

QUANTA SERVICES INC

Form 10-Q/A

November 09, 2006

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

**Form 10-Q/ A  
(Amendment No. 1)**

(Mark One)

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

**For the quarterly period ended June 30, 2006**

**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. 001-13831**

**Quanta Services, Inc.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of  
Incorporation or organization)*

**74-2851603**

*(I.R.S. Employer  
Identification No.)*

**1360 Post Oak Blvd.**

**Suite 2100**

**Houston, Texas 77056**

*(Address of principal executive offices, including zip code)*

**Registrant's telephone number, including area code:**

**(713) 629-7600**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Accelerated filer  Non-accelerated filer

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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117,600,022 shares of Common Stock were outstanding as of August 1, 2006. As of the same date, 918,447 shares of Limited Vote Common Stock were outstanding.

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**EXPLANATORY NOTE**

This Amendment No. 1 on Form 10-Q/ A (Amendment) is being filed to amend, as described below, Items 1 and 2 of Part I of the quarterly report on Form 10-Q of Quanta Services, Inc. (Quanta) filed with the Securities and Exchange Commission (SEC) on August 9, 2006 (Original Report on Form 10-Q). The purpose of this Amendment is to amend (i) the condensed consolidated balance sheet as of June 30, 2006 to reclassify certain investments as short-term investments that were classified as cash and cash equivalents in the Original Report on Form 10-Q and (ii) the condensed consolidated statements of cash flows for the three and six months ended June 30, 2006 to correct cash flows from investing activities as a result of the above reclassification by presenting Quanta's investments in these short-term securities as cash flows from investing activities. Specifically, the Original Report on Form 10-Q classified \$272.2 million of variable rate demand notes as cash equivalents. The above reclassification had no effect on previously reported current or non-current assets, current or non-current liabilities, stockholders' equity, net income, earnings per share or net cash provided by operating activities.

In addition to the amendments discussed above, Quanta has added additional disclosures regarding Quanta's short-term investments in (i) note 1 of the notes to condensed consolidated financial statements, (ii) Management's Discussion and Analysis of Financial Condition and Results of Operations and (iii) Controls and Procedures Management's Consideration of the Restatement. The complete text of Items 1, 2 and 4 of Part I have been set forth in its entirety, in accordance with Rule 12b-15 under the Securities Exchange Act of 1934, as amended, and the other Items from the Original Report on Form 10-Q are included for the convenience of the reader. In connection with the filing of this Amendment and pursuant to the rules of the SEC, Quanta is including with this Amendment currently dated certifications. Unless otherwise indicated, the exhibits previously filed with the Original Report on Form 10-Q are not re-filed herewith.

Except for the matters discussed in this Explanatory Note, this Amendment reflects the disclosures made at the time of the filing of the Original Report on Form 10-Q, and no attempt has been made in this Amendment to modify or update such disclosures presented in the Original Report on Form 10-Q. This Amendment does not reflect events occurring after the filing of the Original Report on Form 10-Q or modify or update those disclosures affected by subsequent events. Accordingly, this Amendment should be read in conjunction with our filings made with the SEC subsequent to the filing of the Original Report on Form 10-Q, including any amendments to those filings.

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**QUANTA SERVICES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share information)  
(Unaudited)

	December 31, 2005	June 30, 2006	
			(Restated)
<b>ASSETS</b>			
Current Assets:			
Cash and cash equivalents	\$ 304,267	\$ 37,356	
Short-term investments		272,165	
Accounts receivable, net of allowances of \$6,566 and \$5,699, respectively	431,584	450,533	
Costs and estimated earnings in excess of billings on uncompleted contracts	38,053	45,255	
Inventories	25,717	27,526	
Prepaid expenses and other current assets	31,389	29,680	
<b>Total current assets</b>	<b>831,010</b>	<b>862,515</b>	
Property and equipment, net	286,606	286,594	
Accounts and notes receivable, net of an allowance of \$42,953	15,229	9,707	
Other assets, net	33,583	33,788	
Goodwill and other intangibles, net	388,357	388,226	
<b>Total assets</b>	<b>\$ 1,554,785</b>	<b>\$ 1,580,830</b>	
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>			
Current Liabilities:			
Current maturities of long-term debt	\$ 2,252	\$ 922	
Accounts payable and accrued expenses	241,811	229,270	
Billings in excess of costs and estimated earnings on uncompleted contracts	14,008	18,384	
<b>Total current liabilities</b>	<b>258,071</b>	<b>248,576</b>	
Long-term debt, net of current maturities	7,591		
Convertible subordinated notes	442,500	447,023	
Deferred income taxes and other non-current liabilities	142,885	149,912	
<b>Total liabilities</b>	<b>851,047</b>	<b>845,511</b>	
Commitments and Contingencies			
Stockholders Equity:			
Common stock, \$.00001 par value, 300,000,000 shares authorized, 118,771,776 and 119,580,855 shares issued and 117,153,038 and 117,600,022 outstanding, respectively			
Limited Vote Common Stock, \$.00001 par value, 3,345,333 shares authorized, 1,011,780 and 918,447 shares issued and outstanding, respectively			

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Additional paid-in capital	1,096,795	1,101,427
Deferred compensation	(6,448)	
Accumulated deficit	(369,122)	(343,604)
Treasury stock, 1,618,738 and 1,980,833 common shares, at cost	(17,487)	(22,504)
<b>Total stockholders equity</b>	<b>703,738</b>	<b>735,319</b>
 Total liabilities and stockholders equity	 \$ 1,554,785	 \$ 1,580,830

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

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**QUANTA SERVICES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands, except per share information)  
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
Revenues	\$ 439,287	\$ 514,048	\$ 811,792	\$ 1,010,542
Cost of services (including depreciation)	385,471	433,693	721,884	870,739
Gross profit	53,816	80,355	89,908	139,803
Selling, general and administrative expenses	43,874	46,640	86,336	88,915
Income from operations	9,942	33,715	3,572	50,888
Other income (expense):				
Interest expense	(5,904)	(9,794)	(11,922)	(15,678)
Interest income	1,696	3,036	3,215	6,015
Gain on early extinguishment of debt, net		1,598		1,598
Other, net	97	180	262	328
Income (loss) before income tax provision (benefit)	5,831	28,735	(4,873)	43,151
Provision (benefit) for income taxes	2,488	11,075	(3,088)	17,633
Net income (loss)	\$ 3,343	\$ 17,660	\$ (1,785)	\$ 25,518
Earnings (loss) per share:				
Basic	\$ 0.03	\$ 0.15	\$ (0.02)	\$ 0.22
Diluted	\$ 0.03	\$ 0.14	\$ (0.02)	\$ 0.21
Shares used in computing earnings (loss) per share:				
Basic	115,713	117,152	115,472	116,840
Diluted	116,341	142,014	115,472	141,827

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



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**QUANTA SERVICES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)  
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006 (Restated)	2005	2006 (Restated)
<b>Cash Flows from Operating Activities:</b>				
Net income (loss)	\$ 3,343	\$ 17,660	\$ (1,785)	\$ 25,518
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities				
Depreciation and amortization	14,016	12,886	28,231	25,566
Amortization of debt issuance costs	914	4,253	1,826	5,167
Loss (gain) on sale of property and equipment	47	(124)	213	(587)
Gain on early extinguishment of debt		(2,088)		(2,088)
Provision for doubtful accounts	51	757	472	855
Deferred income tax provision (benefit)	253	(1,877)	(7,760)	26
Non-cash stock-based compensation	890	1,568	2,128	3,017
Tax benefit from stock-based equity awards		(285)		(4,643)
Changes in operating assets and liabilities, net of non-cash transactions				
(Increase) decrease in				
Accounts receivable	(33,663)	2,021	(16,747)	(14,282)
Costs and estimated earnings in excess of billings on uncompleted contracts	(6,935)	1,770	(15,798)	(7,202)
Inventories	(759)	614	(4,902)	(1,809)
Prepaid expenses and other current assets	5,294	1,170	3,883	1,229
Increase (decrease) in				
Accounts payable and accrued expenses and other non-current liabilities	16,790	144	21,416	(3,707)
Billings in excess of costs and estimated earnings on uncompleted contracts	835	1,098	891	4,376
Other, net	(1,205)	2,362	(2,233)	1,051
Net cash provided by (used in) operating activities	(129)	41,929	9,835	32,487
<b>Cash Flows from Investing Activities:</b>				
Proceeds from sale of property and equipment	1,844	3,016	2,406	4,622
Additions of property and equipment	(16,688)	(15,716)	(28,908)	(29,307)
Proceeds from the sale of short-term investments		21,875		21,875
Purchases of short-term investments		(233,525)		(294,040)
Net cash used in investing activities	(14,844)	(224,350)	(26,502)	(296,850)

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<b>Cash Flows from Financing Activities:</b>				
Payments under credit facility	(8,500)	(4,500)	(18,800)	(7,500)
Borrowings under credit facility	14,000		14,000	
Proceeds from other long-term debt		144,098	127	145,576
Payments on other long-term debt	(3,793)	(138,856)	(5,020)	(140,386)
Issuances of stock, net of offering costs			1,530	
Debt issuance and amendment costs		(5,671)	(41)	(5,671)
Tax benefit from stock-based equity awards		285		4,643
Exercise of stock options	1	173	48	790
Net cash provided by (used in) financing activities	1,708	(4,471)	(8,156)	(2,548)
Net Increase (Decrease) in Cash and Cash Equivalents	(13,265)	(186,892)	(24,823)	(266,911)
Cash and Cash Equivalents, beginning of period	254,002	224,248	265,560	304,267
Cash and Cash Equivalents, end of period	\$ 240,737	\$ 37,356	\$ 240,737	\$ 37,356
<b>Supplemental Disclosure of Cash Flow Information</b>				
Interest paid	\$ (6,309)	\$ (8,790)	\$ (6,672)	\$ (12,452)
Income taxes paid	\$ (347)	\$ (4,143)	\$ (1,430)	\$ (5,390)
Income tax refunds	\$ 247	\$ 90	\$ 509	\$ 195

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

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**QUANTA SERVICES INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

**1. BUSINESS AND ORGANIZATION:**

Quanta Services, Inc. (Quanta) is a leading provider of specialized contracting services, offering end-to-end network solutions to the electric power, gas, telecommunications and cable television industries. Quanta's comprehensive services include designing, installing, repairing and maintaining network infrastructure.

*Interim Condensed Consolidated Financial Information*

These unaudited condensed consolidated financial statements have been prepared pursuant to the rules of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures, normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States, have been condensed or omitted pursuant to those rules and regulations. Quanta believes that the disclosures made are adequate to make the information presented not misleading. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to fairly state the financial position, results of operations and cash flows with respect to the interim consolidated financial statements have been included. The results of operations for the interim periods are not necessarily indicative of the results for the entire fiscal year. The results of Quanta historically have been subject to significant seasonal fluctuations.

Quanta recommends that these unaudited condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto of Quanta and its subsidiaries included in Quanta's Annual Report on Form 10-K for the year ended December 31, 2005, which was filed with the SEC on March 2, 2006.

*Use of Estimates and Assumptions*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates and assumptions by management in determining the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities known to exist as of the date the financial statements are published and the reported amount of revenues and expenses recognized during the periods presented. Quanta reviews all significant estimates affecting its consolidated financial statements on a recurring basis and records the effect of any necessary adjustments prior to their publication. Judgments and estimates are based on Quanta's beliefs and assumptions derived from information available at the time such judgments and estimates are made. Uncertainties with respect to such estimates and assumptions are inherent in the preparation of financial statements. Estimates are primarily used in Quanta's assessment of the allowance for doubtful accounts, valuation of inventory, useful lives of property and equipment, fair value assumptions in analyzing goodwill and long-lived asset impairments, self-insured claims liabilities, revenue recognition under percentage-of-completion accounting and provision for income taxes.

*RESTATEMENT Short-Term Investments*

Quanta invests a portion of its cash in variable rate demand notes (VRDNs), which are classified as short-term investments. The income from these VRDNs is tax-exempt to Quanta. The interest rates on these instruments are variable and reset daily or weekly, depending on the security. As a result of the reset feature, Quanta continually earns the market interest rate. While VRDNs are debt instruments with scheduled maturities ranging from 10-30 years, Quanta has the right to tender the securities to a third-party liquidity provider for payment at the aggregate principal amount plus accrued interest at any time with seven days notice pursuant to the put right granted to all holders of these notes. Payment of these notes is secured by an irrevocable letter of credit issued by an investment-grade financial institution. Due to the liquidity and the short-term nature of Quanta's investment in these securities, they have been classified as current assets in its condensed consolidated balance sheet and are classified as available for sale. These securities are carried at the

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aggregate principal amount, which approximates fair value, resulting in no unrealized gain (loss) to be recorded in other comprehensive income.

As shown in the table below, the cash and cash equivalents as of June 30, 2006 and the net cash used in investing activities for the three and six months ended June 30, 2006 have been restated to reclassify certain short-term investments which had been classified as cash and cash equivalents, when such securities should have been reported as short-term investments in the condensed consolidated balance sheet and as purchases or sales of short-term investments in condensed consolidated statements of cash flows.

	<b>June 30, 2006 As Reported</b>	<b>June 30, 2006 As Restated</b>
Cash and cash equivalents	\$ 309,521	\$ 37,356
Short-term investments		272,165
	<b>Three Months Ended June 30, 2006 As Reported</b>	<b>Three Months Ended June 30, 2006 As Restated</b>
Purchases of short-term investments	\$	\$ (233,525)
Proceeds from the sale of short-term investments		21,875
Net cash used in investing activities	(12,700)	(224,350)
	<b>Six Months Ended June 30, 2006 As Reported</b>	<b>Six Months Ended June 30, 2006 As Restated</b>
Purchases of short-term investments	\$	\$ (294,040)
Proceeds from the sale of short-term investments		21,875
Net cash used in investing activities	(24,685)	(296,850)

*Current and Long-Term Accounts and Notes Receivable and Allowance for Doubtful Accounts*

Quanta provides an allowance for doubtful accounts when collection of an account or note receivable is considered doubtful. Inherent in the assessment of the allowance for doubtful accounts are certain judgments and estimates including, among others, the customer's access to capital, the customer's willingness or ability to pay, general economic conditions and the ongoing relationship with the customer. Under certain circumstances such as foreclosures or negotiated settlements, Quanta may take title to the underlying assets in lieu of cash in settlement of receivables. As of June 30, 2006, Quanta has provided allowances for doubtful accounts of approximately \$48.7 million. Should customers experience financial difficulties or file for bankruptcy, or should anticipated recoveries relating to receivables in existing bankruptcies or other workout situations fail to materialize, Quanta could experience reduced cash flows and losses in excess of current allowances provided. In addition, material changes in Quanta's customers revenues or cash flows could affect its ability to collect amounts due from them.

Included in accounts and notes receivable are amounts due from a customer relating to the construction of independent power plants. During the first quarter of 2006, the underlying assets which had secured these notes

receivable were sold pursuant to liquidation proceedings and the net proceeds are being held by a trustee. The final collection of amounts owed to Quanta are subject to further legal proceedings; however, Quanta has provided allowances for a significant portion of these notes receivable. Also included in accounts and notes receivable are \$4.7 million in retainage balances with settlement dates beyond the next twelve months. As of June 30, 2006, the total balance due from these customers was \$52.7 million, with an allowance for doubtful accounts of \$43.0 million. During 2004, Quanta sold its prepetition receivable due from Adelpia Communications Corporation and its affiliated companies (Adelpia) to a third party with \$6.0 million of the proceeds held by the buyer pending the resolution of certain preferential payment claims. Through March 31, 2006, the

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**QUANTA SERVICES INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

account receivable associated with the holdback was recorded in accounts and notes receivable. The preferential payment claims have been settled; as such, Quanta expects to receive the \$6.0 million during the third quarter of 2006 and therefore, has reclassified the amount into current accounts receivable as of June 30, 2006.

*Concentration of Credit Risk*

Quanta grants credit under normal payment terms, generally without collateral, to its customers, which include electric power and gas companies, telecommunications and cable television system operators, governmental entities, general contractors and builders, owners and managers of commercial and industrial properties located primarily in the United States. Consequently, Quanta is subject to potential credit risk related to changes in business and economic factors throughout the United States; however, Quanta generally has certain statutory lien rights with respect to services provided. No customer accounted for more than 10% of accounts receivable as of December 31, 2005 and June 30, 2006 or revenues for the three and six months ended June 30, 2005 and June 30, 2006.

*Goodwill and Other Intangibles*

In accordance with Statement of Financial Accounting Standards (SFAS) No. 142 Goodwill and Other Intangible Assets, goodwill attributable to each of Quanta's reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. Fair value is determined using a combination of the discounted cash flow, market multiple and market capitalization valuation approaches. Significant estimates used in the above methodologies include estimates of future cash flows, future short-term and long-term growth rates, weighted average cost of capital and estimates of market multiples for each of the reportable units. On an ongoing basis, absent impairment indicators, Quanta performs impairment tests annually during the fourth quarter. SFAS No. 142 does not allow increases in the carrying value of reporting units that may result from Quanta's impairment test, therefore Quanta may record goodwill impairments in the future, even when the aggregate fair value of Quanta's reporting units and Quanta as a whole may increase. Any future impairment adjustments would be recognized as operating expenses.

*Income Taxes*

Quanta follows the liability method of accounting for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes. Under this method, deferred assets and liabilities are recorded for future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that are expected to be in effect when the underlying assets or liabilities are recovered or settled.

Quanta regularly evaluates valuation allowances established for deferred tax assets for which future realization is uncertain, and Quanta maintains an allowance for tax contingencies that Quanta believes is adequate. The estimation of required valuation allowances includes estimates of future taxable income. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Quanta considers projected future taxable income and tax planning strategies in making this assessment. If actual future taxable income differs from these estimates, Quanta may not realize deferred tax assets to the extent estimated.

*New Accounting Pronouncements*

In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments An Amendment of FASB Statements No. 133 and 140. SFAS No. 155 provides entities with relief from having to separately determine the fair value of an embedded derivative that would otherwise be required to be bifurcated from its host contract in accordance with SFAS

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No. 133. SFAS No. 155 allows an entity to make an irrevocable election to measure such a hybrid financial instrument at fair value in its entirety, with changes in fair value recognized in earnings. SFAS No. 155 is effective for all financial instruments acquired, issued or subject to a remeasurement event occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006. Quanta anticipates that the adoption of SFAS No. 155 will not have a material impact on Quanta's financial position, results of operations or cash flows.

In July 2006, the FASB issued Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement 109. FIN No. 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing uncertain tax positions within financial statements. The provisions of FIN No. 48 are effective for fiscal years beginning after December 15, 2006. Quanta is currently analyzing the provisions of FIN No. 48 and has not yet made a determination of the impact the adoption will have on its consolidated financial position, results of operations and cash flows.

**2. STOCK-BASED COMPENSATION:**

Effective January 1, 2006, Quanta adopted SFAS No. 123 (revised 2004), Share-Based Payment—SFAS No. 123(R) using the modified prospective method of adoption, which requires recognition of compensation expense for all stock-based compensation beginning on the effective date. Under this method of accounting, compensation cost for stock-based compensation awards is based on the fair value of the awards granted, net of estimated forfeitures, at the date they are granted. The resulting compensation cost is recognized over the service period of each award. In accordance with the modified prospective method of adoption, Quanta has not adjusted consolidated financial statements for prior periods.

Prior to January 1, 2006, Quanta accounted for its stock-based compensation awards under APB Opinion No. 25, Accounting for Stock Issued to Employees. Under this accounting method, no compensation expense was recognized in the consolidated statements of operations if no intrinsic value of the stock-based compensation award existed at the date of grant. SFAS No. 123—Accounting for Stock Based Compensation, which encouraged companies to account for stock-based compensation awards based on the fair value of the awards at the date they were granted, required disclosure as to what net income and earnings per share would have been had SFAS No. 123 been followed. Had compensation expense for the 2001 Stock Incentive Plan and the Employee Stock Purchase Plan, which was terminated in 2005, been determined consistent with SFAS No. 123, Quanta's net income (loss) and earnings (loss) per share for the three and six months ended June 30, 2005 would have been reduced to the following as adjusted amounts (in thousands, except per share information):

	<b>Three Months Ended June 30, 2005</b>	<b>Six Months Ended June 30, 2005</b>
Net income (loss) as reported	\$ 3,343	\$ (1,785)
Add: stock-based employee compensation expense included in reported net income (loss), net of tax	890	2,128
Deduct: total stock-based employee compensation expense determined under fair value based method for all awards, net of tax	(1,193)	(2,589)
Net income (loss)		
As adjusted—basic and diluted	\$ 3,040	\$ (2,246)
Earnings (loss) per share		
As reported—basic and diluted	\$ 0.03	\$ (0.02)
As adjusted—basic and diluted	\$ 0.03	\$ (0.02)





**Table of Contents****QUANTA SERVICES INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Beginning January 1, 2006, Quanta accounted for stock options in accordance with SFAS No. 123(R); however, the effect of expensing the fair value of the stock options did not have a material impact on Quanta's financial position or results of operations, as the number of unvested shares remaining is not significant. Certain disclosures required under SFAS No. 123(R) have been omitted due to immateriality.

The actual tax benefit realized for the tax deductions from option exercises totaled approximately \$0.1 million for the three months ended June 30, 2006 and \$0.3 million for the six months ended June 30, 2006. This tax benefit is reported as a cash inflow from financing activities and an adjustment to net income to derive cash flow from operations within the statement of cash flows for the three and six months ended June 30, 2006, as required by SFAS No. 123(R), and as stated above, prior periods have not been adjusted in accordance with the modified prospective method of application.

*Restricted Stock*

During 2003, Quanta began using restricted stock rather than stock options for Quanta's various stock incentive programs. Pursuant to the 2001 Stock Incentive Plan, Quanta issues restricted common stock at the fair market value of the common stock as of the date of issuance. The shares of restricted common stock issued pursuant to the 2001 Stock Incentive Plan are subject to forfeiture, restrictions on transfer and certain other conditions until they vest, which generally occurs over three years in equal annual installments. During the restriction period, the plan participants are entitled to vote and receive dividends on such shares. During the three months ended June 30, 2005 and 2006, Quanta granted 77,381 and 48,846 shares of restricted stock with a weighted average grant price of \$8.86 and \$15.97. During each of the six months ended June 30, 2005 and 2006, Quanta granted approximately 0.7 million shares of restricted stock with a weighted average grant price of \$7.55 and \$13.89. During the three months ended June 30, 2005 and 2006, 49,256 and 73,456 shares vested with a approximate fair value of \$0.5 million and \$1.2 million. Approximately 1.0 million and 1.2 million shares vested during the six months ended June 30, 2005 and 2006 with a total fair value of \$8.3 million and \$16.6 million. A summary of Quanta's restricted stock activity for the six months ended June 30, 2006 is as follows (in thousands, except fair value amounts):

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2006	1,904	\$ 5.70
Granted	677	\$ 13.89
Vested	(1,190)	\$ 4.64
Forfeited	(65)	\$ 8.06
Nonvested at June 30, 2006	1,326	\$ 10.71

During the three months ended June 30, 2005 and 2006, Quanta recorded non-cash compensation expense with respect to restricted stock in the amount of \$0.9 million and \$1.6 million and a related income tax benefit of \$0.3 million and \$0.6 million. During the six months ended June 30, 2005 and 2006, Quanta recorded non-cash compensation expense with respect to restricted stock in the amount of \$2.1 million and \$3.0 million and a related income tax benefit of \$0.8 million and \$1.2 million. The fair value of the restricted stock is determined based on the number of shares granted and the closing price of Quanta's common stock on the date of grant. The adoption of SFAS No. 123(R) requires estimating future forfeitures in determining the period expense, rather than recording forfeitures when they occur as previously permitted. Quanta used historical data to estimate the forfeiture rate. The

effect of estimating forfeitures in determining the period expense, rather than recording forfeitures as they actually occurred, was not significant.

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During the three months ended June 30, 2005 and 2006, the actual tax benefit realized for the tax deductions from vested restricted stock totaled approximately \$0.1 million and \$0.2 million. During the six months ended June 30, 2005 and 2006, the actual tax benefit realized for the tax deductions from vested restricted stock totaled approximately \$1.5 million and \$4.2 million. This tax benefit is reported as a cash inflow from financing activities and an adjustment to net income to derive cash flow from operations within the statement of cash flows for the three and six months ended June 30, 2006, as required by SFAS No. 123(R), and as stated above, prior periods have not been adjusted in accordance with the modified prospective method of application.

Total unrecognized compensation cost related to nonvested restricted stock granted to both employees and non-employees was \$12.9 million as of June 30, 2006. The unrecognized compensation cost is expected to be recognized over a weighted-average period of 2.1 years. The estimate of unrecognized compensation cost uses the expected forfeiture rate, and to the extent that Quanta revises that estimate in the future, the estimate may not necessarily represent the value that will ultimately be realized as compensation expense. As of December 31, 2005, unrecognized compensation expense related to nonvested shares of restricted stock granted to employees was recorded as deferred compensation in stockholders' equity. As part of the adoption of SFAS No. 123(R), \$6.4 million of deferred compensation was reversed against additional paid-in capital during the first quarter of 2006.

**3. PER SHARE INFORMATION:**

Basic earnings (loss) per share is computed using the weighted average number of common shares outstanding during the period, and diluted earnings (loss) per share is computed using the weighted average number of common shares outstanding during the period adjusted for all potentially dilutive common stock equivalents, except in cases where the effect of the common stock equivalent would be antidilutive. The weighted average number of shares used to compute the basic and diluted earnings (loss) per share for the three and six months ended June 30, 2005 and 2006 is illustrated below (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2006</b>
<b>NET INCOME (LOSS):</b>				
Net income (loss)	\$ 3,343	\$ 17,660	\$ (1,785)	\$ 25,518
Effect of convertible subordinated notes under the if converted method interest expense addback, net of taxes		2,230		4,460
Net income (loss) for diluted earnings (loss) per share	\$ 3,343	\$ 19,890	\$ (1,785)	\$ 29,978
<b>WEIGHTED AVERAGE SHARES:</b>				
Weighted average shares outstanding for basic earnings (loss) per share, if dilutive	115,713	117,152	115,472	116,840
Effect of dilutive stock options and restricted stock	628	625		750
Effect of convertible subordinated notes under the if converted method weighted convertible shares issuable		24,237		24,237
Weighted average shares outstanding for diluted earnings (loss) per share	116,341	142,014	115,472	141,827



**Table of Contents****QUANTA SERVICES INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

For the three and six months ended June 30, 2006, approximately 0.2 million stock options were excluded from the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of Quanta's common stock. For the three and six months ended June 30, 2006, the effect of assuming conversion of the 4.0% and 3.75% convertible subordinated notes would be antidilutive, and the shares issuable upon conversion of those notes were therefore excluded from the calculation of diluted earnings per share.

For the three and six months ended June 30, 2005, approximately 0.4 million and 0.5 million stock options were excluded from the computation of diluted earnings (loss) per share because the options' exercise prices were greater than the average market price of Quanta's common stock. For the six months ended June 30, 2005, approximately 0.1 million stock options with exercise prices lower than the average market price of Quanta's common stock were also excluded from the computation of diluted earnings (loss) per share because the effect of including them would have been antidilutive as Quanta incurred a net loss for the period. For the six months ended June 30, 2005, 0.4 million shares of nonvested restricted stock were excluded from the calculation of diluted earnings (loss) per share as the impact would have been antidilutive. For the three and six months ended June 30, 2005, the effect of assuming conversion of the 4.0% and the 4.5% convertible subordinated notes would be antidilutive, and the shares issuable upon conversion were therefore excluded from the calculation of diluted earnings per share.

**4. DEBT:***Credit Facility*

On June 12, 2006, Quanta entered into an amended and restated credit facility with various lenders which provides for a \$300.0 million senior secured revolving credit facility maturing on June 12, 2011 (the credit facility). The credit facility amended and restated Quanta's prior credit facility. The entire amount of the credit facility is available for the issuance of standby letters of credit. In addition, subject to the conditions specified in the credit facility, Quanta has the option to increase the revolving commitments under the credit facility by up to an additional \$125.0 million from time to time upon receipt of additional commitments from new or existing lenders. Borrowings under the credit facility are to be used for working capital, capital expenditures and for other general corporate purposes.

As of June 30, 2006, Quanta had approximately \$124.4 million of letters of credit issued under the credit facility and no outstanding revolving loans. The remaining \$175.6 million was available for revolving loans or issuing new letters of credit. Amounts borrowed under the credit facility bear interest, at Quanta's option, at a rate equal to either (a) the Eurodollar Rate (as defined in the credit facility) plus 1.25% to 1.875%, as determined by the ratio of Quanta's total funded debt to EBITDA, or (b) the base rate (as described below) plus 0.25% to 0.875%, as determined by the ratio of Quanta's total funded debt to EBITDA. Letters of credit issued under the credit facility are subject to a letter of credit fee of 1.25% to 1.875%, based on the ratio of Quanta's total funded debt to EBITDA. Quanta is also subject to a commitment fee of 0.25% to 0.35%, based on the ratio of its total funded debt to EBITDA, on any unused availability under the credit facility. The base rate equals the higher of (i) the Federal Funds Rate (as defined in the credit facility) plus 1/2 of 1% and (ii) the bank's prime rate.

The credit facility contains certain covenants, including covenants with respect to maximum funded debt to EBITDA, maximum senior debt to EBITDA, minimum interest coverage and minimum consolidated net worth, in each case as specified in the credit facility. For purposes of calculating the maximum funded debt to EBITDA ratio and the maximum senior debt to EBITDA ratio, Quanta's maximum funded debt and maximum senior debt are reduced by all cash and cash equivalents (as defined in the credit facility) held by Quanta in excess of \$25.0 million. As of June 30, 2006, Quanta was in compliance with all of its covenants. The credit facility also limits certain acquisitions, mergers and consolidations, capital expenditures, asset sales and prepayments of indebtedness and, subject to certain exceptions, prohibits liens on material assets. The

**Table of Contents****QUANTA SERVICES INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

credit facility also includes limits on the payment of dividends and stock repurchase programs in any fiscal year to an annual aggregate amount of up to 25% of Quanta's consolidated net income (plus the amount of non-cash charges that reduced such consolidated net income) for the prior fiscal year. The credit facility does not limit dividend payments or other distributions payable solely in capital stock. The credit facility provides for customary events of default and carries cross-default provisions with all of Quanta's existing subordinated notes, its continuing indemnity and security agreement with its surety and all of its other debt instruments exceeding \$10.0 million in borrowings. If an event of default (as defined in the credit facility) occurs and is continuing, on the terms and subject to the conditions set forth in the credit facility, amounts outstanding under the credit facility may be accelerated and may become or be declared immediately due and payable.

The credit facility is secured by a pledge of all of the capital stock of Quanta's U.S. subsidiaries, 65% of the capital stock of its foreign subsidiaries and substantially all of Quanta's assets. Quanta's U.S. subsidiaries guarantee the repayment of all amounts due under the credit facility. Quanta's obligations under the credit facility constitute designated senior indebtedness under its 3.75%, 4.0% and 4.5% convertible subordinated notes.

As of December 31, 2005, Quanta had a \$182.0 million credit facility with various lenders (the prior facility). The prior facility was amended during the second quarter of 2006 to permit, among other things, Quanta's cash tender offer for its 4.0% convertible subordinated notes and Quanta's issuance of its 3.75% convertible subordinated notes, each as described below. The prior facility consisted of a \$147.0 million letter of credit facility maturing on June 19, 2008, which also provided for term loans, and a \$35.0 million revolving credit facility which provided for revolving loans and letters of credit and was scheduled to mature on December 19, 2007. Upon the amendment and restatement of Quanta's credit facility, the obligations under the prior facility were terminated, and related unamortized debt issuance costs in the amount of approximately \$2.6 million were expensed in the second quarter of 2006 and included in interest expense. As of December 31, 2005, Quanta had approximately \$142.6 million of letters of credit outstanding under the prior facility and \$7.5 million of the letter of credit facility outstanding as a term loan.

*4.0% Convertible Subordinated Notes*

As of June 30, 2006, Quanta had \$33.3 million aggregate principal amount of 4.0% convertible subordinated notes (4.0% Notes) outstanding. The 4.0% Notes are convertible into shares of Quanta's common stock at a price of \$54.53 per share, subject to adjustment as a result of certain events. The sale of the notes and the shares issuable upon conversion thereof was registered by Quanta in a registration statement filed with the SEC. The 4.0% Notes require semi-annual interest payments on July 1 and December 31 until the notes mature on July 1, 2007. Quanta has the option to redeem some or all of the 4.0% Notes at specified redemption prices, together with accrued and unpaid interest. If certain fundamental changes occur, as described in the indenture under which Quanta issued the 4.0% Notes, holders of the 4.0% Notes may require Quanta to purchase all or part of the notes at a purchase price equal to 100% of the principal amount, plus accrued and unpaid interest. During the second quarter of 2006, Quanta conducted a cash tender offer for all of the 4.0% Notes. The tender offer expired on June 13, 2006 and, as a result of the offer, \$139.2 million of the 4.0% Notes were repurchased, representing approximately 80.7% of the outstanding 4.0% Notes. As a result of the repurchase of a portion of the 4.0% Notes, Quanta recorded a gain on early extinguishment of debt of approximately \$2.1 million, which was partially offset by costs associated with the tender offer of approximately \$0.5 million. In addition, approximately \$0.7 million in related unamortized debt issuance costs associated with the retirement of a portion of the tendered 4.0% Notes has been expensed and included in interest expense. On July 1, 2006, Quanta reclassified the remaining \$33.3 million of the 4.0% Notes as a current obligation as they will mature within the next twelve months. The credit facility permits the repayment of these 4.0% Notes on or before maturity at Quanta's sole discretion.

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**QUANTA SERVICES INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*4.5% Convertible Subordinated Notes*

As of June 30, 2006, Quanta had \$270.0 million aggregate principal amount of 4.5% convertible subordinated notes (4.5% Notes) outstanding. The resale of the notes and the shares issuable upon conversion thereof was registered for the benefit of the holders in a shelf registration statement filed with the SEC. The 4.5% Notes require semi-annual interest payments on April 1 and October 1, until the notes mature on October 1, 2023.

The 4.5% Notes are convertible into shares of Quanta's common stock based on an initial conversion rate of 89.7989 shares of Quanta's common stock per \$1,000 principal amount of 4.5% Notes (which is equal to an initial conversion price of approximately \$11.14 per share), subject to adjustment as a result of certain events. The 4.5% Notes are convertible by the holder (i) during any fiscal quarter if the last reported sale price of Quanta's common stock is greater than or equal to 120% of the conversion price for at least 20 trading days in the period of 30 consecutive trading days ending on the first trading day of such fiscal quarter, (ii) during the five business day period after any five consecutive trading day period in which the trading price per note for each day of that period was less than 98% of the product of the last reported sale price of Quanta's common stock and the conversion rate, (iii) upon Quanta calling the notes for redemption or (iv) upon the occurrence of specified corporate transactions. If the notes become convertible under any of these circumstances, Quanta has the option to deliver cash, shares of Quanta's common stock or a combination thereof, with the amount of cash determined in accordance with the terms of the indenture under which the notes were issued. During the three months ended June 30, 2006, the market price condition described in clause (i) above was satisfied, and the notes are presently convertible at the option of each holder. The conversion period will expire on September 30, 2006, but may resume upon the satisfaction of the market condition or other conditions in future periods.

Beginning October 8, 2008, Quanta may redeem for cash some or all of the 4.5% Notes at the principal amount thereof plus accrued and unpaid interest. The holders of the 4.5% Notes may require Quanta to repurchase all or some of the notes at the principal amount thereof plus accrued and unpaid interest on October 1, 2008, 2013 or 2018, or upon the occurrence of a fundamental change, as defined by the indenture. Quanta must pay any required repurchases on October 1, 2008 in cash. For all other required repurchases, Quanta has the option to deliver cash, shares of its common stock or a combination thereof to satisfy its repurchase obligation. Quanta presently does not anticipate using stock to satisfy any future obligations. If Quanta were to satisfy the obligation with shares of its common stock, the number of shares delivered will equal the dollar amount to be paid in common stock divided by 98.5% of the market price of Quanta's common stock, as defined by the indenture. The number of shares to be issued under this circumstance is not limited. The right to settle for shares of common stock can be surrendered by Quanta. The 4.5% Notes carry cross-default provisions with Quanta's other debt instruments exceeding \$10.0 million in borrowings, which includes Quanta's existing credit facility.

*3.75% Convertible Subordinated Notes*

During the second quarter of 2006, Quanta issued \$143.8 million aggregate principal amount of 3.75% convertible subordinated notes due 2026 (3.75% Notes). The 3.75% Notes mature on April 30, 2026 and bear interest at the annual rate of 3.75%, payable semi-annually on April 30 and October 30, commencing on October 30, 2006.

The 3.75% Notes are convertible into Quanta's common stock, based on an initial conversion rate of 44.6229 shares of Quanta's common stock per \$1,000 principal amount of 3.75% Notes (which is equal to an initial conversion price of approximately \$22.41 per share), subject to adjustment as a result of certain events. The 3.75% Notes are convertible by the holder (i) during any fiscal quarter if the closing price of Quanta's common stock is greater than 130% of the conversion price for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter, (ii) upon

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Quanta calling the 3.75% Notes for redemption, (iii) upon the occurrence of specified distributions to holders of Quanta's common stock or specified corporate transactions or (iv) at any time on or after March 1, 2026 until the business day immediately preceding the maturity date of the 3.75% Notes. If the 3.75% Notes become convertible under any of these circumstances, Quanta has the option to deliver cash, shares of Quanta's common stock or a combination thereof, with the amount of cash determined in accordance with the terms of the indenture under which the notes were issued. The holders of the 3.75% Notes who convert their notes in connection with certain change in control transactions, as defined in the indenture, may be entitled to a make whole premium in the form of an increase in the conversion rate. In the event of a change in control, in lieu of paying holders a make whole premium, if applicable, Quanta may elect, in some circumstances, to adjust the conversion rate and related conversion obligations so that the 3.75% Notes are convertible into shares of the acquiring or surviving company. The resale of the notes and the shares issuable upon conversion thereof is required to be registered by Quanta for the benefit of the holders in a registration statement which Quanta intends to file with the SEC during the third quarter 2006.

Beginning on April 30, 2010 until April 30, 2013, Quanta may redeem for cash all or part of the 3.75% Notes at a price equal to 100% of the principal amount plus accrued and unpaid interest, if the closing price of Quanta's common stock is equal to or greater than 130% of the conversion price then in effect for the 3.75% Notes for at least 20 trading days in the 30 consecutive trading day period ending on the trading day immediately prior to the date of mailing of the notice of redemption. In addition, Quanta may redeem for cash all or part of the 3.75% Notes at any time on or after April 30, 2010 at certain redemption prices, plus accrued and unpaid interest. Beginning with the six-month interest period commencing on April 30, 2010, and for each six-month interest period thereafter, Quanta would be required to pay contingent interest on any outstanding 3.75% Notes during the applicable interest period if the average trading price of the 3.75% Notes reaches a specified threshold. The contingent interest payable within any applicable interest period will equal an annual rate of 0.25% of the average trading price of the 3.75% Notes during a five trading day reference period.

The holders of the 3.75% Notes may require Quanta to repurchase all or a part of the notes in cash on each of April 30, 2013, April 30, 2016 and April 30, 2021, and in the event of a change in control of Quanta, as defined in the indenture, at a purchase price equal to 100% of the principal amount of the 3.75% Notes plus accrued and unpaid interest. The 3.75% Notes carry cross-default provisions with Quanta's other debt instruments exceeding \$20.0 million in borrowings, which includes Quanta's existing credit facility.

**5. STOCKHOLDERS EQUITY:***Deferred Compensation*

Prior to the adoption of SFAS No. 123 (R), effective January 1, 2006, discussed previously, upon issuance of the restricted stock, pursuant to the 2001 Stock Incentive Plan, an unamortized compensation expense equivalent to the market value of the shares on the date of grant was charged to stockholders' equity as deferred compensation and amortized over the restriction period as non-cash compensation expense. Effective with the adoption of SFAS No. 123 (R), deferred compensation is no longer recorded and the amount recorded as of December 31, 2005, \$6.4 million, was reversed against additional paid in capital in the first quarter of 2006.

*Treasury Stock*

Pursuant to the 2001 Stock Incentive Plan, employees may elect to satisfy their tax withholding obligations upon vesting of restricted stock by having Quanta make such tax payments and withhold a number of vested shares having a value on the date of vesting equal to their tax withholding obligation. As a result of such employee elections, during the first six months of 2006, Quanta withheld 362,095 shares with a total market value of \$5.0 million, to satisfy the tax withholding obligations, and these shares were accounted for as treasury stock.



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**QUANTA SERVICES INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**6. SEGMENT INFORMATION:**

Quanta has aggregated each of its individual operating units into one reportable segment as a specialty contractor. Quanta provides comprehensive network solutions to the electric power, gas, telecommunications and cable television industries, including designing, installing, repairing and maintaining network infrastructure. In addition, Quanta provides ancillary services such as inside electrical wiring, intelligent traffic networks, cable and control systems for light rail lines, airports and highways, and specialty rock trenching, directional boring and road milling for industrial and commercial customers. Each of these services is provided by various Quanta subsidiaries and discrete financial information is not provided to management at the service level. The following table presents information regarding revenues derived from the industries noted above (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
Electric power and gas network services	\$ 278,893	\$ 340,758	\$ 525,005	\$ 670,443
Telecommunications and cable television network services	73,144	85,936	127,491	154,537
Ancillary services	87,250	87,354	159,296	185,562
	\$ 439,287	\$ 514,048	\$ 811,792	\$ 1,010,542

Quanta does not have significant operations or long-lived assets in countries outside of the United States. Quanta derived \$4.7 million and \$9.5 million of its revenues from foreign operations during the three and six months ended June 30, 2005 and \$8.1 million and \$26.8 million of its revenue from foreign operations during the three and six months ended June 30, 2006. Property and equipment in the amount of \$4.9 million and \$6.1 million were located in foreign countries as of December 31, 2005 and 2006.

**7. COMMITMENTS AND CONTINGENCIES:***Litigation*

Quanta is from time to time party to various lawsuits, claims and other legal proceedings that arise in the ordinary course of business. These actions typically seek, among other things, compensation for alleged personal injury, breach of contract and/or property damages, punitive damages, civil penalties or other losses, or injunctive or declaratory relief. With respect to all such lawsuits, claims and proceedings, Quanta records reserves when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. Quanta does not believe that any of these proceedings, separately or in the aggregate, would be expected to have a material adverse effect on Quanta's financial position, results of operations or cash flows.

*Self-Insurance*

As of June 30, 2006, Quanta is insured for employer's liability and general liability claims, subject to a deductible of \$1.0 million per occurrence and for auto liability and workers compensation claims, subject to a deductible of \$2.0 million per occurrence. Quanta also has a non-union employee health care benefits plan that is subject to a deductible of \$250,000 per claimant per year. Losses are accrued based upon Quanta's estimates of the ultimate liability for claims incurred and an estimate of claims incurred but not reported, with assistance from a third-party actuary. The accruals are based upon known facts and historical trends and management believes such accruals to be adequate. As of December 31, 2005 and June 30, 2006, the gross amount accrued for self-insurance claims totaled \$99.5 million and \$104.5 million, with \$64.4 million and \$67.5 million considered to be long-term and included in other non-current liabilities. Related insurance recoveries/receivables as of December 31, 2005 and June 30, 2006

were \$6.3 million and \$6.6 million, of

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which \$3.3 million and \$1.4 million are included in prepaid expenses and other current assets and \$3.0 million and \$5.2 million are included in other assets, net.

Quanta's casualty insurance carrier for the policy periods from August 1, 2000 to February 28, 2003 is experiencing financial distress but is currently paying valid claims. In the event that this insurer's financial situation deteriorates, Quanta may be required to pay certain obligations that otherwise would have been paid by this insurer. Quanta estimates that the total future claim amount that this insurer is currently obligated to pay on Quanta's behalf for the above-mentioned policy periods is approximately \$5.0 million, and Quanta has recorded a receivable and corresponding liability for such amount as of June 30, 2006. However, Quanta's estimate of the potential range of these future claim amounts is between \$4.0 million and \$10.0 million. The actual amounts ultimately paid by Quanta related to these claims, if any, may vary materially from the above range and could be impacted by further claims development and the extent to which the insurer could not honor its obligations. Quanta continues to monitor the financial situation of this insurer and analyze any alternative actions that could be pursued. In any event, Quanta does not expect any failure by this insurer to honor its obligations to Quanta, or any alternative actions Quanta may pursue, to have a material adverse impact on Quanta's financial condition; however, the impact could be material to Quanta's results of operations or cash flows in a given period.

*Performance Bonds*

In certain circumstances, Quanta is required to provide performance bonds in connection with its contractual commitments. Quanta has indemnified the surety for any expenses paid out under these performance bonds. As of June 30, 2006, the total amount of outstanding performance bonds was approximately \$558.2 million.

*Leases*

Quanta leases certain land, buildings and equipment under non-cancelable lease agreements, including related party leases. The terms of these agreements vary from lease to lease, including some with renewal options and escalation clauses. The following schedule shows the future minimum lease payments under these leases as of June 30, 2006 (in thousands):

	<b>Operating Leases</b>
<b>Year Ending December 31</b>	
2006	\$ 14,524
2007	22,521
2008	19,711
2009	15,801
2010	13,123
Thereafter	11,728
 Total minimum lease payments	 \$ 97,408

Quanta has guaranteed the residual value on certain of its equipment operating leases. Quanta guarantees the difference between this residual value and the fair market value of the underlying asset at the date of termination of the leases. At June 30, 2006, the maximum guaranteed residual value was approximately \$95.1 million. Quanta believes that no significant payments will be made as a result of the difference between the fair market value of the leased equipment and the guaranteed residual value. However, there can be no assurance that future significant payments will not be required.



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**QUANTA SERVICES INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of June 30, 2006, Quanta had capital lease obligations of \$0.4 million included within current maturities of long-term debt.

*Employment Agreements*

Quanta has entered into various employment agreements with certain executives which provide for compensation and certain other benefits and for severance payments under certain circumstances. In addition, certain employment agreements contain clauses that become effective upon a change of control of Quanta. Upon the occurrence of any of the defined events in the various employment agreements, Quanta will pay certain amounts to the employee, which vary with the level of the employee's responsibility.

*Collective Bargaining Agreements*

Certain of the subsidiaries are party to various collective bargaining agreements with certain of their employees. The agreements require such subsidiaries to pay specified wages and provide certain benefits to their union employees. These agreements expire at various times.

*Income Tax Audits*

Quanta has received federal tax refunds in the amounts of \$38.1 million in 2003 and \$30.2 million in 2004 from the Internal Revenue Service (IRS) due to the carry back of taxable losses reported on Quanta's 2002 and 2003 income tax returns. The IRS is required by law to review Quanta's refund claims. As a result, Quanta is currently under audit for tax years 2000 through 2004. Quanta fully cooperates with all audits, but defends existing positions vigorously. To provide for potential tax exposures, Quanta maintains an allowance for tax contingencies, which management believes is adequate. As of December 31, 2005 and June 30, 2006 the amounts accrued for tax contingencies totaled \$67.5 million and \$72.9 million, with \$46.8 and \$51.1 million considered to be long-term and included in other non-current liabilities. The results of future audit assessments, if any, could have a material effect on Quanta's cash flows during the periods in which these audits are settled. However, management does not believe that any of these matters will have a material adverse effect on Quanta's consolidated results of operations.

*Indemnities*

Quanta has indemnified various parties against specified liabilities that those parties might incur in the future in connection with Quanta's previous acquisitions of certain companies. These indemnities usually are contingent upon the other party incurring liabilities that reach specified thresholds. As of June 30, 2006, Quanta is not aware of circumstances that would lead to future indemnity claims against it for material amounts in connection with these transactions.

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**QUANTA SERVICES INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and with our Annual Report on Form 10-K, which was filed with the SEC on March 2, 2006 and is available on the SEC's website at [www.sec.gov](http://www.sec.gov). The discussion below contains forward-looking statements that are based upon our current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these expectations due to inaccurate assumptions and known or unknown risks and uncertainties, including those identified in *Uncertainty of Forward-Looking Statements and Information*.

**Introduction**

We are a leading national provider of specialty contracting services, offering end-to-end network solutions to the electric power, gas, telecommunications, cable television and specialty services industries. We believe that we are the largest contractor servicing the transmission and distribution sector of the North American electric utility industry. We derive our revenues from one reportable segment. Our customers include electric power, gas, telecommunications and cable television companies, as well as commercial, industrial and governmental entities. We had consolidated revenues for the six months ended June 30, 2006 of approximately \$1.01 billion, of which 66.3% was attributable to electric power and gas customers, 15.3% to telecommunications and cable television customers and 18.4% to ancillary services, such as inside electrical wiring, intelligent traffic networks, cable and control systems for light rail lines, airports and highways, and specialty rock trenching, directional boring and road milling for industrial and commercial customers.

Our customers include many of the leading companies in the industries we serve. We have developed strong strategic alliances with numerous customers and strive to develop and maintain our status as a preferred vendor to our customers. We enter into various types of contracts, including competitive unit price, hourly rate, cost-plus (or time and materials basis), and fixed price (or lump sum basis), the final terms and prices of which we frequently negotiate with the customer. Although the terms of our contracts vary considerably, most are made on either a unit price or fixed price basis in which we agree to do the work for a price per unit of work performed (unit price) or for a fixed amount for the entire project (fixed price). We complete a substantial majority of our fixed price projects within one year, while we frequently provide maintenance and repair work under open-ended unit price or cost-plus master service agreements that are renewable annually. Some of our customers require us to post performance and payment bonds upon execution of the contract, depending upon the nature of the work to be performed.

We generally recognize revenue on our unit price and cost-plus contracts when units are completed or services are performed. For our fixed price contracts, we typically record revenues as work on the contract progresses on a percentage-of-completion basis. Under this valuation method, revenue is recognized based on the percentage of total costs incurred to date in proportion to total estimated costs to complete the contract. Fixed price contracts generally include retainage provisions under which a percentage of the contract price is withheld until the project is complete and has been accepted by our customer.

**Seasonality; Fluctuations of Results**

Our revenues and results of operations can be subject to seasonal variations. These variations are influenced by weather, customer spending patterns, bidding seasons and holidays. Typically, our revenues are lowest in the first quarter of the year because cold, snowy or wet conditions cause delays. The second quarter is typically better than the first, as some projects begin, but continued cold and wet weather can often impact second quarter productivity. The third quarter is typically the best of the year, as a greater number of projects are underway and weather is more accommodating to work on projects. Revenues during the fourth quarter of the year are typically lower than the third quarter but higher than the second quarter. Many projects are completed in the fourth quarter and revenues often are impacted positively by customers seeking to spend their capital budget before the end of the year; however, the holiday season and inclement weather sometimes can cause delays.



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Additionally, our industry can be highly cyclical. As a result, our volume of business may be adversely affected by declines in new projects in various geographic regions in the United States. The financial condition of our customers and their access to capital, variations in the margins of projects performed during any particular quarter, regional economic conditions, timing of acquisitions and the timing and magnitude of acquisition assimilation costs may also materially affect quarterly results. Accordingly, our operating results in any particular quarter or year may not be indicative of the results that can be expected for any other quarter or for any other year. You should read *Outlook* and *Understanding Gross Margins* for additional discussion of trends and challenges that may affect our financial condition and results of operations.

**Understanding Gross Margins**

Our gross margin is gross profit expressed as a percentage of revenues. Cost of services consists primarily of salaries, wages and benefits to employees, depreciation, fuel and other equipment expenses, equipment rentals, subcontracted services, insurance, facilities expenses, materials and parts and supplies. Various factors – some controllable, some not – impact our gross margins on a quarterly or annual basis.

*Seasonal and Geographical.* As discussed above, seasonal patterns can have a significant impact on gross margins. Generally, business is slower in the winter months versus the warmer months of the year. This can be offset somewhat by increased demand for electrical service and repair work resulting from severe weather. In addition, the mix of business conducted in different parts of the country will affect margins, as some parts of the country offer the opportunity for higher gross margins than others.

*Weather.* Adverse or favorable weather conditions can impact gross margins in a given period. For example, it is typical in the first quarter of any fiscal year that parts of the country may experience snow or rainfall that may negatively impact our revenue and gross margin. In many cases, projects may be delayed or temporarily placed on hold due to inclement weather. Conversely, in periods when weather remains dry and temperatures are accommodating, more work can be done, sometimes with less cost, which would have a favorable impact on gross margins. In some cases, strong storms or hurricanes can provide us with high margin emergency service restoration work, which generally has a positive impact on margins.

*Revenue Mix.* The mix of revenue derived from the industries we serve will impact gross margins. Changes in our customers' spending patterns in each of the industries we serve can cause an imbalance in supply and demand and, therefore, affect margins and mix of revenue by industry served.

*Service and Maintenance versus Installation.* In general, installation work has a higher gross margin than maintenance work. This is because installation work is often obtained on a fixed price basis which has higher risk than other types of pricing arrangements. We typically derive approximately 50% of our revenue from maintenance work, which is performed under pre-established or negotiated prices or cost-plus pricing arrangements. Thus, a higher portion of installation work in a given quarter may result in a higher gross margin.

*Subcontract Work.* Work that is subcontracted to other service providers generally has lower gross margins. An increase in subcontract work in a given period may contribute to a decrease in gross margin. We typically subcontract approximately 10% - 15% of our work to other service providers.

*Materials versus Labor.* Margins may be lower on projects on which we furnish materials as material prices are generally more predictable than labor costs. Consequently, we generally are not able to mark up materials as much as labor costs. In a given period, a higher percentage of work that has a higher materials component may decrease overall gross margin.

*Depreciation.* We include depreciation in cost of services. This is common practice in our industry, but can make comparability to other companies difficult. This must be taken into consideration when comparing us to other companies.

*Insurance.* Gross margins could be impacted by fluctuations in insurance accruals related to our deductibles in the period in which such adjustments are made. As of June 30, 2006, we had a deductible of \$1.0 million per occurrence related to employer's and general liability insurance and a deductible of



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\$2.0 million per occurrence for automobile liability and workers compensation insurance. We also have a non-union employee health care benefit plan that is subject to a deductible of \$250,000 per claimant per year.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses consist primarily of compensation and related benefits to management, administrative salaries and benefits, incentive bonuses, marketing, office rent and utilities, communications, professional fees, bad debt expense, letter of credit fees and gains and losses on the sale of property and equipment.

**Results of Operations**

The following table sets forth selected statements of operations data and such data as a percentage of revenues for the three and six months indicated (dollars in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2005		2006		2005		2006	
Revenues	\$ 439,287	100.0%	\$ 514,048	100.0%	\$ 811,792	100.0%	\$ 1,010,542	100.0%
Cost of services (including depreciation)	385,471	87.7	433,693	84.4	721,884	88.9	870,739	86.2
Gross profit	53,816	12.3	80,355	15.6	89,908	11.1	139,803	13.8
Selling, general and administrative expenses	43,874	10.0	46,640	9.0	86,336	10.7	88,915	8.8
Income from operations	9,942	2.3	33,715	6.6	3,572	0.4	50,888	5.0
Interest expense	(5,904)	(1.3)	(9,794)	(1.9)	(11,922)	(1.5)	(15,678)	(1.6)
Interest income	1,696	0.3	3,036	0.6	3,215	0.4	6,015	0.6
Gain on early extinguishment of debt			1,598	0.3			1,598	0.2
Other income (expense), net	97		180		262	0.1	328	0.1
Income (loss) before income taxes	5,831	1.3	28,735	5.6	(4,873)	(0.6)	43,151	4.3
Provision (benefit) for income taxes	2,488	0.5	11,075	2.2	(3,088)	(0.4)	17,633	1.8
Net income (loss)	\$ 3,343	0.8%	\$ 17,660	3.4%	\$ (1,785)	(0.2)%	\$ 25,518	2.5%

**Three months ended June 30, 2006 compared to the three months ended June 30, 2005**

**Revenues.** Revenues increased \$74.8 million, or 17.0%, to \$514.0 million for the three months ended June 30, 2006, with revenues derived from the electric power and gas network services industry increasing by \$61.9 million, revenues from the telecommunications and cable television network services industry increasing by approximately \$12.8 million and revenues from ancillary services remaining relatively constant. The increase in revenues is a result of a higher volume of work from increased spending by our customers resulting from the continued improving

financial health of our customers and improved pricing.

*Gross profit.* Gross profit increased \$26.5 million, or 49.3%, to \$80.4 million for the three months ended June 30, 2006. As a percentage of revenues, gross margin increased from 12.3% for the three months ended June 30, 2005 to 15.6% for the three months ended June 30, 2006. This increase in gross margin is primarily attributable to higher margins on work from our electric power and gas network services customers due to continued strengthening market conditions. In addition, we achieved higher margins on certain jobs due to better productivity and cost control as well as improved overall fixed cost absorption as a result of higher revenues.

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*Selling, general and administrative expenses.* Selling, general and administrative expenses increased \$2.8 million or 6.3% to \$46.6 million for the three months ended June 30, 2006. As a percentage of revenues, selling, general and administrative expenses decreased from 10.0% to 9.0%. The \$2.8 million increase was primarily due to \$5.4 million in increased salaries and benefits costs associated with increased personnel, cost of living adjustments and increased performance bonuses, as well as \$0.7 million in increased bad debt expense. Offsetting these increases was a decrease in professional fees of \$3.5 million. Last year's second quarter was negatively impacted by \$1.7 million in costs associated with our margin enhancement program as well as \$0.6 million associated costs with specific bidding activity. The remaining decrease in professional fees is due to higher legal costs from ongoing litigation in the second quarter of 2005 as compared to the second quarter of 2006.

*Interest expense.* Interest expense for the three months ended 2006 increased \$3.9 million as compared to the three months ended June 30, 2005, primarily due to the expensing of unamortized debt issuance costs of \$3.3 million. We replaced our prior credit facility in June 2006 and expensed the remaining balance of unamortized debt issuance costs of \$2.6 million. In addition, we expensed approximately 80.7% or \$0.7 million of unamortized debt issuance costs related to the 4.0% convertible subordinated notes repurchased during the second quarter of 2006. The remaining increase in interest expense was due to a timing difference between the issuance of the 3.75% convertible subordinated notes during the second quarter of 2006 and use of those proceeds to affect the tender offer for the 4.0% convertible subordinated notes in the second quarter of 2006.

*Interest income.* Interest income was \$3.0 million for the three months ended June 30, 2006 compared to \$1.7 million for the three months ended June 30, 2005. The increase is primarily due to a higher average cash balance for the quarter ended June 30, 2006 as compared to the quarter ended June 30, 2005 as well as higher overall interest rates. Included in these higher average cash balances is the effect of the timing difference between the issuance of the 3.75% convertible subordinated notes during the second quarter of 2006 and use of those proceeds to affect the tender offer for the 4.0% convertible subordinated notes in the second quarter of 2006.

*Provision for income taxes.* The provision for income taxes was \$11.1 million for the three months ended June 30, 2006, with an effective tax rate of 38.5%, compared to a provision of \$2.5 million for the three months ended June 30, 2005, with an effective tax rate of 42.7%. The lower effective tax rate for the three months ended June 30, 2006 primarily results from the recording of a \$1.6 million refund related to the settlement of a multi-year state tax claim.

***Six months ended June 30, 2006 compared to the six months ended June 30, 2005***

*Revenues.* Revenues increased \$198.8 million, or 24.5%, to \$1.01 billion for the six months ended June 30, 2006, with revenues derived from the electric power and gas network services industry increasing by approximately \$145.5 million, revenues from the telecommunications and cable television network services industry increasing by approximately \$27.0 million and revenues from ancillary services increasing by approximately \$26.3 million. The increase in revenues is a result of a higher volume of work from increased spending by our customers resulting from their continued improving financial health, favorable weather conditions experienced during the first quarter and greater demand for all the primary services we offer.

*Gross profit.* Gross profit increased \$49.9 million, or 55.5%, to \$139.8 million for the six months ended June 30, 2006. As a percentage of revenues, gross margin increased from 11.1% for the six months ended June 30, 2005 to 13.8% for the six months ended June 30, 2006. Consistent with second quarter results, the increase in margins for the six months ended June 30, 2006 over the six months ended June 30, 2005 is attributable to higher margins on work from our electric power and gas network services customers, due to continued strengthening market conditions. In addition, we achieved higher margins on certain jobs due to better productivity and cost control and relatively mild weather as compared to the first half of 2005, which was negatively impacted by cost overruns and weather delays on certain projects during the first quarter.

*Selling, general and administrative expenses.* Selling, general and administrative expenses increased \$2.6 million, or 3.0%, to \$88.9 million for the six months ended June 30, 2006. As a percentage of revenues, selling, general and administrative expenses decreased from 10.7% to 8.8% for the six months ended June 30,

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2006. The \$2.6 million increase was primarily due to \$7.4 million in increased salaries and benefits costs associated with increased personnel, costs of living adjustments and increased performance bonuses, as well as \$0.4 million in increased bad debt expense and \$0.5 million in increased travel expenditures. Partially offsetting the increases was a decrease in professional fees of \$5.1 million. For the six months ended June 30, 2005, professional fees included costs associated with our margin enhancement program of \$2.8 million as well as \$0.6 million associated with specific bidding activity. The remaining decrease in professional fees is due to higher legal costs from ongoing litigation in the six months ended June 30, 2005 as compared to the six months ended June 30, 2006.

*Interest expense.* Interest expense for the six months ended of June 30, 2006 increased \$3.8 million as compared to the six months ended June 30, 2005, primarily due to the expensed of unamortized debt issuance costs of \$3.3 million. We replaced our prior credit facility and expensing the remaining balance of unamortized debt issuance costs of \$2.6 million. In addition, we expensed approximately 80.7% or \$0.7 million of unamortized debt issuance costs related to the 4.0% convertible subordinated notes repurchased during the second quarter of 2006. The remaining increase in interest expense was due to a timing difference between the issuance of the 3.75% convertible subordinated notes during the second quarter of 2006 and use of those proceeds to affect the tender offer for the 4.0% convertible subordinated notes in the second quarter of 2006.

*Interest income.* Interest income was \$3.2 million for the six months ended June 30, 2005, compared to \$6.0 million for the six months ended June 30, 2006. The increase in interest income primarily relates to a higher average cash balance and higher average interest rates for the six months ended June 30, 2006 as compared to the six months ended June 30, 2005. Included in these higher average cash balances is the effect of the timing difference between the issuance of the 3.75% convertible subordinated notes during the second quarter of 2006 and use of those proceeds to affect the tender offer for the 4.0% convertible subordinated notes in the second quarter of 2006.

*Provision (benefit) for income taxes.* The benefit for income taxes was \$3.1 million for the six months ended June 30, 2005, with an effective tax rate of 63.4%, compared to a provision of \$17.6 million for the six months ended June 30, 2006, with an effective tax rate of 40.9%. The lower effective tax rate for 2006 results from higher projected income for 2006 as compared to projected income for 2005 as well as the recording of a \$1.6 million refund related to the settlement of a multi-year state tax claim.

**Liquidity and Capital Resources*****Cash Requirements***

We anticipate that our cash on hand and short-term investments (as restated), which together totaled \$309.5 million as of June 30, 2006, the availability under our credit facility and our future cash flow from operations will be sufficient to enable us to meet our future operating needs, debt service requirements, and planned capital expenditures and to ensure our future ability to grow. We began to invest in variable rate demand notes during 2006. These instruments have long-term scheduled maturities, but provide the option to tender to a third-party liquidity provider at any time with seven days notice and are therefore classified as short-term investments. Momentum in deployment of fiber to the premises or initiatives to rebuild the United States electric power grid may require a significant amount of additional working capital. However, we feel that we have adequate cash, short-term investments and availability under our credit facility to meet such needs.

***Sources and Uses of Cash***

As of June 30, 2006, we had cash and cash equivalents (as restated) of \$37.4 million, short-term investments (as restated) of \$272.2 million, working capital of \$613.9 million and long-term debt of \$447.0 million, net of current maturities. Our long-term debt balance at that date included \$447.0 million of convertible subordinated notes. We also had \$124.4 million of letters of credit outstanding under our credit facility.

During the six months ended June 30, 2006, operating activities provided net cash to us of \$32.5 million. Cash flow from operations is primarily influenced by demand for our services, operating margins and the type

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of services we provide. In accordance with the adoption of SFAS No. 123(R), as discussed in Note 2 to the Condensed Consolidated Financial Statements, the tax benefit from stock-based equity awards is recorded as an adjustment to net income in the operating section of the statements of cash flows; therefore, for the six months ended June 30, 2006, a \$4.6 million tax benefit from stock-based equity awards has been recorded as a reduction to cash flows from operations. We used net cash in investing activities (as restated) of \$296.9 million, including \$272.2 million in net purchases of short-term investments and \$29.3 million used for capital expenditures, offset by \$4.6 million of proceeds from the sale of equipment. Financing activities used net cash flow of \$2.5 million, resulting primarily from a payment of \$5.7 million in debt issuance costs, a \$7.5 million repayment under the term loan portion of our prior credit facility together with \$1.4 million in net repayments of other long-term debt, partially offset by \$6.6 million in net borrowings from the repurchase of our 4.0% convertible subordinated notes and the issuance of our 3.75% convertible subordinated notes as discussed below, coupled with \$4.6 million in tax benefits from stock-based equity awards and \$0.8 million received from the exercise of stock options.

***Debt Instruments******Credit Facility***

On June 12, 2006, we entered into an amended and restated credit facility with various lenders which provides for a \$300.0 million senior secured revolving credit facility maturing on June 12, 2011 (the credit facility). The credit facility amended and restated our prior credit facility. The entire amount of the credit facility is available for the issuance of standby letters of credit. In addition, subject to the conditions specified in the credit facility, we have the option to increase the revolving commitments under the credit facility by up to an additional \$125.0 million from time to time upon receipt of additional commitments from new or existing lenders. Borrowings under the credit facility are to be used for working capital, capital expenditures and for other general corporate purposes.

As of June 30, 2006, we had approximately \$124.4 million of letters of credit issued under the credit facility and no outstanding revolving loans. The remaining \$175.6 million was available for revolving loans or issuing new letters of credit. Amounts borrowed under the credit facility bear interest, at our option, at a rate equal to either (a) the Eurodollar Rate (as defined in the credit facility) plus 1.25% to 1.875%, as determined by the ratio of our total funded debt to EBITDA, or (b) the base rate (as described below) plus 0.25% to 0.875%, as determined by the ratio of our total funded debt to EBITDA. Letters of credit issued under the credit facility are subject to a letter of credit fee of 1.25% to 1.875%, based on the ratio of our total funded debt to EBITDA. We are also subject to a commitment fee of 0.25% to 0.35%, based on the ratio of our total funded debt to EBITDA, on any unused availability under the credit facility. The base rate equals the higher of (i) the Federal Funds Rate (as defined in the credit facility) plus  $\frac{1}{2}$  of 1% and (ii) the bank's prime rate.

The credit facility contains certain covenants, including covenants with respect to maximum funded debt to EBITDA, maximum senior debt to EBITDA, minimum interest coverage and minimum consolidated net worth, in each case as specified in the credit facility. For purposes of calculating the maximum funded debt to EBITDA ratio and the maximum senior debt to EBITDA ratio, our maximum funded debt and maximum senior debt are reduced by all cash and cash equivalents (as defined in the credit facility) held by us in excess of \$25.0 million. As of June 30, 2006, we were in compliance with all of our covenants. The credit facility also limits certain acquisitions, mergers and consolidations, capital expenditures, asset sales and prepayments of indebtedness and, subject to certain exceptions, prohibits liens on material assets. The credit facility also includes limits on the payment of dividends and stock repurchase programs in any fiscal year to an annual aggregate amount of up to 25% of our consolidated net income (plus the amount of non-cash charges that reduced such consolidated net income) for the prior fiscal year. The credit facility does not limit dividend payments or other distributions payable solely in capital stock. The credit facility provides for customary events of default and carries cross-default provisions with all of our existing subordinated notes, our continuing indemnity and security agreement with our surety and all of our other debt instruments exceeding \$10.0 million in borrowings. If an event of default (as defined in the credit facility) occurs and is continuing, on the terms and subject to the conditions set forth in the credit facility, amounts outstanding under the credit facility may be accelerated and may become or be declared immediately due and payable.



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The credit facility is secured by a pledge of all of the capital stock of our U.S. subsidiaries, 65% of the capital stock of its foreign subsidiaries and substantially all of our assets. Our U.S. subsidiaries guarantee the repayment of all amounts due under the credit facility. Our obligations under the credit facility constitute designated senior indebtedness under our 3.75%, 4.0% and 4.5% convertible subordinated notes.

As of December 31, 2005, we had a \$182.0 million credit facility with various lenders (the prior facility). The prior facility was amended during the second quarter of 2006 to permit, among other things, our cash tender offer for our 4.0% convertible subordinated notes and the issuance of our 3.75% convertible subordinated notes, each as described below. The prior facility consisted of a \$147.0 million letter of credit facility maturing on June 19, 2008, which also provided for term loans, and a \$35.0 million revolving credit facility which provided for revolving loans and letters of credit and was scheduled to mature on December 19, 2007. Upon the amendment and restatement of our credit facility, the obligations under the prior facility were terminated, and related unamortized debt issuance costs in the amount of approximately \$2.6 million were expensed in the second quarter of 2006 and included in interest expense. As of December 31, 2005, we had approximately \$142.6 million of letters of credit outstanding under the prior credit facility and \$7.5 million of the letter of credit facility outstanding as a term loan.

*4.0% Convertible Subordinated Notes*

As of June 30, 2006, we had \$33.3 million aggregate principal amount of 4.0% convertible subordinated notes (4.0% Notes) outstanding. The 4.0% Notes are convertible into shares of our common stock at a price of \$54.53 per share, subject to adjustment as a result of certain events. The sale of the notes and the shares issuable upon conversion thereof was registered in a registration statement filed with the SEC. The 4.0% Notes require semi-annual interest payments on July 1 and December 31 until the notes mature on July 1, 2007. We have the option to redeem some or all of the 4.0% Notes at specified redemption prices, together with accrued and unpaid interest. If certain fundamental changes occur, as described in the indenture under which we issued the 4.0% Notes, holders of the 4.0% Notes may require us to purchase all or part of the notes at a purchase price equal to 100% of the principal amount, plus accrued and unpaid interest. During the second quarter of 2006, we conducted a cash tender offer for all of the 4.0% Notes. The tender offer expired on June 13, 2006 and, as a result of the offer, \$139.2 million of the 4.0% Notes were repurchased, representing approximately 80.7% of outstanding 4.0% Notes. As a result of the repurchase of a portion of the 4.0% Notes, we recorded a gain on early extinguishment of debt of approximately \$2.1 million, which was partially offset by costs associated with the tender offer of approximately \$0.5 million. In addition, approximately \$0.7 million in related unamortized debt issuance costs associated with the retirement of a portion of the repurchased 4.0% Notes has been expensed and included in interest expense. On July 1, 2006, Quanta reclassified the remaining \$33.3 million of the 4.0% Notes as a current obligation as they will mature within the next twelve months. The credit facility permits the repayment of these 4.0% Notes on or before maturity at Quanta's sole discretion.

*4.5% Convertible Subordinated Notes*

As of June 30, 2006, we had \$270.0 million aggregate principal amount of 4.5% convertible subordinated notes (4.5% Notes) outstanding. The resale of the notes and the shares issuable upon conversion thereof was registered for the benefit of the holders in a shelf registration statement filed with the SEC. The 4.5% Notes require semi-annual interest payments on April 1 and October 1 until the notes mature on October 1, 2023.

The 4.5% Notes are convertible into shares of our common stock based on an initial conversion rate of 89.7989 shares of Quanta's common stock per \$1,000 principal amount of 4.5% Notes (which is equal to an initial conversion price of approximately \$11.14 per share), subject to adjustment as a result of certain events. The 4.5% Notes are convertible by the holder (i) during any fiscal quarter if the last reported sale price of our common stock is greater than or equal to 120% of the conversion price for at least 20 trading days in the period of 30 consecutive trading days ending on the first trading day of such fiscal quarter, (ii) during the five business day period after any five consecutive trading day period in which the trading price per note for each day of that period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate, (iii) upon us calling the notes for redemption or (iv) upon the occurrence of specified

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corporate transactions. If the notes become convertible under any of these circumstances, we have the option to deliver cash, shares of our common stock or a combination thereof, with the amount of cash determined in accordance with the terms of the indenture under which the notes were issued. During the second quarter of 2006, the market price condition described in clause (i) above was satisfied, and the notes are presently convertible at the option of each holder. The conversion period will expire on September 30, 2006, but may resume upon the satisfaction of the market condition or other conditions in future periods.

Beginning October 8, 2008, we can redeem for cash some or all of the 4.5% Notes at the principal amount thereof plus accrued and unpaid interest. The holders of the 4.5% Notes may require us to repurchase all or some of their notes at the principal amount thereof plus accrued and unpaid interest on October 1, 2008, 2013 or 2018, or upon the occurrence of a fundamental change, as defined by the indenture under which we issued the notes. We must pay any required repurchase on October 1, 2008 in cash. For all other required repurchases, we have the option to deliver cash, shares of our common stock or a combination thereof to satisfy our repurchase obligation. We presently do not anticipate using stock to satisfy any future repurchase obligations. If we were to satisfy the obligation with shares of our common stock, the number of shares delivered would equal the dollar amount to be paid in common stock divided by 98.5% of the market price of our common stock, as defined by the indenture. The number of shares to be issued under this circumstance is not limited. The right to settle for shares of common stock can be surrendered by us. The 4.5% Notes carry cross-default provisions with our other debt instruments exceeding \$10.0 million in borrowings, which includes our existing credit facility.

*3.75% Convertible Subordinated Notes*

During the second quarter of 2006, we issued \$143.8 million aggregate principal amount of 3.75% convertible subordinated notes due 2026 (3.75% Notes). The 3.75% Notes mature on April 30, 2026 and bear interest at the annual rate of 3.75%, payable semi-annually on April 30 and October 30, commencing on October 30, 2006.

The 3.75% Notes are convertible into our common stock, based on an initial conversion rate of 44.6229 shares of our common stock per \$1,000 principal amount of 3.75% Notes (which is equal to an initial conversion price of approximately \$22.41 per share), subject to adjustment as a result of certain events. The 3.75% Notes are convertible by the holder (i) during any fiscal quarter if the closing price of our common stock is greater than 130% of the conversion price for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter, (ii) upon our calling the 3.75% Notes for redemption, (iii) upon the occurrence of specified distributions to holders of our common stock or specified corporate transactions or (iv) at any time on or after March 1, 2026 until the business day immediately preceding the maturity date of the 3.75% Notes. If the 3.75% Notes become convertible under any of these circumstances, we have the option to deliver cash, shares of our common stock or a combination thereof, with the amount of cash determined in accordance with the terms of the indenture under which the notes were issued. The holders of the 3.75% Notes who convert their notes in connection with certain change in control transactions, as defined in the indenture, may be entitled to a make whole premium in the form of an increase in the conversion rate. In the event of a change in control, in lieu of paying holders a make whole premium, if applicable, we may elect, in some circumstances, to adjust the conversion rate and related conversion obligations so that the 3.75% Notes are convertible into shares of the acquiring or surviving company. The resale of the notes and the shares issuable upon conversion thereof is required to be registered by us for the benefit of the holders in a registration statement which we intend to file with the SEC during the third quarter of 2006.

Beginning on April 30, 2010 until April 30, 2013, we may redeem for cash all or part of the 3.75% Notes at a price equal to 100% of the principal amount plus accrued and unpaid interest, if the closing price of our common stock is equal to or greater than 130% of the conversion price then in effect for the 3.75% Notes for at least 20 trading days in the 30 consecutive trading day period ending on the trading day immediately prior to the date of mailing of the notice of redemption. In addition, we may redeem for cash all or part of the 3.75% Notes at any time on or after April 30, 2010 at certain redemption prices, plus accrued and unpaid interest. Beginning with the six-month interest period commencing on April 30, 2010, and for each six-month



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interest period thereafter, we will pay contingent interest during the applicable interest period if the average trading price of the 3.75% Notes reaches a specified threshold. The contingent interest payable within any applicable interest period will equal an annual rate of 0.25% of the average trading price of the 3.75% Notes during a five trading day reference period.

The holders of the 3.75% Notes may require us to repurchase all or a part of the notes in cash on each of April 30, 2013, April 30, 2016 and April 30, 2021, and in the event of a change in control, as defined in the indenture, at a purchase price equal to 100% of the principal amount of the 3.75% Notes plus accrued and unpaid interest. The 3.75% Notes carry cross-default provisions with our other debt instruments exceeding \$20.0 million in borrowings, which includes our existing credit facility.

**Off-Balance Sheet Transactions**

As is common in our industry, we have entered into certain off-balance sheet arrangements in the ordinary course of business that result in risks not directly reflected in our balance sheets. Our significant off-balance sheet transactions include liabilities associated with non-cancelable operating leases, letter of credit obligations and surety guarantees. We have not engaged in any off-balance sheet financing arrangements through special purpose entities.

***Leases***

We enter into non-cancelable operating leases for many of our facility, vehicle and equipment needs. These leases allow us to conserve cash by paying a monthly lease rental fee for use of facilities, vehicles and equipment rather than purchasing them. We may decide to cancel or terminate a lease before the end of its term, in which case we are typically liable to the lessor for the remaining lease payments under the term of the lease.

We have guaranteed the residual value of the underlying assets under certain of our equipment operating leases at the date of termination of such leases. We have agreed to pay any difference between this residual value and the fair market value of each underlying asset as of the lease termination date. As of June 30, 2006, the maximum guaranteed residual value was approximately \$95.1 million. We believe that no significant payments will be made as a result of the difference between the fair market value of the leased equipment and the guaranteed residual value. However, there can be no assurance that future significant payments will not be required.

***Letters of Credit***

Certain of our vendors require letters of credit to ensure reimbursement for amounts they are disbursing on our behalf, such as to beneficiaries under our self-funded insurance programs. In addition, from time to time some customers require us to post letters of credit to ensure payment to our subcontractors and vendors under those contracts and to guarantee performance under our contracts. Such letters of credit are generally issued by a bank or similar financial institution. The letter of credit commits the issuer to pay specified amounts to the holder of the letter of credit if the holder demonstrates that we have failed to perform specified actions. If this were to occur, we would be required to reimburse the issuer of the letter of credit. Depending on the circumstances of such a reimbursement, we may also have to record a charge to earnings for the reimbursement. We do not believe that it is likely that any claims will be made under a letter of credit in the foreseeable future.

As of June 30, 2006, we had \$124.4 million in letters of credit outstanding under our credit facility primarily to secure obligations under our casualty insurance program. These are irrevocable stand-by letters of credit with maturities expiring at various times throughout 2006. Upon maturity, it is expected that the majority of these letters of credit will be renewed for subsequent one-year periods.

**Table of Contents****Performance Bonds**

Many customers, particularly in connection with new construction, require us to post performance and payment bonds issued by a financial institution known as a surety. These bonds provide a guarantee to the customer that we will perform under the terms of a contract and that we will pay subcontractors and vendors. If we fail to perform under a contract or to pay subcontractors and vendors, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the surety for any expenses or outlays it incurs. Under our continuing indemnity and security agreement with the surety, we have posted letters of credit in the amount of \$15.0 million in favor of the surety and, with the consent of our lenders under our credit facility, we have granted security interests in certain of our assets to collateralize our obligations to the surety. We may be required to post additional letters of credit or other collateral in favor of the surety or our customers in the future. Posting letters of credit in favor of the surety or our customers also will reduce the borrowing availability under our credit facility. To date, we have not been required to make any reimbursements to the surety for bond-related costs. We believe that it is unlikely that we will have to fund significant claims under our surety arrangements in the foreseeable future. As of June 30, 2006, an aggregate of approximately \$558.2 million in original face amount of bonds issued by the surety were outstanding. Our estimated cost to complete these bonded projects was approximately \$139.5 million as of June 30, 2006.

**Contractual Obligations**

As of June 30, 2006, our future contractual obligations are as follows (in thousands):

	Total	2006	2007	2008	2009	2010	Thereafter
Long-term debt principal	\$ 447,559	\$ 435	\$ 33,374	\$ 270,000	\$	\$ 143,750	\$
Long-term debt interest	49,332	9,436	18,206	14,503	5,390	1,797	
Capital lease obligations, including interest	389	389					
Operating lease obligations	97,408	14,524	22,521	19,711	15,801	13,123	11,728
<b>Total</b>	<b>\$ 594,688</b>	<b>\$ 24,784</b>	<b>\$ 74,101</b>	<b>\$ 304,214</b>	<b>\$ 21,191</b>	<b>\$ 158,670</b>	<b>\$ 11,728</b>

Excluded from the above table is interest associated with borrowings under the credit facility because both the amount borrowed and applicable interest rate are variable. As of June 30, 2006, we had no borrowings under our credit facility. In addition, our multi-employer pension plan contributions are determined annually based on our union employee payrolls, which cannot be determined for future periods in advance.

**Concentration of Credit Risk**

We grant credit under normal payment terms, generally without collateral, to our customers, which include electric power and gas companies, telecommunications and cable television system operators, governmental entities, general contractors, and builders, owners and managers of commercial and industrial properties located primarily in the United States. Consequently, we are subject to potential credit risk related to changes in business and economic factors throughout the United States. However, we generally have certain statutory lien rights with respect to services provided. Under certain circumstances such as foreclosures or negotiated settlements, we may take title to the underlying assets in lieu of cash in settlement of receivables. No customer accounted for more than 10% of accounts receivable as of June 30, 2006 or revenues for the three or six months ended June 30, 2006.

**Litigation**

We are from time to time party to various lawsuits, claims and other legal proceedings that arise in the ordinary course of business. These actions typically seek, among other things, compensation for alleged personal injury, breach of contract and/or, property damages, punitive damages, civil penalties or other losses, or injunctive or declaratory relief. With respect to all such lawsuits, claims and proceedings, we record reserves when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. We



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do not believe that any of these proceedings, separately or in the aggregate, would be expected to have a material adverse effect on our financial position, results of operations or cash flows.

### **Related Party Transactions**

In the normal course of business, we enter into transactions from time to time with related parties. These transactions typically take the form of facility leases with prior owners of certain acquired companies.

### **New Accounting Pronouncements**

In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* An Amendment of FASB Statements No. 133 and 140. SFAS No. 155 provides entities with relief from having to separately determine the fair value of an embedded derivative that would otherwise be required to be bifurcated from its host contract in accordance with SFAS No. 133. SFAS No. 155 allows an entity to make an irrevocable election to measure such a hybrid financial instrument at fair value in its entirety, with changes in fair value recognized in earnings. SFAS No. 155 is effective for all financial instruments acquired, issued or subject to a remeasurement event occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006. We anticipate that the adoption of SFAS No. 155 will not have a material impact on our financial position, results of operations or cash flows.

In July 2006, the FASB issued Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes* An Interpretation of FASB Statement 109. FIN No. 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing uncertain tax positions within financial statements. The provisions of FIN No. 48 are effective for fiscal years beginning after December 15, 2006. We are currently analyzing the provisions of FIN No. 48 and have not yet made a determination of the impact the adoption will have on our consolidated financial positions, results of operations and cash flows.

### **Critical Accounting Policies**

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities known to exist at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. We evaluate our estimates on an ongoing basis, based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. There can be no assurance that actual results will not differ from those estimates. Management has reviewed its development and selection of critical accounting estimates with the audit committee of our board of directors. We believe the following accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

*Revenue Recognition.* We recognize revenue when services are performed except when work is being performed under a fixed price contract. Revenues from fixed price contracts are recognized using the percentage-of-completion method, measured by the percentage of costs incurred to date to total estimated costs for each contract. Such contracts generally provide that the customer accept completion of progress to date and compensate us for services rendered, measured typically in terms of units installed, hours expended or some other measure of progress. Contract costs typically include all direct material, labor and subcontract costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. Provisions for the total estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, estimated profitability and final contract settlements may result in revisions to costs and income and their effects are recognized in the period in which the revisions are determined.

*Self-Insurance.* We are insured for employer's liability and general liability claims, subject to a deductible of \$1.0 million per occurrence, and for auto liability and workers' compensation subject to a deductible of \$2.0 million per occurrence. We also have a non-union employee health care benefit plan



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that is subject to a deductible of \$250,000 per claimant per year. Losses are accrued based upon our estimates of the ultimate liability for claims incurred and an estimate of claims incurred but not reported, with assistance from a third-party actuary. However, insurance liabilities are difficult to assess and estimate due to unknown factors, including the severity of an injury, the determination of our liability in proportion to other parties, the number of incidents not reported and the effectiveness of our safety program. The accruals are based upon known facts and historical trends and management believes such accruals to be adequate.

Our casualty insurance carrier for the policy periods from August 1, 2000 to February 28, 2003 has been experiencing financial distress but is currently paying valid claims. In the event that this insurer's financial situation further deteriorates, we may be required to pay certain obligations that otherwise would have been paid by this insurer. We estimate that the total future claim amount that this insurer is currently obligated to pay on our behalf for the above mentioned policy periods is approximately \$5.0 million; however, our estimate of the potential range of these future claim amounts is between \$4.0 million and \$10.0 million. The actual amounts ultimately paid by us in connection with such claims, if any, may vary materially from the above range and could be impacted by further claims development and the extent to which the insurer could not honor its obligations. In any event, we do not expect any failure by this insurer to honor its obligations to us to have a material adverse impact on our financial condition; however, the impact could be material to our results of operations or cash flow in a given period. We continue to monitor the financial situation of this insurer and analyze any alternative actions that could be pursued.

*Valuation of Intangibles and Long-Lived Assets.* SFAS No. 142 provides that goodwill and other intangible assets that have indefinite useful lives not be amortized but, instead, must be tested at least annually for impairment, and intangible assets that have finite useful lives should continue to be amortized over their useful lives. SFAS No. 142 also provides specific guidance for testing goodwill and other nonamortized intangible assets for impairment. SFAS No. 142 does not allow increases in the carrying value of reporting units that may result from our impairment test; therefore, we may record goodwill impairments in the future, even when the aggregate fair value of our reporting units and the company as a whole may increase. Goodwill of a reporting unit will be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Examples of such events or circumstances may include a significant change in business climate or a loss of key personnel, among others. SFAS No. 142 requires that management make certain estimates and assumptions in order to allocate goodwill to reporting units and to determine the fair value of reporting unit net assets and liabilities, including, among other things, an assessment of market conditions, projected cash flows, cost of capital and growth rates, which could significantly impact the reported value of goodwill and other intangible assets. Estimating future cash flows requires significant judgment, and our projections may vary from cash flows eventually realized.

We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be realizable. If an evaluation is required, the estimated future undiscounted cash flows associated with the asset are compared to the asset's carrying amount to determine if an impairment of such asset is necessary. Estimating future cash flows requires significant judgment, and our projections may vary from cash flows eventually realized. The effect of any impairment would be to expense the difference between the fair value of such asset and its carrying value. In addition, we estimate the useful lives of our long-lived assets and other intangibles. We periodically review factors to determine whether these lives are appropriate. Net gains or losses from the sale of property and equipment are reflected in Selling, General and Administrative Expenses.

*Current and Non-Current Accounts and Notes Receivable and Provision for Doubtful Accounts.* We provide an allowance for doubtful accounts when collection of an account or note receivable is considered doubtful. Inherent in the assessment of the allowance for doubtful accounts are certain judgments and estimates relating to, among others, our customer's access to capital, our customer's willingness or ability to pay, general economic conditions and the ongoing relationship with the customer.



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Should customers experience financial difficulties or file for bankruptcy, or should anticipated recoveries relating to the receivables in existing bankruptcies and other workout situations fail to materialize, we could experience reduced cash flows and losses in excess of current reserves. In addition, material changes in our customers revenues or cash flows could affect our ability to collect amounts due from them.

*Income Taxes.* We follow the liability method of accounting for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes. Under this method, deferred assets and liabilities are recorded for future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that are expected to be in effect when the underlying assets or liabilities are recovered or settled.

We regularly evaluate valuation allowances established for deferred tax assets for which future realization is uncertain and we maintain an allowance for tax contingencies that we believe is adequate. The estimation of required valuation allowances includes estimates of future taxable income. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. We consider projected future taxable income and tax planning strategies in making this assessment. If actual future taxable income differs from our estimates, we may not realize deferred tax assets to the extent we have estimated.

**Outlook**

The following statements are based on current expectations. These statements are forward-looking, and actual results may differ materially.

Many utilities across the country have regained their financial health and we believe they are making plans to increase spending on their transmission and distribution systems. As a result, we anticipate more extensive pole change outs, line upgrades and maintenance projects on many systems over the next several quarters. Further, the recently enacted Energy Policy Act of 2005 requires the power industry to meet federal reliability standards for their transmission and distribution systems and provides further incentives to the industry to invest in and improve maintenance on their systems. While this Act is likely to stimulate spending by our customers, we do not expect to begin to realize substantial benefits of this spending for at least twelve to twenty-four months.

We are also seeing improvement in the financial health of telecommunications customers. There are several telecommunications initiatives currently in discussion and underway by several wireline carriers and government organizations that provide us with pockets of opportunity, particularly from fiber to the premises (FTTP) and fiber to the node (FTTN) initiatives. Such initiatives have been announced by Verizon and AT&T (formerly SBC), and municipalities and other government jurisdictions have also become active in these initiatives. We anticipate increased spending by wireless telecommunications customers on their networks, as the impact of mergers within the wireless industry has begun to lessen. In addition, several wireless companies have announced plans to increase their cell site deployment plans over the next year, including the expansion of third generation technology.

Spending in the cable television industry remains flat. However, with several telecommunications companies increasing the pace of their FTTP and FTTN projects that will enable them to offer TV services via fiber to their customers, such initiatives could serve as a catalyst for the cable industry to begin a new network upgrade cycle to expand its service offerings in an effort to retain and attract customers. On July 21, 2006, Adelphia Communications Corporation and its affiliated companies (Adelphia) signed a plan agreement with their creditors' committee and other unsecured creditors providing a framework for a plan of reorganization intended to result in Adelphia's emergence from Chapter 11 bankruptcy in the fourth quarter of 2006. The plan of reorganization outlined in the plan agreement was conditioned on Adelphia's closing of the sale of substantially all of its assets to Time Warner Cable and Comcast Corporation and, on July 31, 2006, the sale was successfully completed. As a result of these transactions, we expect increased spending initiatives by Time Warner Cable and Comcast Corporation as they integrate the systems acquired from Adelphia.



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With the stabilization of several of our markets and our margin enhancement initiatives, we have begun to see our gross margins generally improve as well. While operating conditions are challenging, we are beginning to see margins improve, but they are not expected to return to historical levels in the near term. To the extent that our primary markets remain stable or continue to improve, margins should gradually improve.

We continue to focus on the elements of the business we can control, including cost control, the margins we accept on projects, collecting receivables, ensuring quality service and rightsizing initiatives to match the markets we serve. These initiatives include aligning our workforce with our current revenue base, evaluating opportunities to reduce the number of field offices and evaluating our non-core assets for potential sale. Such initiatives could result in future charges related to, among others, severance, facilities shutdown and consolidation, property disposal and other exit costs.

Capital expenditures in 2006 are expected to be approximately \$60.0 million. A majority of the expenditures will be for operating equipment. We expect expenditures for 2006 to be funded substantially through internal cash flows and, to the extent necessary, from cash on hand.

We believe that we are adequately positioned to capitalize upon opportunities in the industries we serve because of our proven full-service operating units with broad geographic reach, financial capability and technical expertise.

**Uncertainty of Forward-Looking Statements and Information**

This Quarterly Report on Form 10-Q includes statements reflecting assumptions, expectations, projections, intentions or beliefs about future events that are intended as forward-looking statements under the Private Securities Litigation Reform Act of 1995. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They use words such as anticipate, estimate, project, forecast, may, will, should, expect, believe and other words of similar meaning. In particular, these include, but are not limited to, statements relating to the following:

Projected operating or financial results;

Expectations regarding capital expenditures;

The effects of competition in our markets;

The benefits of the Energy Policy Act of 2005;

The current economic condition in the industries we serve;

Our ability to achieve cost savings; and

The effects of any acquisitions and divestitures we may make.

Such forward-looking statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict. We have based our forward-looking statements on our management's beliefs and assumptions based on information available to our management at the time the statements are made. We caution you that actual outcomes and results may differ materially from what is expressed, implied, or forecast by our forward-looking statements and that any or all of our forward-looking statements may turn out to be wrong. They can be affected by inaccurate assumptions and by known or unknown risks and uncertainties, including the following:

Quarterly variations in our operating results;

Adverse changes in economic conditions in the markets served by us or by our customers;

Our ability to effectively compete for market share;

Estimates and assumptions in determining our financial results;

Beliefs and assumptions about the collectibility of receivables;

The inability of our customers to pay for services following a bankruptcy or other financial difficulty;

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The financial distress of our casualty insurance carrier that may require payment for losses that would otherwise be insured;

Liabilities for claims that are self-insured or for claims that our casualty insurance carrier fails to pay;

Potential liabilities relating to occupational health and safety matters;

Estimates relating to our use of percentage-of-completion accounting;

Our dependence on fixed price contracts;

Rapid technological and structural changes that could reduce the demand for the services we provide;

Our ability to obtain performance bonds;

Cancellation provisions within our contracts and the risk that contracts expire and are not renewed or are replaced on less favorable terms;

Our ability to effectively integrate the operations of businesses acquired;

Retention of key personnel and qualified employees;

The impact of our unionized workforce on our operations and on our ability to complete future acquisitions;

Our ability to attract skilled labor and the potential shortage of skilled employees;

Our growth outpacing our infrastructure;

Risks associated with expanding our business in international markets;

Potential exposure to environmental liabilities;

Requirements relating to governmental regulation;

Our ability to continue to meet the requirements of the Sarbanes-Oxley Act of 2002;

The cost of borrowing, availability of credit, debt covenant compliance and other factors affecting our financing activities;

Our ability to generate internal growth;

Our ability to successfully identify and complete acquisitions;

The adverse impact of goodwill impairments;

The potential conversion of our 4.5% Notes into cash and/or common stock; and

The other risks and uncertainties as are described under **Risk Factors** in our Form 10-K for the fiscal year ending December 31, 2005 and as may be detailed from time to time in our other public filings with the SEC.

All of our forward-looking statements, whether written or oral, are expressly qualified by these cautionary statements and any other cautionary statements that may accompany such forward-looking statements or that are otherwise included in this report. In addition, we do not undertake any obligation to update any forward-looking statements to reflect events or circumstances after the date of this report.

**Item 3. *Quantitative and Qualitative Disclosures About Market Risk.***

*Interest Rates.* As of December 31, 2005, the fair value of our fixed-rate debt of \$444.8 million aggregate principal amount was approximately \$520.1 million, based upon current market prices. Due to the repurchase of a portion of our 4.0% Notes and the issuance of our 3.75% Notes, the fair value of our fixed-rate debt as of June 30, 2006 was approximately \$602.0 million, based upon current market prices.

**Table of Contents****Item 4. *Controls and Procedures.***

Our management evaluated, with the participation of our Chairman and Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures, as of June 30, 2006. Based on their evaluation, our Chairman and Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2006.

Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and breakdowns can occur because of simple errors or mistakes. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

There has been no change in our internal control over financial reporting that occurred during the quarter ended June 30, 2006, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

***Management's Consideration of the Restatement***

In coming to the conclusion that our disclosure controls and procedures were effective as of June 30, 2006, our management considered, among other things, the control deficiency related to the financial reporting for our investment in variable rate demand notes, which resulted in the restatement of our previously issued financial statements as disclosed in Note 1 to the consolidated financial statements included in Item 1 of this quarterly report on Form 10-Q/A. After taking into consideration that there has been significant debate within the standard-setting community around the classification of VRDNs, requiring significant judgment by registrants and resulting in some disparity in practice, our management concluded that the judgment exercised by management in carrying out the relevant control procedures were appropriate and concluded that the control deficiency that contributed to the restatement did not constitute a material weakness.

**PART II OTHER INFORMATION**  
**QUANTA SERVICES, INC. AND SUBSIDIARIES**

**Item 1. *Legal Proceedings.***

We are from time to time a party to various lawsuits, claims and other legal proceedings that arise in the ordinary course of business. These actions typically seek, among other things, compensation for alleged personal injury, breach of contract and/or property damage, punitive damages, civil penalties or other losses, or injunctive or declaratory relief. With respect to all such lawsuits, claims and proceedings, we accrue reserves when it is probable a liability has been incurred and the amount of loss can be reasonably estimated. We do not believe that any of these proceedings, separately or in the aggregate, would be expected to have a material adverse effect on our results of operations, cash flow or financial position.

**Table of Contents****Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds.***

During the second quarter of 2006, 73,456 shares of restricted stock that had been issued pursuant to our 2001 Stock Incentive Plan vested. Pursuant to the 2001 Stock Incentive Plan, employees may elect to satisfy their tax withholding obligations upon vesting by having Quanta make such tax payments and withhold a number of vested shares having a value on the date of vesting equal to their tax withholding obligation. As a result of such employee elections, Quanta withheld shares as follows:

<b>Period</b>	<b>(a) Total Number of Shares Purchased</b>	<b>(b) Average Price Paid Per Share</b>	<b>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>(d) Maximum Number of Shares that may yet be Purchased Under the Plans or Programs</b>
June 1, 2006    June 30, 2006	6,147(i)	\$        16.53	None	None

(i) These shares were not purchased through a publicly announced plan or program.

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

We held our annual meeting of stockholders in Houston, Texas on May 24, 2006. Eleven members were elected to the board of directors, each to serve until our next annual meeting of stockholders and until their respective successors have been elected and qualified.

The following ten individuals were elected to the board of directors by the holders of our Common Stock, with no abstentions or broker non-votes:

<b>Nominee</b>	<b>For</b>	<b>Withheld</b>
James R. Ball	104,622,176	1,143,194
John R. Colson	104,458,241	1,307,129
Ralph R. DiSibio	104,620,173	1,145,197
Bernard Fried	104,510,122	1,255,248
Louis C. Golm	103,544,649	2,220,721
Worthing F. Jackman	104,625,680	1,139,690
Bruce Ranck	104,544,076	1,221,294
Gary A. Tucci	104,445,096	1,320,274
John R. Wilson	104,447,655	1,317,715
Pat Wood, III	104,620,163	1,145,207

The holders of our Limited Vote Common Stock elected Vincent D. Foster to the board of directors by a vote of 509,723 shares of Limited Vote Common Stock, with no shares withheld and no abstentions or broker non-votes.

The stockholders ratified the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2006 by a vote of 106,187,640 shares of Common Stock and Limited Vote Common Stock, voting together, with (i) 40,702 shares of Common Stock and no shares of Limited Vote Common Stock voting against and (ii) 46,751 shares of Common Stock and no shares of Limited Vote Common Stock abstaining. There were no broker non-votes for this item.

**Table of Contents****Item 6. Exhibits.**

<b>Exhibit No.</b>	<b>Description</b>
3.1	Restated Certificate of Incorporation (previously filed as Exhibit 3.3 to the Company's Form 10-Q (No. 001-13831) filed August 14, 2003 and incorporated herein by reference)
3.2	Amended and Restated Bylaws (previously filed as Exhibit 3.2 to the Company's 2000 Form 10-K (No. 001-13831) filed April 2, 2001 and incorporated herein by reference)
4.1	Indenture, dated as of May 3, 2006, between Quanta Services, Inc. and Wells Fargo Bank, National Association, as trustee (previously filed as Exhibit 99.2 to the Company's Form 8-K (001-13831) filed May 4, 2006 and incorporated herein by reference)
10.1	Third Amendment to Credit Agreement dated as of April 26, 2006 among Quanta Services, Inc., the subsidiaries of Quanta Services, Inc. identified therein, Bank of America, N.A., and other Lenders identified therein (previously filed as Exhibit 99.1 to the Company's Form 8-K (No. 001-13831) filed April 27, 2006 and incorporated herein by reference)
10.2	Purchase Agreement, dated April 26, 2006, by and among Quanta Services, Inc., Banc of America Securities LLC, J.P. Morgan Securities Inc. and Credit Suisse Securities (USA) LLC (previously filed as Exhibit 99.1 to the Company's Form 8-K (No. 001-13831) filed May 2, 2006 and incorporated herein by reference)
10.3	Registration Rights Agreement, dated May 3, 2006, between Quanta Services, Inc., Banc of America Securities LLC, J.P. Morgan Securities Inc. and Credit Suisse Securities (USA) LLC (previously filed as Exhibit 99.1 to the Company's Form 8-K (001-13831) filed May 4, 2006 and incorporated herein by reference)
10.4	Amended and Restated Credit Agreement, dated as of June 12, 2006, among Quanta Services, Inc., as Borrower, the subsidiaries of Quanta Services, Inc. identified therein, as Guarantors, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, and the Lenders party thereto (previously filed as Exhibit 99.1 to the Company's Form 8-K (001-13831) filed June 15, 2006 and incorporated herein by reference)
10.5	Amended and Restated Security Agreement, dated as of June 12, 2006, among Quanta Services, Inc., the other Debtors identified therein and Bank of America, N.A., as Administrative Agent for the Lenders (previously filed as Exhibit 99.2 to the Company's Form 8-K (001-13831) filed June 15, 2006 and incorporated herein by reference)
10.6	Amended and Restated Pledge Agreement, dated as of June 12, 2006, among Quanta Services, Inc., the other Pledgors identified therein and Bank of America, N.A., as Administrative Agent for the Lenders (previously filed as Exhibit 99.3 to the Company's Form 8-K (001-13831) filed June 15, 2006 and incorporated herein by reference)
31.1	Certification of Periodic Report by Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) and pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
31.2	Certification of Periodic Report by Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) and pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed



- 32.1 herewith)  
Certification of Periodic Report by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)

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**SIGNATURE**

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

QUANTA SERVICES, INC.

By: /s/Derrick A. Jensen

Derrick A. Jensen  
*Vice President, Controller and  
Chief Accounting Officer*

Dated: November 9, 2006

Table of Contents**INDEX TO EXHIBITS**

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4.1	Indenture, dated as of May 3, 2006, between Quanta Services, Inc. and Wells Fargo Bank, National Association, as trustee (previously filed as Exhibit 99.2 to the Company's Form 8-K (001-13831) filed May 4, 2006 and incorporated herein by reference)
10.1	Third Amendment to Credit Agreement dated as of April 26, 2006 among Quanta Services, Inc., the subsidiaries of Quanta Services, Inc. identified therein, Bank of America, N.A., and other Lenders identified therein (previously filed as Exhibit 10.1 to the Company's Form 8-K (No. 001-13831) filed April 27, 2006 and incorporated herein by reference)
10.2	Purchase Agreement, dated April 26, 2006, by and among Quanta Services, Inc., Banc of America Securities LLC, J.P. Morgan Securities Inc. and Credit Suisse Securities (USA) LLC (previously filed as Exhibit 10.1 to the Company's Form 8-K (No. 001-13831) filed May 2, 2006 and incorporated herein by reference)
10.3	Registration Rights Agreement, dated May 3, 2006, between Quanta Services, Inc., Banc of America Securities LLC, J.P. Morgan Securities Inc. and Credit Suisse Securities (USA) LLC (previously filed as Exhibit 99.1 to the Company's Form 8-K (001-13831) filed May 4, 2006 and incorporated herein by reference)
10.4	Amended and Restated Credit Agreement, dated as of June 12, 2006, among Quanta Services, Inc., as Borrower, the subsidiaries of Quanta Services, Inc. identified therein, as Guarantors, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, and the Lenders party thereto (previously filed as Exhibit 99.1 to the Company's Form 8-K (001-13831) filed June 15, 2006 and incorporated herein by reference)
10.5	Amended and Restated Security Agreement, dated as of June 12, 2006, among Quanta Services, Inc., the other Debtors identified therein and Bank of America, N.A., as Administrative Agent for the Lenders (previously filed as Exhibit 99.2 to the Company's Form 8-K (001-13831) filed June 15, 2006 and incorporated herein by reference)
10.6	Amended and Restated Pledge Agreement, dated as of June 12, 2006, among Quanta Services, Inc., the other Pledgors identified therein and Bank of America, N.A., as Administrative Agent for the Lenders (previously filed as Exhibit 99.3 to the Company's Form 8-K (001-13831) filed June 15, 2006 and incorporated herein by reference)
31.1	Certification of Periodic Report by Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) and pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
31.2	Certification of Periodic Report by Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) and pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)

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Certification of Periodic Report by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)

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