

Mistras Group, Inc.  
Form 10-Q  
April 09, 2012  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended February 29, 2012

Or

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

For the transition period to

Commission file number 001- 34481

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## Mistras Group, Inc.

(Exact name of registrant as specified in its charter)

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**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**22-3341267**

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

**195 Clarksville Road**

**Princeton Junction, New Jersey**

(Address of principal executive offices)

**08550**

(Zip Code)

**(609) 716-4000**

(Registrant's telephone number, including area code)

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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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

As of April 2, 2012, the registrant had 27,938,173 shares of common stock outstanding.



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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. Financial Statements (unaudited)**

**Mistras Group, Inc. and Subsidiaries**  
**Unaudited Consolidated Balance Sheets**  
(in thousands, except share data)

|   | February 29, 2012 | May 31, 2011 |
|---|-------------------|--------------|
| <b>ASSETS</b>   |                   |              |
| Current Assets  |                   |              |
| Cash and cash equivalents   | \$ 7,931          | \$ 10,879    |
| Accounts receivable, net  | 95,257            | 78,031       |
| Inventories, net  | 13,173            | 9,830        |
| Deferred income taxes   | 1,324             | 1,278        |
| Prepaid expenses and other current assets   | 9,354             | 6,761        |
| Total current assets  | 127,039           | 106,779      |
| Property, plant and equipment, net  | 58,570            | 49,168       |
| Intangible assets, net  | 33,559            | 27,304       |
| Goodwill  | 80,053            | 64,146       |
| Other assets  | 1,511             | 1,240        |
| Total assets  | \$ 300,732        | \$ 248,637   |
| <b>LIABILITIES, PREFERRED STOCK AND EQUITY</b>  |                   |              |
| Current Liabilities   |                   |              |
| Current portion of long-term debt   | \$ 5,963          | \$ 7,226     |
| Current portion of capital lease obligations  | 6,644             | 5,853        |
| Accounts payable  | 7,142             | 6,656        |
| Accrued expenses and other current liabilities  | 40,332            | 28,028       |
| Income taxes payable  | 466               | 2,825        |
| Total current liabilities   | 60,547            | 50,588       |
| Long-term debt, net of current portion  | 34,645            | 14,625       |
| Obligations under capital leases, net of current portion  | 12,847            | 9,623        |
| Deferred income taxes   | 2,425             | 2,863        |
| Other long-term liabilities   | 5,197             | 3,452        |
| Total liabilities   | 115,661           | 81,151       |
| Commitments and contingencies   |                   |              |
| Preferred stock, 10,000,000 shares authorized   |                   |              |
| Equity  |                   |              |
| Common stock, \$0.01 par value, 200,000,000 shares authorized, 27,938,173 and 27,667,122 shares issued and outstanding as of February 29, 2012 and May 31, 2011, respectively |                   |              |
|   | 279               | 277          |
| Additional paid-in capital  | 185,984           | 180,594      |
| Retained earnings (accumulated deficit)   | 204               | (14,017)     |
| Accumulated other comprehensive (loss) income   | (1,675)           | 303          |
| Total Mistras Group, Inc. stockholders' equity  | 184,792           | 167,157      |
| Noncontrolling interest   | 279               | 329          |
| Total equity  | 185,071           | 167,486      |
| Total liabilities, preferred stock and equity   | \$ 300,732        | \$ 248,637   |

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

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**Mistras Group, Inc. and Subsidiaries**  
**Unaudited Consolidated Statements of Operations**  
(in thousands, except per share data)

|  | Three months ended |                   | Nine months ended |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | February 29, 2012  | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| <b>Revenues:</b>   |                    |                   |                   |                   |
| Services   | \$ 94,253          | \$ 72,411         | \$ 281,097        | \$ 216,616        |
| Products   | 9,865              | 6,802             | 28,688            | 19,844            |
| <b>Total revenues</b>  | <b>104,118</b>     | <b>79,213</b>     | <b>309,785</b>    | <b>236,460</b>    |
| <b>Cost of revenues:</b>   |                    |                   |                   |                   |
| Cost of services   | 66,336             | 50,696            | 194,270           | 147,754           |
| Cost of products sold  | 4,238              | 2,460             | 12,094            | 7,804             |
| Depreciation related to services   | 3,760              | 3,307             | 10,639            | 9,252             |
| Depreciation related to products   | 200                | 153               | 563               | 467               |
| <b>Total cost of revenues</b>  | <b>74,534</b>      | <b>56,616</b>     | <b>217,566</b>    | <b>165,277</b>    |
| <b>Gross profit</b>  | <b>29,584</b>      | <b>22,597</b>     | <b>92,219</b>     | <b>71,183</b>     |
| Selling, general and administrative expenses                             | 20,806             | 16,005            | 59,565            | 47,099            |
| Research and engineering   | 578                | 514               | 1,769             | 1,638             |
| Depreciation and amortization  | 1,805              | 1,385             | 4,787             | 3,889             |
| Acquisition-related costs  | 849                |                   | 510               |                   |
| Legal reserve  |                    |                   |                   | 351               |
| Income from operations   | 5,546              | 4,693             | 25,588            | 18,206            |
| <b>Other expenses</b>  |                    |                   |                   |                   |
| Interest expense   | 814                | 596               | 2,620             | 1,957             |
| Loss on extinguishment of long-term debt                                 | 113                |                   | 113               |                   |
| Income before provision for income taxes                                 | 4,619              | 4,097             | 22,855            | 16,249            |
| Provision for income taxes   | 1,548              | 1,690             | 8,672             | 6,562             |
| <b>Net income</b>  | <b>3,071</b>       | <b>2,407</b>      | <b>14,183</b>     | <b>9,687</b>      |
| Net (income) loss attributable to noncontrolling interests, net of taxes | (34)               | 36                | 38                | 26                |
| Net income attributable to Mistras Group, Inc.                           | \$ 3,037           | \$ 2,443          | \$ 14,221         | \$ 9,713          |
| Earnings per common share (see Note 4):                                  |                    |                   |                   |                   |
| Basic  | \$ 0.11            | \$ 0.09           | \$ 0.51           | \$ 0.36           |
| Diluted  | \$ 0.11            | \$ 0.09           | \$ 0.50           | \$ 0.36           |
| Weighted average common shares outstanding:                              |                    |                   |                   |                   |
| Basic  | 27,921             | 26,667            | 27,794            | 26,665            |
| Diluted  | 28,829             | 26,919            | 28,563            | 26,824            |

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

Table of Contents**Mistras Group, Inc. and Subsidiaries****Unaudited Consolidated Statements of Stockholders' Equity**

(in thousands)

|  | Common Stock<br>Shares | Stock<br>Amount | Additional<br>paid-in<br>capital | Retained<br>earnings<br>(accumulated<br>deficit) | Accumulated<br>other<br>comprehensive<br>income (loss) | Total<br>Mistras Group,<br>Inc.<br>Stockholders'<br>Equity | Noncontrolling<br>Interest | Total Equity |
|--|------------------------|-----------------|----------------------------------|--|--|--|----------------------------|--------------|
| <b>Nine months ended</b>                               |                        |                 |                                  |  |  |  |                            |              |
| <b>February 28, 2011:</b>                              |                        |                 |                                  |  |  |  |                            |              |
| <b>Balance at May 31, 2010</b>                         | 26,664                 | \$ 267          | \$ 162,054                       | \$ (30,448)                                      | \$ (1,587)   | \$ 130,286   | \$ 268                     | \$ 130,554   |
| Net income   |                        |                 |                                  | 9,713  |  | 9,713  | (26)                       | 9,687        |
| Other comprehensive income,<br>net of tax:             |                        |                 |                                  |  |  |  |                            |              |
| Foreign currency translation<br>adjustment             |                        |                 |                                  |  | 880  | 880  | 5                          | 885          |
| <b>Comprehensive Income</b>                            |                        |                 |                                  |  |  | 10,593   | (21)                       | 10,572       |
| Stock compensation                                     | 1                      |                 | 2,680                            |  |  | 2,680  |                            | 2,680        |
| Exercise of stock options                              | 5                      |                 | 30                               |  |  | 30   |                            | 30           |
| Noncontrolling interest in<br>subsidiary               |                        |                 |                                  |  |  |  | 117                        | 117          |
| <b>Balance at February 28,<br/>2011</b>                | 26,670                 | \$ 267          | \$ 164,764                       | \$ (20,735)                                      | \$ (707)   | \$ 143,589   | \$ 364                     | \$ 143,953   |
| <b>Nine months ended</b>                               |                        |                 |                                  |  |  |  |                            |              |
| <b>February 29, 2012:</b>                              |                        |                 |                                  |  |  |  |                            |              |
| <b>Balance at May 31, 2011</b>                         | 27,667                 | \$ 277          | \$ 180,594                       | \$ (14,017)                                      | \$ 303   | \$ 167,157   | \$ 329                     | \$ 167,486   |
| Net income   |                        |                 |                                  | 14,221   |  | 14,221   | (38)                       | 14,183       |
| Other comprehensive income,<br>net of tax:             |                        |                 |                                  |  |  |  |                            |              |
| Foreign currency translation<br>adjustment             |                        |                 |                                  |  | (1,978)  | (1,978)  | (12)                       | (1,990)      |
| <b>Comprehensive Income</b>                            |                        |                 |                                  |  |  | 12,243   | (50)                       | 12,193       |
| Stock compensation                                     | 14                     |                 | 3,791                            |  |  | 3,791  |                            | 3,791        |
| Net settlement on vesting of<br>restricted stock units | 36                     |                 | (281)                            |  |  | (281)  |                            | (281)        |
| Excess tax benefit from stock<br>compensation          |                        |                 | 405                              |  |  | 405  |                            | 405          |
| Exercise of stock options                              | 221                    | 2               | 1,475                            |  |  | 1,477  |                            | 1,477        |
| <b>Balance at February 29,<br/>2012</b>                | 27,938                 | \$ 279          | \$ 185,984                       | \$ 204   | \$ (1,675)   | \$ 184,792   | \$ 279                     | \$ 185,071   |

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





Table of Contents**Mistras Group, Inc. and Subsidiaries****Unaudited Consolidated Statements of Cash Flows**

(in thousands)

|  | Nine months ended |                   |
|--|-------------------|-------------------|
|  | February 29, 2012 | February 28, 2011 |
| <b>Cash flows from operating activities</b>  |                   |                   |
| Net income attributable to Mistras Group, Inc.   | \$ 14,221         | \$ 9,713          |
| Adjustments to reconcile net income to net cash provided by operating activities         |                   |                   |
| Depreciation and amortization  | 15,989            | 13,608            |
| Deferred income taxes  | (479)             | 171               |
| Provision for doubtful accounts  | 189               | 45                |
| Loss on extinguishment of long-term debt   | 113               |                   |
| (Gain) loss on sale of assets  | (40)              | 38                |
| Amortization of deferred financing costs   | 116               | 127               |
| Stock compensation expense   | 3,791             | 2,680             |
| Interest rate swap   |                   | (210)             |
| Noncontrolling interest  | (38)              | (26)              |
| Foreign currency loss (gain)   | 231               | (310)             |
| Changes in operating assets and liabilities, net of effect of acquisitions of businesses |                   |                   |
| Accounts receivable  | (10,160)          | (6,620)           |
| Inventories  | (2,624)           | (1,377)           |
| Prepaid expenses and other current assets  | (1,386)           | (1,743)           |
| Other assets   | (42)              | 971               |
| Accounts payable   | (1,310)           | 410               |
| Income taxes payable   | (2,302)           | (302)             |
| Accrued expenses and other current liabilities   | 4,703             | 1,468             |
| Net cash provided by operating activities  | 20,972            | 18,643            |
| <b>Cash flows from investing activities</b>  |                   |                   |
| Purchase of property, plant and equipment  | (6,407)           | (6,051)           |
| Purchase of intangible assets  | (437)             | (398)             |
| Acquisition of businesses, net of cash acquired  | (26,273)          | (18,301)          |
| Proceeds from sale of equipment  | 301               | 170               |
| Net cash used in investing activities  | (32,816)          | (24,580)          |
| <b>Cash flows from financing activities</b>  |                   |                   |
| Repayment of capital lease obligations   | (5,136)           | (4,631)           |
| Repayment of long-term debt  | (4,420)           | (6,808)           |
| Net borrowings from revolver   | 19,050            | 5,000             |
| Net (repayments) proceeds from other short-term borrowings                               | (1,868)           | 2,722             |
| Proceeds from borrowings of long-term debt   | 837               | 42                |
| Payment of financing costs   | (623)             |                   |
| Taxes paid related to net share settlement of equity awards                              | (281)             |                   |
| Excess tax benefit from stock compensation   | 405               |                   |
| Proceeds from the exercise of stock options  | 1,477             | 30                |
| Net cash provided by (used in) financing activities                                      | 9,441             | (3,645)           |
| Effect of exchange rate changes on cash and cash equivalents                             | (545)             | 105               |
| Net change in cash and cash equivalents  | (2,948)           | (9,477)           |
| <b>Cash and cash equivalents</b>   |                   |                   |
| Beginning of period  | 10,879            | 16,037            |
| End of period  | \$ 7,931          | \$ 6,560          |
| <b>Supplemental disclosure of cash paid</b>  |                   |                   |
| Interest   | \$ 1,720          | \$ 2,058          |

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|  |    |        |    |       |
|--|----|--------|----|-------|
| Income taxes   | \$ | 11,995 | \$ | 6,581 |
| <b>Noncash investing and financing</b>   |    |        |    |       |
| Equipment acquired through capital lease obligations                                   | \$ | 8,613  | \$ | 3,678 |
| Issuance of notes payable and other debt obligations primarily related to acquisitions | \$ | 2,444  | \$ | 1,637 |

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

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**Mistras Group, Inc. and Subsidiaries**

**Notes to Unaudited Consolidated Financial Statements**

**(tabular dollars in thousands, except per share data)**

**1. Description of Business & Basis of Presentation**

*Description of Business*

Mistras Group, Inc. and subsidiaries (the Company) is a leading one source global provider of technology-enabled asset protection solutions used to evaluate the structural integrity and reliability of critical energy, industrial and public infrastructure. The Company combines industry-leading products and technologies, expertise in mechanical integrity (MI) and non-destructive testing (NDT) services and proprietary data analysis software to deliver a comprehensive portfolio of customized solutions, ranging from routine inspections to complex, plant-wide asset integrity assessments and management. These mission critical solutions enhance customers' ability to extend the useful life of their assets, increase productivity, minimize repair costs, comply with governmental safety and environmental regulations, manage risk and avoid catastrophic disasters. Given the role the services of the Company play in ensuring the safe and efficient operation of infrastructure, the Company has historically provided a majority of its services to its customers on a regular, recurring basis. The Company serves a global customer base of companies with asset-intensive infrastructure, including companies in the oil and gas, fossil and nuclear power, alternative and renewable energy, public infrastructure, chemicals, aerospace and defense, transportation, primary metals and metalworking, pharmaceuticals and food processing industries.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair statement have been included. Operating results for the three and nine months ended February 29, 2012 are not necessarily indicative of the results that may be expected for the year ending May 31, 2012. The balance sheet at May 31, 2011 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. You should read these unaudited consolidated financial statements together with the historical consolidated financial statements of the Company as filed with the Securities and Exchange Commission.

*Principles of Consolidation*

The accompanying consolidated financial statements include the accounts of Mistras Group, Inc. and its wholly or majority-owned subsidiaries. Where the Company's ownership interest is less than 100%, the noncontrolling interests are reported in stockholders' equity in the accompanying consolidated balance sheets. The noncontrolling interest in net income, net of tax, is classified separately in the accompanying consolidated statements of operations.

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All significant intercompany accounts and transactions have been eliminated in consolidation. Mistras Group, Inc. s and its subsidiaries fiscal years end on May 31 except for the companies in the International segment, which end on April 30. The effect of this difference in timing of reporting foreign operations on the consolidated results of operations and consolidated financial position is not significant.

### ***Reclassification***

Certain amounts in prior periods have been reclassified to conform to the current year presentation. Such reclassifications did not have a material effect on the Company s financial condition or results of operations as previously reported.

### ***Revision of Prior Period Financial Statements***

The Company has revised the consolidated statement of cash flows for the nine months ended February 28, 2011 to reflect the cash flows associated with the financing of an insurance premium as cash flows from financing activities. Such cash flows were previously reported in operating activities. A summary of the revisions to the consolidated statements of cash flows for the nine months ended February 28, 2011 is as follows:

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**Mistras Group, Inc. and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
**(tabular dollars in thousands, except per share data)**

|   | As previously<br>reported | Nine months months ended<br>February 28, 2011<br>Revision | As revised |
|---|---------------------------|---|------------|
| Net cash flows provided by operating activities               | \$ 21,365                 | \$ (2,722)  | \$ 18,643  |
| Net cash flows used in investing activities                   | (24,580)                  |   | (24,580)   |
| Net cash flows provided by financing activities               | (6,367)                   | 2,722   | (3,645)    |
| Effects of exchange rate changes on cash and cash equivalents | 105                       |   | 105        |
| Net increase in cash and cash equivalents during the period   | (9,477)                   |   | (9,477)    |

These revisions had no impact on the annual statement of cash flows as presented in the 2011 Form 10-K.

## 2. Summary of Significant Accounting Policies

### *Revenue Recognition*

Revenue recognition policies for the various sources of revenues are as follows:

#### *Services*

The Company predominantly derives revenues by providing its services on a time and material basis and recognizes revenues when services are rendered. At the end of any reporting period, there may be earned but unbilled revenues that are accrued. Payments received in advance of revenue recognition are reflected as deferred revenues.

#### *Software*

Revenues from the sale of perpetual licenses are recognized upon the delivery and acceptance of the software. Revenues from term licenses are recognized ratably over the period of the license. Revenues from maintenance, unspecified upgrades and technical support are recognized ratably over the period such items are delivered. For multiple-element arrangement software contracts that include non-software elements, and where the software is essential to the functionality of the non-software elements (collectively referred to as software multiple-element arrangements), the Company applies the rules as noted below.

*Products*

Revenues from product sales are recognized when risk of loss and title passes to the customer. The exceptions to this accounting treatment would be for multiple-element arrangements (described below) or those situations where specialized installation or customer acceptance is required. Payments received in advance of revenue recognition are reflected as deferred revenues.

*Percentage of Completion*

A portion of the Company's revenues are generated from engineering and manufacturing of custom products under long-term contracts that may last from several months to several years, depending on the contract. Revenues from long-term contracts are recognized on the percentage-of-completion method of accounting. Under the percentage-of-completion method of accounting, revenues are recognized as work is performed. The percentage of completion at any point in time is based on total costs or total labor dollars incurred to date in relation to the total estimated costs or total labor dollars estimated at completion. The percentage of completion is then applied to the total contract revenue to determine the amount of revenue to be recognized in the period. Application of the percentage-of-completion method of accounting requires the use of estimates of costs to be incurred for the performance of the contract. Contract costs include all direct materials, direct labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and all costs associated with operation of equipment. The cost estimation process is based upon the professional knowledge and experience of the Company's engineers, project managers and financial professionals. Factors that are considered in estimating the work to be completed include the availability and productivity of labor, the nature and complexity of the work to be performed, the effect of change orders, the availability of materials, the effect of any delays in project

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**Mistras Group, Inc. and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
**(tabular dollars in thousands, except per share data)**

performance and the recoverability of any claims. Whenever revisions of estimated contract costs and contract values indicate that the contract costs will exceed estimated revenues, thus creating a loss, a provision for the total estimated loss is recorded in that period.

*Multiple-element Arrangements*

The Company occasionally enters into transactions that represent multiple-element arrangements, which may include any combination of services, software, and hardware. When a sales arrangement contains multiple elements, such as hardware and services and/or software products, the Company allocates revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its vendor specific objective evidence (VSOE) if available, third party evidence (TPE) if VSOE is not available, or estimated selling price (ESP) if neither VSOE nor TPE is available. The Company has historically utilized the VSOE due to the nature of its products. In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy.

*Use of Estimates*

These unaudited consolidated financial statements have been prepared in conformity with GAAP, which requires management to make estimates and assumptions about future events that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The more significant estimates include valuation of goodwill and intangible assets, useful lives of long-lived assets, acquisition-related contingent consideration, allowance for doubtful accounts, inventory valuation, reserves for self-insured workers compensation and health benefits and provision for income taxes.

*Goodwill and Intangible Assets*

Goodwill represents the excess of the purchase price over the fair market value of net assets of the acquired business at the date of acquisition. The Company tests for impairment annually, in its fiscal fourth quarter, using a two-step process. The first step identifies potential impairment by comparing the fair value of the Company's reporting units to its carrying value. If the fair value is less than the carrying value, the second step measures the amount of impairment, if any. The impairment loss is the amount by which the carrying amount of goodwill exceeds the implied fair value of that goodwill. The most recent annual test for impairment performed for fiscal 2011 did not identify any instances of impairment and there were no events through February 29, 2012 that warranted a reconsideration of the impairment test results.

Intangible assets are recorded at cost. Intangible assets with finite lives are amortized on a straight-line basis over their estimated useful lives.



*Concentration of Credit Risk*

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. At times, cash deposits may exceed the limits insured by the Federal Deposit Insurance Corporation. The Company believes it is not exposed to any significant credit risk or risk of nonperformance of financial institutions.

The Company sells primarily to large companies, extends reasonably short collection terms, performs credit evaluations and does not require collateral. The Company maintains reserves for potential credit losses.

The Company has one customer, BP plc. (BP), which accounted for 16% and 21% of revenues for the three months ended February 29, 2012 and February 28, 2011, respectively, and 16% and 17% of revenues for the nine months ended February 29, 2012 and February 28, 2011, respectively. Accounts receivable from this customer were approximately 14% and 15% of total accounts receivable, net as of February 29, 2012 and May 31, 2011, respectively. The relationship with BP is comprised of separate contracts for non-destructive testing and inspection services with multiple affiliated entities within the broad BP organization. The Company conducts business with various divisions or affiliates of the BP organization through numerous contracts covering many segments of BP's business including downstream (refinery), midstream (pipelines) and upstream (exploration). These contracts are typically negotiated locally with the specific BP division or

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affiliate, are of varying lengths, have different start and end dates and differ in terms of the scope of work and nature of services provided. Most contracts are based on time and materials.

***Equity-based Compensation***

The Company measures the cost of employee services received in exchange for an award of equity instruments based upon the grant-date fair value of the award. The Company uses the straight-line attribution method for allocating compensation costs and recognizes the fair value of each equity award on a straight-line basis over the vesting period of the related awards.

The Company uses the Black-Scholes option-pricing model to estimate the fair value of the stock option awards as of the grant date. The Black-Scholes model, by its design, is highly complex and dependent upon key data inputs estimated by management. The primary data inputs with the greatest degree of judgment are the expected term of stock option awards and the estimated volatility of the Company's common stock price. The Black-Scholes model is sensitive to changes in these two variables. Since the Company's initial public offering (IPO), the expected term of the Company's stock options is generally determined using the mid-point between the vesting period and the end of the contractual term. Expected stock price volatility is typically based on the daily historical trading data for a period equal to the expected term. Because the Company's historical trading data only dates back to October 8, 2009, the first trading date after its IPO, the Company has estimated expected volatility using an analysis of the stock price volatility of comparable peer companies. Prior to the Company's IPO, the exercise price equaled the estimated fair market value of the Company's common stock, as determined by its board of directors. Since the Company's IPO, the exercise price of stock option grants is determined using the closing market price of the Company's common stock on the date of grant.

***Recent Accounting Pronouncements***

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Task Force), which requires companies to allocate the overall consideration in multiple-element arrangements to each deliverable by using a best estimate of the selling price of individual deliverables in the arrangement in the absence of vendor-specific objective evidence or other third-party evidence of the selling price. Effective June 1, 2011, the Company adopted, on a prospective basis, the provisions of this updated accounting standard related to revenue recognition associated with contractual arrangements involving multiple elements. The adoption of this pronouncement did not have a material impact on the Company's consolidated financial statements.

In April 2010, the FASB issued ASU 2010-17, Revenue Recognition Milestone Method (Topic 605): Milestone Method of Revenue Recognition (a consensus of the FASB Emerging Issues Task Force). ASU 2010-17 provides guidance on applying the milestone method to milestone payments for achieving specified performance measure when those payments are related to uncertain future events limited to transactions involving research and development. Entities can make an accounting policy election to recognize arrangement consideration received for achieving specified performance measures during the period in which the milestones are achieved, provided certain criteria are met. Effective

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June 1, 2011, the Company adopted, on a prospective basis, the provisions of this updated accounting standard related to milestones. The adoption of this pronouncement did not have a material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. ASU 2011-05 allows an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This authoritative guidance eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 does not change the items that must be reported in other comprehensive income, when an item of other comprehensive income must be reclassified to net income, or the Company's option to present components of other comprehensive income either net of related tax effects or before related tax effects, nor does it affect how earnings per share is calculated or presented. ASU 2011-05 requires retrospective application, and it is effective for fiscal years and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The Company does not expect that the adoption of this pronouncement will have a material impact on the Company's consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely

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than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is then necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. ASU 2011-08 is effective for the Company in fiscal 2013 and earlier adoption is permitted. The Company does not expect that the adoption of this pronouncement will have a material impact on the Company's consolidated financial statements.

**3. Capitalization**

*Common Stock*

In May 2011, the Company completed a secondary offering of 3,754,061 shares of common stock at a price of \$16.00 per share. The Company sold 989,660 shares and 2,764,401 shares were sold by a selling stockholder. The Company received net proceeds of approximately \$14.7 million from the offering. The Company used the net proceeds for general corporate purposes including the reduction of outstanding indebtedness, acquisitions, capital expenditures and working capital.

Dividends on common stock will be paid when, and if, declared by the board of directors. Each holder of common stock is entitled to vote on all matters and is entitled to one vote for each share held.

*Equity Awards*

In September 2009, the Company's board of directors and shareholders adopted and approved the 2009 Long-Term Incentive Plan (the 2009 Plan), which became effective upon the closing of the IPO. Awards may be in the form of stock options, restricted stock units and other forms of stock-based incentives, including stock appreciation rights and deferred stock rights. The term of each incentive and non-qualified stock option is ten years. Vesting generally occurs over a period of four years, the expense for which is recorded on a straight-line basis over the requisite service period. The 2009 Plan allows for the grant of awards of up to approximately 2,286,000 shares of common stock, of which 1,705,000 shares were available for future grants as of February 29, 2012. Prior to the Company's IPO in October 2009, the Company had two stock option plans: (i) the 1995 Incentive Stock Option and Restricted Stock Purchase Plan (the 1995 Plan), and (ii) the 2007 Stock Option Plan (the 2007 Plan). No additional awards may be granted from these two plans. As of February 29, 2012, there was an aggregate of approximately 2,630,000 stock options outstanding and approximately 443,000 unvested restricted stock units outstanding under the 2009 Plan, the 2007 Plan, and the 1995 Plan.

The fair value of the Company's stock option awards for the nine months ended February 28, 2011 was estimated at the date of grant using the Black-Scholes option-pricing model with the range of assumptions below. No stock options were granted during the nine months ended February 29, 2012.

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**Nine months ended  
February 28, 2011**

|                         |      |
|-------------------------|------|
| Dividend yield          | 0.0% |
| Expected volatility     | 44%  |
| Risk-free interest rate | 2.6% |
| Expected term (years)   | 6.3  |

The Company recognized stock-based compensation expense related to stock option awards of approximately \$0.8 million for the each of the three month periods ended February 29, 2012 and February 28, 2011. For each of the nine month periods ended February 29, 2012 and February 28, 2011, the Company recognized stock-based compensation expense related to stock option awards of \$2.4 million. As of February 29, 2012, there was approximately \$4.6 million of unrecognized compensation costs, net of estimated forfeitures, related to stock option awards, which are expected to be recognized over a remaining weighted average period of 1.5 years. Cash proceeds from and the aggregate intrinsic value of stock options exercised during the three and nine months ended February 29, 2012 and February 28, 2011 were as follows:

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|  | Three months ended |                   | Nine months ended |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | February 29, 2012  | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| Cash proceeds from options exercised           | \$ 152             | \$ 30             | \$ 1,477          | \$ 30             |
| Aggregate intrinsic value of options exercised | \$ 337             | \$ 43             | \$ 3,399          | \$ 43             |

The Company also recognized approximately \$0.5 million and \$0.1 million in stock-based compensation expense related to restricted stock unit awards during the three months ended February 29, 2012 and February 28, 2011, respectively. For the nine months ended February 29, 2012 and February 28, 2011, the Company recognized stock-based compensation expense related to restricted stock unit awards of \$1.1 million and \$0.3 million, respectively. As of February 29, 2012, there was approximately \$6.1 million of unrecognized compensation costs, net of estimated forfeitures, related to restricted stock unit awards, which are expected to be recognized over a remaining weighted average period of 3.3 years.

In October 2011, the Company granted approximately 9,000 shares of fully-vested common stock to its five non-employee directors, in connection with its non-employee director compensation plan. These shares had a grant date fair value of approximately \$0.2 million, which was recorded as stock-based compensation expense during the nine months ended February 29, 2012.

During the nine months ended February 29, 2012, approximately 52,000 restricted stock units vested, the fair value of which was \$0.5 million. Upon vesting, restricted stock units are generally net share-settled to cover the required withholding tax and the remaining amount is converted into an equivalent number of shares of common stock. The restricted stock units that vested in the first nine months of fiscal 2012 were net-share settled such that the Company withheld shares with value equivalent to the employees' minimum statutory obligation for the applicable income and other employment taxes, and remitted the cash to the appropriate taxing authorities. The Company withheld approximately 16,000 shares based on the value of the restricted stock units on their vesting date as determined by the Company's closing stock price. Total payments for the employees' tax obligations to the taxing authorities were \$0.3 million and are reflected as a financing activity within the consolidated statements of cash flows. These net-share settlements had the effect of share repurchases by the Company as they reduced and retired the number of shares that otherwise would have been issued as a result of the vesting and did not represent an expense to the Company.

#### 4. Earnings per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the sum of (1) the weighted-average number of shares of common stock outstanding during the period, and (2) the dilutive effect of assumed conversion of equity awards using the treasury stock method. With respect to the number of weighted-average shares outstanding (denominator), diluted shares reflects: (i) only the exercise of options to acquire common stock to the extent that the options' exercise prices are less than the average market price of common shares during the period and (ii) the pro forma vesting of restricted stock units.

The following table sets forth the computations of basic and diluted earnings per share:



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|   | Three months ended |                   | Nine months ended |                   |
|---|--------------------|-------------------|-------------------|-------------------|
|   | February 29, 2012  | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| <b>Basic earnings per share</b>                       |                    |                   |                   |                   |
| Numerator:  |                    |                   |                   |                   |
| Net income attributable to Mistras Group, Inc.        | \$ 3,037           | \$ 2,443          | \$ 14,221         | \$ 9,713          |
| Denominator:  |                    |                   |                   |                   |
| Weighted average common shares outstanding            | 27,921             | 26,667            | 27,794            | 26,665            |
| Basic earnings per share                              | \$ 0.11            | \$ 0.09           | \$ 0.51           | \$ 0.36           |
| <b>Diluted earnings per share:</b>                    |                    |                   |                   |                   |
| Numerator:  |                    |                   |                   |                   |
| Net income attributable to Mistras Group, Inc.        | \$ 3,037           | \$ 2,443          | \$ 14,221         | \$ 9,713          |
| Denominator:  |                    |                   |                   |                   |
| Weighted average common shares outstanding            | 27,921             | 26,667            | 27,794            | 26,665            |
| Dilutive effect of stock options outstanding          | 795                | 202               | 688               | 137               |
| Dilutive effect of restricted stock units outstanding | 113                | 50                | 81                | 22                |
|   | 28,829             | 26,919            | 28,563            | 26,824            |
| Diluted earnings per share                            | \$ 0.11            | \$ 0.09           | \$ 0.50           | \$ 0.36           |

## 5. Acquisitions

The Company completed the acquisition of eight companies during the nine months ended February 29, 2012. These acquisitions were asset protection companies specializing in advanced ultrasonic inspection, NDT services and inspection, ultrasonic testing (UT) and acoustic emission (AE) products and systems, and in-house component inspection. These companies were acquired to complement the service and product offerings within the Services, Products and Systems, and International segments. Three of the acquired companies were asset purchases that met the definition of acquisitions of businesses under the provision of FASB Accounting Standards Codification (ASC) 805-10-20. In the remaining acquisitions, the Company acquired 100% of the common stock of the acquirees. Five of the acquired companies have been integrated into the International segment; two of the acquired companies have been integrated into the Services segment; and one of the acquired companies has been integrated into the Products segment. In addition to the cash and debt consideration related to the acquisitions completed in fiscal 2012, the Company accrued a liability of approximately \$3.3 million, which represents the estimated fair value of contingent consideration expected to be payable in the event that certain of the acquired companies achieve specific performance metrics over the next four years of operations. The total potential contingent consideration ranges from zero to \$4.5 million for acquisitions completed in fiscal 2012.

Assets and liabilities of the acquired businesses were included in the consolidated balance sheets as of February 29, 2012 based on their estimated fair value on the date of acquisition as determined in a purchase price allocation, using available information and making assumptions management believes are reasonable. The Company is still in the process of completing its valuations of the intangible assets for these acquisitions. These valuations and purchase price allocations are expected to be finalized prior to the end of the Company's fiscal year ending May 31, 2012. The results of operations of each of the acquisitions completed in fiscal 2012 are reported in each respective operating segment's



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statement of operations from the date of acquisition. The Company's preliminary allocation of purchase price for these acquisitions is included in the table below. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition:

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|                                    | Nine months ended |                   |
|------------------------------------|-------------------|-------------------|
|                                    | February 29, 2012 | February 28, 2011 |
| Number of entities                 | 8                 | 4                 |
| Cash paid                          | \$ 27,514         | \$ 18,301         |
| Subordinated notes issued          | 2,444             | 1,637             |
| Debt and other liabilities assumed | 3,095             | 1,100             |
| Contingent consideration           | 3,445             | 697               |
| Purchase price                     | \$ 36,498         | \$ 21,735         |
| Current net assets acquired        | 3,801             | 127               |
| Property, plant and equipment      | 6,350             | 6,341             |
| Deferred tax asset                 | 130               | 41                |
| Intangibles                        | 9,710             | 6,465             |
| Goodwill                           | 16,507            | 8,878             |
| Less: noncontrolling interest      |                   | (117)             |
| Net assets acquired                | \$ 36,498         | \$ 21,735         |

The amortization period of intangible assets acquired ranges from one to fifteen years. The Company recorded approximately \$16.5 million of goodwill in connection with its fiscal 2012 acquisitions, reflecting the strategic fit and revenue and earnings growth potential of these businesses. Substantially all of the goodwill recognized is expected to be deductible for tax purposes.

Revenues included in the consolidated statement of operations for the three and nine months ended February 29, 2012 from these acquisitions for the period subsequent to the closing of each transaction was approximately \$10.6 million and \$12.9 million, respectively. Loss from operations included in the consolidated statement of operations for each of the three and nine month periods ended February 29, 2012 from these acquisitions for the period subsequent to the closing of each transaction was approximately (\$0.5) million.

The unaudited pro forma information for the periods set forth below gives effect to the fiscal 2012 acquisitions as if they had occurred at the beginning of each period presented. The pro forma information is presented for informational purposes only and is not necessarily indicative of the results of operations that actually would have been achieved had the acquisitions been consummated as of that time (unaudited, in thousands):

|                        | Three months ended |                   | Nine months ended |                   |
|------------------------|--------------------|-------------------|-------------------|-------------------|
|                        | February 29, 2012  | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| Revenues               | \$ 117,241         | \$ 90,287         | \$ 347,412        | \$ 268,065        |
| Income from operations | \$ 5,119           | \$ 4,899          | \$ 27,041         | \$ 19,268         |

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During the three and nine month periods ended February 29, 2012, the Company incurred acquisition-related costs of \$1.0 million and \$1.4 million, respectively, in connection with due diligence, professional fees, and other expenses for its fiscal 2012 acquisition activity. Additionally, the Company adjusted the fair value of certain acquisition-related contingent consideration liabilities. For the three month and nine month periods ended February 29, 2012 the adjustments resulted in a net decrease of approximately \$0.1 million and \$0.9 million, respectively, to the Company's acquisition-related contingent consideration liabilities, which were approximately \$7.5 million as of February 29, 2012 and recorded on the balance sheet

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in accrued expenses and other liabilities. These adjustments also resulted in a corresponding net increase to income from operations of approximately \$0.1 million and \$0.9 million for the three and nine month periods ended February 29, 2012, respectively. Both the fair value adjustments to acquisition-related contingent consideration liabilities and the acquisition-related expenses have been classified as acquisition-related costs in the statement of operations for the three and nine months ended February 29, 2012. Acquisition-related costs for the Company's fiscal 2011 acquisition activity were insignificant for the three and nine months ended February 28, 2011.

**6. Accounts Receivable, net**

Accounts receivable consist of the following:

|                                 | As of<br>February 29, 2012 | As of<br>May 31, 2011 |
|---------------------------------|----------------------------|-----------------------|
| Trade accounts receivable       | \$ 97,363                  | \$ 79,800             |
| Allowance for doubtful accounts | (2,106)                    | (1,769)               |
| Total                           | \$ 95,257                  | \$ 78,031             |

**7. Inventories, net**

Inventories consist of the following:

|                 | As of<br>February 29, 2012 | As of<br>May 31, 2011 |
|-----------------|----------------------------|-----------------------|
| Raw materials   | \$ 2,912                   | \$ 2,832              |
| Work in process | 1,991                      | 1,531                 |
| Finished goods  | 6,170                      | 3,623                 |
| Supplies        | 2,100                      | 1,844                 |
| Total           | \$ 13,173                  | \$ 9,830              |

Inventories are net of reserves for slow-moving and obsolete inventory of approximately \$1.2 million and \$1.0 million as of February 29, 2012 and May 31, 2011, respectively.

**8. Property, Plant and Equipment, net**

Property, plant and equipment consist of the following:

|   | Useful Life<br>(Years) | As of<br>February 29, 2012 |          | As of<br>May 31, 2011 |          |
|---|------------------------|----------------------------|----------|-----------------------|----------|
| Land                                      |                        | \$                         | 2,213    | \$                    | 2,210    |
| Building and improvements                 | 30-40                  |                            | 17,632   |                       | 14,779   |
| Office furniture and equipment            | 5-8                    |                            | 6,372    |                       | 5,006    |
| Machinery and equipment                   | 5-7                    |                            | 93,214   |                       | 80,587   |
|   |                        |                            | 119,431  |                       | 102,582  |
| Accumulated depreciation and amortization |                        |                            | (60,861) |                       | (53,414) |
| Property, plant and equipment, net        |                        | \$                         | 58,570   | \$                    | 49,168   |

Depreciation expense for the three months ended February 29, 2012 and February 28, 2011 was approximately \$4.2 million and \$3.5 million, respectively. Depreciation expense for the nine months ended February 29, 2012 and February 28, 2011 was approximately \$11.8 million and \$9.5 million, respectively.

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**9. Accrued Expenses and Other Current Liabilities**

Accrued expenses and other current liabilities consist of the following:

|   | As of<br>February 29, 2012 | As of<br>May 31, 2011 |
|---|----------------------------|-----------------------|
| Accrued salaries, wages and related employee benefits | \$ 15,185                  | \$ 12,066             |
| Other accrued expenses                                | 13,033                     | 7,452                 |
| Accrued worker compensation and health benefits       | 7,344                      | 6,471                 |
| Deferred revenues                                     | 4,770                      | 2,039                 |
| Total   | \$ 40,332                  | \$ 28,028             |

**10. Long-Term Debt**

Long-term debt consists of the following:

|   | As of<br>February 29, 2012 | As of<br>May 31, 2011 |
|---|----------------------------|-----------------------|
| <b>Senior credit facility:</b>            |                            |                       |
| Revolver                                  | \$ 22,900                  | \$ 3,850              |
| Notes payable                             | 13,588                     | 15,808                |
| Other                                     | 4,120                      | 2,193                 |
|   | 40,608                     | 21,851                |
| Less: Current maturities                  | (5,963)                    | (7,226)               |
| Long-term debt, net of current maturities | \$ 34,645                  | \$ 14,625             |

**Senior Credit Facility**

In December 2011, the Company entered into a Third Amended and Restated Credit Agreement (Credit Agreement) with Bank of America, N.A., as agent for the lenders and a lender, and JPMorgan Chase Bank, N.A., Keybank National Association and TD Bank, N.A., as lenders. The Credit Agreement provides the Company with a \$125.0 million revolving line of credit, which, under certain circumstances, can be increased to \$150.0 million. The Credit Agreement has a maturity date of December 20, 2016. The Company may borrow up to \$30.0 million in non-U.S. dollar currencies and use up to \$10.0 million of the credit limit for the issuance of letters of credit. In December 2011, outstanding borrowings under the former credit agreement were repaid in full using proceeds from the Credit Agreement. As of February 29, 2012, there

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were outstanding borrowings of \$22.9 million and a total of \$3.8 million of outstanding letters of credit under the current revolving credit facility.

Loans under the Credit Agreement bear interest at LIBOR or base rate, at the option of the Company, plus an applicable LIBOR margin ranging from 1% to 2%, or base rate margin ranging from -1.25% to -.25%, based upon its Funded Debt Leverage Ratio. Funded Debt Leverage Ratio is generally the ratio of (1) all outstanding indebtedness for borrowed money and other interest-bearing indebtedness as of the date of determination to (2) EBITDA (which is (a) net income, less (b) income (or plus loss) from discontinued operations and extraordinary items, plus (c) income tax expenses, plus (d) interest expense, plus (e) depreciation, depletion, and amortization (including non-cash loss on retirement of assets), plus (f) stock compensation expense, less (g) cash expense related to stock compensation, plus or minus certain other adjustments) for the period of four consecutive fiscal quarters immediately preceding the date of determination. The Company has the benefit of the lowest margin if its Funded Debt Leverage Ratio is equal to or less than 0.5 to 1, and the margin increases as the ratio increases, to the maximum margin if the ratio is greater than 2.5 to 1. The Company will also bear additional costs for market disruption, regulatory changes effecting the lenders' funding costs, and default pricing of an additional 2% interest rate margin if the Funded Debt Leverage Ratio exceeds 3.0 to 1. Amounts borrowed under the Credit Agreement are secured by liens on substantially all of the assets of the Company.

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The Credit Agreement contains financial covenants requiring that the Company maintain a Funded Debt Leverage Ratio of less than 3.0 to 1 and an Interest Coverage Ratio of at least 3.0 to 1. Interest Coverage Ratio means the ratio, as of any date of determination, of (a) EBITDA for the 12 month period immediately preceding the date of determination, to (b) all interest, premium payments, debt discount, fees, charges and related expenses of the Company and its subsidiaries in connection with borrowed money (including capitalized interest) or in connection with the deferred purchase price of assets, in each case to the extent treated as interest in accordance with GAAP, paid during the 12 month period immediately preceding the date of determination. The Credit Agreement also limits the Company's ability to, among other things, create liens, make investments, incur more indebtedness, merge or consolidate, make dispositions of property, pay dividends and make distributions to stockholders, enter into a new line of business, enter into transactions with affiliates and enter into burdensome agreements. The Credit Agreement does not limit the Company's ability to acquire other businesses or companies except that the acquired business or company must be in its line of business, the Company must be in compliance with the financial covenants on a pro forma basis after taking into account the acquisition, and, if the acquired business is a separate subsidiary, in certain circumstances the lenders will receive the benefit of a guaranty of the subsidiary and liens on its assets and a pledge of its stock.

During the nine months ended February 29, 2012, the Company capitalized approximately \$0.6 million of costs related to the new credit agreement and expensed approximately \$0.1 million of deferred financing costs related to its former credit facility. The accelerated amounts expensed are classified as loss on extinguishment of long-term debt in the consolidated statement of operations.

*Notes Payable and Other*

In connection with certain of the acquisitions the Company has completed, it has, at various times, issued subordinated notes payable to the sellers. The maturity of these notes range from three to five years from the date of acquisition with interest rates ranging from 0% to 7%. The Company has discounted these obligations to reflect a 3.5% to 10% imputed interest rate. Unamortized discount on these notes totaled approximately \$0.1 million as of February 29, 2012 and May 31, 2011. Amortization is recorded as interest expense in the consolidated statement of operations. The Company also has payment obligations to the sellers or the shareholders of the sellers pursuant to non-compete agreements which require the sellers and shareholders of the sellers not to compete with the Company. The payment obligations under these agreements range from 3 to 5 years.

**11. Commitments and Contingencies**

*Litigation*

The Company is subject to periodic lawsuits, investigations and claims that arise in the ordinary course of business. Although the Company cannot predict with certainty the ultimate resolution of lawsuits, investigations and claims asserted against it, the Company does not believe that any currently pending legal proceeding to which the Company is a party will have a material adverse effect on its business, results of operations, cash flows or financial condition. The costs of defense and amounts that may be recovered in such matters may be covered by insurance.



The Company was a defendant in two related purported class action lawsuits in California, based upon alleged violations of California labor and employment law: *Quiroz v. Mistras Group, Inc., et al*, U.S. District Court, Central District of California (Case No. CV09-7146 PSG), filed in September 2009, and *Ballard v. Mistras Group, Inc., et al*, U.S. District Court, Central District of California (Case No. 2:10-cv-03186 (PSG)), filed in March 2010. The settlement for these cases received final court approval in August 2011. The Company took a \$0.4 million charge during the nine months ending February 28, 2011 for these cases.

*Acquisition-related contingencies*

The Company is liable for contingent consideration in connection with certain of its acquisitions. As of February 29, 2012, total potential acquisition-related contingent consideration ranged from zero to \$13.7 million and would be payable upon the achievement of specific performance metrics by certain of the acquired companies over the next four years of operations. See Note 5 to these consolidated financial statements for further discussion of the Company's acquisitions.

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**12. Subsequent Event**

In March 2012, the Company completed the acquisition of two companies to continue its strategic efforts in market expansion. The Company's cash outlay with regards to these acquisitions was approximately \$1.8 million. The Company is in the process of completing the preliminary purchase price allocation. These acquisitions were not individually significant and no pro forma information has been included.

**13. Segment Disclosure**

The Company's three segments are:

*Services.* This segment provides asset protection solutions primarily in North America with the largest concentration in the United States, consisting primarily of non-destructive testing and inspection services that are used to evaluate the structural integrity and reliability of critical energy, industrial and public infrastructure.

*Products and Systems.* This segment designs, manufactures, sells, installs and services the Company's asset protection products and systems, including equipment and instrumentation, predominantly in the United States.

*International.* This segment offers services, products and systems similar to those of the other segments to global markets, principally in Europe, the Middle East, Africa, Asia and South America, but not to customers in China and South Korea, which are served by the Products and Systems segment.

Allocations for general corporate services, including accounting, audit, and contract management, that are provided to the segments are reported within Corporate and eliminations. Sales to the International segment from the Products and Systems segment and subsequent sales by the International segment of the same items are recorded and reflected in the operating performance of both segments. Additionally, engineering charges and royalty fees charged to the Services and International segments by the Products and Systems segment are reflected in the operating performance of each segment. All such intersegment transactions are eliminated in the Company's consolidated financial reporting.

Segment income from operations is determined based on internal performance measures used by the Chief Executive Officer, who is the chief operating decision maker, to assess the performance of each business in a given period and to make decisions as to resource allocations. In connection with that assessment, the Chief Executive Officer may exclude matters such as charges for stock-based compensation and certain

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other acquisition-related charges and balances, technology and product development costs, certain gains and losses from dispositions, and litigation settlements or other charges. Certain general and administrative costs such as human resources, information technology and training are allocated to the segments. Segment income from operations also excludes interest and other financial charges and income taxes. Corporate and other assets are comprised principally of cash, deposits, property, plant and equipment, domestic deferred taxes, deferred charges and other assets. Corporate loss from operations consists of depreciation on the corporate office facilities and equipment, administrative charges related to corporate personnel and other charges that cannot be readily identified for allocation to a particular segment.

Selected consolidated financial information by segment for the periods shown was as follows:

|                            | Three months ended |                   | Nine months ended |                   |
|----------------------------|--------------------|-------------------|-------------------|-------------------|
|                            | February 29, 2012  | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| <b>Revenues</b>            |                    |                   |                   |                   |
| Services                   | \$ 80,895          | \$ 66,708         | \$ 253,493        | \$ 198,098        |
| Products and Systems       | 9,824              | 5,436             | 26,429            | 15,974            |
| International              | 17,164             | 8,671             | 38,794            | 27,062            |
| Corporate and eliminations | (3,765)            | (1,602)           | (8,931)           | (4,674)           |
|                            | \$ 104,118         | \$ 79,213         | \$ 309,785        | \$ 236,460        |

Revenues by operating segment include intercompany transactions, which are eliminated in Corporate and eliminations. The Services segment had sales to other operating segments of \$0.5 million and \$0.4 million for the three months ended

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**Mistras Group, Inc. and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
**(tabular dollars in thousands, except per share data)**

February 29, 2012 and February 28, 2011, respectively. For the nine months ended February 29, 2012 and February 28, 2011, Services segment sales to other operating segments totaled \$2.3 million and \$0.8 million, respectively.

The Products and Systems segment had sales to other operating segments of \$3.1 million and \$1.0 million for the three months ended February 29, 2012 and February 28, 2011, respectively. For the nine months ended February 29, 2012 and February 28, 2011, Products and Systems segment sales to other operating segments totaled \$6.4 million and \$3.1 million, respectively.

The International segment had sales to other operating segments of \$0.3 million and \$0.1 million for the three months ended February 29, 2012 and February 28, 2011, respectively. For the nine months ended February 29, 2012 and February 28, 2011, International segment sales to other operating segments totaled \$0.5 million and \$0.2 million, respectively.

|                            | Three months ended |                   | Nine months ended |                   |
|----------------------------|--------------------|-------------------|-------------------|-------------------|
|                            | February 29, 2012  | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| <b>Gross profit</b>        |                    |                   |                   |                   |
| Services                   | \$ 20,640          | \$ 16,650         | \$ 68,001         | \$ 53,404         |
| Products and Systems       | 4,938              | 3,049             | 12,952            | 8,440             |
| International              | 4,586              | 2,935             | 12,263            | 9,466             |
| Corporate and eliminations | (580)              | (37)              | (997)             | (127)             |
|                            | \$ 29,584          | \$ 22,597         | \$ 92,219         | \$ 71,183         |

|                               | Three months ended |                   | Nine months ended |                   |
|-------------------------------|--------------------|-------------------|-------------------|-------------------|
|                               | February 29, 2012  | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| <b>Income from operations</b> |                    |                   |                   |                   |
| Services                      | \$ 7,207           | \$ 5,494          | \$ 27,983         | \$ 19,591         |
| Products and Systems          | 2,476              | 1,213             | 6,038             | 2,980             |
| International                 | 340                | 404               | 2,430             | 2,514             |
| Corporate and eliminations    | (4,477)            | (2,418)           | (10,863)          | (6,879)           |
|                               | \$ 5,546           | \$ 4,693          | \$ 25,588         | \$ 18,206         |

Operating income by operating segment includes intercompany transactions, which are eliminated in Corporate and eliminations.

|                                      | Three months ended |                   | Nine months ended |                   |
|--------------------------------------|--------------------|-------------------|-------------------|-------------------|
|                                      | February 29, 2012  | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| <b>Depreciation and amortization</b> |                    |                   |                   |                   |
| Services                             | \$ 4,587           | \$ 4,247          | \$ 12,988         | \$ 11,855         |

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|                            |          |          |           |           |
|----------------------------|----------|----------|-----------|-----------|
| Products and Systems       | 500      | 206      | 1,451     | 624       |
| International              | 670      | 350      | 1,474     | 1,016     |
| Corporate and eliminations | 8        | 42       | 76        | 113       |
|                            | \$ 5,765 | \$ 4,845 | \$ 15,989 | \$ 13,608 |

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**Mistras Group, Inc. and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
(tabular dollars in thousands, except per share data)

|                               | As of<br>February 29, 2012 | As of<br>May 31, 2011 |
|-------------------------------|----------------------------|-----------------------|
| <b>Intangible assets, net</b> |                            |                       |
| Services                      | \$ 16,868                  | \$ 15,900             |
| Products and Systems          | 10,390                     | 10,250                |
| International                 | 5,480                      | 771                   |
| Corporate and eliminations    | 821                        | 383                   |
|                               | \$ 33,559                  | \$ 27,304             |

|                            | As of<br>February 29, 2012 | As of<br>May 31, 2011 |
|----------------------------|----------------------------|-----------------------|
| <b>Goodwill</b>            |                            |                       |
| Services                   | \$ 57,252                  | \$ 51,745             |
| Products and Systems       | 13,594                     | 10,557                |
| International              | 9,207                      | 1,844                 |
| Corporate and eliminations |                            |                       |
|                            | \$ 80,053                  | \$ 64,146             |

|                            | As of<br>February 29, 2012 | As of<br>May 31, 2011 |
|----------------------------|----------------------------|-----------------------|
| <b>Long-lived assets</b>   |                            |                       |
| Services                   | \$ 120,604                 | \$ 109,978            |
| Products and Systems       | 24,531                     | 23,235                |
| International              | 25,041                     | 6,504                 |
| Corporate and eliminations | 2,006                      | 901                   |
|                            | \$ 172,182                 | \$ 140,618            |

|                            | As of<br>February 29, 2012 | As of<br>May 31, 2011 |
|----------------------------|----------------------------|-----------------------|
| <b>Total assets</b>        |                            |                       |
| Services                   | \$ 205,934                 | \$ 188,693            |
| Products and Systems       | 39,976                     | 36,450                |
| International              | 52,740                     | 26,431                |
| Corporate and eliminations | 2,082                      | (2,937)               |
|                            | \$ 300,732                 | \$ 248,637            |

Revenues by geographic area for the three and nine months ended February 29, 2012 and February 28, 2011, respectively, were as follows:



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**Mistras Group, Inc. and Subsidiaries**  
**Notes to Unaudited Consolidated Financial Statements**  
 (tabular dollars in thousands, except per share data)

|                 | Three months ended |                   | Nine months ended |                   |
|-----------------|--------------------|-------------------|-------------------|-------------------|
|                 | February 29, 2012  | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| <b>Revenues</b> |                    |                   |                   |                   |
| United States   | \$ 74,416          | \$ 64,189         | \$ 237,215        | \$ 191,309        |
| Other Americas  | 11,500             | 6,448             | 32,357            | 20,088            |
| Europe          | 13,721             | 6,818             | 27,797            | 18,960            |
| Asia-Pacific    | 4,481              | 1,758             | 12,416            | 6,103             |
|                 | \$ 104,118         | \$ 79,213         | \$ 309,785        | \$ 236,460        |



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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (Securities Act), and Section 21E of the Securities Exchange Act of 1934 (Exchange Act). Forward-looking statements reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, our competitive position and the effects of competition, the projected growth of the industries in which we operate, the benefits and synergies to be obtained from our completed and any future acquisitions, and statements of management's goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as may, should, could, would, predicts, potential, continue, expects, and future, intends, plans, believes, estimates, appears, projects and similar expressions, as well as statements in the future tense, identify forward-looking statements. Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and management's good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Important factors that could cause such differences include, but are not limited to the factors discussed under the Risk Factors section below.

The following is a discussion and analysis of our financial condition and results of operations and should be read together with our condensed consolidated financial statements and related notes to the condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q and our audited consolidated financial statements and related notes to the audited consolidated financial statements included in our Annual Report on Form 10-K. In this quarterly report, our fiscal years, which end on May 31, are identified according to the calendar year in which they end (e.g., the fiscal year ended May 31, 2011 is referred to as fiscal 2011), and unless otherwise specified or the context otherwise requires, Mistras, the Company, we, us and our refer to Mistras Group, Inc. and its consolidated subsidiaries.

**Overview**

We are a leading one source global provider of technology-enabled asset protection solutions used to evaluate the structural integrity and reliability of critical energy, industrial and public infrastructure. We combine industry-leading products and technologies, expertise in mechanical integrity (MI) and non-destructive testing (NDT) services and proprietary data analysis software to deliver a comprehensive portfolio of customized solutions, ranging from routine inspections to complex, plant-wide asset integrity assessments and management. These mission critical solutions enhance our customers' ability to extend the useful life of their assets, increase productivity, minimize repair costs, comply with governmental safety and environmental regulations, manage risk and avoid catastrophic disasters. Given the role our services play in ensuring the safe and efficient operation of infrastructure, we have historically provided a majority of our services to our customers on a regular, recurring basis. We serve a global customer base of companies with asset-intensive infrastructure, including companies in the oil and gas, fossil and nuclear power, public infrastructure, chemicals, aerospace and defense, transportation, primary metals and metalworking, pharmaceuticals and food processing industries. During fiscal 2011, we provided our asset protection solutions to approximately 5,600 customers. As of February 29, 2012, we had approximately 3,100 employees, including approximately 30 Ph.D.'s and 100 other degreed engineers and certified technicians, in approximately 80 offices across 15 countries. We have established long-term relationships as a critical solutions provider to many leading companies in our target markets. Our current principal market is the oil and gas industry, which accounted for approximately 56% and 61% of our revenues for the first nine months of fiscal 2012 and 2011, respectively.

For the last several years, we have focused on introducing our advanced asset protection solutions to our customers using proprietary, technology-enabled software and testing instruments, including those developed by our Products and Systems segment. During this period, the demand for outsourced asset protection solutions, in general, has increased, creating demand from which our entire industry has benefited. We have experienced compounded annual growth rate (CAGR) for revenue of 31% over the last three fiscal years, including the impact of

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acquisitions and currency fluctuations. We believe further growth can be realized in all of our target markets. Concurrent with this growth, we have worked to build our infrastructure to profitably absorb additional growth and have made a number of small acquisitions in an effort to leverage our fixed costs, grow our base of experienced, certified personnel, expand our product and technical capabilities and increase our geographical reach.

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We have increased our capabilities and the size of our customer base through the development of applied technologies and managed support services, organic growth and the integration of acquired companies. These acquisitions have provided us with additional products, technologies, resources and customers that we believe will enhance our advantages over our competition.

The global economy continues to be fragile. Global financial markets continue to experience uncertainty, including tight liquidity and credit availability, relatively low consumer confidence, slow economic growth, persistently high unemployment rates, volatile currency exchange rates and continued uncertainty about economic stability. However, we believe these conditions have allowed us to capitalize on an opportunity to selectively hire new talented individuals that otherwise might not have been available to us, to acquire and develop new technologies in order to aggressively expand our proprietary portfolio of customized solutions, and to make acquisitions of complementary businesses at reasonable valuations.

**Consolidated Results of Operations***Three months ended February 29, 2012 compared to the three months ended February 28, 2011*

Our consolidated results of operations for the three months ended February 29, 2012 and February 28, 2011 were as follows:

|  | Three months ended |                   |
|--|--------------------|-------------------|
|  | February 29, 2012  | February 28, 2011 |
|  | (\$ in thousands)  |                   |
| <b>Statement of Operations Data</b>                                      |                    |                   |
| Revenues   | \$ 104,118         | \$ 79,213         |
| Cost of revenues   | 70,574             | 53,156            |
| Depreciation   | 3,960              | 3,460             |
| <b>Gross profit</b>  | <b>29,584</b>      | <b>22,597</b>     |
| Selling, general and administrative expenses                             | 20,806             | 16,005            |
| Research and engineering   | 578                | 514               |
| Depreciation and amortization  | 1,805              | 1,385             |
| Acquisition-related costs  | 849                |                   |
| Income from operations   | 5,546              | 4,693             |
| Interest expense   | 814                | 596               |
| Loss on extinguishment of long-term debt                                 | 113                |                   |
| Income before provision for income taxes                                 | 4,619              | 4,097             |
| Provision for income taxes   | 1,548              | 1,690             |
| Net income   | 3,071              | 2,407             |
| Net loss (income) attributable to noncontrolling interests, net of taxes | (34)               | 36                |
| Net income attributable to Mistras Group, Inc.                           | \$ 3,037           | \$ 2,443          |

Our EBITDA and Adjusted EBITDA, non-GAAP measures explained below, for the three months ended February 29, 2012 and February 28, 2011 were as follows:



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|  | Three months ended |                   |
|--|--------------------|-------------------|
|  | February 29, 2012  | February 28, 2011 |
|  | (\$ in thousands)  |                   |
| <b>EBITDA and Adjusted EBITDA data</b>         |                    |                   |
| Net income attributable to Mistras Group, Inc. | \$ 3,037           | \$ 2,443          |
| Interest expense                               | 814                | 596               |
| Provision for income taxes                     | 1,548              | 1,690             |
| Depreciation and amortization                  | 5,765              | 4,845             |
| EBITDA   | \$ 11,164          | \$ 9,574          |
| Stock compensation expense                     | 1,244              | 903               |
| Acquisition-related costs                      | 849                |                   |
| Loss on extinguishment of long-term debt       | 113                |                   |
| Adjusted EBITDA                                | \$ 13,370          | \$ 10,477         |

***Note About Non-GAAP Measures***

EBITDA and Adjusted EBITDA are performance measures used by management that are not calculated in accordance with U.S. generally accepted accounting principles (GAAP). EBITDA is defined in this Quarterly Report as net income attributable to Mistras Group, Inc. plus: interest expense, provision for income taxes and depreciation and amortization. Adjusted EBITDA is defined in this Quarterly Report as net income attributable to Mistras Group, Inc. plus: interest expense, provision for income taxes, depreciation and amortization, stock-based compensation expense, and, if applicable, certain acquisition related costs (including adjustments to the fair value of contingent consideration) and certain non-recurring items (which items are described below or in the reconciliation table above).

Our management uses Adjusted EBITDA as a measure of operating performance to assist in comparing performance from period to period on a consistent basis, as a measure for planning and forecasting overall expectations and for evaluating actual results against such expectations. Adjusted EBITDA is also used as a performance evaluation metric for our executive and employee incentive compensation programs.

We believe investors and other users of our financial statements benefit from the presentation of Adjusted EBITDA in evaluating our operating performance because it provides an additional tool to compare our operating performance on a consistent basis and measure underlying trends and results in our business. Adjusted EBITDA removes the impact of certain items that management believes do not directly reflect our core operations. For instance, Adjusted EBITDA generally excludes interest expense, taxes and depreciation and amortization, each of which can vary substantially from company to company depending upon accounting methods and the book value and age of assets, capital structure, capital investment cycles and the method by which assets were acquired. It also eliminates stock-based compensation, which is a non-cash expense and is excluded by management when evaluating the underlying performance of our business operations.

While Adjusted EBITDA is a term and financial measurement commonly used by investors and securities analysts, it has limitations. As a non-GAAP measurement, Adjusted EBITDA has no standard meaning and, therefore, may not be comparable with similar measurements for other companies. Adjusted EBITDA is generally limited as an analytical tool because it excludes charges and expenses we do incur as part of our operations. For example, Adjusted EBITDA excludes income taxes, but we generally incur significant U.S. federal, state and foreign income taxes each year and the provision for income taxes is a necessary cost. Adjusted EBITDA should not be considered in isolation or as a substitute for analyzing our results as reported under U.S. generally accepted accounting principles.

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*Revenues.* Revenues were \$104.1 million for the three months ended February 29, 2012 compared to \$79.2 million for the three months ended February 28, 2011. Revenues by segment for the third quarter of fiscal 2012 and 2011 were as follows:

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|                            | Three months ended |                   |
|----------------------------|--------------------|-------------------|
|                            | February 29, 2012  | February 28, 2011 |
|                            | (\$ in thousands)  |                   |
| <b>Revenues</b>            |                    |                   |
| Services                   | \$ 80,895          | \$ 66,708         |
| Products and Systems       | 9,824              | 5,436             |
| International              | 17,164             | 8,671             |
| Corporate and eliminations | (3,765)            | (1,602)           |
|                            | \$ 104,118         | \$ 79,213         |

We estimate our growth rates for the third quarter of fiscal 2012 and 2011 were as follows:

|  | Three months ended |                   |
|--|--------------------|-------------------|
|  | February 29, 2012  | February 28, 2011 |
|  | (\$ in thousands)  |                   |
| Revenue growth                         | \$ 24,905          | \$ 14,857         |
| % Growth over prior year               | 31.4%              | 23.1%             |
| Comprised of:                          |                    |                   |
| % of organic growth                    | 16.5%              | 16.7%             |
| % of acquisition growth                | 15.2%              | 6.2%              |
| % foreign exchange increase (decrease) | (0.3)%             | 0.2%              |
|  | 31.4%              | 23.1%             |

Revenues increased \$24.9 million, or approximately 31%, for the three months ended February 29, 2012 compared to the three months ended February 28, 2011 as a result of growth in all our segments, but principally attributable to growth in our Services segment. For the third quarter of fiscal 2012 and 2011, we estimate that our organic growth rate, as compared to growth driven by acquisitions, was approximately 17%. In the third quarter of fiscal 2012, we estimate that our acquisition growth was approximately 15% compared to approximately 6% in the third quarter of fiscal 2011. We completed the acquisition of eight companies during the nine months ended February 29, 2012 and four companies during the nine months ended February 28, 2011, which accounts for the increase in acquisition growth.

We continued to experience growth in many of our target markets during the third quarter of fiscal 2012. Oil and gas is our largest target market and represented approximately 55% of total revenues in the third quarter of fiscal 2012, compared to approximately 64% in the third quarter of fiscal 2011. Oil and gas revenue in the third quarter of fiscal 2012 increased approximately 14% over the prior year with the largest increases coming from the downstream and midstream sections of the oil and gas industry. We also experienced growth in several of our other target markets outside of oil and gas, including industrial markets, aerospace and defense and engineering. Taken as a group, revenues for all target markets other than oil and gas grew approximately 63% in the third quarter of fiscal 2012 over the prior year period. Our largest customer in both periods was BP plc. (BP), accounting for approximately 16% of our revenues in the third quarter of fiscal 2012 and approximately 21% in the third quarter of fiscal 2011. Our top ten customers represented approximately 38% of our revenues in the third quarter of fiscal 2012 compared to 50% in the same quarter last year.

*Gross Profit.* Our gross profit was \$29.6 million and increased \$7.0 million, or 31% in the third quarter of fiscal 2012 compared to \$22.6 million in the third quarter of fiscal 2011. Gross profit by segment for the three months ended February 29, 2012 and February 28, 2011 was as follows:





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|                            | Three months ended |                   |
|----------------------------|--------------------|-------------------|
|                            | February 29, 2012  | February 28, 2011 |
|                            | (\$ in thousands)  |                   |
| <b>Gross profit</b>        |                    |                   |
| Services                   | \$ 20,640          | \$ 16,650         |
| Products and Systems       | 4,938              | 3,049             |
| International              | 4,586              | 2,935             |
| Corporate and eliminations | (580)              | (37)              |
|                            | \$ 29,584          | \$ 22,597         |

As a percentage of revenues, our gross profit and its components for the three months ended February 29, 2012 and February 28, 2011 were as follows:

|  | Three months ended |                   |
|--|--------------------|-------------------|
|  | February 29, 2012  | February 28, 2011 |
|  | (\$ in thousands)  |                   |
| Gross profit                                       | \$ 29,584          | \$ 22,597         |
| Gross profit % comprised of:                       |                    |                   |
| Revenues   | 100.0%             | 100.0%            |
| Cost of revenues                                   | (67.8)%            | (67.1)%           |
| Depreciation                                       | (3.8)%             | (4.4)%            |
| Total  | 28.4%              | 28.5%             |
| Gross profit % increase (decrease) from prior year | (0.1)%             | 1.1%              |

As a percentage of revenues, our gross profit remained fairly consistent at approximately 28% for each of the third quarters of fiscal 2012 and fiscal 2011. Cost of revenues, excluding depreciation, as a percentage of revenues was approximately 68% and 67% in the third quarter of fiscal 2012 and fiscal 2011, respectively. Depreciation expense included in the determination of gross profit for the third quarter of fiscal 2012 and fiscal 2011 was \$4.0 million and \$3.5 million, respectively.

Our gross profit as a percentage of revenues was somewhat impacted by a change in the mix of revenues generated during the quarter coupled with a decrease in gross profit in our International segment, which relates to the integration of three acquisitions during the quarter. This was offset by improvements in our Services segment gross profit, which was achieved through reductions in our unbilled direct labor as a percentage of revenues. Revenue from the oil and gas industry increased approximately 14% during the third quarter of fiscal 2012 and represented approximately 55% of total revenues. Revenue from this industry tends to have lower gross margins than other industries due to the existence of longer term contracts which typically have a high concentration of lower margin, traditional NDT services. Offsetting the impact of higher oil and gas revenues in the third quarter of fiscal 2012 was revenue growth of approximately 63% in all other industries, where gross margins tend to be higher.

*Income from Operations.* Our income from operations by segment for the three months ended February 29, 2012 and February 28, 2011 were as follows:

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|                               | Three months ended |                   |
|-------------------------------|--------------------|-------------------|
|                               | February 29, 2012  | February 28, 2011 |
|                               | (\$ in thousands)  |                   |
| <b>Income from operations</b> |                    |                   |
| Services                      | \$ 7,207           | \$ 5,494          |
| Products and Systems          | 2,476              | 1,213             |
| International                 | 340                | 404               |
| Corporate and eliminations    | (4,477)            | (2,418)           |
|                               | \$ 5,546           | \$ 4,693          |

Our income from operations of \$5.5 million for the third quarter of fiscal 2012 increased \$0.9 million, or 18%, compared to the third quarter of fiscal 2011. As a percentage of revenues, our income from operations was approximately 5% and 6% in the third quarter of fiscal 2012 and fiscal 2011, respectively. The decrease in income from operations as a percentage of revenues partially relates to lower margins and increased selling, general and administrative (SG&A) expenses related to the integration of our recent acquisitions in our International segment.

Our SG&A expenses for the third quarter of fiscal 2012 increased approximately \$4.8 million over the third quarter of fiscal 2011. Of this amount, SG&A for companies acquired within the last twelve months accounted for approximately \$2.3 million of the total increase. SG&A expenses, as a percentage of revenues, was approximately 20% for each of the third quarters of fiscal 2012 and 2011. The increase in expense was primarily due to the cost of additional salary and other infrastructure costs to support our growth in revenues, including the addition of new locations and personnel in connection with our recent acquisitions. Excluding acquisitions, our SG&A expenses included higher compensation and benefit expenses of \$1.7 million over the same period in the prior year attributed to normal salary increases, as well as our investment in additional management and corporate staff to support our growth. Other increases in SG&A expenses, excluding acquisitions, included increased stock compensation costs of \$0.4 million and insurance expense of \$0.4 million, partially offset by foreign currency gains of \$0.1 million over the third quarter of fiscal 2011. Depreciation and amortization included in the determination of income from operations for the third quarter of fiscal 2012 and fiscal 2011 was \$1.8 million and \$1.4 million, respectively, each representing approximately 2% of revenues.

Our acquisition-related costs for the third quarter of fiscal 2012 were approximately \$1.0 million and related to professional fees and other expenses in connection with our fiscal 2012 acquisition activity. These amounts were offset by approximately \$0.1 million in adjustments to the estimated fair value of certain acquisition-related contingent consideration liabilities. Acquisition-related costs for the three months ended February 28, 2011 were insignificant.

*Interest Expense.* Interest expense was \$0.8 million and \$0.6 million for the third quarter of fiscal 2012 and 2011, respectively. The increase in the third quarter of fiscal 2012 related to an increase in average borrowings in the current year quarter compared to the prior year and interest accretion from the estimated fair value of our contingent consideration related to our acquisitions.

*Net Income Attributable to Noncontrolling Interests, net of taxes.* The net income attributable to noncontrolling interests for the three months ended February 29, 2012 is primarily related to the net income incurred by Diapac, our subsidiary in Russia.

*Income Taxes.* Our effective income tax rate was approximately 34% for the third quarter of fiscal 2012 compared to approximately 41% for the third quarter of fiscal 2011. The decrease was primarily due to the impact of permanent tax differences, tax credits, and changes in the geographic mix of earnings in the various state and foreign jurisdictions.

*Net Income Attributable to Mistras Group, Inc.* Net income attributable to Mistras Group, Inc. for the third quarter of fiscal 2012 was \$3.0 million, or 3% of our revenues, an increase of \$0.6 million over the third quarter of fiscal 2011, which was \$2.4 million, or 3% of revenues. The increase in net income was primarily the result of our revenue growth, partially offset by increases in our SG&A expenses and acquisition-related costs.

**Consolidated Results of Operations**

*Nine months ended February 29, 2012 compared to the nine months ended February 28, 2011*

Our consolidated results of operations for the nine months ended February 29, 2012 and February 28, 2011 were as follows:

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|  | Nine months ended |                   |
|--|-------------------|-------------------|
|  | February 29, 2012 | February 28, 2011 |
|  | (\$ in thousands) |                   |
| <b>Statement of Operations Data</b>                                      |                   |                   |
| Revenues   | \$ 309,785        | \$ 236,460        |
| Cost of revenues   | 206,364           | 155,558           |
| Depreciation   | 11,202            | 9,719             |
| <b>Gross profit</b>  | <b>92,219</b>     | <b>71,183</b>     |
| Selling, general and administrative expenses                             | 59,565            | 47,099            |
| Research and engineering   | 1,769             | 1,638             |
| Depreciation and amortization  | 4,787             | 3,889             |
| Acquisition-related costs  | 510               |                   |
| Legal reserve  |                   | 351               |
| Income from operations   | 25,588            | 18,206            |
| Interest expense   | 2,620             | 1,957             |
| Loss on extinguishment of long-term debt                                 | 113               |                   |
| Income before provision for income taxes                                 | 22,855            | 16,249            |
| Provision for income taxes   | 8,672             | 6,562             |
| Net income   | 14,183            | 9,687             |
| Net loss (income) attributable to noncontrolling interests, net of taxes | 38                | 26                |
| Net income attributable to Mistras Group, Inc.                           | \$ 14,221         | \$ 9,713          |

Our EBITDA and Adjusted EBITDA, non-GAAP measures explained below, for the nine months ended February 29, 2012 and February 28, 2011 were as follows:

|  | Nine months ended |                   |
|--|-------------------|-------------------|
|  | February 29, 2012 | February 28, 2011 |
|  | (\$ in thousands) |                   |
| <b>EBITDA and Adjusted EBITDA data</b>         |                   |                   |
| Net income attributable to Mistras Group, Inc. | \$ 14,221         | \$ 9,713          |
| Interest expense                               | 2,620             | 1,957             |
| Provision for income taxes                     | 8,672             | 6,562             |
| Depreciation and amortization                  | 15,989            | 13,608            |
| EBITDA   | \$ 41,502         | \$ 31,840         |
| Stock compensation expense                     | 3,791             | 2,680             |
| Acquisition-related costs                      | 510               |                   |
| Legal reserve                                  |                   | 351               |
| Loss on extinguishment of long-term debt       | 113               |                   |
| Adjusted EBITDA                                | \$ 45,916         | \$ 34,871         |

See explanation and definition of EBITDA and Adjusted EBITDA above on page 22.

*Revenues.* Revenues were \$309.8 million for nine months ended February 29, 2012 compared to \$236.5 million for the nine months ended February 28, 2011. Revenues by segment for the first nine months of fiscal 2012 and 2011 were as follows:

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|                            | Nine months ended |                   |
|----------------------------|-------------------|-------------------|
|                            | February 29, 2012 | February 28, 2011 |
|                            | (\$ in thousands) |                   |
| <b>Revenues</b>            |                   |                   |
| Services                   | \$ 253,493        | \$ 198,098        |
| Products and Systems       | 26,429            | 15,974            |
| International              | 38,794            | 27,062            |
| Corporate and eliminations | (8,931)           | (4,674)           |
|                            | \$ 309,785        | \$ 236,460        |

We estimate our growth rates for the first nine months of fiscal 2012 and 2011 were as follows:

|  | Nine months ended |                   |
|--|-------------------|-------------------|
|  | February 29, 2012 | February 28, 2011 |
|  | (\$ in thousands) |                   |
| Revenue growth                         | \$ 73,325         | \$ 44,116         |
| % Growth over prior year               | 31.0%             | 22.9%             |
| Comprised of:                          |                   |                   |
| % of organic growth                    | 18.5%             | 16.2%             |
| % of acquisition growth                | 11.9%             | 6.8%              |
| % foreign exchange increase (decrease) | 0.6%              | (0.1)%            |
|  | 31.0%             | 22.9%             |

Revenues increased \$73.3 million, or approximately 31%, for the nine months ended February 29, 2012 compared to the nine months ended February 28, 2011 as a result of growth in all our segments, but principally attributable to growth in our Services segment. For the nine months ended February 29, 2012 and February 28, 2011, we estimate that our organic growth rate, as compared to growth driven by acquisitions, was approximately 19% and 16%, respectively. For the nine months ended February 29, 2012, we estimate that our acquisition growth was approximately 12% compared to approximately 7%, in the nine months ended February 28, 2011. We completed the acquisition of eight companies during the nine months ended February 29, 2012 and four companies during the nine months ended February 28, 2011, which accounts for the increase in acquisition growth.

We continued to experience growth in many of our target markets during the first nine months of fiscal 2012. Oil and gas is our largest target market and in the first nine months of fiscal 2012 represented approximately 56% of total revenues, compared to approximately 61% in the comparable period of fiscal 2011. Oil and gas revenue in the first nine months of fiscal 2012 increased approximately 20% over the prior year period with the largest increases coming from the downstream and midstream sections of the oil and gas industry. We experienced growth in several of our other target markets outside of oil and gas, including industrial markets, chemical, and aerospace and defense. Taken as a group, revenues for all target markets other than oil and gas grew approximately 49% in the nine months ended February 29, 2012 over the comparable prior year period. Our largest customer in both periods was BP plc., (BP), accounting for approximately 16% of our revenues in the nine months ended February 29, 2012 and approximately 17% of our revenues in the nine months ended February 28, 2011. Our top ten customers represented approximately 40% of our revenues in the nine months ended February 29, 2012 and approximately 44% of our revenues in the nine months ended February 28, 2011.

*Gross Profit.* Our gross profit was \$92.2 million and increased \$21.0 million, or 30%, during the nine months ended February 29, 2012 compared to \$71.2 million during the nine months ended February 28, 2011. Gross profit by segment for the first nine months of fiscal 2012 and 2011 was as follows:



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|                            | Nine months ended |                   |
|----------------------------|-------------------|-------------------|
|                            | February 29, 2012 | February 28, 2011 |
|                            | (\$ in thousands) |                   |
| <b>Gross profit</b>        |                   |                   |
| Services                   | \$ 68,001         | \$ 53,404         |
| Products and Systems       | 12,952            | 8,440             |
| International              | 12,263            | 9,466             |
| Corporate and eliminations | (997)             | (127)             |
|                            | \$ 92,219         | \$ 71,183         |

As a percentage of revenues, our gross profit and its components for the first nine months of fiscal 2012 and 2011 were as follows:

|  | Nine months ended |                   |
|--|-------------------|-------------------|
|  | February 29, 2012 | February 28, 2011 |
|  | (\$ in thousands) |                   |
| Gross profit                                       | \$ 92,219         | \$ 71,183         |
| Gross profit % comprised of:                       |                   |                   |
| Revenues   | 100.0%            | 100.0%            |
| Cost of revenues                                   | (66.6)%           | (65.8)%           |
| Depreciation                                       | (3.6)%            | (4.1)%            |
| Total  | 29.8%             | 30.1%             |
| Gross profit % increase (decrease) from prior year | (0.3)%            | 0.1%              |

As a percentage of revenues, our gross profit decreased 30 basis points in the first nine months of fiscal 2012 compared to the comparable prior year period. Cost of revenues, excluding depreciation, as a percentage of revenues was approximately 67% and 66% in the nine months ended February 29, 2012 and February 28, 2011, respectively. Depreciation expense included in the determination of gross profit for the first nine months of fiscal 2012 and 2011 was \$11.2 million and \$9.7 million, respectively.

The 30 basis point decrease in our gross profit as a percentage of revenues was primarily attributable to a change in the mix of revenues generated during the period and slightly higher unbilled direct labor. Revenue from the oil and gas industry increased approximately 20% during the first nine months of fiscal 2012 and represented approximately 56% of total revenues. Revenue from this industry tends to have lower gross margins than other industries due to the existence of longer term contracts which typically have a high concentration of lower margin, traditional NDT services. Offsetting the impact of higher oil and gas revenues in the first nine months of fiscal 2012 was revenue growth of approximately 49% in all other industries, where gross margins tend to be higher. In addition, revenues from Advanced NDT services, which have higher margins than traditional NDT services, increased approximately 39% during the first nine months of fiscal 2012 and now represent approximately 16% of our Services segment revenues compared to approximately 14% in the comparable period of fiscal 2011.

Unbilled direct labor increased \$1.5 million in the first nine months of fiscal 2012 compared to the first nine months of fiscal 2011. Unbilled direct labor includes professional training time for our technicians which increased as a result of the increase in technicians in the first nine months of fiscal 2012 compared to the prior year period.

*Income from Operations.* Our income from operations by segment for the nine months ended February 29, 2012 and February 28, 2011 were as follows:





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|                               | Nine months ended |                   |
|-------------------------------|-------------------|-------------------|
|                               | February 29, 2012 | February 28, 2011 |
|                               | (\$ in thousands) |                   |
| <b>Income from operations</b> |                   |                   |
| Services                      | \$ 27,983         | \$ 19,591         |
| Products and Systems          | 6,038             | 2,980             |
| International                 | 2,430             | 2,514             |
| Corporate and eliminations    | (10,863)          | (6,879)           |
|                               | \$ 25,588         | \$ 18,206         |

Our income from operations of \$25.6 million for the nine months February 29, 2012 increased \$7.4 million, or 41%, compared to \$18.2 million for the nine months ended February 28, 2011. As a percentage of revenues, our income from operations was approximately 8% for each of the first nine months of fiscal 2012 and 2011.

Our selling, general and administrative (SG&A) expenses for the nine months ended February 29, 2012 increased approximately \$12.5 million over the comparable prior year period. Of this amount, SG&A for companies acquired within the last twelve months accounted for approximately \$4.8 million of the total increase. As a percentage of revenues, SG&A expenses for the first nine months of fiscal 2012 decreased to approximately 19% from approximately 20% for the first nine months of fiscal 2011. The increase in expense was primarily due to the cost of additional salary and other infrastructure costs to support our growth in revenues, including the addition of new locations and personnel in connection with our recent acquisitions. Excluding acquisitions, our SG&A expenses included higher compensation and benefit expenses of \$5.4 million over the same period in the prior year attributed to normal salary increases, as well as our investment in additional management and corporate staff to support our growth. Other increases in SG&A expenses, excluding acquisitions, included increased stock compensation costs of \$1.1 million, insurance expense of \$1.1 million and foreign currency losses of \$0.7 million over the comparable prior year period. Depreciation and amortization included in the determination of income from operations for the nine months ended February 29, 2012 and February 28, 2011 was \$4.8 million and \$3.9 million, respectively, each representing approximately 2% of revenues.

Our acquisition-related costs for the nine months ended February 29, 2012 were approximately \$1.4 million and related to professional fees and other expenses in connection with our fiscal 2012 acquisition activity. These amounts were offset by approximately \$0.9 million in adjustments to the estimated fair value of certain acquisition-related contingent consideration liabilities. Acquisition-related costs for the nine months ended February 28, 2011 were insignificant.

*Interest Expense.* Interest expense for the nine months ended February 29, 2012 was \$2.6 million, an increase of \$0.7 million when compared to the prior year period. This increase primarily related to an increase in average borrowings in the current year as well as interest accretion from the estimated fair value of contingent consideration related to our acquisitions.

*Net Loss Attributable to Noncontrolling Interests, net of taxes.* The net loss attributable to noncontrolling interests for the nine months ended February 29, 2012 is primarily related to the net loss incurred by Diapac, our subsidiary in Russia.

*Income Taxes.* Our effective income tax rate was approximately 38% for the nine months ended February 29, 2012 compared to approximately 40% for the nine months ended February 28, 2011. The decrease was primarily due to the impact of permanent tax differences, tax credits, and changes in the geographic mix of earnings in the various state and foreign jurisdictions.

*Net Income Attributable to Mistras Group, Inc.* Net income attributable to Mistras Group, Inc. for the nine months ended February 29, 2012 was \$14.2 million, or 5% of revenues, an increase of \$4.5 million over net income attributable to Mistras Group, Inc. for the nine months ended February 28, 2011, which was \$9.7 million, or 4% of revenues. The increase in net income was primarily the result of our revenue growth, partially offset by increases in our SG&A expenses and our provision for income taxes.

Table of Contents**Liquidity and Capital Resources*****Cash Flows Table***

Our cash flows are summarized in the table below:

|   | Nine months ended |                   |
|---|-------------------|-------------------|
|   | February 29, 2012 | February 28, 2011 |
|   | (\$ in thousands) |                   |
| Net cash provided by (used in):         |                   |                   |
| Operating Activities                    | \$ 20,972         | \$ 18,643         |
| Investing Activities                    | (32,816)          | (24,580)          |
| Financing Activities                    | 9,441             | (3,645)           |
| Effect of exchange rate changes on cash | (545)             | 105               |
| Net change in cash and cash equivalents | \$ (2,948)        | \$ (9,477)        |

***Cash Flows from Operating Activities***

During the nine months ended February 29, 2012, cash provided by our operating activities was \$21.0 million, an increase of \$2.3 million from the comparable period of fiscal 2011. Positive operating cash flow was primarily attributable to higher net income, excluding depreciation, amortization and other non-cash expenses of \$34.1 million offset by \$13.1 million of cash utilized to fund an increase in our working capital, which primarily related to an increase in our trade accounts receivable.

During the nine months ended February 28, 2011, cash provided by our operating activities was \$18.6 million, an increase of \$6.9 million from the comparable period of fiscal 2010. Positive operating cash flow was primarily attributable to higher net income, excluding depreciation, amortization and other non-cash expenses, of \$25.8 million offset by \$7.2 million of cash utilized to fund an increase in our working capital, which primarily related to an increase in our trade accounts receivable.

***Cash Flows from Investing Activities***

During the nine months ended February 29, 2012, cash used in investing activities was \$32.8 million, an increase of \$8.2 million from the comparable period of fiscal 2011. Cash used in investing activities included our acquisition of eight companies for an aggregate of \$26.3 million, net of cash acquired. Cash purchases of property, plant and equipment were \$6.4 million and were primarily related to equipment used by our technicians.

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During the nine months ended February 28, 2011, cash used in investing activities was \$24.6 million compared to \$15.9 million from the comparable period of fiscal 2010. Cash used in investing activities also included our acquisition of four asset protection businesses for cash payments aggregating \$18.3 million. Cash purchases of property, plant and equipment were \$6.1 million and were primarily related to equipment used by our technicians, as well as a land purchase and construction costs for our new operations and training facility in Houston, Texas.

### *Cash Flows from Financing Activities*

Net cash provided by financing activities was \$9.4 million for the nine months ended February 29, 2012, an increase of \$13.1 million from the comparable period of fiscal 2011. Net cash provided by financing activities related primarily to net borrowings under our revolving credit facility of \$19.1 million and proceeds of \$1.5 million received from the exercise of stock options, offset by repayments of our capital lease obligations, long-term debt, and other short-term borrowings of \$5.1 million, \$4.4 million, \$1.9 million, respectively.

Net cash used in financing activities was \$3.6 million for the nine months ended February 28, 2011. Net cash used in financing activities related primarily to repayments of our long-term debt and capital lease obligations of \$6.8 million and \$4.6 million, respectively, offset by net borrowings under our revolving credit facility and other short-term borrowings of \$5.0 million and \$2.7 million, respectively.

### *Effect of Exchange Rate Changes on Cash and Cash Equivalents*

The effect of exchange rate changes on our cash and cash equivalents was approximately (\$0.6) million and \$0.1 million for the nine months ended February 29, 2012 and February 28, 2011, respectively.

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**Cash Balance and Credit Facility Borrowings**

As of February 29, 2012, we had cash and cash equivalents totaling \$7.9 million and available borrowing capacity of \$98.3 million under our current revolving credit facility. As of February 29, 2012, there were outstanding borrowings of \$22.9 million and a total of \$3.8 million of outstanding letters of credit under the existing revolving credit facility. We finance our operations primarily through our existing cash balances, cash collected from operations, bank borrowings and capital lease financing. We believe these sources are sufficient to fund our operations for the foreseeable future.

In December 2011, we entered into a Third Amended and Restated Credit Agreement (Credit Agreement), with Bank of America, N.A., as agent for the lenders and a lender, and JPMorgan Chase Bank, N.A., Keybank National Association and TD Bank, N.A., as lenders. The Credit Agreement provides us with a \$125.0 million revolving line of credit, which, under certain circumstances, can be increased to \$150.0 million. The Credit Agreement has a maturity date of December 20, 2016 and permits us to borrow up to \$30.0 million in non-US dollar currencies and to use up to \$10.0 million of the credit limit for the issuance of letters of credit. Loans under the Credit Agreement bear interest at LIBOR or base rate, at our option, plus an applicable LIBOR margin ranging from 1% to 2%, or base rate margin ranging from -1.25% to -.25%, based upon our Funded Debt Leverage Ratio. Funded Debt Leverage Ratio is generally the ratio of (1) all outstanding indebtedness for borrowed money and other interest-bearing indebtedness as of the date of determination to (2) EBITDA (which is (a) net income, less (b) income (or plus loss) from discontinued operations and extraordinary items, plus (c) income tax expenses, plus (d) interest expense, plus (e) depreciation, depletion, and amortization (including non-cash loss on retirement of assets), plus (f) stock compensation expense, less (g) cash expense related to stock compensation, plus or minus certain other adjustments) for the period of four consecutive fiscal quarters immediately preceding the date of determination. We have the benefit of the lowest margin if our Funded Debt Leverage Ratio is equal to or less than 0.5 to 1, and the margin increases as the ratio increases, to the maximum margin if the ratio is greater than 2.5 to 1. We will also bear additional costs for market disruption, regulatory changes effecting the lenders' funding costs, and default pricing of an additional 2% interest rate margin if the Funded Debt Leverage Ratio exceeds 3.0 to 1. Amounts borrowed under our Credit Agreement are secured by liens on substantially all of our assets.

The Credit Agreement contains financial covenants requiring that we maintain a Funded Debt Leverage Ratio of less than 3.0 to 1 and an Interest Coverage Ratio of at least 3.0 to 1. Interest Coverage Ratio means the ratio, as of any date of determination, of (a) EBITDA for the 12 month period immediately preceding the date of determination, to (b) all interest, premium payments, debt discount, fees, charges and related expenses of us and our subsidiaries in connection with borrowed money (including capitalized interest) or in connection with the deferred purchase price of assets, in each case to the extent treated as interest in accordance with GAAP, paid during the 12 month period immediately preceding the date of determination. The Credit Agreement also limits our ability to, among other things, create liens, make investments, incur more indebtedness, merge or consolidate, make dispositions of property, pay dividends and make distributions to stockholders, enter into a new line of business, enter into transactions with affiliates and enter into burdensome agreements. The Credit Agreement does not limit our ability to acquire other businesses or companies except that the acquired business or company must be in our line of business, we must be in compliance with the financial covenants on a pro forma basis after taking into account the acquisition, and, if the acquired business is a separate subsidiary, in certain circumstances the lenders will receive the benefit of a guaranty of the subsidiary and liens on its assets and a pledge of its stock.

As of February 29, 2012, we were in compliance with the terms of the credit agreement, and we will continuously monitor our compliance with the covenants contained in our new credit agreement.

**Liquidity and Capital Resources Outlook**

**Future Sources of Cash**

We expect our future sources of cash to include cash flow from operations, cash borrowed under our revolving credit facility and cash borrowed from leasing companies to purchase equipment and fleet service vehicles. Our revolving credit facility is available for cash advances required for working capital and for letters of credit to support our operations. To meet our short-and long-term liquidity requirements, we expect primarily to rely on cash generated from our operating activities and borrowings under our revolving credit facility. We are currently funding our acquisitions through our available cash, borrowings under our revolving credit facility and seller notes. We have an effective shelf registration statement with the SEC for the issuance of up to approximately \$64.2 million of securities, including shares of common and preferred stock, debt securities, warrants and units. Accordingly, we may also obtain capital through the issuance of debt or equity securities, or a combination of both. As of March 31, 2012, there were outstanding borrowings of approximately \$28.6 million under our revolving credit facility.

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**Future Uses of Cash**

We expect our future uses of cash will primarily be for acquisitions, international expansion, purchases or manufacture of field testing equipment to support growth, additional investments in technology and software products and the replacement of existing assets and equipment used in our operations. We often make purchases to support new sources of revenues, particularly in our Services segment. In addition, we will need to fund a certain amount of replacement equipment, including our fleet vehicles. We historically spend approximately 3% to 4% of our total revenues on capital expenditures, excluding acquisitions, and expect to fund these expenditures through a combination of cash and lease financing.

Our anticipated acquisitions may also require capital. We have completed the acquisition of ten companies in fiscal 2012, including two acquisitions completed in March 2012, with an initial cash outlay of \$29.3 million. In some cases, additional equipment will be needed to upgrade the capabilities of these acquired companies. In addition, our future acquisition and capital spending may increase as we pursue growth opportunities. Other investments in infrastructure, training and software may also be required to match our growth, but we plan to continue using a disciplined approach to building our business. In addition, we will use cash to fund our operating leases, capital leases and long-term debt repayments and various other obligations as they arise.

We also expect to use cash to support our working capital requirements for our operations, particularly in the event of further growth and due to the impacts of seasonality on our business. Our future working capital requirements will depend on many factors, including the rate of our revenue growth, our introduction of new solutions and enhancements to existing solutions and our expansion of sales and marketing and product development activities. To the extent that our cash and cash equivalents and future cash flows from operating activities are insufficient to fund our future activities, we may need to raise additional funds through bank credit arrangements, public or private equity financings, or debt financings. We also may need to raise additional funds in the event we determine in the future to effect one or more acquisitions of businesses, technologies or products that will complement our existing operations. In the event additional funding is required, we may not be able to obtain bank credit arrangements or effect an equity or debt financing on terms acceptable to us or at all.

**Off-balance Sheet Arrangements**

During the nine months ended February 29, 2012, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

**ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

**Foreign Currency Risk**

We have foreign currency exposure related to our operations in foreign locations where the functional currency is not the U.S. dollar. This foreign currency exposure, particularly the Euro, British Pound Sterling (GBP), Brazilian Real, Russian Ruble, Japanese Yen and the Indian

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Rupee, arises primarily from the translation of our foreign subsidiaries' financial statements into U.S. dollars. For example, a portion of our annual sales and operating costs are denominated in GBP and we have exposure related to sales and operating costs increasing or decreasing based on changes in currency exchange rates. If the U.S. dollar increases in value against these foreign currencies, the value in U.S. dollars of the assets and liabilities originally recorded in these foreign currencies will decrease. Conversely, if the U.S. dollar decreases in value against these foreign currencies, the value in U.S. dollars of the assets and liabilities originally recorded in these foreign currencies will increase. Thus, increases and decreases in the value of the U.S. dollar relative to these foreign currencies have a direct impact on the value in U.S. dollars of our foreign currency denominated assets and liabilities, even if the value of these items has not changed in their original currency. For our foreign subsidiaries, assets and liabilities are translated at period ending rates of exchange. Translation adjustments for the assets and liability accounts are included in accumulated other comprehensive income in stockholders' equity (deficit). We had approximately \$2.0 million of foreign currency translation losses in other comprehensive income for the first nine months of fiscal 2012. We do not currently enter into forward exchange contracts to hedge exposures to foreign currencies. We may consider entering into hedging or forward exchange contracts in the future.

### **Interest Rate Sensitivity**

The interest rate on our revolving credit facility currently ranges from 1.26% to 2.00% and is variable and adjusts periodically. As of February 29, 2012, there were outstanding borrowings of \$22.9 million under our revolving credit



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facility. A hypothetical 100 basis point adverse shift in interest rates would not have had a material effect on our results of operations for the three or nine months ended February 29, 2012.

From time to time, we enter into interest rate swap contracts whereby we would receive or pay an amount equal to the difference between a fixed rate and LIBOR on a quarterly basis in order to reduce our potential exposure to interest rate fluctuations. All gains and losses are recognized as an adjustment to interest expense and the combined fair values are recorded in other liabilities on the consolidated balance sheet. As of February 29, 2012, we had no such contracts in effect.

We had cash and cash equivalents of \$7.9 million as of February 29, 2012. These amounts are held for working capital purposes and were invested primarily in bank deposits, money market funds and short-term, interest-bearing, investment-grade securities. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Declines in interest rates, however, will reduce future investment income.

**Fair Value of Financial Instruments**

We do not believe that we have material exposure to market risk with respect to investments, as our investments consist primarily of highly liquid investments purchased with a remaining maturity of three months or less. We do not use derivative financial instruments for speculative or trading purposes; however, this does not preclude our adoption of specific hedging strategies in the future.

**ITEM 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

As of February 29, 2012, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined in Rule 13a-15(e). Based on the evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

**Changes in Internal Control Over Financial Reporting**

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There has been no change in the Company's internal control over financial reporting that occurred during the Company's quarter ended February 29, 2012 that has materially affected, or is reasonably likely to materially affect, such internal control over financial reporting.

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**PART II OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

We have received notice of a governmental investigation concerning an environmental incident which occurred in February 2011, outside on the premises of our Cudahy, California facility. We acquired this facility as part of the acquisition in October 2010 of the assets and ongoing business operations of General Testing and Inspection, Inc. ( GTI ), a business which provides in-house or shop inspection and non-destructive testing at the Cudahy premises. On February 11, 2011, while liquid hazardous waste was being pumped into the tanker truck of an unaffiliated certified hazardous waste transporter at the Cudahy facility, a chemical reaction occurred that caused an emission of a vapor cloud. No human injury or property damage was reported or appears to have been caused as a result of the incident. The incident was investigated by the L.A. Country Fire Department (the Fire Department ) and the U.S. Environmental Protection Agency ( EPA ). At the conclusion of the Fire Department s investigation, the Fire Department imposed on the Company a fine in the amount of \$4,000 for alleged violations of the California Health and Safety Code in April 2011, which was paid shortly thereafter.

The Company received no further governmental communications or notices concerning fines or sanctions related to the incident until January 13, 2012, when we received grand jury subpoenas from the U.S. Attorney s Office for the Central District of California addressed to the Company, GTI and an employee of the Company. These subpoenas were issued in connection with an EPA criminal investigation. The subpoena received by the Company requested documents and information relating to, among other things, our handling, identification, storage and disposal of hazardous waste, training records, corporate environmental policies, acquisition of GTI and any ongoing organization relationship with GTI, and analytical results of the tests concerning the hazardous materials involved in the incident. In April 2012, we were informed by the U.S. Attorney s Office for the Central District of California that we are a target of a criminal investigation into potential violations of the Resource Conservation and Recovery Act. The violations are alleged to be related to purportedly improper storage and labeling of hazardous waste at the Cudahy facility. This U.S. Attorney s Office also raised a concern about a possible obstruction of justice issue involving the conduct of one or more of our employees at this facility. Upon receiving the subpoenas, we engaged our outside legal counsel to assist us in conducting an investigation concerning the incident, including interviews with our current employees. To date, we have produced documents in response to the subpoena, and are aware of at least one of our employees having testified before the grand jury.

While management cannot predict the ultimate outcome of this matter, based on our internal investigation to date, management does not believe the outcome will have a material effect on the Company s financial condition or results of operations.

See Note 11 to the financial statements included in this report for a description of our other legal proceedings.

**ITEM 1.A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the risk factors discussed under the Risk Factors section included in our Annual Report on Form 10-K, filed with the SEC on August 12, 2011. There have been no material changes to the risk factors previously disclosed in the Annual Report.

**ITEM 2. Unregistered Sale of Equity Securities and Use of Proceeds**

*(a) Sales of Unregistered Securities*

None.

*(b) Use of Proceeds from Public Offering of Common Stock*

None.

*(c) Repurchases of Our Equity Securities*

None.

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**ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 10.1               | Third Amended and Restated Credit Agreement dated December 21, 2011.   |
| 31.1               | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934. |
| 31.2               | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934. |
| 32.1               | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                       |
| 101.INS            | XBRL Instance Document   |
| 101.SCH            | XBRL Schema Document   |
| 101.CAL            | XBRL Calculation Linkbase Document   |
| 101.LAB            | XBRL Labels Linkbase Document  |
| 101.PRE            | XBRL Presentation Linkbase Document  |
| 101.DEF            | XBRL Definition Linkbase Document  |

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**Signatures**

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

**MISTRAS GROUP, INC.**

By: */s/ FRANCIS T. JOYCE*  
Francis T. Joyce  
Executive Vice President, Chief Financial Officer and  
Treasurer  
(Principal Financial Officer and duly authorized  
officer)

Date: April 9, 2012