next stockholders' meeting.

Dividend Policy

The Company has never declared or paid a cash dividend on its common stock. The Company intends to retain any future earnings for reinvestment in its business and does not intend to pay cash dividends in the foreseeable future. In addition, restrictions contained in our loan agreements governing our credit facility with Comerica Bank preclude us from paying any dividends on our common stock while any debt under those agreements is outstanding. The payment of dividends in the future will depend on numerous factors, including the Company's earnings, capital requirements, and operating and financial position as well as on general business conditions.

Stock Repurchase Policy

Restrictions contained in our loan agreements governing our credit facility with Comerica Bank preclude us from effecting a stock repurchase of our common stock while any debt under those agreements is outstanding.

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 (1) Includes options issued through our 1998 Incentive Plan. For a brief description of the material features of the Plan, see Note 13 of the Notes to the Consolidated Financial Statements

ITEM 6. SELECTED FINANCIAL DATA

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### Summary Selected Historical Consolidated Financial Data

The following tables set forth our selected financial data. The data for the years ended December 31, 2008, 2007, and 2006 have been derived from the audited financial statements appearing elsewhere in this document. The data as of December 31, 2005 and 2004 have been derived from audited financial statements not appearing in this document. You should read the selected financial data set forth below in conjunction with our financial statements and the notes thereto included in Part II, Item 8; Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations;" and other financial information appearing elsewhere in this document.

|  | Years Ended Decem         |            |            |
|--|---------------------------|------------|------------|
|  | 2008                      | 2007       | 2006       |
|  | (in thousands, except per |            |            |
| <b>Statement of Operations</b>   |                           |            |            |
| Revenue  |                           |            |            |
| Engineering  | \$ 251,702                | \$ 221,787 | \$ 215,300 |
| Construction   | 139,360                   | 73,210     | 36,120     |
| Automation   | 59,730                    | 37,766     | 34,880     |
| Land   | 42,540                    | 30,464     | 16,760     |
| Total revenue  | 493,332                   | 363,227    | 303,090    |
| Costs and expenses   |                           |            |            |
| Engineering  | 212,833                   | 181,821    | 199,640    |
| Construction   | 128,908                   | 63,486     | 32,400     |
| Automation   | 52,245                    | 34,382     | 30,400     |
| Land   | 35,539                    | 25,921     | 14,370     |
| Selling, general and administrative  | 32,208                    | 34,774     | 29,880     |
| Total costs and expenses   | 461,733                   | 340,384    | 306,710    |
| Operating income (loss)  | 31,599                    | 22,843     | (3,620)    |
| Interest income (expense), net   | (1,636)                   | (2,514)    | (1,310)    |
| Other income (expense), net  | 64                        | 345        | 650        |
| Foreign currency gain (loss)   | (4)                       | (1)        | (10)       |
| Income (loss) from continuing operations before provision for income taxes | 30,023                    | 20,673     | (4,280)    |
| Provision for income taxes   | 11,765                    | 8,209      | (800)      |
| Net income (loss)  | \$ 18,258                 | \$ 12,464  | \$ (3,480) |

### ITEM 6. SELECTED FINANCIAL DATA (Continued)

|  | Years Ended Decem         |      |      |
|--|---------------------------|------|------|
|  | 2008                      | 2007 | 2006 |
|  | (in thousands, except per |      |      |

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### Per Share Data

|                                 |         |         |          |
|---------------------------------|---------|---------|----------|
| Basic earnings (loss) per share |         |         |          |
| Continuing operations           | \$ 0.67 | \$ 0.46 | \$ (0.1) |
| Discontinued operations         | -       | -       |          |
|                                 | -----   | -----   | -----    |
| Net income (loss) per share     | \$ 0.67 | \$ 0.46 | \$ (0.1) |
|                                 | =====   | =====   | =====    |

|                                    |        |        |       |
|------------------------------------|--------|--------|-------|
| Weighted average common            |        |        |       |
| shares outstanding - basic (000's) | 27,180 | 26,916 | 26,53 |

|                                   |         |         |          |
|-----------------------------------|---------|---------|----------|
| Diluted earnings (loss) per share |         |         |          |
| Continuing operations             | \$ 0.66 | \$ 0.45 | \$ (0.1) |
| Discontinued operations           | -       | -       |          |
|                                   | -----   | -----   | -----    |
| Net income (loss) per share       | \$ 0.66 | \$ 0.45 | \$ (0.1) |
|                                   | =====   | =====   | =====    |

|                                      |        |        |       |
|--------------------------------------|--------|--------|-------|
| Weighted average common              |        |        |       |
| shares outstanding - diluted (000's) | 27,672 | 27,435 | 26,53 |

### Cash Flow Data

|   |          |            |          |
|---|----------|------------|----------|
| Operating activities, net               | \$ 8,346 | \$ (1,980) | \$ (8,95 |
| Investing activities, net               | (4,365)  | (1,707)    | (9,33    |
| Financing activities, net               | (3,779)  | 3,167      | 19,55    |
| Exchange rate changes                   | (110)    | 25         | (2       |
|   | -----    | -----      | -----    |
| Net change in cash and cash equivalents | \$ 92    | \$ (495)   | \$ 1,24  |
|   | =====    | =====      | =====    |

### Balance Sheet Data

|  |            |            |           |
|--|------------|------------|-----------|
| Working capital                                  | \$ 58,585  | \$ 42,915  | \$ 35,18  |
| Property and equipment, net                      | \$ 5,744   | \$ 6,472   | \$ 8,72   |
| Total assets                                     | \$ 152,705 | \$ 119,590 | \$ 106,22 |
| Long-term debt, net of current portion           | \$ 23,614  | \$ 29,318  | \$ 27,16  |
| Long-term capital leases, net of current portion | \$ 243     | \$ -       | \$ -      |
| Stockholders' equity                             | \$ 76,766  | \$ 55,797  | \$ 40,86  |

### Material Events and Uncertainties

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The Company experienced events in 2007 and 2006 that had a material adverse effect on net income from operations. In 2006, the Company incurred losses on two large EPC contracts, which caused the overall loss reported for that year. In 2007, the Company was notified by its client, South Louisiana Ethanol ("SLE"), to stop work on a large project due to difficulties SLE was having in obtaining permanent financing. Also in 2007, price and labor increases on materials contributed to the loss reported for the Automation segment. Details of these losses are more fully explained in Item 7 and throughout this Annual Report on Form 10-K.

The Company's involvement with the SLE project resulted from the Company's efforts to diversify its client base. Historically, the Company has performed large projects primarily with Fortune 500 Companies, which generally have good cash flow and established credit. The SLE project involved a smaller developer that planned to retrofit a 20-year old ethanol plant. Due to a number of factors, including, among others, increased corn prices and declining ethanol prices, SLE has been unable to secure permanent financing for the project.

Due to SLE's continued failure to obtain permanent financing, on May 30, 2008 the Company filed suit in the United States District Court for the Eastern District of Louisiana, Cause Number 08-3601, and is seeking damages of \$15.8

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million. An independent appraisal, dated December 31, 2008, from the bridge lending bank's appraiser, indicated that on an in-place basis the materials and

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### ITEM 6. SELECTED FINANCIAL DATA (Continued)

equipment utilized as an ethanol facility would have a fair market value of \$22.1 million, an orderly liquidation value of \$14.9 million, and a forced liquidation value of \$11.7 million. The Company believes that if the collateral is liquidated, SLE's obligations to the Company would be paid in full pursuant to the Collateral Mortgage in favor of the Company. However, collectability is not assured at this time. As of December 31, 2008, the Company performed its impairment analysis for the asset group classified as long-term notes receivable, particularly Notes Receivable - South Louisiana Ethanol, of \$8.6 million. Due to the ongoing discovery and analysis currently in process on our SLE litigation we cannot yet determine the actual proceeds that would be generated for ENGlobal when the courts determine the status of each asset and the relative lien priority of SLE's creditors, and then such assets are sold. However, at this time management believes that, given the Company's lien position as documented in public records, the value of the collateral will cover the current balance sheet exposure. Any additional charge or negative determination by the courts could have a negative impact on future earnings estimated at 2.1 cents per share per million of un-recovered exposure as a result of a non-cash charge to operations. However, at this time the Company believes that the ultimate disposition of the SLE collateral will not materially adversely affect our liquidity or overall financial position.

#### Current Efforts to Mitigate Losses

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The Company has stopped work on the SLE project, and may provide SLE with introductions to third parties. These introductions could potentially result in selling the uncompleted facility, likely for purposes other than as an ethanol facility.

Our project controls department is reviewing projects that may be experiencing degradations on margins to determine methods for protecting current margins.

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is qualified in its entirety by, and should be read in conjunction with, our Consolidated Financial Statements including the Notes thereto, included elsewhere in this Annual Report on Form 10-K. Note 18 to the Financial Statements contains segment information.

#### Overview

#### Results of Operations

The Engineering segment provides consulting services relating to the development, management and execution of projects requiring professional engineering and related project services. Services provided by the Engineering segment include feasibility studies, engineering, design, procurement, and construction management. The Construction segment provides construction management personnel and services in the areas of inspection, mechanical integrity, vendor and turnaround surveillance, field support, construction, quality assurance and plant asset management. The Automation segment provides services related to the design, fabrication, and implementation of process distributed control and analyzer systems, advanced automation, information

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technology, and process piping heat tracing projects. The Land segment provides land management, right-of-way, and governmental regulatory compliance services primarily to pipeline, utility and telecom companies and other owner/operators of infrastructure facilities throughout the United States and Canada.

The Company's revenue is composed of engineering, procurement and construction service revenue and engineered systems sales. The Company recognizes service revenue as soon as the services are performed. The majority of the Company's engineering services have historically been provided through cost-plus contracts whereas a majority of the Company's engineered system sales are earned on fixed-price contracts.

In the course of providing our services, we routinely provide engineering, materials, and equipment and may provide construction services on a direct hire or subcontractor basis. Generally, these materials, equipment and subcontractor costs are passed through to our clients and reimbursed, along with fees, which in total are at margins lower than those of our normal core business. In accordance with industry practice and generally accepted accounting principles,

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

all costs and fees are included in revenue. The use of subcontractor services can change significantly from project to project; therefore, changes in revenue may not be indicative of business trends.

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

Corporate SG&A expense is comprised primarily of marketing costs, as well as costs related to executive, governance/investor relations, finance, accounting, safety, human resources, project controls and information technology departments and other costs generally unrelated to specific client projects. Corporate SG&A expense may vary as costs are incurred to support corporate activities and initiatives.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS

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OF OPERATIONS (Continued)

The following table sets forth, for the periods indicated, certain financial data derived from our consolidated statements of operations.

### Consolidated Results of Operations for the Twelve Months Ended December 31, 2008, 2007 and 2006

| Twelve months ended<br>December 31, 2008<br>----- | Engineering<br>----- | Construction<br>----- | Automation<br>----- | Land<br>----- | All<br>----- |
|---|----------------------|-----------------------|---------------------|---------------|--------------|
| (dollars in thousands)                            |                      |                       |                     |               |              |
| Revenue before eliminations                       | \$ 252,711           | \$ 147,714            | \$ 60,372           | \$ 42,540     | \$           |
| Inter-segment eliminations                        | (1,009)              | (8,354)               | (642)               | -             | -            |
| Revenue   | \$ 251,702           | \$ 139,360            | \$ 59,730           | \$ 42,540     | \$           |
| Gross profit                                      | \$ 38,869            | \$ 10,452             | \$ 7,485            | \$ 7,001      | \$           |
| SG&A  | 7,083                | 2,993                 | 3,741               | 2,887         | -            |
| Operating income (loss)                           | \$ 31,786            | \$ 7,459              | \$ 3,744            | \$ 4,114      | \$           |
| Other income (expense)                            |                      |                       |                     |               |              |
| Tax provision                                     |                      |                       |                     |               |              |
| Net income (loss)                                 |                      |                       |                     |               |              |
| (dollars in thousands)                            |                      |                       |                     |               |              |
| Twelve months ended<br>December 31, 2007<br>----- |                      |                       |                     |               |              |
| Revenue before eliminations                       | \$ 221,802           | \$ 86,811             | \$ 39,115           | \$ 30,464     | \$           |
| Inter-segment eliminations                        | (15)                 | (13,601)              | (1,349)             | -             | -            |
| Revenue   | \$ 221,787           | \$ 73,210             | \$ 37,766           | \$ 30,464     | \$           |
| Gross profit                                      | \$ 39,966            | \$ 9,724              | \$ 3,384            | \$ 4,543      | \$           |
| SG&A  | 11,665               | 2,591                 | 3,442               | 2,438         | -            |
| Operating income (loss)                           | \$ 28,301            | \$ 7,133              | \$ (58)             | \$ 2,105      | \$           |
| Other income (expense)                            |                      |                       |                     |               |              |
| Tax provision                                     |                      |                       |                     |               |              |
| Net income (loss)                                 |                      |                       |                     |               |              |
| (dollars in thousands)                            |                      |                       |                     |               |              |
| Twelve months ended<br>December 31, 2006<br>----- |                      |                       |                     |               |              |
| Revenue before eliminations                       | \$ 215,444           | \$ 37,083             | \$ 37,206           | \$ 16,768     | \$           |
| Inter-segment eliminations                        | (138)                | (955)                 | (2,318)             | -             | -            |
| Revenue   | \$ 215,306           | \$ 36,128             | \$ 34,888           | \$ 16,768     | \$           |

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|                         |    |        |    |       |    |       |    |       |    |
|-------------------------|----|--------|----|-------|----|-------|----|-------|----|
| Gross profit            | \$ | 15,661 | \$ | 3,725 | \$ | 4,488 | \$ | 2,390 | \$ |
| SG&A                    |    | 9,466  |    | 2,146 |    | 3,909 |    | 1,674 |    |
|                         |    | -----  |    | ----- |    | ----- |    | ----- |    |
| Operating income (loss) | \$ | 6,195  | \$ | 1,579 | \$ | 579   | \$ | 716   | \$ |
|                         |    | -----  |    | ----- |    | ----- |    | ----- |    |
| Other income (expense)  |    |        |    |       |    |       |    |       |    |
| Tax provision           |    |        |    |       |    |       |    |       |    |
| Net income (loss)       |    |        |    |       |    |       |    |       |    |

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

OVERALL COMPARISONS

Revenue

Overall revenue increased 35.8%, or \$130.1 million, from \$363.2 million in 2007 to \$493.3 million in 2008 and increased 19.8%, or \$60.1 million, from \$303.1 million in 2006. Only 3% of our growth in 2008 was a result of the incremental revenue contribution from 2008 acquisitions. We had increases in revenue in 2008 of \$8.9 million due to additional work created by Hurricane Ike and \$42.4 million from a refinery rebuild project. Both of these projects included large amounts of material and subcontractor purchases and are expected to be completed by the first quarter of 2009. Revenue also grew due to an overall higher level of project activity in the markets we serve. In particular we benefited from the increased capital spending in the pipeline area which increased revenue in our construction, engineering and land segments. Approximately 36% of our revenue growth from 2006 to 2007 was external growth as a result of the incremental revenue contribution from 2006 acquisitions. The balance of the revenue growth from 2006 to 2007 occurred as a result of internal measures and a higher level of project activity in the market we serve.

Gross Profit

Gross profit increased \$6.2 million, or 10.8%, from \$57.6 million in 2007 to \$63.8 million in 2008 and increased \$31.3 million, or 119.0%, from \$26.3 million in 2006. As a percentage of revenue, gross profit decreased by 3.0% from 15.9% in 2007 to 12.9% in 2008 but increased 7.2% in 2007 from 8.7% in 2006. The major factor that contributed to lower gross profit margins in 2008 relative to 2007 was an increase of \$24.6 million in revenues related to low-margin pass-through procurement and subcontracted construction revenue. The remaining decline was due to increased work on lower margin services such as pipeline inspection.

Selling, General and Administrative ("SG&A") Expenses

Overall SG&A expenses decreased \$2.6 million, or 7.5%, from \$34.8 million in 2007 to \$32.2 million in 2008. In 2007, overall SG&A expense increased \$4.9 million, or 16.4%, from \$29.9 million in 2006. As a percentage of revenue, SG&A decreased 3.1% from 9.6% in 2007 to 6.5% in 2008 and decreased 0.3% from 9.9% in 2006. The main savings occurred in bad debt expense and amortization. In 2007, the bad debt expense was elevated due to the creation of the reserve on the



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notes receivable for the SLE project and amortization was increased by \$432,000 due to the goodwill impairment in the Automation segment. Even though we did not have the significant increase in bad debt due to the SLE project in 2008, we did have increased amounts of general bad debt expense due to the economic instability that has caused some customers to file bankruptcy or to otherwise be unable to pay. Details relating to the changes in each segment are discussed further below.

Corporate SG&A expenses increased \$0.9 million, or 6.2%, from \$14.6 million in 2007 to \$15.5 million in 2008. The increase primarily relates to salaries and employee-related expenses, which increased \$0.7 million. There was also an increase of \$0.2 million in facilities expense, \$0.1 million in professional services for items such as Sarbanes-Oxley ("SOX") compliance and professional consulting services and an increase in amortization and depreciation expense of \$0.2 million. These increases were offset by a decrease in stock compensation expense of \$0.3 million. As a percentage of revenue, corporate SG&A decreased 0.8% from 4.0% in 2007 to 3.2% in 2008.

Corporate SG&A expenses increased \$1.9 million, or 15.0%, from \$12.7 million in 2006 to \$14.6 million in 2007. The increase relates primarily to salaries and employee-related expenses, which increased \$1.7 million. Of these expenses, \$0.9 million relates to the management incentive plan. Since the Company experienced losses in 2006, we incurred no management incentive plan expense during that year. The remainder is attributable to a general increase in corporate overhead positions to support Company growth. There was also an increase in professional services for items such as Sarbanes-Oxley ("SOX") compliance and audits totaling \$0.2 million and an increase of amortization and depreciation expense of \$0.2 million. These increases were offset by a decrease in stock compensation expense of \$0.5 million. As a percent of revenue, corporate SG&A decreased 0.2% from 4.2% in 2006 to 4.0% in 2007.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

#### Operating Profit

Operating profit increased \$8.8 million to \$31.6 million in 2008 as compared to \$22.8 million in 2007, increasing, as a percentage of total revenue, from 6.3% in 2007 to 6.4% in 2008. This increase was primarily the result of higher levels of project activity in the markets we serve, along with savings in the SG&A. Operating profit increased \$26.4 million to \$22.8 million in 2007 as compared to \$(3.6) million in 2006, increasing, as a percentage of total revenue, from (1.2)% in 2006 to 6.3% in 2007. This increase was primarily the result of the Company's loss in 2006 on two fixed-price contracts that did not recur in 2007. However, operating profit in 2007 was reduced by a \$4.0 million charge taken in relation to the SLE project, discussed in further detail in Item 6.

#### Other Income (Expense)

Other income decreased from \$379,600 in 2007 to \$128,800 in 2008. Other income was \$651,500 in 2006. Other income in 2008 was derived mainly from gains on the sale of fixed assets with the majority being from the sale of land in Beaumont which resulted in a gain of \$83,900. Other income in 2007 was derived from a gain of \$483,500 from the sale of our building in Baton Rouge offset by a loss of \$103,900 on the sale of assets from the closing of our Dallas office.

#### Net Income

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Net Income increased \$5.8 million to \$18.3 million in 2008 as compared to \$12.5 million in 2007, increasing, as a percentage of total revenue, from 3.4% in 2007 to 3.7% in 2008. Net Income increased \$16.0 million to \$12.5 million in 2007 as compared to \$(3.5) million in 2006, increasing, as a percentage of total revenue, from (1.2)% in 2006 to 3.4% in 2007.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

2008 Compared to 2007 and 2007 Compared to 2006

Engineering Segment:

|                           | Twelve Months Ended December 31, |         |        |    |         |        |         |         |
|---------------------------|----------------------------------|---------|--------|----|---------|--------|---------|---------|
|                           | 2008                             |         | 2007   |    | 2006    |        |         |         |
|                           | (dollars in thousands)           |         |        |    |         |        |         |         |
| Gross revenue             | \$                               | 252,711 |        | \$ | 221,802 | \$     | 215,444 |         |
| Less intercompany revenue |                                  | (1,009) |        |    | (15)    |        | (138)   |         |
| Total revenue:            |                                  |         |        |    |         |        |         |         |
| Detail-design             |                                  | 168,079 | 66.8%  |    | 132,210 | 59.6%  | 111,503 |         |
| Field services            |                                  | 50,647  | 20.1%  |    | 56,379  | 25.4%  | 53,921  |         |
| Procurement services      |                                  | 30,038  | 11.9%  |    | 16,011  | 7.2%   | 19,271  |         |
| Fixed-price               |                                  | 2,938   | 1.2%   |    | 17,187  | 7.8%   | 30,611  |         |
| Total revenue:            | \$                               | 251,702 | 100.0% | \$ | 221,787 | 100.0% | \$      | 215,306 |
| Gross profit:             | \$                               | 38,869  | 15.4%  | \$ | 39,966  | 18.0%  | \$      | 15,661  |
| Operating SG&A expense:   | \$                               | 7,083   | 2.8%   | \$ | 11,665  | 5.3%   | \$      | 9,466   |
| Operating income:         | \$                               | 31,786  | 12.6%  | \$ | 28,301  | 12.8%  | \$      | 6,195   |

Revenue

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Engineering revenue accounted for 51.0% of our total revenue for the year, increasing \$29.9 million from \$221.8 million in 2007 to \$251.7 million in 2008. During 2007, revenue increased \$6.5 million from \$215.3 million in 2006.

The increase in engineering revenue was primarily brought about by increased midstream and downstream capital spending in the energy industry. Refining

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related activity in 2008 was particularly strong, including projects to satisfy environmental mandates, expand existing facilities and utilize heavier sour crude. Capital spending in the pipeline area also trended higher, with numerous projects in North America currently underway to deliver crude oil, natural gas, petrochemicals and refined products. Renewable energy appears to be an emerging area of activity and potential growth, with the Company currently performing a variety of services primarily on biomass related facilities. The Engineering segment's estimated backlog at December 31, 2008 was \$113.5 million.

Our detail design services proved strong with revenues increasing 27.2%, or \$35.9 million, from \$132.2 million in 2007 to \$168.1 million in 2008. This increase was mainly due to a refinery rebuild project. In 2007, these services increased 18.6%, or \$20.7 million, from \$111.5 million in 2006. As a percent of total engineering revenue, detail design revenue increased 7.2% to 66.8% in 2008 from 59.6% in 2007 and increased 7.8% in 2007 from 51.8% in 2006.

Our field services revenues decreased 10.3%, or \$5.8 million, from \$56.4 million in 2007 to \$50.6 million in 2008 due to a general decrease in demand from our existing customers for in-plant resources. In 2007, field services revenue increased 4.6%, or \$2.5 million, from \$53.9 million in 2006. This was due to an increased demand from our existing customers for in-plant resources. As a percent of total engineering revenue, field services revenue decreased 5.3% to 20.1% in 2008 from 25.4% in 2007 and increased 0.4% in 2007 from 25.0% in 2006.

Revenue from procurement services increased 87.5%, or \$14.0 million, from \$16.0 million in 2007 to \$30.0 million in 2008. In 2007, these services decreased 17.1%, or \$3.3 million, from \$19.3 million in 2006. The significant increase

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

in 2008 is primarily related to a large project to rebuild a client facility which has been completed. The decrease in 2007 was due to the completion of the two EPC projects. As a percent of total engineering revenue, procurement services revenue increased 4.7% to 11.9% in 2008 from 7.2% in 2007 and decreased 1.8% in 2007 from 9.0% in 2006. The level of procurement services varies over time depending on the volume of procurement activity our customers choose to do themselves as opposed to using our services.

Fixed-price revenues decreased 83.1%, or \$14.3 million, from \$17.2 million in 2007 to \$2.9 million in 2008. There was a decrease in 2007 of 43.8%, or \$13.4 million, from \$30.6 million in 2006. As a percent of total engineering revenue, fixed-price revenue decreased 6.6% to 1.2% in 2008 from 7.8% in 2007, and in 2007 it decreased 6.4% from 14.2% in 2006. This decrease was the result of the Company's decision to be very selective in the fixed-price contracts it undertakes due to the risk of loss if the contract costs are not estimated accurately.

#### Gross Profit

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Our Engineering segment's total gross profit decreased \$1.1 million, or 2.8%, from \$40.0 million in 2007 to \$38.9 million in 2008. As a percentage of total gross profit, the Engineering segment's gross profit decreased from 18.0% to 15.4% during the same period. The decrease in total gross profit percentages was due to the increase in low margin procurement services revenue from \$16.0 million to \$30.0 million. Total gross profit in 2007 increased \$24.3 million, or 155.2%, from \$15.7 million in 2006 due to the completion of the two EPC loss projects.

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In 2006, the Company shifted a portion of its services to developer-type work for customers that are typically smaller than its historical customer base, including SLE. The viability of these projects and the creditworthiness of these types of customers must be carefully analyzed to assure profitable results. In the future, the Company intends to analyze these projects on a more comprehensive basis before accepting them. However, the Company believes that some of its customers may begin to require contracts on a fixed-price basis.

The Company has also engaged in a number of entrepreneurial ventures over the past several years, not all of which have been profitable. In the future, the Company intends to scrutinize these projects much more carefully before engaging in them and exit them more quickly if they are not successful. During 2007, one of those ventures was discontinued in March with the closing of our Dallas office as the location did not provide the intended benefits.

We earn a lower margin on procurement services than we earn on our core engineering services. For example, procurement services for 2008 produced a 7.6% gross profit margin, whereas core engineering services produced a gross profit margin of 16.7%. If the Company's business shifts away from predominantly engineering projects to EPC projects which include material procurement and construction responsibility, engineering gross profit as a percentage of revenue will be negatively impacted. This shift would precipitate lower gross profit because higher cost-plus margins on engineering labor, recognized during the period in which it was earned, would be combined with the lower margins on procurement services and construction subcontractor charges and recorded throughout the duration of the projects. In addition, if our business shifts more to fixed price work, our risk assessment and project management tools will be critical to our continued successful operations.

### Operating Selling, General and Administrative ("SG&A") Expenses

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Our Engineering segment's SG&A expenses decreased \$4.6 million, or 39.3%, from \$11.7 million in 2007 to \$7.1 million in 2008. In 2007, the Engineering segment's SG&A expenses increased \$2.2 million, or 23.2%, from \$9.5 million in 2006. As a percent of revenue, SG&A decreased 2.5% from 5.3% in 2007 to 2.8% in 2008, and it increased 0.9% in 2007 from 4.4% in 2006.

The Engineering segment's SG&A expenses decreased \$3.1 million in 2008 from 2007 as a result of decreases for bad debt expense almost entirely related to the creation of the reserve against the SLE notes receivable in 2007. Also, amortization and depreciation decreased \$0.3 million, while salaries and related employee expenses decreased \$1.2 million.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The Engineering segment's SG&A expenses increased \$4.7 million in 2007 over 2006 as a result of increases for bad debt expense. Of this increase, \$4.0 million was related to creation of the reserve against the SLE notes receivable, while the remainder comprised general increases to the allowance for doubtful accounts. To offset these increases, facilities and office expenses decreased by \$1.2 million due to the closing of the Dallas office in March 2007. Also, salaries and employee expenses decreased by \$0.9 million as a result of the reclassification of some employees from overhead to direct expense positions. Additional savings were recognized as a result of the reduction in stock compensation expense and professional services.

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### Operating Profit

Operating profit increased \$3.5 million to \$31.8 million in 2008 as compared to \$28.3 million in 2007, which increased \$22.1 million from \$6.2 million in 2006. As a percentage of total revenue, operating profit remained relatively stable at 12.6% in 2008 compared to 12.8% in 2007, but increased significantly from 2.9% in 2006.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Co

#### Construction Segment:

|                                    | Twelve Months Ended December 31, |               |                  |               |                  |
|------------------------------------|----------------------------------|---------------|------------------|---------------|------------------|
|                                    | 2008                             |               | 2007             |               | 2006             |
| (dollars in thousands)             |                                  |               |                  |               |                  |
| Gross revenue                      | \$ 147,714                       |               | \$ 86,811        |               | \$ 37,080        |
| Less intercompany revenue          | (8,354)                          |               | (13,601)         |               | (95)             |
| <b>Total revenue:</b>              |                                  |               |                  |               |                  |
| Pipeline                           | 125,731                          | 90.2%         | 60,430           | 82.5%         | 28,980           |
| Non-pipeline                       | 13,629                           | 9.8%          | 12,780           | 17.5%         | 7,140            |
| <b>Total revenue:</b>              | <b>\$ 139,360</b>                | <b>100.0%</b> | <b>\$ 73,210</b> | <b>100.0%</b> | <b>\$ 36,120</b> |
| <b>Gross profit:</b>               | <b>\$ 10,452</b>                 | <b>7.5%</b>   | <b>\$ 9,724</b>  | <b>13.3%</b>  | <b>\$ 3,720</b>  |
| <b>Operating SG&amp;A expense:</b> | <b>\$ 2,993</b>                  | <b>2.1%</b>   | <b>\$ 2,591</b>  | <b>3.5%</b>   | <b>\$ 2,140</b>  |
| <b>Operating income:</b>           | <b>\$ 7,459</b>                  | <b>5.4%</b>   | <b>\$ 7,133</b>  | <b>9.7%</b>   | <b>\$ 1,570</b>  |

### Revenue

The Construction segment contributed 28.3% of our total revenue for 2008, as its revenue increased \$66.2 million, or 90.4%, from \$73.2 million in 2007 to \$139.4 million in 2008. The revenue in 2007 for this segment increased 102.8%, or \$37.1 million, from \$36.1 million in 2006. The Construction segment's estimated backlog at December 31, 2008 was \$128.9 million but the backlog and previously anticipated growth expected for pipeline and OSHA plant inspections, as well as plant turnaround and construction management support projects and high-tech maintenance services, may be negatively impacted by current economic conditions.

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Non-pipeline revenue, as a percent of the segment's total revenue, continued to decline from 19.8% in 2006, to 17.5% in 2007 and 9.8% during 2008. Our non-pipeline revenue growth increased 6.6% year-over-year from \$12.8 million in 2007 to \$13.6 million in 2008. Increased capital spending in the pipeline area in 2008, particularly in inspection services, contributed 90.2% of the segment's total revenue in 2008 as pipeline revenue has grown 108% year-over-year from 2006 to 2007 and again from 2007 to 2008.

The revenue from this segment comes entirely from field services that are not typically limited to one project. The Company's past experience with this activity is that the term of these assignments on average spans multiple projects and multiple years.

### Gross Profit

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The Construction segment's gross profit increased \$0.8 million, or 8.3%, from \$9.7 million in 2007 to \$10.5 million in 2008. In 2007, this segment's gross profit increased \$6.0 million, or 162.7%, from \$3.7 million in 2006. As a percent of revenue, gross profit decreased by 5.8%, from 13.3% in 2007 to 7.5% in 2008, but it increased 3.0% in 2007 from 10.3% in 2006.

The percentage of gross profit has decreased while revenue has been increasing significantly due to the changing mix of work being performed in this segment. The main increase in work has been in pipeline related revenues which typically carry lower margins than our non-pipeline related revenues.

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## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

### Operating Selling, General and Administrative ("SG&A") Expenses

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The Construction segment's SG&A expenses increased \$0.4 million, or 15.4%, from \$2.6 million in 2007 to \$3.0 million in 2008. In 2007, SG&A expenses increased \$0.4 million, or 19.1%, from \$2.1 million in 2006. As a percent of revenue, SG&A decreased 1.4% from 3.5% in 2007 to 2.1% in 2008, and decreased 2.4% in 2007 from 5.9% in 2006.

The Construction segment's SG&A expenses increased \$0.4 million in 2008 over 2007 mainly due to increases in salaries and related employee expenses of \$239,000, amortization and depreciation expense of \$128,000 and allowances for bad debt of \$174,000. These increases were offset by savings of \$120,000 in professional services and \$24,000 in facilities expense.

The Construction segment's SG&A expenses increased \$0.4 million in 2007 over 2006 mainly due to increases in salaries and related employee expenses of \$362,000. Overhead positions were added to accommodate the internal and acquisition-related growth of this segment. Additionally, facilities expense increased \$75,000 as a result of additional office space leased to house acquired operations.

### Operating Profit

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This segment's operating profit increased \$0.4 million to \$7.5 million in 2008 from \$7.1 million in 2007, and it increased \$5.5 million in 2007 from \$1.6 million in 2006. As a percentage of total revenue, operating profit decreased to 5.4% in 2008 from 9.7% in 2007, but it increased in 2007 from 4.4% in 2006.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Co

## Automation Segment:

|                           | Twelve Months Ended December 31, |        |        |    |         |        |         |        |
|---------------------------|----------------------------------|--------|--------|----|---------|--------|---------|--------|
|                           | 2008                             |        | 2007   |    | 2006    |        |         |        |
|                           | (dollars in thousands)           |        |        |    |         |        |         |        |
| Gross revenue             | \$                               | 60,372 |        | \$ | 39,115  | \$     | 37,206  |        |
| Less intercompany revenue |                                  | (642)  |        |    | (1,349) |        | (2,318) |        |
| Total revenue:            |                                  |        |        |    |         |        |         |        |
| Fabrication               |                                  | 28,266 | 47.3%  |    | 22,814  | 60.4%  | 26,032  |        |
| Non-fabrication           |                                  | 31,464 | 52.7%  |    | 14,952  | 39.6%  | 8,856   |        |
| Total revenue:            | \$                               | 59,730 | 100.0% | \$ | 37,766  | 100.0% | \$      | 34,888 |
| Gross profit:             | \$                               | 7,485  | 12.6%  | \$ | 3,384   | 9.0%   | \$      | 4,488  |
| Operating SG&A expense:   | \$                               | 3,741  | 6.3%   | \$ | 3,442   | 9.1%   | \$      | 3,909  |
| Operating income (loss):  | \$                               | 3,744  | 6.3%   | \$ | (58)    | (0.2%) | \$      | 579    |

## Revenue

The Automation segment contributed 12.1% of our total revenue for the year, as its revenue increased \$21.9 million, or 57.9%, from \$37.8 million in 2007 to \$59.7 million in 2008. This segment's revenue also increased 8.3% in 2007, or \$2.9 million, from \$34.9 million in 2006. The 2008 revenue increased \$8.9 million as a result of the Hurricane Ike rebuilding project. This project is expected to end during the first quarter of 2009.

The Company began to focus more on automation services beginning in 2005 and began marketing them more aggressively at that time. Refining-related activity has been particularly strong, including projects to satisfy environmental mandates. This, together with the acquisition of Analyzer Technology International, Inc. ("ATI") in January 2006, has increased the client demand for turn-key, analytical solutions. Another factor positively affecting the automation business is that the computer-based distributed control systems equipment used for facility plant automation becomes technologically obsolete over time, supporting ongoing replacement. In 2008, this segment expanded its customer base and geographic reach to include specialty chemicals and pulp and paper markets with the acquisition of Advanced Control Engineering, LLC in September. The Automation segment's estimated backlog at December 31, 2008 was \$43.2 million, but the backlog could be negatively impacted by the current and possible future economic downturn.

Gross Profit

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The Automation segment's gross profit increased \$4.1 million, or 120.6%, from \$3.4 million in 2007 to \$7.5 million in 2008. In 2007, it decreased \$1.1 million, or 24.5%, from \$4.5 million in 2006. Also, as a percent of revenue, gross profit increased by 3.6% from 9.0% in 2007 to 12.6% in 2008, but it decreased 3.9% in 2007 from 12.9% in 2006.

During 2007, the Automation segment expanded into several new regions, resulting in higher increased costs in relation to revenues. Also during 2007, an unanticipated shortage of available experienced labor caused an increase in labor hourly rates of approximately 25%. During that same period, most material costs unexpectedly increased by approximately 8% to 10%, and the price of copper wire increased 300%. These increases in labor and material costs adversely affected project margins on fixed-price projects in 2007.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Selling, General and Administrative ("SG&A") Expenses

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The Automation segment's SG&A expenses increased \$0.3 million, or 8.8%, from \$3.4 million in 2007 to \$3.7 million in 2008. In 2007, SG&A expenses decreased \$0.5 million, or 12.8%, from \$3.9 million in 2006. As a percent of revenue, SG&A decreased 2.8% from 9.1% in 2007 to 6.3% in 2008, and it decreased 2.1% in 2007 from 11.2% in 2006.

The automation segment's SG&A expenses increased \$300,000 in 2008 over 2007, mainly due to increases in allowances for bad debt of \$452,000, facilities expense of \$138,000 and stock compensation expense of \$129,000. These increases were offset by savings in amortization and depreciation expense of \$365,000 due to the goodwill impairment of \$432,000 that was taken in 2007. In 2008, \$100,000 of amortization was recorded in connection with the intangible assets created from the acquisition of Advance Control Engineering, LLC. Additional savings of \$61,000 was recognized in professional services.

This segment's SG&A expenses decreased \$467,000 in 2007 over 2006, mainly due to decreases in salaries and related employee expenses of \$896,000. Salaries and expenses for business development personnel were moved to corporate overhead in July 2006 to be consistent with the reporting of these costs throughout the Company. The reduction of overhead personnel and the transfer of Automation segment overhead personnel expense to direct expense also contributed to this decrease. We also recognized professional services savings of \$152,000 and \$85,000 less in bad debt expense in 2007 compared to 2006. Offsetting these savings, amortization costs increased by \$674,000. Of these additional costs, \$432,000 was goodwill impairment.

Operating Profit

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This segment's operating profit increased \$3,802,000 to a profit of \$3,744,000 in 2008 as compared to a loss of (\$58,000) in 2007. Operating profit in 2007 decreased \$637,000 from \$579,000 in 2006. As a percentage of total revenue, operating profit increased to 6.3% in 2008 from (0.2)% in 2007, but it decreased in 2007 from 1.7% in 2006.



## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Co

## Land Segment:

|                           | Twelve Months Ended December 31, |        |        |    |        |    |        |
|---------------------------|----------------------------------|--------|--------|----|--------|----|--------|
|                           | 2008                             |        | 2007   |    | 2006   |    |        |
|                           | (dollars in thousands)           |        |        |    |        |    |        |
| Gross revenue             | \$                               | 42,540 |        | \$ | 30,464 | \$ | 16,768 |
| Less intercompany revenue |                                  | -      |        |    | -      |    | -      |
| Total Revenue:            | \$                               | 42,540 | 100.0% | \$ | 30,464 | \$ | 16,768 |
| Gross profit:             | \$                               | 7,001  | 16.5%  | \$ | 4,543  | \$ | 2,390  |
| Operating SG&A expense:   | \$                               | 2,887  | 6.8%   | \$ | 2,438  | \$ | 1,674  |
| Operating income:         | \$                               | 4,114  | 9.7%   | \$ | 2,105  | \$ | 716    |

The Land segment was created through an acquisition of WRC Corporation in May 2006. Therefore, financial information for 2006 only includes seven months of activity compared to a complete year in both 2007 and 2008.

## Revenue

The Land segment contributed 8.6% of our total revenues for 2008, as its revenue increased \$12.0 million, or 39.4%, from \$30.5 million in 2007 to \$42.5 million in 2008. This segment's revenue also increased 81.6% in 2007, or \$13.7 million, from \$16.8 million in 2006. The WRC Corporation acquisition in May 2006 was the foundation for this segment. Therefore, 2006 financial information only includes seven months of activity. This acquisition has given ENGlobal additional cross-selling capabilities and allows us to offer our clients a turkey solution for a pipeline project, with the additional capability of right-of-way acquisition through the Land group.

A general increase in capital spending by our clients has contributed to this increase in Land segment revenue. We have also been able to increase our client base. The Land segment's estimated backlog at December 31, 2008 was \$40.1 million. However, the backlog may be negatively impacted by current and possible future economic downturn.

## Gross Profit

Gross profit for our Land segment increased \$2.5 million, or 55.6%, from \$4.5 million in 2007 to \$7.0 million in 2008. In 2007, it increased \$2.2 million, or 91.7%, from \$2.4 million in 2006. This increase in gross profit is attributed to the ability to renegotiate our existing contracts to cover our increased costs. Also, as a percent of revenue, gross profit increased by 1.6% from 14.9% in 2007 to 16.5% in 2008 and increased 0.7% in 2007 from 14.2% in 2006.

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### Selling, General and Administrative ("SG&A") Expenses

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The Land segment's SG&A expenses increased \$0.5 million, or 20.8%, from \$2.4 million in 2007 to \$2.9 million in 2008. In 2007, SG&A expenses increased \$0.7 million, or 41.2%, from \$1.7 million in 2006.

As a percent of revenue, SG&A decreased 1.2% from 8.0% in 2007 to 6.8% in 2008 and decreased 2.0% in 2007 from 10.0% in 2006.

The increase of \$0.5 million is primarily due to increases of \$227,000 in salaries and related employee expenses, \$100,000 in allowance for bad debt, and \$80,000 in marketing expenses with the remainder of the increase occurring in facilities, professional and insurance expense.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The increase in 2007 is primarily due to the extended months reported for 2007. However, in reviewing SG&A as a percentage of revenue, there were decreases of 0.2% in facilities, 0.3% in marketing, and 0.7% in salaries and related employee expenses. In 2007, the Houston operations of the former WRC Corporation moved into the existing ENGlobal facilities and the Engineering segment took over some of the former WRC Corporation's facilities in Denver.

### Operating Profit

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The Land segment's operating profit increased by \$2.0 million from \$2.1 million in 2007 to \$4.1 million in 2008. Operating profit in 2007 increased \$1.4 million from \$0.7 million in 2006. As a percentage of total revenue, operating profit increased to 9.7% in 2008 from 6.9% in 2007, and increased in 2007 from 4.3% in 2006.

### Liquidity and Capital Resources

#### Overview

The Company defines liquidity as its ability to pay liabilities as they become due, fund business operations and meet monetary contractual obligations. Our primary source of liquidity during the year ended December 31, 2008 was borrowings under our senior revolving credit facility with Comerica Bank, discussed under "Senior Revolving Credit Facility" below (the "Comerica Credit Facility"). Cash on hand at December 31, 2008 totaled \$1.0 million and availability under the Comerica Credit Facility totaled \$27.1 million resulting in total liquidity of \$28.1 million. We believe that we have sufficient available cash required for operations for the next 12 months. However, cash and the availability of cash could be materially restricted if:

- (i) revenues decline as a result of the decline in the price of oil or other economic factors,
- (ii) amounts billed are not collected or are not collected in a timely manner,
- (iii) circumstances prevent the timely internal processing of invoices,
- (iv) project mix shifts from cost-reimbursable to fixed-price contracts during significant periods of growth,
- (v) the Company loses one or more of its major customers,
- (vi) the Company experiences cost overruns on fixed-price contracts,
- (vii) our client mix shifts from our historical owner-operator client

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- base to more developer based clients,
- (viii) future acquisitions are not integrated timely, or
- (ix) we are not able to meet the covenants of the Comerica Credit Facility.

If any such event occurs, we would be forced to consider alternative financing options.

### Cash Flows from Operating Activities

Operating activities provided \$8.7 million in net cash in 2008 but required the use of \$2.0 million and \$9.0 million in net cash in each of 2007 and 2006 respectively. For the year ended December 31, 2008, cash generated from operations was offset by the increase in working capital primarily due to increased trade receivables of \$30.1 million, increased accounts payable of \$8.2 million, and increased accrued compensation and benefits of \$7.7 million. The increase in trade receivables was primarily due to amounts billed but not collected in a timely manner in our Engineering segment and circumstances preventing the timely internal processing of invoices in our Automation segment. The increase in accounts payable primarily related to vendor sub-contractor payments of approximately \$8.7 million related to projects in both our Engineering and Automation segments. The increase in accrued compensation and benefits was primarily related to year-over-year timing differences of pay period ending dates during the month of December.

In 2007, the note receivable re-classification on the SLE project was related to the client's obligation in the principal amount of \$12.3 million.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Cash flows from operating activities were significantly lower in 2006 than in 2007 and 2008 primarily due to the \$13.7 million in operating losses recorded during 2006 on two fixed price EPC contracts.

### Cash Flows from Investing Activities

Investing activities used cash totaling \$4.4 million in 2008, compared to \$1.7 million in 2007 and \$9.3 million in 2006. In 2008, investing activities were primarily used for capital additions and the investment made to acquire ACE. In 2007, our investing activities consisted of capital additions of \$2.2 million primarily for computers and technical software applications. The investing activity in 2006, which was significantly higher than in 2007 and 2008, was primarily a result of the investments made in acquiring WRC Corporation and certain assets of both ATI and Watco.

Future investing activities are anticipated to remain consistent with prior years and include capital additions for leasehold improvements, technical applications software, and equipment, such as upgrades to computers. The Comerica Credit Facility, discussed under "Senior Revolving Credit Facility" below, limits annual capital expenditures to \$3.25 million.

### Cash Flows from Financing Activities

Financing activities used cash totaling \$4.1 million in 2008, but provided cash totaling \$3.2 million and \$19.6 million in 2007 and 2006, respectively. Our primary financing mechanism is our line of credit under the Comerica Credit Facility. The line of credit has been used principally to finance working capital requirements. During 2008, our borrowings on the line of credit were

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\$296.0 million in the aggregate, and we repaid an aggregate of \$301.2 million on our short-term and long-term bank and other debt. During 2007, our borrowings on the line of credit were \$175.7 million in the aggregate, and we repaid an aggregate of \$171.8 million on our short-term and long-term bank and other debt. Cash flow from financing activity in 2006, which was significantly higher than in 2007 and 2008, was primarily a result of borrowings related to our acquisitions of WRC Corporation, ATI, and Watco plus the losses related to the two fixed-price contracts.

We anticipate that future cash flows from financing activities will be borrowings, payments on the line of credit and payments on long-term debt instruments. Line of credit fluctuations are a function of timing related to operations, obligations and payments received on accounts receivable. We estimate that payments on long-term debt, including interest for the coming year, will be \$1.9 million.

### Senior Revolving Credit Facility

Historically, we have satisfied our cash requirements through operations and borrowings under a revolving credit facility. During August 2007, the Company entered into a new credit agreement with Comerica Bank, which provides a three-year, \$50 million senior secured revolving credit facility ("Comerica Credit Facility"). The Comerica Credit Facility is guaranteed by substantially all of Company's subsidiaries, is secured by substantially all of the Company's assets, and positions Comerica as senior to all other debt. It replaced a \$35 million senior revolving credit facility that would have expired in July 2009. The outstanding balance on the Comerica Credit Facility as of December 31, 2008 was \$22.5 million. The remaining borrowings available under the Comerica Credit Facility as of December 31, 2008 were \$27.1 million after consideration of loan covenant restrictions.

At the Company's option, amounts borrowed under the Comerica Credit Facility will bear interest at a Eurodollar-based Rate plus an additional margin based on the Leverage Ratio or at the Prime-based Rate. The additional margin ranges from 125 basis points to 175 basis points on the LIBOR-based loans.

Upon maturity, the LIBOR debt will automatically roll into the Revolver unless the Company elects to renew, at which time a new maturity date and interest rate will be set.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The Comerica Credit Facility requires the Company to maintain certain financial covenants as of the end of each calendar month, including the following:

- o Leverage Ratio not to exceed 3.00 to 1.00;
- o Asset Coverage Ratio less than 1.00 to 1.00; and
- o Net Worth greater than the sum of \$40.1 million plus 75% of positive Net Income earned in each fiscal quarter after January 1, 2007 plus 100% of the net proceeds of any offering, sale or other transfer of any capital stock or any equity securities.

The Comerica Credit Facility also contains covenants that place certain limitations on the Company including limits on new debt, mergers, asset sales, investments, fixed-price contracts, and restrictions on certain distributions. The Company was in compliance with all covenants under the Comerica Credit Facility as of December 31, 2008.

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Due to significant losses incurred on two fixed-price projects during the third and fourth quarters of 2006, the Company requested and was successful in obtaining a waiver and subsequent amendment to the Comerica Credit Facility in order to meet the monthly fixed charge ratio. If we had not been able to obtain a waiver or amendment of the covenant, we may have been unable to make further borrowings and may have been required to repay all loans then outstanding under the Comerica Credit Facility.

### Letters of Credit

As of December 31, 2008, the Company had outstanding letters of credit totaling \$367,000 primarily to cover self-insured deductibles under both our general liability and workers' compensation insurance policies.

### Long-term Debt

Our total long-term debt outstanding on December 31, 2008 was \$25.7 million (see Note 10 to Consolidated Financial Statements), a decrease from \$30.8 million as of December 31, 2007. As of December 31, 2008, the Company had outstanding letters of credit totaling \$367,000 primarily to cover self-insured deductibles under both our general liability and workers compensation insurance policies.

The following table summarizes our contractual obligations as of December 31, 2008:

|  | Payments Due by Period |                  |                 |                 |             |
|--|------------------------|------------------|-----------------|-----------------|-------------|
|  | 2009                   | 2010             | 2011            | 2012            | 2013        |
|  | (in thousands)         |                  |                 |                 |             |
| Long-term debt   | \$ 1,686               | \$ 23,614        | \$ -            | \$ -            | \$ -        |
| Capital Lease  | 175                    | 192              | 51              | -               | -           |
| Contractual interest<br>and discount on certain notes(1) | 1,222                  | 1,150            | 1               | -               | -           |
| Subtotal long-term debt                                  | 3,083                  | 24,956           | 52              | -               | -           |
| Insurance note payable                                   | 1,058                  | -                | -               | -               | -           |
| Operating leases   | 5,353                  | 4,819            | 3,991           | 2,636           | -           |
| <b>Total contractual cash obligations</b>                | <b>\$ 9,494</b>        | <b>\$ 29,775</b> | <b>\$ 4,043</b> | <b>\$ 2,636</b> | <b>\$ -</b> |

(1) Future interest consists primarily of interest on the line of credit under the Comerica Credit Facility. The rate applicable to debt outstanding at December 31, 2008 was 3% and fluctuates with the prime rate. Interest and discount rates on the remainder of the Company's notes payable vary from 4% to 6%, with the weighted average being 5.8% at December 31, 2008.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

### 2008 Non-Cash Transactions

In 2008, non-cash transactions included \$1.9 million discounted notes payable issued in connection with the acquisition of ACE. In 2007, non-cash transactions included a \$1.5 million note receivable issued upon the sale of a building the Company owned in Baton Rouge, Louisiana and a note receivable in the principal

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amount of \$12.3 million issued to South Louisiana Ethanol ("SLE") and evidenced by a hand note. To see details of the hand note, see Exhibits 10.19, 10.20 and 10.21 filed with the 2007 10-K. In 2006, non-cash transactions included \$216,000 notes receivable issued in connection with a sale of assets and \$3.9 million notes payable issued for acquisitions. Also in 2006, \$1.4 million of stock was issued associated with the acquisition of WRC Corporation. We also acquired insurance with notes payable of \$1.6 million, \$1.2 million, and \$1.3 million in 2008, 2007, and 2006, respectively.

### Derivative Financial Instruments

We do not hold any derivative financial instruments for trading purposes or otherwise. Furthermore, we have not engaged in energy or commodity trading activities and do not anticipate doing so in the future, nor do we have any transactions involving unconsolidated entities or special purpose entities.

### Long-term Note Receivable

In the first quarter of 2007, ENGlobal Engineering, Inc. ("EEI") and South Louisiana Ethanol, LLC ("SLE") executed an agreement for EPC services relating to the retro-fit of an ethanol plant in southern Louisiana. The history of the SLE project (the "Project") is described in Note 12 to the Company's financial statements included in its Quarterly Report on Form 10-Q for the quarter ended September 30, 2007.

After funding certain initial stages of the Project with cash, SLE obtained temporary financing from its bridge lending bank in the amount of \$20 million until it could obtain permanent financing for the Project. The parties anticipated that permanent financing would be obtained from other lenders no later than August 31, 2007. SLE had engaged a major commercial bank to assist with finding permanent financing. Further, SLE informed EEI that this commercial bank had obtained permanent financing for numerous other ethanol facilities. Based on this, as well as on conversations between the Company's Chief Executive Officer and representatives of this commercial bank, EEI expected the financing for the Project to be consummated on a timely basis. Given this expectation, together with the favorable prices for corn and for ethanol, and the robust credit markets, EEI believed that the Project would be successful and commenced work in the fourth quarter of 2006.

In the late summer of 2007, although SLE was current in its payments it had not obtained permanent financing, corn prices began to increase and ethanol prices began to decline. Accordingly the Company decided that it was advisable to obtain security for the amount due. On August 31, 2007, SLE executed a collateral mortgage, a collateral note, and a promissory note in the amount of up to \$15 million, securing payment of the amount due, and the Company re-classed the amounts receivable from SLE to a Note Receivable. In connection with this promissory note, and as provided for under Louisiana law, SLE executed another promissory note (the "Hand Note") on or about October 22, 2007. The Hand Note had a principal balance of approximately \$12.3 million, constituting all amounts then due.

SLE was current on all invoices through September 18, 2007. However, on September 20, 2007, SLE requested that EEI immediately demobilize its activity and instruct its subcontractors to do the same. EEI complied with this request. Because collectability was not assured, the Company reserved the amounts which were in excess of the Hand Note.

Although work has not recommenced on the Project and SLE has not obtained permanent financing, the Company continues to believe that, due to the value of the collateral and the Company's lien position, the Note Receivable is fully

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

collectible. Specifically, an updated appraisal from the bridge lending bank's appraiser indicates a fair market value of \$22.1 million, an orderly liquidation value of \$14.9 million, and a forced liquidation value of \$11.7 million.

The Company believes that if the collateral is liquidated, SLE's obligations to the Company would be paid in full pursuant to the collateral mortgage in favor of the Company. However, collectability is not assured at this time. As a result, in the fourth quarter of 2007 the Company recorded a valuation reserve and subsequent charge against Bad Debt expense in the amount of \$3.2 million to reduce the book value of the Note Receivable. In the fourth quarter of 2008, the Company increased the valuation reserve and subsequent charge against Bad Debt expense in the amount of \$559,000. As of December 31, 2008, the Company performed its impairment analysis for the asset group classified as long-term notes receivable, particularly Notes Receivable - South Louisiana Ethanol, of \$8.6 million. Due to the ongoing discovery and analysis currently in process on our SLE litigation we cannot yet determine the actual proceeds that would be generated for ENGlobal when the courts determine the status of each asset and the relative lien priorities of SLE's creditors, and then such assets are sold. However, at this time management believes that, given the Company's lien position as documented in public records, the value of the collateral will cover the current balance sheet exposure. Any additional charge, or negative determination by the courts, could have a negative impact on future earnings estimated at 2.1 cents per share per million of un-recovered exposure as a result of a non-cash charge to operations. However, at this time the Company believes that the ultimate disposition of the SLE collateral will not materially adversely affect our liquidity or overall financial position.

The Company will continue to evaluate the SLE situation and, if required in the future, make adjustments to the reserve as necessary to remain in compliance with generally accepted accounting principles.

#### Contingent Liabilities and Commitments

To our knowledge, the Company is not exposed to any environmental liability.

The Company does not have any product liability issues. Lease commitments are included in Footnote 11 of the consolidated financial statements. The Company leases all of its office space.

There are no off-balance sheet financing arrangements.

#### Income Tax Provision

On July 13, 2006, the FASB issued FIN 48, "Accounting for Uncertainty in Income Taxes, and Related Implementation Issues," which provides guidance on the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions that a company has taken or expects to take on a tax return. Under FIN 48, financial statements should reflect expected future tax consequences of such positions presuming the taxing authorities have full knowledge of the position and all relevant facts. This interpretation also revises the disclosure requirements and was adopted by the Company effective as of January 1, 2007. There are currently no material tax positions identified as uncertain for the Company or its' subsidiaries.

We recognize interest related to uncertain tax positions in interest expense and penalties related to uncertain tax positions in governmental penalties. As of December 31, 2008, we have not recognized interest or penalties relating to any

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uncertain tax positions.

The Company is subject to federal and state income tax audits from time to time that could result in proposed assessments. The Company cannot predict with certainty the timing of such audits, how these audits would be resolved and whether the Company would be required to make additional tax payments, which may or may not include penalties and interest.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The Company does not have any examination on-going by the Internal Revenue Service, and the open years subject to audit are currently tax years 2005-2007. For most states where the Company conducts business, the Company is subject to examination for the preceding three to six years.

#### Asset Management

We typically sell our products and services on short-term credit and seek to minimize our credit risk by performing credit checks and conducting our own collection efforts. Our trade accounts receivable increased to \$94.6 million from \$64.1 million as of December 31, 2008 and 2007, respectively. The number of days outstanding for trade accounts receivable increased from 61 days at December 31, 2007, to 64 days at December 31, 2008 primarily due to administrative delays in getting billings completed on new projects and clients extending payments beyond payment terms. We do not expect the number of days outstanding for trade accounts receivable to materially change in the first quarter of 2009. Bad debt expense was approximately .03% and .08% of revenue for the years ended December 31, 2008 and 2007. We increased our allowance for doubtful accounts from \$1.4 million to \$2.3 million or 2.0% of trade accounts receivable balance for each of the years 2007 and 2008, respectively. While we continue to manage this portion of our business very carefully, it is possible that our days sales outstanding, bad debt expense and allowance for doubtful accounts will deteriorate if the economy continues to decline.

#### Risk Management

In performing services for our clients, we could potentially face liability for breach of contract, personal injury, property damage or negligence, including professional errors and omissions. We often agree to indemnify our clients for losses and expenses incurred as a result of our negligence and, in certain cases, the sole or concurrent negligence of our clients. Our quality control and assurance program includes a control function to establish standards and procedures for performance and for documentation of project tasks, and an assurance function to audit and to monitor compliance with procedures and quality standards. We maintain liability insurance for bodily injury and third party property damage, professional errors and omissions, and workers compensation coverage, which we consider sufficient to insure against these risks, subject to self-insured amounts.

#### Seasonality

Holidays and employee vacations during our fourth quarter exert downward pressure on revenues for that quarter, which is only partially offset by the year-end efforts on the part of many clients to spend any remaining funds budgeted for services and capital expenditures during the year. The annual budgeting and approval process under which these clients operate is normally not completed until after the beginning of each new year, which can depress results for the first quarter. Principally due to these factors, our first and fourth



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quarters may be less robust than our second and third quarters.

### Critical Accounting Policies

#### Revenue Recognition

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Because the majority of the Company's revenue is recognized under cost-plus contracts, significant estimates are generally not involved in determining revenue recognition.

Most of our contracts are with Fortune 500 companies. As a result, collection risk is generally not a relevant factor in the recognition of revenue. However, timing of accounts receivable collections could have a serious impact in the Company's liquidity. Also, the Company is engaging in more development contracts with smaller companies. We anticipate that collection risk will be greater on these projects and have instituted new policies relating to ascertaining the creditworthiness of new customers. It is not clear how changes in the economy will impact smaller companies' ability to undertake and finance these projects.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Our revenue is largely composed of engineering service revenue and product sales. The majority of our services are provided through time-and-material contracts (also referred to as cost-plus contracts). Some contracts (typically smaller contracts) have not-to-exceed provisions that place a cap on the revenue that we may receive under a particular contract. The contract is awarded with a maximum aggregate revenue, referred to as the not-to-exceed amount. The Company does not earn revenue over the not-to-exceed amount unless we obtain a change order. The Company is not obligated to complete the contract once the not-to-exceed amount has been reached. Billings on time-and-material contracts are produced every two weeks.

On occasion, we serve as purchasing agent by procuring subcontractors, material and equipment on behalf of a client and passing the cost on to the client with no mark-up or profit. In accordance with Statement of Position ("SOP") 81-1, revenue and cost for these types of purchases are not included in total revenue and cost. For financial reporting this "pass-through" type of transaction is reported net. During 2007 and 2006, pass-through transactions totaled \$0.5 million and \$8.9 million, respectively. We had no pass-through transactions in 2008.

Profits and losses on fixed-price contracts are recorded on the percentage-of-completion method of accounting, measured by the percentage of contract costs incurred to date to estimated total contract costs for each contract. Contract costs include amounts paid for materials, equipment and subcontractors. Anticipated losses on uncompleted construction contracts are charged to operations as soon as such losses can be estimated. Changes in job performance, job conditions, estimated profitability and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined.

The asset, "costs and estimated earnings in excess of billings on uncompleted contracts," represents revenue recognized in excess of amounts billed on fixed-price contracts. The Company's inability to manage significant levels or increases in "costs and estimated earning in excess of billings on uncompleted contracts" could have a serious impact on the Company's cash flow. The liability "billings in excess of costs and estimated profits on uncompleted contracts"

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represents amounts billed in excess of revenue recognized on fixed-price contracts.

### Change Orders

Change orders are modifications of an original contract that effectively change deliverables under a contract without adding new provisions. Either we or our clients may initiate change orders. Change orders may include changes in specifications or design, manner of performance, equipment, materials, scope of work, and/or the period of completion of the project.

Change orders occur when changes are experienced once a contract is begun. Change orders are sometimes documented and in most cases the terms of change orders are agreed upon with the client before the work is performed. Other times, circumstances may require that work progress without the client's written agreement before the work is performed. In those cases, we are taking a risk that the customer will not sign a change order or at a later time the customer will seek to negotiate the pricing of the additional work. Costs related to change orders are recognized when they are incurred. Change orders are included in the total estimated contract revenue when it is more likely than not that the change orders will result in a bona fide addition to value that can be reliably estimated.

We have a favorable history of negotiating and collecting for work performed under change orders and our bi-weekly billing cycle has proven to be timely enough to properly account for change orders.

### Goodwill

Goodwill and intangible assets with indefinite useful lives are not amortized and are tested at least annually for impairment. We perform our annual analysis as of the fourth quarter of each fiscal year and in any period in which indicators of impairment warrant an additional analysis. Goodwill represents the excess of the purchase price of acquisitions over the fair value of the net assets acquired. Goodwill is evaluated for impairment by first comparing management's estimate of the fair value of a reporting unit with its carrying

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## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

value, including goodwill. Reporting units for the purpose of goodwill impairment calculations are components one level below our reportable operating segments.

Management utilizes a discounted cash flow analysis to determine the estimated fair value of our reporting units. Significant judgments and assumptions including determination of an appropriate discount rate, projecting revenue growth and gross margins, estimating operating and interest expense and projecting capital expenditure levels are involved in making these fair value estimates. As a result, actual results may differ from the estimates utilized in our discounted cash flow analysis. The use of alternate judgments and/or assumptions could result in significantly different fair value estimates and therefore different decisions about the appropriate recognition of impairment charges in the financial statements.

As a result of these uncertainties, we utilize multiple scenarios and assign probabilities to each of the scenarios in the discounted cash flow analysis. The

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results of the discounted cash flow analysis are then compared to the carrying value of the reporting unit. If the carrying value of a reporting unit exceeds its fair value, a computation of the implied fair value of goodwill is compared with its carrying value. If the carrying value of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in the amount of the excess. If an impairment charge is incurred, it negatively impacts our results of operations and financial position.

The results of our annual goodwill impairment analysis for the year ended December 31, 2008 indicated no impairment to the recorded value of our goodwill assets. The Company recognized \$432,000 of impairment in our Automation segment in 2007 and did not recognize impairment for the year ended December 31, 2006. If the economic downturn causes the value of one or more of the Company's subsidiaries to decline, the Company might have goodwill impairment in future years.

### Deferred Tax

The Company had net deferred tax asset balances of \$4.4 million and \$3.2 million as of December 31, 2008 and December 31, 2007, respectively. These net deferred tax assets are identified in Footnote 16 to the financial statements.

### Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measurements" which establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The effective date of SFAS 157 for us was January 1, 2008. Adoption of SFAS 157 has not had and is not expected to have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS 160, "Noncontrolling Interests in Consolidated Financial Statements--An Amendment of ARB No. 51." SFAS 160 establishes new accounting and reporting standard for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal periods, and interim periods within those fiscal years, beginning on or after December 15, 2008. This new accounting standard will not have an impact on our financial statements unless and until we enter into transactions that create noncontrolling interests.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R will apply to ENGlobal prospectively for future business combinations with an acquisition date on or after January 1, 2009.

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## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

### Inflation and Changing Prices

The Company is planning to incorporate certain provisions in its future fixed-price contracts that would allow the Company to recover a portion of certain unforeseen price changes in materials and labor that are not in the range of normally expected inflation.

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### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of December 31, 2008 and 2007, the Company did not participate in any derivative financial instruments or other financial and commodity instruments for which fair value disclosure would be required under SFAS No. 107 or SFAS No. 133. There are no material investments at December 31, 2008. Accordingly, the Company has no quantitative information concerning the market risk of participating in such investments.

The Company's primary interest rate risk relates to its variable-rate line of credit debt obligation, which totaled \$22.5 million and \$27.8 million as of December 31, 2008 and 2007, respectively. Assuming a 10% increase in the interest rate on this variable-rate debt obligation i.e., an increase from the actual average interest rate of 5.05% as of December 31, 2008, to an average interest rate of 5.56%, annual interest expense would have been approximately \$144,000 higher in 2008 based on our annual average line of credit obligation. Due to the current credit market, a greater concern might be the impact of a material violation of certain financial covenants in our Credit Agreement resulting in a re-pricing of that agreement. Assuming an increase in interest rate to 7% on our variable-rate debt obligation i.e., an increase from the actual average interest rate of 5.05% as of December 31, 2008, annual interest expense would have been approximately \$556,000 higher in 2008 based on an annual average line of credit debt obligation, plus a renewal or origination fee of equal proportion on a similar Credit Agreement. The Company does not have any interest rate swap or exchange agreements.

The Company has no market risk exposure in the areas of interest rate risk from investments because the Company did not have an investment portfolio as of December 31, 2008.

Currently, the Company does not engage in foreign currency hedging activities. Transactions in Canadian dollars in our Canadian subsidiary have been translated into U.S. dollars using the current rate method, such that assets and liabilities are translated at the rates of exchange in effect at the balance sheet date and revenue and expenses are translated at the average rates of exchange during the appropriate fiscal period. As a result, the carrying value of the Company's investments in Canada is subject to the risk of foreign currency fluctuations. Additionally, any revenue received from the Company's international operations in other than U.S. dollars will be subject to foreign exchange risk. The percentage of revenue received from foreign customers is identified in the discussion of segment revenue. Most revenue received from foreign customers is paid to the Company in U. S. currency, except for revenue collected by our Canadian subsidiaries. The Canadian dollar is not subject to volatile price fluctuations compared to the U.S. dollar.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The audited consolidated balance sheets for ENGlobal Corporation, as of December 31, 2008 and 2007 and statements of income, cash flows and stockholders' equity for the three-year period ended December 31, 2008, are attached hereto and made part hereof.

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON CONSOLIDATED FINANCIAL STATEMENTS

Board of Directors  
ENGlobal Corporation  
Houston, Texas

We have audited the accompanying consolidated balance sheets of ENGlobal Corporation and subsidiaries (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2008. We have also audited the schedule listed in the accompanying Item 8. These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

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

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ENGlobal Corporation and subsidiaries at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the schedule presents fairly, in all material respects, the information set forth, therein in relation to the financial statements taken as a whole.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2008, based on the criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 16, 2009, expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Hein & Associates LLP  
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Hein & Associates LLP  
Houston, Texas

March 16, 2009

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### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors and Stockholders  
ENGlobal Corporation

We have audited ENGlobal Corporation's internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). ENGlobal Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting

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and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, ENGlobal Corporation maintained effective internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of ENGlobal Corporation as of December 31, 2008 and 2007, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2008, of ENGlobal and our report dated March 16, 2009 expressed an unqualified opinion thereon.

/s/ Hein & Associates LLP

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Hein & Associates LLP

Houston, Texas

March 16, 2009

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### ENGLOBAL CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2008 AND 2007 (in thousands)

|   | ASSETS | 2008       |
|---|--------|------------|
| Current Assets  |        | -----      |
| Cash and cash equivalents   |        | \$ 1,000   |
| Trade receivables, net of allowances of \$2,288 and \$1,405                 |        | 96,023     |
| Prepaid expenses and other current assets                                   |        | 2,392      |
| Current portion of notes receivable   |        | 59         |
| Costs and estimated earnings in excess of billings on uncompleted contracts |        | 6,913      |
| Deferred tax asset  |        | 4,281      |
|   |        | -----      |
| Total current assets  |        | \$ 110,668 |

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|   |        |
|---|--------|
| Property and equipment, net                                       | 5,744  |
| Goodwill  | 21,457 |
| Other intangible assets, net                                      | 5,000  |
| Long-term notes receivable, net of current portion and allowances | 8,636  |
| Deferred tax asset, non-current                                   | 153    |
| Other assets  | 1,047  |

Total assets \$ 152,705

LIABILITIES AND STOCKHOLDERS' EQUITY

|   |           |
|---|-----------|
| Current Liabilities   |           |
| Accounts payable  | \$ 18,830 |
| Accrued compensation and benefits   | 24,432    |
| Notes payable   | 1,058     |
| Current portion of long-term debt and leases                                | 1,861     |
| Deferred rent   | 416       |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 208       |
| Federal and state income taxes payable                                      | 2,472     |
| Other   | 2,805     |

Total current liabilities \$ 52,082

|  |        |
|--|--------|
| Long-Term Debt, net of current portion   | 23,614 |
| Long-Term Leases, net of current portion | 243    |

Total liabilities \$ 75,939

Commitments and Contingencies (Notes 3, 10, 11, 16, and 19)

|   |        |
|---|--------|
| Stockholders' Equity  |        |
| Common stock - \$0.001 par value; 75,000,000 shares authorized; 27,294,852 and 27,051,766 shares outstanding and 27,294,852 and 27,051,766 issued at December 31, 2008 and 2007, respectively | 27     |
| Additional paid-in capital  | 36,415 |
| Retained earnings   | 40,439 |
| Accumulated other comprehensive income (loss)   | (115)  |

Total stockholders' equity \$ 76,766

Total liabilities and stockholders' equity \$ 152,705

See accompanying notes to these consolidated financial statements.

ENGLOBAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended December 31,

(in thousands)

2008 2007 2006



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|   |            |            |            |
|---|------------|------------|------------|
| Operating Revenue                               | \$ 493,332 | \$ 363,227 | \$ 303,090 |
|   | -----      | -----      | -----      |
| Operating Costs and Expenses:                   |            |            |            |
| Operating Costs                                 | 429,525    | 305,610    | 276,826    |
| Selling, General, and Administrative Expenses   | 32,208     | 34,774     | 29,884     |
|   | -----      | -----      | -----      |
| Total Operating Costs and Expenses              | 461,733    | 340,384    | 306,710    |
|   | -----      | -----      | -----      |
| Operating Income (Loss)                         | \$ 31,599  | \$ 22,843  | \$ (3,620) |
| Interest and Other expense                      | (1,576)    | (2,170)    | (679)      |
|   | -----      | -----      | -----      |
| Income (loss) before provision for income taxes | \$ 30,023  | \$ 20,673  | \$ (4,299) |
| Provision for Income Taxes                      | 11,765     | 8,209      | (813)      |
|   | -----      | -----      | -----      |
| Net Income (Loss)                               | \$ 18,258  | \$ 12,464  | \$ (3,486) |
|   | =====      | =====      | =====      |
| Basic earnings (loss) per common share          | \$ 0.67    | \$ 0.46    | \$ (0.13)  |
| Weighted average common shares outstanding      | 27,180     | 26,916     | 26,538     |
|   | =====      | =====      | =====      |
| Diluted earnings (loss) per common share        | \$ 0.66    | \$ 0.45    | \$ (0.13)  |
| Weighted average common shares outstanding      | 27,672     | 27,435     | 26,538     |
|   | =====      | =====      | =====      |

See accompanying notes to these consolidated financial statements.

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ENGLOBAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
FOR YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006  
(in thousands)

|                              | 2008   | 2007   | 2006   |
|------------------------------|--------|--------|--------|
|                              | -----  | -----  | -----  |
| Preferred Stock              | \$ --  | \$ --  | \$ --  |
| Common Stock                 |        |        |        |
| Balance at beginning of year | 28     | 28     | 27     |
| Common stock issued          | --     | --     | 1      |
| Retirement of treasury stock | (1)    |        |        |
|                              | -----  | -----  | -----  |
| Balance at end of year       | 27     | 28     | 28     |
|                              | -----  | -----  | -----  |
| Paid-in Capital              |        |        |        |
| Balance at beginning of year | 33,593 | 31,147 | 27,230 |
| Common stock issued          | 1,338  | 1,007  | 2,333  |

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|   |           |           |           |
|---|-----------|-----------|-----------|
| Stock based compensation                                    | 1,171     | 1,439     | 2,176     |
| Deferred tax adjustment                                     | 313       |           |           |
|   | -----     | -----     | -----     |
| Balance at end of year                                      | 36,415    | 33,593    | 31,147    |
|   | -----     | -----     | -----     |
| Retained Earnings   |           |           |           |
| Balance at beginning of year                                | 22,181    | 9,717     | 13,203    |
| Net income (loss)   | 18,258    | 12,464    | (3,486)   |
|   | -----     | -----     | -----     |
| Balance at end of year                                      | 40,439    | 22,181    | 9,717     |
|   | -----     | -----     | -----     |
| Treasury Stock  |           |           |           |
| Balance at beginning of year                                | --        | --        | (592)     |
| Retirement of treasury stock                                | --        | --        | 592       |
|   | -----     | -----     | -----     |
| Balance at end of year                                      | --        | --        | --        |
|   | -----     | -----     | -----     |
| Accumulated Other Comprehensive Income (Loss), net of taxes |           |           |           |
| Balance at beginning of year                                | (5)       | (30)      | (4)       |
| Foreign currency translation adjustment                     | (110)     | 25        | (26)      |
|   | -----     | -----     | -----     |
| Balance at end of year                                      | (115)     | (5)       | (30)      |
|   | -----     | -----     | -----     |
| Total Stockholder's Equity                                  | \$ 76,766 | \$ 55,797 | \$ 40,862 |
|   | =====     | =====     | =====     |

See accompanying notes to these consolidated financial statements.

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ENGLOBAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOW

|   | Years Ended December |           |
|---|----------------------|-----------|
|   | (in thousands)       |           |
|   | 2008                 | 2007      |
|   | -----                | -----     |
| Cash Flows from Operating Activities  |                      |           |
| Net income (loss)   | \$ 18,258            | \$ 12,464 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities - |                      |           |
| Depreciation and amortization   | 4,642                | 4,550     |
| Goodwill impairment   | --                   | 432       |
| Stock based compensation  | 1,233                | 1,439     |
| Deferred income tax expense   | (1,200)              | (1,962)   |
| (Gain) Loss on disposal of property, plant and equipment  | (100)                | (408)     |

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|  |           |           |
|--|-----------|-----------|
| Changes in current assets and liabilities, net of acquisitions - |           |           |
| Trade receivables  | (30,145)  | (3,894)   |
| Notes receivable   | --        | (12,329)  |
| Reserve on notes receivable                                      | 558       | 3,150     |
| Costs and estimated earnings in excess of billings               | 68        | (1,591)   |
| Prepaid expenses and other assets                                | (792)     | (1,652)   |
| Accounts payable   | 8,185     | (4,190)   |
| Accrued compensation and benefits                                | 7,729     | 3,375     |
| Billings in excess of costs and estimated earnings               | (755)     | 423       |
| Other liabilities  | (844)     | (3,416)   |
| Income taxes   | 1,509     | 1,629     |
|  | -----     | -----     |
| Net cash provided by (used in) operating activities              | 8,346     | (1,980)   |
|  | -----     | -----     |
| Cash Flows from Investing Activities                             |           |           |
| Purchase of property and equipment                               | (1,920)   | (2,195)   |
| Additional consideration for acquisitions                        | --        | 18        |
| Proceeds from insurance  | --        | --        |
| Partnership distributions  | --        | --        |
| Acquisitions of businesses, net of cash acquired                 | (2,843)   | --        |
| Proceeds from asset sales  | 398       | 470       |
|  | -----     | -----     |
| Net cash (used in) investing activities                          | (4,365)   | (1,707)   |
|  | -----     | -----     |
| Cash Flows from Financing Activities                             |           |           |
| Borrowings on line of credit                                     | 295,982   | 175,674   |
| Payments on line of credit                                       | (301,287) | (171,802) |
| Proceeds from issuance of common stock                           | 1,650     | 1,007     |
| Proceeds from notes receivable                                   | 1,494     | 93        |
| Borrowings on capital lease                                      | 418       | --        |
| Payments on other long-term debt                                 | (2,036)   | (1,805)   |
|  | -----     | -----     |
| Net cash provided by (used in) financing activities              | (3,779)   | 3,167     |
|  | -----     | -----     |
| Effect of Exchange Rate Changes on Cash                          | (110)     | 25        |
|  | -----     | -----     |
| Net change in cash and cash equivalents                          | 92        | (495)     |
| Cash and Cash Equivalents - beginning of year                    | 908       | 1,403     |
|  | -----     | -----     |
| Cash and Cash Equivalents - end of year                          | \$ 1,000  | \$ 908    |
|  | =====     | =====     |

See accompanying notes to these consolidated financial statements.

### ENGLOBAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION

##### Organization and Operations

-----  
ENGlobal Corporation is a Nevada corporation formed in 1994. Unless the context requires otherwise, references to "we", "us", "our", "the Company" or "ENGlobal" are intended to mean the consolidated business and operations of ENGlobal Corporation.

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Our business operations consist of providing engineering and other professional project services related to design, fabrication, procurement, maintenance, environmental and other governmental compliance and construction management, primarily with respect to energy sector infrastructure facilities throughout the United States and Canada. Please see "Note 18-Segment Information" for a description of our segments and segment operations.

### Basis of Presentation

-----

The accompanying consolidated financial statements and related notes present our consolidated financial position as of December 31, 2008 and 2007, and the results of our operations, cash flows and changes in stockholder's equity for the years ended December 31, 2008, 2007 and 2006. They are prepared in accordance with accounting principles generally accepted in the United States of America. Certain amounts for prior periods have been reclassified to conform to the current presentation. In preparing financial statements, management makes informed judgments and estimates that affect the reported amounts of assets and liabilities as of the date of the financial statements and affect the reported amounts of revenues and expenses during the reporting periods. On an ongoing basis, management reviews its estimates, including those related to percentage-of-completion contracts in progress, litigation, income taxes, impairment of long-lived assets and fair values. Changes in facts and circumstances or discovery of new information may result in revised estimates. Actual results could differ from these estimates.

### NOTE 2 -ACCOUNTING POLICIES AND RELATED MATTERS

#### Cash and cash equivalents

-----

Cash and cash equivalents include all cash on hand, demand deposits, and investments with original maturities of three months or less. We consider cash equivalents to include short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

The company utilizes a cash management system whereby bank accounts are swept daily to reduce outstanding balances on the Company's line of credit. Major operating bank accounts are automatically replenished daily to meet check-clearing requirements. Outstanding checks are recorded as a reduction of cash when they are issued. Our checks that have not yet been paid by banks at a reporting date are reclassified to accounts payable in the financial statements.

#### Consolidation Policy

-----

Our consolidated financial statements include our accounts and those of our majority-owned subsidiaries in which we have a controlling interest after the elimination of all material inter-company accounts and transactions. Currently, all of our subsidiaries are wholly-owned. We also consolidate other entities and ventures in which we possess a controlling interest. We evaluate our financial interests in business enterprises to determine if they represent variable interest entities where we are the primary beneficiary. If such criteria are met, we consolidate the financial statements of such businesses with those of our own. We do not currently hold such interests.

While we do not currently own any significant equity interests in unconsolidated affiliates and do not frequently conduct our business through such entities, it is our policy to follow the equity method of accounting if our ownership interest is between 20% and 50% and we exercise significant influence over the operating and financial policies of an entity. Our proportionate share of profits and losses from transactions with equity method unconsolidated

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## ENGLOBAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 2 -ACCOUNTING POLICIES AND RELATED MATTERS (Continued)

affiliates is eliminated in consolidation to the extent such amounts are material and remain on our equity method investees' balance sheet in inventory or similar accounts.

If our ownership interest in an investee does not provide us with either control or significant influence over the investee, we account for the investment using the cost method.

#### Comprehensive Income

Comprehensive income includes net income and other comprehensive income. Currently our other comprehensive income is comprised of unrealized foreign exchange gains and losses.

Accumulated other comprehensive income is as follows:

|   | 2008           | 2007      | 2006       |
|---|----------------|-----------|------------|
|   | -----          | -----     | -----      |
|   | (in thousands) |           |            |
|   | -----          | -----     | -----      |
| Net income (loss)                       | \$ 18,258      | \$ 12,464 | \$ (3,486) |
| Foreign currency translation adjustment | (115)          | (5)       | (26)       |
|   | -----          | -----     | -----      |
| Comprehensive income (loss)             | \$ 18,143      | \$ 12,459 | \$ (3,512) |
|   | =====          | =====     | =====      |

#### Concentration of Credit Risk

Financial instruments which potentially subject ENGlobal to concentrations of credit risk consist primarily of trade accounts and notes receivable. Although our services are provided largely to the energy sector, management believes the risk due to this concentration is limited because a significant portion of our services are provided under contracts with major integrated oil and gas companies and other industry leaders.

We extend credit to customers and other parties in the normal course of business. We have established various procedures to manage our credit exposure, including initial credit approvals, credit limits and terms, letters of credit, and occasionally through rights of offset. We also use prepayments and guarantees to limit credit risk to ensure that our established credit criteria are met. Our most significant exposure to credit risks relates to situations under which we provide services early in the life of a project that is dependent on financing. Certain of these development projects are susceptible to unforeseen delays and other issues that expose us to reduced margins and possible losses. Risks increase in times of general economic crisis and under conditions that threaten project feasibility.

Estimated losses on accounts receivable are provided through an allowance for doubtful accounts. In evaluating the level of established reserves, we make judgments regarding each party's ability to make required payments, economic events and other factors. As the financial condition of any party changes, circumstances develop or additional information becomes available, adjustments to the allowance for doubtful accounts may be required.

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### Earnings per share

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The Company's basic earnings per share (EPS) amounts have been computed based on the average number of shares of common stock outstanding for the period. Diluted EPS amounts include the effect of our outstanding stock options, restricted stock awards and restricted stock units under the treasury stock method, if including such potential shares of common stock is dilutive. See Note 5.

### Debt Issue Costs

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Costs incurred in connection with the issuance of long-term debt are capitalized and charged to interest expense over the term of the related debt on a straight-line basis, which approximates the interest method.

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## ENGLOBAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 2 -ACCOUNTING POLICIES AND RELATED MATTERS (Continued)

#### Goodwill and other intangible assets

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Goodwill represents the excess of the purchase price of acquisitions over the fair value of the assets acquired and liabilities assumed. The Company assesses the carrying amount of goodwill by testing the goodwill for impairment annually. We perform a test for impairment as of the fourth quarter of each fiscal year and in any period in which impairment indicators arise. The impairment test requires allocating goodwill and all other assets and liabilities to business units referred to as reporting units. The fair value of each reporting unit is determined and compared to the carrying value of the reporting unit. If the fair value of the reporting unit is less than the carrying value, including goodwill, then the goodwill is written down to the implied fair value of the goodwill through a charge to expense. Reporting units for the purpose of goodwill impairment calculations are components one level below our operating segments.

Changes in goodwill may result from, among other things, changes in deferred income tax liabilities related to previous acquisitions, impairments, future acquisitions or future divestitures.

Intangible assets are comprised primarily of non-compete covenants and customer relationships acquired through acquisitions and are amortized using the straight-line method based on the estimated useful life of the intangible assets.

#### Property and Equipment

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Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The estimated service lives of our asset groups are as follows:

| Asset Group                         | Range of<br>Years |
|-------------------------------------|-------------------|
| -----                               | -----             |
| Machinery and equipment             | 7-10              |
| Furniture and fixtures              | 5-7               |
| Computing equipment and automobiles | 3-5               |
| Software                            | 3-5               |

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Leasehold improvements are amortized over the term of the related lease. See Note 7 for details related to property and equipment and related depreciation. Expenditures for maintenance and repairs are expensed as incurred. Upon disposition or retirement of property and equipment, any gain or loss is charged to operations.

The Company reviews property and equipment and identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized when estimated future cash flows expected to result from the use of an asset and its eventual disposition is less than its carrying amount.

### Pre-Contract Costs

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The Company expenses pre-contract costs as they are incurred. Pre-contract costs otherwise called Proposal costs are recorded in accordance with SOP 81-1, which requires that costs that are incurred for a specific anticipated contract and that will result in no future benefits unless the contract is obtained should not be included in contract costs or inventory before the receipt of the contract. Costs related to anticipated contracts are charged to expenses as incurred because their recovery is not considered probable and are not reinstated by a credit to income on the subsequent receipt of the contract.

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## ENGLOBAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 2 -ACCOUNTING POLICIES AND RELATED MATTERS (Continued)

#### Income Taxes

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The Company accounts for deferred income taxes in accordance with the asset and liability method, whereby deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the respective tax basis of its assets and liabilities. The provision for income taxes represents the current taxes payable or refundable for the period plus or minus the tax effect of the net change in the deferred tax assets and liabilities during the period. Valuation allowances are provided for deferred tax assets when their recovery is doubtful.

The Company files income tax returns in federal, state and foreign jurisdictions as more fully described in Note 16. It has not taken an uncertain tax position as defined by authoritative accounting literature and does not expect to take such a position on a tax return not yet filed.

#### Revenue Recognition

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Our revenue is comprised of engineering, construction management and procurement service fees and sales of control systems that we design and fabricate. In general, we recognize revenues when all of the following criteria are met: (1) persuasive evidence of an exchange arrangement exists, if applicable, (2) delivery has occurred or services have been rendered, (3) the price is fixed or determinable and (4) collection is reasonably assured. The Company recognizes service revenue as the services are performed. The majority of the Company's engineering services are provided under cost-plus contracts. A majority of sales of fabricated systems are under fixed-price contracts that may also include a service element covered under that contract price.

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We also sometimes serve as purchasing agent by procuring subcontractors, materials and equipment on behalf of a client and pass the cost on to the client with no mark-up or profit. In accordance with Statement of Position ("SOP") 81-1, revenues and costs for these types of "pass-through" transactions are reported net. During 2008 we had no pass-through transactions but in 2007 and 2006, pass-through transactions totaled \$0.5 million and \$8.9 million, respectively.

Profits and losses on our fixed-price contracts are recognized on the percentage-of-completion method of accounting, measured by the percentage-of-contract cost incurred to date relative to estimated total contract cost. Contract costs used for estimating percentage-of-completion factors include professional compensation and related benefits, materials, subcontractor services and other direct cost of projects. Freight charges and inspection costs are charged directly to projects to which they relate. Costs recognized for labor include all actual employee compensation plus a burden factor to cover estimated variable labor expenses. These variable labor expenses consist of payroll taxes, self-insured medical plan expenses, workers compensation insurance, general liability insurance, and paid time off. These estimated amounts are adjusted to actual costs incurred at the end of each quarter.

Under the percentage-of-completion method, revenue recognition is dependent upon the accuracy of a variety of estimates, including the progress of engineering and design efforts, material installation, labor productivity, cost estimates and others. These estimates are based on various professional judgments and are difficult to accurately determine until projects are significantly underway. Due to uncertainties inherent to the estimation process, it is possible that actual percentage-of-completion may vary materially from our estimates. Estimating errors may cause errors in revenue recognition on uncompleted contracts and may even result in losses on the contracts. Our borrowing covenants limit our use of fixed price contracts without prior written approval from the lender to \$2.0 million on any fixed price engineering, procurement and construction contract and \$5.0 million on any fixed price engineering contract as discussed in Note 10. Anticipated losses on uncompleted contracts are charged to operations as soon as such losses can be estimated. Changes in job performance, job conditions, estimated profitability and final contract settlements may result in revisions to costs and revenues and are recognized in the period in which the revisions are determined.

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### ENGLOBAL CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 2 -ACCOUNTING POLICIES AND RELATED MATTERS (Continued)

Occasionally, it is appropriate for us to combine or segment contracts in order to meet requirements of SOP 81-1. Contracts are combined in those limited circumstances when they are negotiated as a package in the same economic environment with an overall profit margin objective and constitute, in essence, an agreement to do a single project. In such cases, we recognize revenue and cost over the performance period of the combined contracts as if they were one. Contracts may be segmented if the customer has the right to accept separate elements of a contract and the total economic returns and risks of the separate contract elements are similar to the economic returns and risks of the overall contract. For segmented contracts, we recognize revenue as if they were separate contracts over the performance periods of the individual elements or phases.

Software Development Costs



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ENGlobal capitalizes costs associated with software developed or acquired for internal use when these criteria are met-- the preliminary project stage is completed, management authorizes funding for the project and the project is deemed probable of completion. Capitalized costs include external costs of materials and services incurred in obtaining and developing the software and payroll and payroll related costs for employees in proportion to time devoted to the project. Capitalization of these costs ceases no later than the point at which the project is substantially complete and the software is ready for its intended use. Software development costs are included in property and equipment and are amortized on the straight-line basis over five years.

### Stock-Based Compensation

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The Company accounts for stock-based compensation at fair value. The company grants various types of stock-based awards including stock options and nonvested equity shares (restricted stock awards and units). The fair value of stock option awards is determined using the Black-Scholes option pricing model. Restricted stock awards and units are valued using the market price of ENGlobal common stock on the grant date. The Company records compensation cost for stock-based compensation awards over the requisite service period (usually a vesting period). Compensation expense is recognized net of estimated forfeitures. As each award vests, adjustments are made to compensation cost for any difference between estimated forfeitures and the actual forfeitures related to the awards.

### Significant Commercial Relationships

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The following table lists the percentage of our consolidated sales by customer, which accounted for more than 10% of our consolidated revenues for the years indicated:

|                | 2008 | 2007 | 2006 |
|----------------|------|------|------|
|                | ---- | ---- | ---- |
| Spectra Energy | 10%  | 4%   | 0%   |
| Alon USA       | 10%  |      |      |