

QUANTA SERVICES INC

Form 10-Q

November 10, 2008

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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 September 30, 2008**
- ☐ or**
- ☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from        to**

**Commission file no. 001-13831**

**Quanta Services, Inc.**

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

**Delaware**

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

**74-2851603**

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

**1360 Post Oak Blvd.**

**Suite 2100**

**Houston, Texas 77056**

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

**(Registrant's telephone number, including area code)**

**(713) 629-7600**

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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 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 ☒

196,560,225 shares of Common Stock were outstanding as of November 3, 2008. As of the same date, 744,154 shares of Limited Vote Common Stock were outstanding.

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**QUANTA SERVICES, INC. AND SUBSIDIARIES**

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Table of Contents**QUANTA SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share information)

(Unaudited)

|                                                                                                                                | <b>December 31,<br/>2007</b> | <b>September 30,<br/>2008</b> |
|--------------------------------------------------------------------------------------------------------------------------------|------------------------------|-------------------------------|
| <b>ASSETS</b>                                                                                                                  |                              |                               |
| Current Assets:                                                                                                                |                              |                               |
| Cash and cash equivalents                                                                                                      | \$ 407,081                   | \$ 266,429                    |
| Accounts receivable, net of allowances of \$4,620 and \$6,001, respectively                                                    | 719,672                      | 958,931                       |
| Costs and estimated earnings in excess of billings on uncompleted contracts                                                    | 72,424                       | 71,492                        |
| Inventories                                                                                                                    | 25,920                       | 26,335                        |
| Prepaid expenses and other current assets                                                                                      | 79,665                       | 59,595                        |
| Total current assets                                                                                                           | 1,304,762                    | 1,382,782                     |
| Property and equipment, net of accumulated depreciation of \$300,178 and \$333,566, respectively                               | 532,285                      | 640,079                       |
| Other assets, net                                                                                                              | 42,992                       | 35,772                        |
| Intangible assets, net of accumulated amortization of \$20,915 and \$50,379, respectively                                      | 152,695                      | 144,262                       |
| Goodwill                                                                                                                       | 1,355,098                    | 1,359,674                     |
| Total assets                                                                                                                   | \$ 3,387,832                 | \$ 3,562,569                  |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                                                                                     |                              |                               |
| Current Liabilities:                                                                                                           |                              |                               |
| Current maturities of long-term debt                                                                                           | \$ 271,011                   | \$ 268,847                    |
| Accounts payable and accrued expenses                                                                                          | 420,815                      | 459,989                       |
| Billings in excess of costs and estimated earnings on uncompleted contracts                                                    | 65,603                       | 51,514                        |
| Total current liabilities                                                                                                      | 757,429                      | 780,350                       |
| Convertible subordinated notes                                                                                                 | 143,750                      | 143,750                       |
| Deferred income taxes                                                                                                          | 101,416                      | 79,580                        |
| Insurance and other non-current liabilities                                                                                    | 200,094                      | 219,417                       |
| Total liabilities                                                                                                              | 1,202,689                    | 1,223,097                     |
| Commitments and Contingencies                                                                                                  |                              |                               |
| Stockholders' Equity:                                                                                                          |                              |                               |
| Common stock, \$.00001 par value, 300,000,000 shares authorized, 172,455,951 and 174,805,974 shares issued and 170,255,631 and | 2                            | 2                             |

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172,418,188 shares outstanding, respectively

Limited Vote Common Stock, \$.00001 par value, 3,345,333 shares authorized,

760,171 and 748,381 shares issued and outstanding, respectively

|                                                                |              |              |
|----------------------------------------------------------------|--------------|--------------|
| Additional paid-in capital                                     | 2,423,349    | 2,464,776    |
| Accumulated deficit                                            | (214,191)    | (94,563)     |
| Accumulated other comprehensive income                         | 3,663        | 1,418        |
| Treasury stock, 2,200,320 and 2,387,786 common shares, at cost | (27,680)     | (32,161)     |
| Total stockholders' equity                                     | 2,185,143    | 2,339,472    |
| Total liabilities and stockholders' equity                     | \$ 3,387,832 | \$ 3,562,569 |

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

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

|                                                                                                                                             | <b>Three Months Ended</b> |              | <b>Nine Months Ended</b> |              |
|---------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|--------------|--------------------------|--------------|
|                                                                                                                                             | <b>September 30,</b>      |              | <b>September 30,</b>     |              |
|                                                                                                                                             | <b>2007</b>               | <b>2008</b>  | <b>2007</b>              | <b>2008</b>  |
| Revenues                                                                                                                                    | \$ 655,865                | \$ 1,053,355 | \$ 1,777,044             | \$ 2,858,679 |
| Cost of services (including depreciation)                                                                                                   | 540,812                   | 867,789      | 1,499,172                | 2,390,546    |
| Gross profit                                                                                                                                | 115,053                   | 185,566      | 277,872                  | 468,133      |
| Selling, general and administrative expenses                                                                                                | 59,816                    | 80,126       | 155,793                  | 227,134      |
| Amortization of intangible assets                                                                                                           | 4,868                     | 8,998        | 6,332                    | 29,464       |
| Operating income                                                                                                                            | 50,369                    | 96,442       | 115,747                  | 211,535      |
| Interest expense                                                                                                                            | (5,165)                   | (5,223)      | (16,261)                 | (15,642)     |
| Interest income                                                                                                                             | 5,389                     | 2,022        | 15,341                   | 8,105        |
| Loss on early extinguishment of debt                                                                                                        | (11)                      | (2)          | (11)                     | (2)          |
| Other income (expense), net                                                                                                                 | (702)                     | (74)         | (591)                    | 408          |
| Income from continuing operations before income tax provision                                                                               | 49,880                    | 93,165       | 114,225                  | 204,404      |
| Provision for income taxes                                                                                                                  | 2,930                     | 38,307       | 14,626                   | 84,776       |
| Income from continuing operations                                                                                                           | 46,950                    | 54,858       | 99,599                   | 119,628      |
| Discontinued operation:                                                                                                                     |                           |              |                          |              |
| Income from discontinued operation (net of income tax expense of \$1,046 and \$1,316 in the three and nine months ended September 30, 2007) | 2,371                     |              | 2,791                    |              |
| Net income                                                                                                                                  | \$ 49,321                 | \$ 54,858    | \$ 102,390               | \$ 119,628   |
| Basic earnings per share:                                                                                                                   |                           |              |                          |              |
| Income from continuing operations                                                                                                           | \$ 0.34                   | \$ 0.32      | \$ 0.80                  | \$ 0.70      |
| Income from discontinued operation                                                                                                          | 0.02                      |              | 0.02                     |              |
| Net income                                                                                                                                  | \$ 0.36                   | \$ 0.32      | \$ 0.82                  | \$ 0.70      |
| Weighted average basic shares outstanding                                                                                                   | 136,279                   | 171,693      | 124,362                  | 170,938      |
| Diluted earnings per share:                                                                                                                 |                           |              |                          |              |
| Income from continuing operations                                                                                                           | \$ 0.30                   | \$ 0.29      | \$ 0.70                  | \$ 0.64      |
| Income from discontinued operation                                                                                                          | 0.01                      |              | 0.02                     |              |
| Net income                                                                                                                                  | \$ 0.31                   | \$ 0.29      | \$ 0.72                  | \$ 0.64      |

|                                             |         |         |         |         |
|---------------------------------------------|---------|---------|---------|---------|
| Weighted average diluted shares outstanding | 167,869 | 203,131 | 155,828 | 202,292 |
|---------------------------------------------|---------|---------|---------|---------|

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

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

|                                                                                  | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|----------------------------------------------------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                                                                  | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                                                                  | <b>2007</b>               | <b>2008</b> | <b>2007</b>              | <b>2008</b> |
| Cash Flows from Operating Activities:                                            |                           |             |                          |             |
| Net income                                                                       | \$ 49,321                 | \$ 54,858   | \$ 102,390               | \$ 119,628  |
| Adjustments to reconcile net income to net cash provided by operating activities |                           |             |                          |             |
| Depreciation                                                                     | 13,792                    | 19,806      | 38,661                   | 57,986      |
| Amortization of intangibles                                                      | 4,868                     | 8,998       | 6,332                    | 29,464      |
| Amortization of debt issuance costs                                              | 649                       | 655         | 1,999                    | 1,964       |
| Amortization of deferred revenue                                                 | (687)                     | (2,635)     | (687)                    | (6,886)     |
| Loss (gain) on sale of property and equipment                                    | (1,095)                   | (841)       | (864)                    | (1,147)     |
| Gain on sale of discontinued operation                                           | (2,348)                   |             | (2,348)                  |             |
| Loss on early extinguishment of debt                                             | 11                        | 2           | 11                       | 2           |
| Provision for doubtful accounts                                                  | 642                       | 1,328       | 1,015                    | 4,230       |
| Provision for insurance receivable                                               |                           |             |                          | 3,375       |
| Deferred income tax provision                                                    | 5,846                     | 9,970       | 7,329                    | 7,747       |
| Non-cash stock-based compensation                                                | 2,464                     | 4,043       | 6,085                    | 12,402      |
| Tax impact of stock-based equity awards                                          | (1,559)                   | (318)       | (7,146)                  | (2,625)     |
| Non-cash loss on foreign currency derivative                                     | 497                       |             | 497                      |             |
| Changes in operating assets and liabilities, net of non-cash transactions        |                           |             |                          |             |
| (Increase) decrease in                                                           |                           |             |                          |             |
| Accounts and notes receivable                                                    | (41,823)                  | (139,659)   | (2,139)                  | (234,316)   |
| Costs and estimated earnings in excess of billings on uncompleted contracts      | 11,887                    | 10,624      | (1,119)                  | 7,118       |
| Inventories                                                                      | 725                       | 4,698       | 6,099                    | (213)       |
| Prepaid expenses and other current assets                                        | (3,194)                   | 10,308      | (3,417)                  | 9,886       |
| Increase (decrease) in                                                           |                           |             |                          |             |
| Accounts payable and accrued expenses and other non-current liabilities          | (8,245)                   | 33,193      | (42,549)                 | 55,910      |
| Billings in excess of costs and estimated earnings on uncompleted contracts      | 9,175                     | 2,826       | 4,462                    | (14,271)    |
| Other, net                                                                       | 1,854                     | (1,040)     | 647                      | (136)       |
| Net cash provided by operating activities                                        | 42,780                    | 16,816      | 115,258                  | 50,118      |
| Cash Flows from Investing Activities:                                            |                           |             |                          |             |
| Proceeds from sale of property and equipment                                     | 10,472                    | 2,058       | 14,746                   | 11,122      |
| Additions of property and equipment                                              | (18,958)                  | (51,776)    | (61,023)                 | (164,925)   |
| Cash paid for acquisitions, net of cash acquired                                 | 20,596                    | (4,819)     | 862                      | (27,728)    |

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|                                                                      |            |             |             |             |
|----------------------------------------------------------------------|------------|-------------|-------------|-------------|
| Cash paid for developed technology                                   |            |             |             | (14,573)    |
| Purchases of short-term investments                                  |            |             | (309,055)   |             |
| Proceeds from the sale of short-term investments                     |            |             | 309,055     |             |
| Net cash provided by (used in) investing activities                  | 12,110     | (54,537)    | (45,415)    | (196,104)   |
| Cash Flows from Financing Activities:                                |            |             |             |             |
| Proceeds from other long-term debt                                   | 330        |             | 5,205       | 635         |
| Repayments of convertible subordinated notes                         | (33,273)   | (1)         | (33,273)    | (1)         |
| Payments on other long-term debt                                     | (60,869)   | (45)        | (67,400)    | (1,643)     |
| Debt issuance and amendment costs                                    | (875)      |             | (875)       |             |
| Tax impact of stock-based equity awards                              | 1,559      | 318         | 7,146       | 2,625       |
| Exercise of stock options                                            | 2,219      | 315         | 5,440       | 5,963       |
| Net cash provided by (used in) financing activities                  | (90,909)   | 587         | (83,757)    | 7,579       |
| Net decrease in cash and cash equivalents                            | (36,019)   | (37,134)    | (13,914)    | (138,407)   |
| Effect of foreign exchange rate changes on cash and cash equivalents | 1,697      | (1,228)     | 1,697       | (2,245)     |
| Cash and cash equivalents, beginning of period                       | 405,792    | 304,791     | 383,687     | 407,081     |
| Cash and cash equivalents, end of period                             | \$ 371,470 | \$ 266,429  | \$ 371,470  | \$ 266,429  |
| Supplemental disclosure of cash flow information                     |            |             |             |             |
| Cash (paid) received during the period for                           |            |             |             |             |
| Interest paid                                                        | \$ (781)   | \$ (148)    | \$ (10,517) | \$ (9,285)  |
| Income taxes paid                                                    | \$ (7,234) | \$ (25,478) | \$ (35,827) | \$ (60,933) |
| Income tax refunds                                                   | \$ 46      | \$ 171      | \$ 202      | \$ 656      |

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

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**QUANTA SERVICES INC. AND SUBSIDIARIES**

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

**1. BUSINESS AND ORGANIZATION:**

Quanta Services, Inc. (Quanta) is a leading national provider of specialized contracting services. Beginning January 1, 2008, Quanta began reporting its results under two business segments. The infrastructure services (Infrastructure Services) segment provides specialized contracting services, offering end-to-end network solutions to the electric power, gas, telecommunications and cable television industries, including the design, installation, repair and maintenance of network infrastructure, as well as certain ancillary services. Additionally, the dark fiber (Dark Fiber) segment designs, procures, constructs and maintains fiber-optic telecommunications infrastructure in select markets and licenses the right to use point-to-point fiber-optic telecommunications facilities to its customers. Prior to January 1, 2008, Quanta reported results under one business segment, which consisted primarily of the services now under the Infrastructure Services segment.

On August 30, 2007, Quanta acquired, through a merger transaction (the Merger), all of the outstanding common stock of InfraSource Services, Inc. (InfraSource). For accounting purposes, the transaction was effective as of August 31, 2007, and results of InfraSource's operations have been included in the consolidated financial statements subsequent to August 31, 2007. Accordingly, the condensed consolidated financial statements for the three and nine month periods ended September 30, 2007 only include results from InfraSource's operations for one month. Similar to Quanta, InfraSource provided specialized infrastructure contracting services to the electric power, gas and telecommunications industries primarily in the United States. The acquisition enhanced and expanded Quanta's capabilities in its existing service areas and added the Dark Fiber segment.

On August 31, 2007, Quanta sold the operating assets associated with the business of Environmental Professional Associates, Limited (EPA), a Quanta subsidiary. Accordingly, Quanta has presented EPA's results of operations for the 2007 periods as a discontinued operation in the accompanying consolidated statements of operations.

*Interim Condensed Consolidated Financial Information*

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

Quanta recommends that these unaudited condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto of Quanta and its subsidiaries included in Quanta's Annual Report on Form 10-K for the year ended December 31, 2007, which was filed with the SEC on February 29, 2008.

*Use of Estimates and Assumptions*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates and assumptions by management in determining the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities known to exist as of the date the financial statements are published and the reported amount of revenues and expenses recognized during the periods presented. Quanta reviews all significant estimates affecting its consolidated financial statements on a recurring basis and records the effect of any necessary adjustments prior to their publication. Judgments and estimates are

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**QUANTA SERVICES INC. AND SUBSIDIARIES**

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

based on Quanta's beliefs and assumptions derived from information available at the time such judgments and estimates are made. Uncertainties with respect to such estimates and assumptions are inherent in the preparation of financial statements. Estimates are primarily used in Quanta's assessment of the allowance for doubtful accounts, valuation of inventory, useful lives of assets, fair value assumptions in analyzing goodwill, other intangibles and long-lived asset impairments, self-insured claims liabilities, revenue recognition for construction contracts and for dark fiber licensing, share-based compensation, provision for income taxes and purchase price allocations.

*Reclassifications*

Certain reclassifications have been made in prior years' financial statements to conform to classifications used in the current year.

*Cash and Cash Equivalents*

Cash and cash equivalents include interest-bearing demand deposits and investment grade commercial paper with original maturities of three months or less and are carried at cost, which approximates fair value. As of December 31, 2007 and September 30, 2008, cash held in domestic bank accounts was approximately \$405.4 million and \$260.0 million and cash held in foreign bank accounts was approximately \$1.7 million and \$6.4 million.

*Short-Term Investments*

Quanta held no short-term investments as of December 31, 2007 or September 30, 2008; however, during the first quarter of 2007, Quanta invested from time to time in variable rate demand notes (VRDNs), which were classified as short-term investments, available for sale when held. The income from VRDNs was tax-exempt to Quanta.

*Accounts Receivable and Allowance for Doubtful Accounts*

Quanta provides an allowance for doubtful accounts when collection of an account or note receivable is considered doubtful, and receivables are written off against the allowance when deemed uncollectible. Inherent in the assessment of the allowance for doubtful accounts are certain judgments and estimates including, among others, the customer's access to capital, the customer's willingness or ability to pay, general economic conditions and the ongoing relationship with the customer. Under certain circumstances such as foreclosures or negotiated settlements, Quanta may take title to the underlying assets in lieu of cash in settlement of receivables. Material changes in Quanta's customers' business or cash flows, which may be further impacted by the current financial crisis and volatility of the markets, could affect its ability to collect amounts due from them. As of September 30, 2008, Quanta had total allowances for doubtful accounts of approximately \$6.0 million. Should customers experience financial difficulties or file for bankruptcy, or should anticipated recoveries relating to receivables in existing bankruptcies or other workout situations fail to materialize, Quanta could experience reduced cash flows and losses in excess of current allowances provided.

The balances billed but not paid by customers pursuant to retainage provisions in certain contracts will be due upon completion of the contracts and acceptance by the customer. Based on Quanta's experience with similar contracts in recent years, the majority of the retainage balances at each balance sheet date will be collected within the subsequent fiscal year. Current retainage balances as of December 31, 2007 and September 30, 2008 were approximately

\$60.2 million and \$91.6 million and are included in accounts receivable. Retainage balances with settlement dates beyond the next twelve months are included in other assets, net and as of December 31, 2007 and September 30, 2008 were \$2.1 million and \$5.3 million.

Within accounts receivable, Quanta recognizes unbilled receivables in circumstances such as when revenues have been earned and recorded but the amount cannot be billed under the terms of the contract until a later date,

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**QUANTA SERVICES INC. AND SUBSIDIARIES**

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

costs have been incurred but are yet to be billed under cost-reimbursement type contracts, or amounts arise from routine lags in billing (for example, work completed in one month but not billed until the next month). These balances do not include revenues accrued for work performed under fixed price contracts as these amounts are recorded as costs and estimated earnings in excess of billings on uncompleted contracts. At December 31, 2007 and September 30, 2008, the balances of unbilled receivables included in accounts receivable were approximately \$132.3 million and \$212.8 million.

As of December 31, 2007, other assets, net included accounts and notes receivable due from a customer relating to the construction of independent power plants. During 2006, the underlying assets which had secured these notes receivable were sold pursuant to liquidation proceedings and the net proceeds were being held by a trustee. Quanta recorded allowances for a significant portion of these notes receivable in prior periods. As of December 31, 2007, the collection of amounts owed Quanta were subject to further legal proceedings; however, in March 2008, the parties reached a settlement resulting in the payment of the net receivable amount and the release of any future claims against Quanta. The remaining note receivable balance was written off against the related allowance of approximately \$43.0 million in March 2008, without any significant impact to Quanta's results of operations for the nine months ended September 30, 2008.

*Income Taxes*

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

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

Quanta accounts for uncertain tax positions in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes. An Interpretation of SFAS No. 109, Accounting for Income Taxes (FIN No. 48). FIN No. 48 prescribes a comprehensive model for how companies should recognize, measure, present and disclose in their financial statements uncertain tax positions taken or to be taken on a tax return.

As of September 30, 2008, the total amount of unrecognized tax benefits relating to uncertain tax positions was \$56.7 million, an increase from December 31, 2007 of \$7.4 million related to tax positions expected to be taken for 2008. Additionally, for the three and nine months ended September 30, 2008, Quanta recognized \$1.2 million and \$4.0 million of interest and penalties in the provision for income taxes. Quanta believes that it is reasonably possible that within the next 12 months unrecognized tax benefits will decrease \$16.5 million to \$18.3 million due to the expiration of certain statutes of limitations.

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The income tax laws and regulations are voluminous and often ambiguous. As such, Quanta is required to make many subjective assumptions and judgments regarding its tax positions that could materially affect amounts recognized in its future consolidated balance sheets and statements of operations.

Quanta is subject to income tax in the United States, multiple state jurisdictions and a few foreign jurisdictions. Quanta does not consider any state in which it does business to be a major tax jurisdiction under FIN No. 48.

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**QUANTA SERVICES INC. AND SUBSIDIARIES**

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

*Revenue Recognition*

**Infrastructure Services** Quanta designs, installs and maintains networks for the electric power, gas, telecommunications and cable television industries, as well as provides various ancillary services to commercial, industrial and governmental entities. These services may be provided pursuant to master service agreements, repair and maintenance contracts and fixed price and non-fixed price installation contracts. Pricing under these contracts may be competitive unit price, cost-plus/hourly (or time and materials basis) or fixed price (or lump sum basis), and the final terms and prices of these contracts are frequently negotiated with the customer. Under unit-based contracts, the utilization of an output-based measurement is appropriate for revenue recognition. Under these contracts, Quanta recognizes revenue when units are completed based on pricing established between Quanta and the customer for each unit of delivery, which best reflects the pattern in which the obligation to the customer is fulfilled. Under cost-plus/hourly and time and materials type contracts, Quanta recognizes revenue on an input-basis, as labor hours are incurred and services are performed.

Revenues from fixed price contracts are recognized using the percentage-of-completion method, measured by the percentage of costs incurred to date to total estimated costs for each contract. These contracts provide for a fixed amount of revenues for the entire project. Such contracts provide that the customer accept completion of progress to date and compensate Quanta for services rendered, measured in terms of units installed, hours expended or some other measure of progress. Contract costs include all direct material, labor and subcontract costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. Much of the materials associated with Quanta's work are owner-furnished and are therefore not included in contract revenues and costs. The cost estimation process is based on the professional knowledge and experience of Quanta's engineers, project managers and financial professionals. Changes in job performance, job conditions and final contract settlements are factors that influence management's assessment of the total estimated costs to complete those contracts and therefore, Quanta's profit recognition. Changes in these factors may result in revisions to costs and income, and their effects are recognized in the period in which the revisions are determined. Provisions for the total estimated losses on uncompleted contracts are made in the period in which such losses are determined.

Quanta may incur costs subject to change orders, whether approved or unapproved by the customer, and/or claims related to certain contracts. Quanta determines the probability that such costs will be recovered based upon evidence such as past practices with the customer, specific discussions or preliminary negotiations with the customer or verbal approvals. Quanta treats items as a cost of contract performance in the period incurred if it is not probable that the costs will be recovered or will recognize revenue if it is probable that the contract price will be adjusted and can be reliably estimated.

The current asset Costs and estimated earnings in excess of billings on uncompleted contracts represents revenues recognized in excess of amounts billed for fixed price contracts. The current liability Billings in excess of costs and estimated earnings on uncompleted contracts represents billings in excess of revenues recognized for fixed price contracts.

**Dark Fiber** Quanta has fiber-optic facility licensing agreements with various customers, pursuant to which it recognizes revenues, including any initial fees or advance billings, ratably over the expected length of the agreements, including probable renewal periods. As of December 31, 2007 and September 30, 2008, initial fees and advanced billings on these licensing agreements not yet recorded in revenue were \$23.2 million and \$31.8 million and are

recognized as deferred revenue, with \$15.6 million and \$22.4 million considered to be long-term and included in other non-current liabilities.

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

The Dark Fiber segment constructs and licenses the right to use fiber-optic telecommunications facilities to its customers pursuant to licensing agreements, typically with terms from five to twenty-five years, inclusive of certain renewal options. Under those agreements, customers are provided the right to use a portion of the capacity of a fiber-optic facility, with the facility owned and maintained by Quanta. Minimum future licensing revenue expected to be received by Quanta pursuant to these agreements at September 30, 2008 are as follows (in thousands):

|                                                 | <b>Minimum<br/>Future<br/>Licensing<br/>Revenues</b> |
|-------------------------------------------------|------------------------------------------------------|
| Year Ending December 31                         |                                                      |
| Remainder of 2008                               | \$ 10,584                                            |
| 2009                                            | 38,941                                               |
| 2010                                            | 32,027                                               |
| 2011                                            | 24,211                                               |
| 2012                                            | 17,759                                               |
| Thereafter                                      | 53,666                                               |
| Fixed non-cancelable minimum licensing revenues | \$ 177,188                                           |

*Stock-Based Compensation*

Effective January 1, 2006, Quanta adopted SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)), using the modified prospective method of adoption, which requires recognition of compensation expense for all stock-based compensation beginning on the effective date. Under this method of accounting, compensation cost for stock-based compensation awards is based on the fair value of the awards granted, net of estimated forfeitures, at the date of grant. Quanta calculates the fair value of stock options using the Black-Scholes option pricing model. The fair value of restricted stock awards is determined based on the number of shares granted and the closing price of Quanta's common stock on the date of the grant. Forfeitures are estimated based upon historical activity. The resulting compensation expense from discretionary awards is recognized on a straight-line basis over the requisite service period, which is generally the vesting period, while compensation expense from performance based awards is recognized using the graded vesting method over the requisite service period. SFAS No. 123(R) requires the cash flows resulting from the tax deductions in excess of the compensation cost recognized during the applicable period be classified as financing cash flows.

*New Accounting Pronouncements*

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes methods used to measure fair value and expands disclosure requirements about fair value measurements.

SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal periods, as it relates to financial assets and liabilities, as well as for any non-financial assets and liabilities that are carried at fair value. SFAS No. 157 also requires certain tabular disclosures related to the application of SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets and SFAS No. 142, Goodwill and Other Intangible Assets. On November 14, 2007, the FASB provided a one year deferral for the implementation of SFAS No. 157 for non-financial assets and liabilities. SFAS No. 157 excludes from its scope SFAS No. 123(R) and its related interpretive accounting pronouncements that address share-based payment transactions. Quanta adopted SFAS No. 157 on January 1, 2008 as it applies to its

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

financial assets and liabilities, and based on the November 14, 2007 deferral of SFAS No. 157 for non-financial assets and liabilities, Quanta will begin following the guidance of SFAS No. 157 with respect to its non-financial assets and liabilities in the quarter ended March 31, 2009. Quanta does not currently have any material financial assets and liabilities recognized on its balance sheet that are impacted by the partial adoption of SFAS No. 157. Additionally, Quanta does not currently have any material non-financial assets or liabilities that are carried at fair value on a recurring basis; however, Quanta does have non-financial assets that are evaluated against measures of fair value on a non-recurring or as-needed basis, including goodwill, other intangibles and long-term assets held and used. Based on the financial and non-financial assets and liabilities on its balance sheet as of September 30, 2008, Quanta does not expect the full adoption of SFAS No. 157 to have a material impact on its consolidated financial position, results of operations or cash flows. In October 2008, the FASB issued FASB Staff Position FSP FAS 157-3 Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. FSP FAS 157-3 provides clarifying guidance with respect to the application of SFAS No. 157 in determining the fair value of a financial asset when the market for that asset is not active. FSP FAS 157-3 was effective upon its issuance. The application of FSP FAS 157-3 did not have a material impact on Quanta's consolidated financial position, results of operations or cash flows.

On January 1, 2008, Quanta adopted SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB No. 115. SFAS No. 159 permits entities to choose to measure at fair value many financial instruments and certain other items that were not previously required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value. The adoption of SFAS No. 159 did not have any material impact on Quanta's consolidated financial position, results of operations or cash flows.

On January 1, 2008, Quanta adopted EITF Issue No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. EITF 06-11 requires that a realized income tax benefit from dividends or dividend equivalent units paid on unvested restricted shares and restricted share units be reflected as an increase in contributed surplus and as an addition to the company's excess tax benefit pool, as defined under SFAS No. 123(R). Because Quanta did not declare any dividends during the first nine months of 2008 and does not currently anticipate declaring dividends in the near future, the adoption of EITF 06-11 did not have any impact during the first nine months of 2008, and is not expected to have a material impact in the near term, on Quanta's consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51. SFAS No. 160 addresses the accounting and reporting framework for minority interests by a parent company. SFAS No. 160 is to be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Accordingly, Quanta will adopt SFAS No. 160 on January 1, 2009. As Quanta does not currently have any subsidiaries with non-controlling interests, the adoption of SFAS No. 160 is not anticipated to have a material impact on its consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. Earlier application is prohibited. Assets and liabilities that arose from business combinations occurring prior to the adoption of SFAS No. 141(R) cannot be adjusted upon the adoption of SFAS No. 141(R). SFAS No. 141(R) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the business combination; establishes the acquisition date as the

measurement date to determine the fair value for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information needed to evaluate and understand the nature and financial effect of the business combination. As it relates to recognizing all (and only) the assets acquired and liabilities assumed in a business combination, costs an acquirer expects but is not obligated to incur in the future to exit an activity of an acquiree or to terminate or relocate an acquiree's employees are not

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

liabilities at the acquisition date but must be expensed in accordance with other applicable generally accepted accounting principles. If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer must report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, which must not exceed one year from the acquisition date, the acquirer will retrospectively adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date. The acquirer will be required to expense all acquisition-related costs in the periods such costs are incurred, other than costs to issue debt or equity securities in connection with the acquisition. Quanta does not expect SFAS No. 141(R) to have an impact on Quanta's consolidated financial position, results of operations or cash flows at the date of adoption, but it could have a material impact on its consolidated financial position, results of operations or cash flows in future periods when it is applied to acquisitions that occur in 2009 and beyond.

In December 2007, the SEC published Staff Accounting Bulletin (SAB) No. 110 (SAB 110). SAB 110 expresses the views of the SEC staff regarding the use of a simplified method, as discussed in SAB No. 107 (SAB 107), in developing an estimate of the expected term of plain vanilla share options in accordance with SFAS No. 123(R). In particular, the SEC staff indicated in SAB 107 that it will accept a company's election to use the simplified method, regardless of whether the company has sufficient information to make more refined estimates of the expected term. However, the SEC staff stated in SAB 107 that it would not expect a company to use the simplified method for share option grants after December 31, 2007. In SAB 110, the SEC staff states that they would continue to accept, under certain circumstances, the use of the simplified method beyond December 31, 2007. Because Quanta currently does not anticipate issuing stock options in the near future, SAB 110 is not anticipated to have a material impact on its consolidated financial position, results of operations or cash flows in the near term.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities. An Amendment of FASB No. 133. SFAS No. 161 requires enhanced disclosures to enable investors to better understand how a reporting entity's derivative instruments and hedging activities impact the entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued after November 15, 2008, including interim financial statements. Although early application is encouraged, Quanta will adopt SFAS No. 161 on January 1, 2009. As Quanta has not entered into any material derivatives or hedging activities, SFAS No. 161 is not anticipated to have a material impact on Quanta's consolidated financial position, results of operations, cash flows or disclosures.

In April 2008, the FASB issued FSP 142-3, Determination of the Useful Life of Intangible Assets. FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142. The intent of FSP 142-3 is to improve the consistency between the useful life of an intangible asset and the period of expected cash flows used to measure its fair value and to enhance existing disclosure requirements relating to intangible assets. FSP 142-3 is effective for fiscal years beginning after December 15, 2008 and should be applied prospectively to intangible assets acquired after the effective date. Early adoption is not permitted. Accordingly, Quanta will adopt FSP 142-3 on January 1, 2009. Quanta does not anticipate FSP 142-3 to have an impact on its consolidated financial position, results of operations or cash flows at the date of adoption, but it could have a material impact on its consolidated financial position, results of operations or cash flows in future periods.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of non-governmental entities that are presented in conformity with generally accepted accounting principles in the United States. SFAS No. 162 will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. Quanta will adopt

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**QUANTA SERVICES INC. AND SUBSIDIARIES**

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

SFAS No. 162 once it is effective, but has not yet determined the impact, if any, on its consolidated financial statements.

In May 2008, the FASB issued FSP APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). FSP APB 14-1 will require issuers of convertible debt instruments within its scope to first determine the carrying amount of the liability component of the convertible debt by measuring the fair value of a similar liability that does not have an associated equity component. Issuers will then calculate the carrying amount of the equity component represented by the embedded conversion option by deducting the fair value of the liability component from the initial proceeds ascribed to the convertible debt instrument as a whole. The excess of the principal amount of the liability component over its initial fair value will be amortized to interest expense using the effective interest method. FSP APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Accordingly, Quanta will adopt FSP APB 14-1 on January 1, 2009, and will apply FSP APB 14-1 retrospectively to all periods presented. For periods prior to those presented, Quanta will record a cumulative effect of the change in accounting principle as of the beginning of the first period presented. The impact of FSP APB 14-1 may be material to Quanta's results of operations during certain periods but is not expected to materially impact its cash flows. Quanta is in the process of determining the cumulative effect of the change in accounting principle and the impact to its consolidated financial position, results of operations and cash flows for all periods presented.

In June 2008, the FASB issued Staff Position EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. EITF 03-6-1 states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities under the definition of SFAS No. 128, Earnings per Share and should be included in the computation of both basic and diluted earnings per share. EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. Accordingly, Quanta will adopt EITF 03-6-1 on January 1, 2009. All prior period earnings per share data presented will be adjusted retrospectively to conform to the provisions of EITF 03-6-1. Early application is not permitted. Quanta has granted unvested share-based payment awards that have non-forfeitable rights to dividends in the form of restricted stock awards, which are currently accounted for under the treasury stock method in diluted earnings per share. The treasury stock method specifies that only unvested restricted common shares that are dilutive be included in weighted average diluted shares outstanding. Under EITF 03-6-1, Quanta will retrospectively restate earnings per share data for prior periods beginning in the first quarter of 2009 to include all unvested restricted common shares as participating securities as of the date of grant. The adoption of EITF 03-6-1 is not anticipated to have any material impact on Quanta's consolidated financial position, results of operations or cash flows but may lower basic and diluted earnings per share amounts previously reported due to the inclusion of the additional shares in computing these amounts.

In June 2008, the FASB ratified EITF Issue 07-5, Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock (EITF 07-5). The primary objective of EITF 07-5 is to provide guidance for determining whether an equity-linked financial instrument or embedded feature within a contract is indexed to an entity's own stock, which is a key criterion of the scope exception to paragraph 11(a) of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. This criterion is also important in evaluating whether EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock applies to certain financial instruments that are not derivatives under SFAS No. 133. An equity-linked financial instrument or embedded feature within a contract that is not considered indexed to an entity's own stock could be

required to be classified as an asset or liability and marked-to-market through earnings. EITF 07-5 specifies a two-step approach in evaluating whether an equity-linked financial instrument or embedded feature within a contract is indexed to its own stock. The first step involves evaluating the instrument's contingent exercise provisions, if any, and the second step involves evaluating the instrument's settlement provisions. EITF 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and must be applied to all instruments outstanding as of the effective date. Accordingly, Quanta will adopt EITF 07-5 on January 1, 2009,

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but has not yet determined the impact, if any, on its consolidated financial position, results of operations and cash flows.

**2. ACQUISITIONS:***InfraSource Acquisition*

On August 30, 2007, Quanta acquired through the Merger all of the outstanding common stock of InfraSource. In connection with the acquisition, Quanta issued to InfraSource's stockholders 1.223 shares of Quanta common stock for each outstanding share of InfraSource common stock, resulting in the issuance of a total of 49,975,553 shares of common stock for an aggregate purchase price of approximately \$1.3 billion.

The following summarizes the allocation of the purchase price and estimated transaction costs related to the InfraSource acquisition. This allocation is based on the significant use of estimates and on information that was available to management at the time these condensed consolidated financial statements were prepared.

The following table summarizes the estimated fair values (in thousands):

|                               | <b>August 31,<br/>2007</b> |
|-------------------------------|----------------------------|
| Current assets                | \$ 288,300                 |
| Non-current assets            | 9,277                      |
| Property and equipment        | 209,724                    |
| Intangible assets             | 158,840                    |
| Goodwill                      | 962,020                    |
| <br>Total assets acquired     | <br>1,628,161              |
| <br>Current liabilities       | <br>197,260                |
| Long-term liabilities         | 156,382                    |
| <br>Total liabilities assumed | <br>353,642                |
| <br>Net assets acquired       | <br>\$ 1,274,519           |

Additionally, Quanta incurred approximately \$12.1 million of costs related to the Merger which have been included in goodwill but are not in the above purchase price allocation.

The amounts assigned to various intangible assets at August 31, 2007 related to the InfraSource acquisition are customer relationships of \$95.3 million, backlog of \$50.5 million and non-compete agreements of \$13.0 million. The customer relationships are being amortized on a straight-line basis over 15.0 years, backlog is being amortized based

on the estimated pattern of the consumption of the economic benefit over an original weighted average period of 1.3 years and the non-compete agreements are being amortized on a straight-line basis over the lives of the underlying contracts over the original weighted average period of 2.0 years.

Goodwill represents the excess of the purchase price over the fair value of the acquired net assets. Quanta anticipates it will continue to realize meaningful operational and cost synergies, such as enhancing the combined service offerings, expanding the geographic reach and resource base of the combined company, improving the utilization of personnel and fixed assets, eliminating duplicate corporate functions, as well as accelerating revenue growth through enhanced cross-selling and marketing opportunities. Quanta believes these opportunities contribute to the recognition of the substantial goodwill.

The following unaudited supplemental pro forma results of operations have been provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined company for the periods presented or that may be achieved by the combined company in the future.

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Future results may vary significantly from the results reflected in the following pro forma financial information because of future events and transactions, as well as other factors. The following pro forma results of operations have been provided for the three and nine months ended September 30, 2007 as though the Merger had been completed as of January 1, 2007 (in thousands except per share amounts).

|                                                | <b>Three Months<br/>Ended<br/>September 30, 2007</b> | <b>Nine Months Ended<br/>September 30, 2007</b> |
|------------------------------------------------|------------------------------------------------------|-------------------------------------------------|
| Revenues                                       | \$ 818,835                                           | \$ 2,383,390                                    |
| Gross profit                                   | \$ 138,270                                           | \$ 370,149                                      |
| Selling, general and administrative expenses   | \$ 86,064                                            | \$ 237,168                                      |
| Amortization of intangible assets              | \$ 13,936                                            | \$ 37,254                                       |
| Income from continuing operations              | \$ 40,492                                            | \$ 89,403                                       |
| Net income                                     | \$ 42,849                                            | \$ 92,169                                       |
| Earnings per share from continuing operations: |                                                      |                                                 |
| Basic                                          | \$ 0.24                                              | \$ 0.53                                         |
| Fully diluted                                  | \$ 0.22                                              | \$ 0.49                                         |

The pro forma combined results of operations have been prepared by adjusting the historical results of Quanta to include the historical results of InfraSource prior to the Merger, the reduction in interest expense and interest income as a result of the repayment of InfraSource's outstanding indebtedness on the acquisition date and certain reclassifications to conform InfraSource's presentation to Quanta's accounting policies. The pro forma results of operations do not include any cost savings that may result from the Merger or any estimated costs that have been or will be incurred by Quanta to integrate the businesses. As noted above, the pro forma results of operations do not purport to be indicative of the actual results that would have been achieved by the combined company for the periods presented or that may be achieved by the combined company in the future. For example, Quanta recorded tax benefits in the first and third quarters of 2007 of \$15.3 million and \$17.9 million primarily due to a decrease in reserves for uncertain tax positions resulting from the settlement of a multi-year IRS audit. Additionally, InfraSource incurred \$9.3 million and \$13.4 million of Merger-related costs in the three and nine months ended September 30, 2007 that have not been eliminated in the pro forma results of operations above. Items such as these, coupled with other risk factors that could have affected the combined company and its operations, make it difficult to use the pro forma results of operations to project future results of operations.

*Other Acquisitions*

In July 2008, Quanta acquired a helicopter-assisted transmission line construction, maintenance and repair services company for a purchase price of approximately \$6.1 million, consisting of approximately \$3.8 million in cash and 82,862 shares of Quanta common stock valued at approximately \$2.3 million at the date of acquisition on a discounted basis as a result of the restricted nature of the shares. The acquisition allows Quanta to augment its existing transmission resources and better position Quanta to meet the evolving needs of its customers, especially in environmentally sensitive areas. The estimated fair value of the tangible assets acquired was \$3.0 million, consisting of current assets of \$0.6 million and property and equipment of \$2.4 million. Net tangible assets acquired were

\$2.9 million after considering the assumed liabilities of \$0.1 million. The excess of the purchase price over net tangible assets acquired was recorded as goodwill in the amount of \$2.6 million and intangible assets in the amount of \$0.6 million, consisting of non-compete agreements. This allocation is based on the significant use of estimates and on information that was available to management at the time these condensed consolidated financial statements were prepared. Portions of the allocation of purchase price are preliminary. Accordingly, the allocation will change as management continues to assess available information, and the impact of such changes may be material.

In April 2008, Quanta acquired a telecommunication and cable construction company for a purchase price of approximately \$37.7 million, consisting of approximately \$23.7 million in cash and 593,470 shares of Quanta

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common stock valued at approximately \$14.0 million at the date of acquisition on a discounted basis as a result of the restricted nature of the shares. The acquisition allows Quanta to further expand its telecommunications and cable capabilities in the southwestern United States. The estimated fair value of the tangible assets acquired was \$21.1 million, consisting of current assets of \$14.2 million, property and equipment of \$6.8 million and other non-current assets of \$0.1 million. Net tangible assets acquired were \$14.3 million after considering the assumed liabilities of \$6.8 million. The excess of the purchase price over net tangible assets acquired was recorded as goodwill in the amount of \$17.5 million and intangible assets in the amount of \$5.9 million, consisting of customer relationships, backlog and a non-compete agreement. This allocation is based on the significant use of estimates and on information that was available to management at the time these condensed consolidated financial statements were prepared. Portions of the allocation of purchase price are preliminary. Accordingly, the allocation will change as management continues to assess available information, and the impact of such changes may be material.

**3. GOODWILL AND INTANGIBLE ASSETS:**

A summary of changes in Quanta's goodwill between December 31, 2007 and September 30, 2008 is as follows (in thousands):

|                                                                                                  | <b>Total</b> |
|--------------------------------------------------------------------------------------------------|--------------|
| Balance at December 31, 2007                                                                     | \$ 1,355,098 |
| Acquisition of a telecommunication and cable construction company in April 2008                  | 17,529       |
| Acquisition of helicopter-assisted transmission line services company in July 2008               | 2,624        |
| Purchase price adjustments related to acquisitions which closed subsequent to September 30, 2007 | (15,577)     |
| Balance at September 30, 2008                                                                    | \$ 1,359,674 |

Intangible assets are comprised of (in thousands):

|                                          | <b>December 31,<br/>2007</b> | <b>September 30,<br/>2008</b> |
|------------------------------------------|------------------------------|-------------------------------|
| Intangible assets:                       |                              |                               |
| Customer relationships                   | \$ 104,834                   | \$ 109,474                    |
| Backlog                                  | 53,242                       | 53,500                        |
| Non-compete agreements                   | 14,030                       | 15,589                        |
| Patented rights and developed technology | 1,504                        | 16,078                        |
| Total intangible assets                  | 173,610                      | 194,641                       |
| Accumulated amortization:                |                              |                               |
| Customer relationships                   | (4,054)                      | (9,515)                       |

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|                                          |            |            |
|------------------------------------------|------------|------------|
| Backlog                                  | (14,274)   | (34,262)   |
| Non-compete agreements                   | (1,644)    | (5,194)    |
| Patented rights and developed technology | (943)      | (1,408)    |
| Total accumulated amortization           | (20,915)   | (50,379)   |
| Intangible assets, net                   | \$ 152,695 | \$ 144,262 |

In May 2008, Quanta acquired the rights to certain developed technology, along with pending and issued patent protections to this technology, for approximately \$14.6 million. This developed technology will enhance Quanta's energized services capabilities and is being amortized on a straight-line basis over an estimated economic life of approximately 13 years. The acquired technology is included in patented rights and developed technology in the above table.

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Expenses for the amortization of intangible assets were \$4.9 million and \$9.0 million for the three months ended September 30, 2007 and 2008, and \$6.3 million and \$29.5 million for the nine months ended September 30, 2007 and 2008. The remaining weighted average amortization period for all intangible assets as of September 30, 2008 is 11.3 years, while the remaining weighted average amortization periods for customer relationships, backlog, non-compete agreements and the patented rights and developed technology are 13.9 years, 1.9 years, 2.8 years and 11.9 years, respectively. The estimated future aggregate amortization expense of intangible assets as of September 30, 2008 is set forth below (in thousands):

**For the Fiscal Year Ended December 31,  
Remainder of 2008**

|              |                   |
|--------------|-------------------|
|              | \$ 6,733          |
| 2009         | 18,786            |
| 2010         | 13,871            |
| 2011         | 12,727            |
| 2012         | 13,526            |
| Thereafter   | 78,619            |
| <b>Total</b> | <b>\$ 144,262</b> |

**4. DISCONTINUED OPERATION:**

On August 31, 2007, Quanta sold the operating assets associated with the business of EPA, a Quanta subsidiary, for approximately \$6.0 million in cash. Quanta has presented EPA's results of operations for the three and nine months ended September 30, 2007 as a discontinued operation in the accompanying condensed consolidated statements of operations. Quanta does not allocate corporate debt or interest expense to discontinued operations. As a result of the sale, a pre-tax gain of approximately \$3.7 million was recorded in the three and nine months ended September 30, 2007 and included as income from discontinued operation in the consolidated income statements for such periods.

The amounts of revenues and pre-tax income (including the pre-tax gain of \$3.7 million in the three and nine months ended September 30, 2007) related to EPA and included in income from discontinued operation are as follows (in thousands):

|                                    | <b>Three Months<br/>Ended<br/>September 30,<br/>2007      2008</b> |    | <b>Nine Months Ended<br/>September 30,<br/>2007      2008</b> |    |
|------------------------------------|--------------------------------------------------------------------|----|---------------------------------------------------------------|----|
| Revenues                           | \$ 3,392                                                           | \$ | \$ 14,693                                                     | \$ |
| Income before income tax provision | \$ 3,417                                                           | \$ | \$ 4,107                                                      | \$ |

The assets, liabilities and cash flows associated with EPA have historically been immaterial to Quanta's balance sheet and cash flows.

## 5. STOCK-BASED COMPENSATION:

### *Stock Incentive Plans*

Pursuant to the Quanta Services, Inc. 2007 Stock Incentive Plan (the 2007 Plan), which was adopted on May 24, 2007, Quanta may award restricted common stock, incentive stock options and non-qualified stock options. The purpose of the 2007 Plan is to provide directors, key employees, officers and certain consultants and advisors with additional performance incentives by increasing their proprietary interest in Quanta. Prior to the adoption of the 2007 Plan, Quanta had issued awards of restricted common stock and stock options under its 2001 Stock Incentive Plan (as amended and restated March 13, 2003) (the 2001 Plan), which was terminated effective May 24, 2007, except that outstanding awards will continue to be governed by the terms of the 2001 Plan. The 2007 Plan and the 2001 Plan are referred to as the Quanta Plans.

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

In connection with the Merger, Quanta assumed InfraSource's 2003 Omnibus Stock Incentive Plan and 2004 Omnibus Stock Incentive Plan, in each case as amended (the InfraSource Plans). Outstanding awards of InfraSource stock options were converted to options to acquire Quanta common stock, and outstanding awards of InfraSource restricted common stock were converted to Quanta restricted common stock, each as described in further detail below. The InfraSource Plans were terminated in connection with the Merger, and no further awards will be made under these plans, although the terms of these plans will govern outstanding awards.

*Stock Options*

In connection with the Merger, each option to purchase shares of InfraSource common stock granted under the InfraSource Plans that was outstanding on August 30, 2007 was converted into an option to purchase the number of whole shares of Quanta common stock that was equal to the number of shares of InfraSource common stock subject to that option immediately prior to the effective time of the Merger multiplied by 1.223. These options were converted on the same terms and conditions as applied to each such option immediately prior to the Merger. The exercise price for each InfraSource option granted was also adjusted by dividing the exercise price in effect immediately prior to the Merger for each InfraSource option by 1.223. The former InfraSource options generally vest over four years and have a maximum term of ten years; however, some options vested on August 30, 2007 due to change of control provisions in place in certain InfraSource option or management agreements, and there has been and may be additional accelerated vesting if the employment of certain option holders is terminated within a certain period following the Merger.

In connection with the Merger, Quanta calculated the fair value of the former InfraSource stock options as of August 30, 2007 using the Black-Scholes model. Assumptions used in this model were based on historic estimates of both Quanta and InfraSource. Quanta estimated expected stock price volatility based on the historical volatility of Quanta's common stock. The risk-free interest rate assumption included in the calculation is based upon observed interest rates appropriate for the expected life of the InfraSource options. The dividend yield assumption is based on Quanta's intent not to issue a dividend. Quanta used the simplified method to calculate expected term. Forfeitures were estimated based on Quanta's historical experience. These assumptions remained unchanged at September 30, 2008.

**August 30, 2007**

## Weighted Average Assumptions:

|                          |            |
|--------------------------|------------|
| Expected volatility      | 40%        |
| Dividend yield           | 0%         |
| Risk-free interest rate  | 4.13-4.20% |
| Annual forfeiture rate   | 8%         |
| Expected term (in years) | 6.25       |

The following tables summarize information for all of the former InfraSource options:

|                 |                 |
|-----------------|-----------------|
| <b>Weighted</b> | <b>Weighted</b> |
|                 | <b>Average</b>  |

|                                                              | <b>Options<br/>(In<br/>thousands)</b> | <b>Average<br/>Exercise<br/>Price Per<br/>Share</b> | <b>Remaining<br/>Contractual<br/>Life<br/>(In Years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(In<br/>thousands)</b> |
|--------------------------------------------------------------|---------------------------------------|-----------------------------------------------------|----------------------------------------------------------|-----------------------------------------------------------------|
| Total outstanding, December 31, 2007                         | 1,313                                 | \$ 10.73                                            |                                                          |                                                                 |
| Granted                                                      |                                       |                                                     |                                                          |                                                                 |
| Exercised                                                    | (601)                                 | \$ 9.43                                             |                                                          |                                                                 |
| Canceled                                                     | (26)                                  | \$ 11.14                                            |                                                          |                                                                 |
| Total outstanding September 30, 2008                         | 686                                   | \$ 11.84                                            | 6.99                                                     | \$ 10,414                                                       |
| As of September 30, 2008:                                    |                                       |                                                     |                                                          |                                                                 |
| Fully vested options and options expected to ultimately vest | 661                                   | \$ 11.74                                            | 6.96                                                     | \$ 10,097                                                       |
| Options exercisable                                          | 329                                   | \$ 9.88                                             | 6.28                                                     | \$ 5,638                                                        |

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

|                          | As of September 30, 2008  |             |          | Options Exercisable |          |
|--------------------------|---------------------------|-------------|----------|---------------------|----------|
|                          | Stock Options Outstanding |             |          |                     |          |
|                          | Number                    | Weighted    |          | Number              | Weighted |
|                          | of Stock                  | Average     |          | of Stock            | Average  |
|                          | Options                   | Remaining   | Weighted | Options             | Exercise |
|                          | (In                       | Contractual | Average  | (In                 |          |
|                          | thousands)                | Life        | Exercise | thousands)          | Price    |
| Range of Exercise Prices |                           | (In Years)  | Price    |                     |          |
| \$3.76 - \$3.76          | 86                        | 5.01        | \$ 3.76  | 86                  | \$ 3.76  |
| \$6.44 - \$9.80          | 211                       | 7.13        | \$ 9.55  | 66                  | \$ 9.51  |
| \$10.63 - \$13.09        | 106                       | 5.62        | \$ 10.63 | 103                 | \$ 10.63 |
| \$13.84 - \$16.80        | 270                       | 7.97        | \$ 16.23 | 71                  | \$ 15.99 |
| \$20.29 - \$20.55        | 13                        | 8.32        | \$ 20.38 | 3                   | \$ 20.38 |
|                          | 686                       |             |          | 329                 |          |

The aggregate intrinsic value above represents the total pre-tax intrinsic value, based on Quanta's closing stock price of \$27.01 on September 30, 2008, which would have been received by the option holders had all option holders exercised their options as of that date. Former InfraSource options exercised during the nine months ended September 30, 2008 had an intrinsic value of \$11.1 million, generated \$5.7 million of cash proceeds and generated \$4.3 million of associated income tax benefit. When stock options are exercised, Quanta has historically issued new shares to the option holders.

As of September 30, 2008, there was approximately \$3.5 million of total unrecognized compensation cost related to unvested stock options issued under the InfraSource Plans. That cost is expected to be recognized over a weighted average period of 1.6 years. The total fair value of the stock options issued under the InfraSource Plans that vested during the nine months ended September 30, 2008 was \$2.0 million.

*Restricted Stock*

Under the Quanta Plans, Quanta has issued restricted common stock at the fair market value of the common stock as of the date of issuance. The shares of restricted common stock issued are subject to forfeiture, restrictions on transfer and certain other conditions until they vest, which generally occurs over three years in equal annual installments. During the restriction period, the restricted stockholders are entitled to vote and receive dividends on such shares.

In connection with the Merger, each share of restricted common stock issued under the InfraSource Plans that was outstanding on August 30, 2007 was converted into 1.223 restricted shares of Quanta common stock. The shares of restricted common stock issued under the InfraSource Plans remain subject to forfeiture, restrictions on transfer and certain other conditions of the awards until they vest, which generally occurs in equal annual installments over three or four year periods commencing on the first anniversary of the grant date, with certain exceptions. During the

restriction period, the restricted stockholders are entitled to vote and receive dividends on such shares. The vesting period for some holders of restricted stock accelerated and the forfeiture and transfer restrictions lapsed when their employment was terminated following the Merger.

During the three months ended September 30, 2007 and 2008, Quanta granted 7,675 and 7,098 shares of restricted stock under the 2007 Plan with a weighted average grant price of \$27.16 and \$31.62. During the nine months ended September 30, 2007 and 2008, Quanta granted approximately 0.4 million and 0.8 million shares of restricted stock under the Quanta Plans with a weighted average grant price of \$25.70 and \$23.69. Additionally, during the three months ended September 30, 2007 and 2008, approximately 11,182 and 17,066 shares vested with an approximate fair value at the time of vesting of \$0.3 million and \$0.5 million. During the nine months ended September 30, 2007 and 2008, approximately 0.6 million and 0.6 million shares vested with an approximate fair value at the time of vesting of \$16.1 million and \$15.0 million. Amounts granted in 2007 include restricted shares

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

that were issued on August 30, 2007 upon conversion of the InfraSource restricted stock in connection with the Merger, and vested amounts in 2007 include restricted shares that vested under the InfraSource Plans following the Merger.

A summary of the restricted stock activity for the nine months ended September 30, 2008 is as follows (shares in thousands):

|                                | <b>Shares</b> |    | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value<br/>(Per Share)</b> |
|--------------------------------|---------------|----|---------------------------------------------------------------------------|
| Unvested at December 31, 2007  | 1,129         | \$ | 15.84                                                                     |
| Granted                        | 805           | \$ | 23.69                                                                     |
| Vested                         | (578)         | \$ | 15.29                                                                     |
| Forfeited                      | (49)          | \$ | 22.56                                                                     |
| Unvested at September 30, 2008 | 1,307         | \$ | 22.70                                                                     |

As of September 30, 2008, there was approximately \$19.3 million of total unrecognized compensation cost related to unvested restricted stock granted to both employees and non-employees. That cost is expected to be recognized over a weighted average period of 1.93 years.

Compensation expense is measured based on the fair value of the restricted stock. For discretionary awards, compensation expense is recognized on a straight-line basis over the requisite service period, which is generally the vesting period, and for performance based awards, compensation expense is recognized using the graded vesting method over the requisite service period. The fair value of the restricted stock is determined based on the number of shares granted and the closing price of Quanta's common stock on the date of grant. SFAS No. 123(R) requires estimating future forfeitures in determining the period expense, rather than recording forfeitures when they occur as previously permitted. Quanta uses historical data to estimate the forfeiture rate. The estimate of unrecognized compensation cost uses the expected forfeiture rate; however, the estimate may not necessarily represent the value that will ultimately be realized as compensation expense.

Table of Contents**QUANTA SERVICES INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Non-Cash Compensation Expense and Related Tax Benefits*

The amounts of non-cash compensation expense and related tax benefits, as well as the amount of actual tax benefits related to vested restricted stock and options exercised and Quanta's and InfraSource's employee stock purchase plans, both of which have been terminated, are as follows (in thousands):

|                                                                                         | <b>Three Months Ended<br/>September 30,<br/>2007                  2008</b> |          | <b>Nine Months Ended<br/>September 30,<br/>2007                  2008</b> |           |
|-----------------------------------------------------------------------------------------|----------------------------------------------------------------------------|----------|---------------------------------------------------------------------------|-----------|
| Non-cash compensation expense related to restricted stock                               | \$ 2,127                                                                   | \$ 3,432 | \$ 5,748                                                                  | \$ 9,879  |
| Non-cash compensation expense related to stock options                                  | 337                                                                        | 611      | 337                                                                       | 2,523     |
| Total stock-based compensation included in selling, general and administrative expenses | \$ 2,464                                                                   | \$ 4,043 | \$ 6,085                                                                  | \$ 12,402 |
| Actual tax benefit for the tax deductions from vested restricted stock                  | \$ 202                                                                     | \$ 209   | \$ 2,542                                                                  | \$ 1,635  |
| Actual tax benefit for the tax deductions from options exercised                        | 1,357                                                                      | 211      | 4,567                                                                     | 4,490     |
| Actual tax benefit related to the employee stock purchase plans                         |                                                                            |          | 37                                                                        |           |
| Actual tax benefit related to stock-based compensation expense                          | 1,559                                                                      | 420      | 7,146                                                                     | 6,125     |
| Income tax benefit related to non-cash compensation expense                             | 256                                                                        | 1,577    | 2,596                                                                     | 4,837     |
| Total tax benefit related to stock-based compensation expense                           | \$ 1,815                                                                   | \$ 1,997 | \$ 9,742                                                                  | \$ 10,962 |

Table of Contents**QUANTA SERVICES INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****6. PER SHARE INFORMATION:**

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

|                                                                                                               | <b>Three Months Ended<br/>September 30,<br/>2007</b> |             | <b>Nine Months Ended<br/>September 30,<br/>2007</b> |             |
|---------------------------------------------------------------------------------------------------------------|------------------------------------------------------|-------------|-----------------------------------------------------|-------------|
|                                                                                                               |                                                      | <b>2008</b> |                                                     | <b>2008</b> |
| <b>Income for basic earnings per share:</b>                                                                   |                                                      |             |                                                     |             |
| From continuing operations                                                                                    | \$ 46,950                                            | \$ 54,858   | \$ 99,599                                           | \$ 119,628  |
| From discontinued operation                                                                                   | 2,371                                                |             | 2,791                                               |             |
| Net income                                                                                                    | \$ 49,321                                            | \$ 54,858   | \$ 102,390                                          | \$ 119,628  |
| Weighted average shares outstanding for basic earnings per share                                              | 136,279                                              | 171,693     | 124,362                                             | 170,938     |
| <b>Basic earnings per share:</b>                                                                              |                                                      |             |                                                     |             |
| From continuing operations                                                                                    | \$ 0.34                                              | \$ 0.32     | \$ 0.80                                             | \$ 0.70     |
| From discontinued operation                                                                                   | 0.02                                                 |             | 0.02                                                |             |
| Net income                                                                                                    | \$ 0.36                                              | \$ 0.32     | \$ 0.82                                             | \$ 0.70     |
| <b>Income for diluted earnings per share:</b>                                                                 |                                                      |             |                                                     |             |
| Income from continuing operations                                                                             | \$ 46,950                                            | \$ 54,858   | \$ 99,599                                           | \$ 119,628  |
| Effect of convertible subordinated notes under the if-converted method interest expense addback, net of taxes | 3,198                                                | 3,181       | 9,596                                               | 9,578       |
| Income from continuing operations for diluted earnings per share                                              | 50,148                                               | 58,039      | 109,195                                             | 129,206     |
| Income from discontinued operation                                                                            | 2,371                                                |             | 2,791                                               |             |
| Net income for diluted earnings per share                                                                     | \$ 52,519                                            | \$ 58,039   | \$ 111,986                                          | \$ 129,206  |
| <b>Calculation of weighted average shares for diluted earnings per share:</b>                                 |                                                      |             |                                                     |             |
| Weighted average shares outstanding for basic earnings per share                                              | 136,279                                              | 171,693     | 124,362                                             | 170,938     |

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|                                                                                                                   |         |         |         |         |
|-------------------------------------------------------------------------------------------------------------------|---------|---------|---------|---------|
| Effect of dilutive stock options and restricted stock                                                             | 939     | 801     | 815     | 709     |
| Effect of convertible subordinated notes under the<br>if-converted method weighted convertible shares<br>issuable | 30,651  | 30,637  | 30,651  | 30,645  |
| Weighted average shares outstanding for diluted<br>earnings per share                                             | 167,869 | 203,131 | 155,828 | 202,292 |
| <b>Diluted earnings per share:</b>                                                                                |         |         |         |         |
| From continuing operations                                                                                        | \$ 0.30 | \$ 0.29 | \$ 0.70 | \$ 0.64 |
| From discontinued operation                                                                                       | 0.01    |         | 0.02    |         |
| Net income                                                                                                        | \$ 0.31 | \$ 0.29 | \$ 0.72 | \$ 0.64 |

For the three months ended September 30, 2007 and 2008, stock options and restricted stock of approximately 0.7 million and 0.8 million shares, respectively, were excluded from the computation of diluted earnings per share

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

because the grant prices of these common stock equivalents were greater than the average market price of Quanta's common stock. For the nine months ended September 30, 2007 and 2008, stock options and restricted stock of approximately 0.7 million and 0.9 million shares, respectively, were excluded from the computation of diluted earnings per share because the grant prices of these common stock equivalents were greater than the average market price of Quanta's common stock. For the nine months ended September 30, 2007, the effect of assuming conversion of the 4.0% convertible subordinated notes would be antidilutive, and accordingly were excluded from the calculation of diluted earnings per share. The 4.0% convertible subordinated notes were repaid on July 2, 2007, and therefore were not outstanding for any material portion of the three months ended September 30, 2007.

**7. DEBT:***Credit Facility*

Quanta has a credit facility with various lenders that provides for a \$475.0 million senior secured revolving credit facility maturing on September 19, 2012. Subject to the conditions specified in the credit facility and receipt of additional commitments from new or existing lenders, Quanta has the option to increase the revolving commitments under the credit facility by up to an additional \$125.0 million from time to time, although under current market conditions, it is unlikely Quanta would be able to obtain such additional commitments. Borrowings under the credit facility are to be used for working capital, capital expenditures and other general corporate purposes. The entire unused portion of the credit facility is available for the issuance of letters of credit.

As of September 30, 2008, Quanta had approximately \$197.0 million of letters of credit issued under the credit facility and no outstanding revolving loans. The remaining \$278.0 million was available for revolving loans or issuing new letters of credit. Amounts borrowed under the credit facility bear interest, at Quanta's option, at a rate equal to either (a) the Eurodollar Rate (as defined in the credit facility) plus 0.875% to 1.75%, as determined by the ratio of Quanta's total funded debt to consolidated EBITDA (as defined in the credit facility), or (b) the base rate (as described below) plus 0.00% to 0.75%, as determined by the ratio of Quanta's total funded debt to consolidated EBITDA. Letters of credit issued under the credit facility are subject to a letter of credit fee of 0.875% to 1.75%, based on the ratio of Quanta's total funded debt to consolidated EBITDA. Quanta is also subject to a commitment fee of 0.15% to 0.35%, based on the ratio of its total funded debt to consolidated EBITDA, on any unused availability under the credit facility. The base rate equals the higher of (i) the Federal Funds Rate (as defined in the credit facility) plus 1/2 of 1% or (ii) the bank's prime rate.

The credit facility contains certain covenants, including covenants with respect to maximum funded debt to consolidated EBITDA, maximum senior debt to consolidated EBITDA and minimum interest coverage, in each case as specified in the credit facility. For purposes of calculating the maximum funded debt to consolidated EBITDA ratio and the maximum senior debt to consolidated EBITDA ratio, Quanta's maximum funded debt and maximum senior debt are reduced by all cash and cash equivalents (as defined in the credit facility) held by Quanta in excess of \$25.0 million. As of September 30, 2008, Quanta was in compliance with all of its covenants. The credit facility limits certain acquisitions, mergers and consolidations, capital expenditures, asset sales and prepayments of indebtedness and, subject to certain exceptions, prohibits liens on material assets. The credit facility also limits the payment of dividends and stock repurchase programs in any fiscal year except those payments or other distributions payable solely in capital stock. The credit facility provides for customary events of default and carries cross-default provisions with all of Quanta's existing subordinated notes, its continuing indemnity and security agreement with its sureties and

all of its other debt instruments exceeding \$15.0 million in borrowings. If an event of default (as defined in the credit facility) occurs and is continuing, on the terms and subject to the conditions set forth in the credit facility, amounts outstanding under the credit facility may be accelerated and may become or be declared immediately due and payable.

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

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**QUANTA SERVICES INC. AND SUBSIDIARIES**

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

*4.0% Convertible Subordinated Notes*

During the first half of 2007, Quanta had outstanding \$33.3 million aggregate principal amount of 4.0% convertible subordinated notes (4.0% Notes), which matured on July 1, 2007. The outstanding principal balance of the 4.0% Notes plus accrued interest was repaid on July 2, 2007, the first business day after the maturity date.

*4.5% Convertible Subordinated Notes*

At September 30, 2008, Quanta had outstanding approximately \$268.8 million aggregate principal amount of 4.5% convertible subordinated notes due 2023 (4.5% Notes). As described below, none of the 4.5% Notes remain outstanding. The resale of the 4.5% Notes and the shares issuable upon their conversion was registered for the benefit of the holders in a shelf registration statement filed with the SEC. The outstanding 4.5% Notes required semi-annual interest payments on April 1 and October 1 until maturity.

The indenture under which the 4.5% Notes were issued provided the holders of the notes the right to require Quanta to repurchase in cash, on October 1, 2008, all or some of their notes at the principal amount thereof plus accrued and unpaid interest. As a result of this repurchase right, Quanta reclassified approximately \$270.0 million outstanding aggregate principal amount of the 4.5% Notes as a current obligation in October 2007.

The indenture also provided that, beginning October 8, 2008, Quanta had the right to redeem for cash some or all of the 4.5% Notes at the principal amount thereof plus accrued and unpaid interest. On August 27, 2008, Quanta notified the registered holders of the 4.5% Notes that it would redeem the notes on October 8, 2008. Upon notification of the redemption and until October 6, 2008, the holders of the 4.5% Notes had the right to convert all or a portion of the principal amount of their notes to shares of Quanta's common stock at a conversion rate of 89.7989 shares of common stock for each \$1,000 principal amount of notes converted, which equates to a conversion price of \$11.14 per share.

Following the redemption notice and prior to September 30, 2008, the holders of \$1.2 million aggregate principal amount of the 4.5% Notes elected to convert their notes, resulting in the issuance of 107,846 shares of Quanta common stock in the third quarter of 2008. After September 30, 2008, the holders of an additional \$268.6 million aggregate principal amount of the 4.5% Notes elected to convert their notes, resulting in the issuance of 24,121,935 shares of Quanta common stock in the fourth quarter of 2008. Quanta also repurchased \$106,000 aggregate principal amount of the 4.5% Notes on October 1, 2008 pursuant to the holders' election and redeemed for cash \$49,000 aggregate principal amount of the notes, plus accrued and unpaid interest, on October 8, 2008. As a result of these transactions, none of the 4.5% Notes remain outstanding.

*3.75% Convertible Subordinated Notes*

At September 30, 2008, Quanta had outstanding \$143.8 million aggregate principal amount of 3.75% convertible subordinated notes due 2026 (3.75% Notes). The resale of the notes and the shares issuable upon conversion thereof was registered for the benefit of the holders in a shelf registration statement filed with the SEC. The 3.75% Notes mature on April 30, 2026 and bear interest at the annual rate of 3.75%, payable semi-annually on April 30 and October 30, until maturity.

The 3.75% Notes are convertible into Quanta's common stock, based on an initial conversion rate of 44.6229 shares of Quanta's common stock per \$1,000 principal amount of 3.75% Notes (which is equal to an initial conversion price of approximately \$22.41 per share), subject to adjustment as a result of certain events. The 3.75% Notes are convertible by the holder (i) during any fiscal quarter if the closing price of Quanta's common stock is greater than 130% of the conversion price for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter, (ii) upon Quanta calling the 3.75% Notes for redemption, (iii) upon the occurrence of specified distributions to holders of Quanta's common stock or specified corporate transactions or (iv) at any time on or after March 1, 2026 until the business day immediately preceding the maturity date of the 3.75% Notes. The 3.75% Notes are not presently convertible,

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

although they have been convertible in certain prior quarters as a result of the satisfaction of the market price condition in clause (i) above. If the 3.75% Notes become convertible under any of these circumstances, Quanta has the option to deliver cash, shares of Quanta's common stock or a combination thereof, with the amount of cash determined in accordance with the terms of the indenture under which the notes were issued. Conversions that may occur in the future could result in the recording of losses on extinguishment of debt if the conversions are settled in cash for an amount in excess of the principal amount. The holders of the 3.75% Notes who convert their notes in connection with certain change in control transactions, as defined in the indenture, may be entitled to a make whole premium in the form of an increase in the conversion rate. In the event of a change in control, in lieu of paying holders a make whole premium, if applicable, Quanta may elect, in some circumstances, to adjust the conversion rate and related conversion obligations so that the 3.75% Notes are convertible into shares of the acquiring or surviving company.

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

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

*Fair Value of Convertible Subordinated Notes*

The fair market value of Quanta's convertible subordinated notes is subject to interest rate risk because of their fixed interest rates and market risk due to the convertible feature of the convertible subordinated notes. Generally, the fair market value of fixed interest rate debt will increase as interest rates fall and decrease as interest rates rise. The fair market value of Quanta's convertible subordinated notes will also increase as the market price of our stock increases and decrease as the market price falls. The interest and market value changes affect the fair market value of our convertible subordinated notes but do not impact their carrying value. The fair values of Quanta's convertible subordinated notes based upon market prices on or before the dates specified were as follows (in millions):

| December 31, 2007        |            | September 30, 2008       |            |
|--------------------------|------------|--------------------------|------------|
| Principal<br>Outstanding | Fair Value | Principal<br>Outstanding | Fair Value |

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|             |    |       |    |       |    |       |    |       |
|-------------|----|-------|----|-------|----|-------|----|-------|
| 4.5% Notes  | \$ | 270.0 | \$ | 640.2 | \$ | 268.8 | \$ | 680.7 |
| 3.75% Notes |    | 143.8 |    | 185.4 |    | 143.8 |    | 187.1 |
| Total       | \$ | 413.8 | \$ | 825.6 | \$ | 412.6 | \$ | 867.8 |

As a result of certain repurchases, redemptions and conversions, which are described in further detail above, none of the 4.5% Notes remained outstanding as of October 8, 2008.

Table of Contents**QUANTA SERVICES INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. STOCKHOLDERS' EQUITY:***Treasury Stock*

Pursuant to the stock incentive plans described in Note 5, employees may elect to satisfy their tax withholding obligations upon vesting of restricted stock by having Quanta make such tax payments and withhold a number of vested shares having a value on the date of vesting equal to their tax withholding obligation. As a result of such employee elections, during the nine months ended September 30, 2008, Quanta withheld 187,466 shares of Quanta common stock with a total market value of \$4.5 million for settlement of employee tax liabilities. These shares were accounted for as treasury stock. Under Delaware corporate law, treasury stock is not entitled to vote or be counted for quorum purposes.

*Comprehensive Income*

Quanta's foreign operations are translated into U.S. dollars, and a translation adjustment is recorded in other comprehensive income as a result. The following table presents the components of comprehensive income for the periods presented (in thousands):

|                                         | <b>Three Months Ended<br/>September 30,<br/>2007      2008</b> |           | <b>Nine Months Ended<br/>September 30,<br/>2007      2008</b> |            |
|-----------------------------------------|----------------------------------------------------------------|-----------|---------------------------------------------------------------|------------|
| Net income                              | \$ 49,321                                                      | \$ 54,858 | \$ 102,390                                                    | \$ 119,628 |
| Foreign currency translation adjustment | 1,697                                                          | (1,228)   | 1,697                                                         | (2,245)    |
| Comprehensive income                    | \$ 51,018                                                      | \$ 53,630 | \$ 104,087                                                    | \$ 117,383 |

**9. SEGMENT INFORMATION:**

Prior to January 1, 2008, Quanta aggregated each of its individual operating units into one reportable segment as a specialty contractor. Beginning January 1, 2008, Quanta began reporting its results under two business segments, which are the Infrastructure Services and Dark Fiber segments described above in Note 1. The Infrastructure Services segment provides comprehensive network solutions to the electric power, gas, telecommunications and cable television industries, including designing, installing, repairing and maintaining network infrastructure. In addition, the Infrastructure Services segment provides ancillary services such as inside electrical wiring, intelligent traffic networks, cable and control systems for light rail lines, airports and highways, and specialty rock trenching, directional boring and road milling for industrial and commercial customers. The Dark Fiber segment designs, procures, constructs and maintains fiber-optic telecommunications infrastructure in select markets and licenses the right to use point-to-point fiber-optic telecommunications facilities to its customers. The Dark Fiber segment services large industrial and financial services customers, school districts and other entities with high bandwidth telecommunication needs. The telecommunication services provided through this business are subject to regulation by the Federal Communications Commission and certain state public utility commissions. The Dark Fiber segment was

acquired August 30, 2007 as part of the Merger. Accordingly, Quanta's results of operations for the three and nine months ended September 30, 2007 only include one month of results from the dark fiber business, and segment reporting is only provided for the three and nine month periods ended September 30, 2008.

Corporate costs not readily identifiable to a reportable segment are allocated based upon each segment's revenue contribution to consolidated revenues. The assets as of September 30, 2008 and the revenues, operating

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

income and capital expenditures for the three and nine months ended September 30, 2008 by segment are as follows (in thousands):

|                                  | <b>Infrastructure<br/>Services<br/>Segment</b> | <b>Dark Fiber<br/>Segment</b> | <b>Total<br/>Reportable<br/>Segments</b> |
|----------------------------------|------------------------------------------------|-------------------------------|------------------------------------------|
| <b>As of September 30, 2008:</b> |                                                |                               |                                          |
| Assets                           | \$ 2,587,508                                   | \$ 598,928                    | \$ 3,186,436                             |

As of September 30, 2008, goodwill included in the asset segment balances was \$1,022,883 for the Infrastructure Services segment and \$336,791 for the Dark Fiber segment. The following is a reconciliation of reportable segment assets to Quanta's consolidated assets as of September 30, 2008.

**Assets:**

|                                      |              |
|--------------------------------------|--------------|
| Total assets for reportable segments | \$ 3,186,436 |
| Unallocated amounts:                 |              |
| Cash at corporate                    | 286,863      |
| Other unallocated amounts, net       | 89,270       |
| Consolidated total assets            | \$ 3,562,569 |

|                                                       | <b>Infrastructure<br/>Services<br/>Segment</b> | <b>Dark<br/>Fiber<br/>Segment</b> | <b>Total<br/>Reportable<br/>Segments</b> |
|-------------------------------------------------------|------------------------------------------------|-----------------------------------|------------------------------------------|
| <b>For the Three Months Ended September 30, 2008:</b> |                                                |                                   |                                          |
| Revenues (unaffiliated)                               | \$ 1,036,526                                   | \$ 16,829                         | \$ 1,053,355                             |
| Operating income from external customers              | \$ 88,804                                      | \$ 7,638                          | \$ 96,442                                |
| Capital expenditures                                  | \$ 18,486                                      | \$ 33,841                         | \$ 52,327                                |

The following is a reconciliation of reportable segment capital expenditures to Quanta's consolidated capital expenditures for the three months ended September 30, 2008 (in thousands):

**Capital expenditures:**

|                                                    |           |
|----------------------------------------------------|-----------|
| Total capital expenditures for reportable segments | \$ 52,327 |
| Elimination of intersegment profits                | (1,470)   |
| Corporate capital expenditures                     | 919       |
| Consolidated total capital expenditures            | \$ 51,776 |

|                                               | Infrastructure | Dark      | Total        |
|-----------------------------------------------|----------------|-----------|--------------|
|                                               | Services       | Fiber     | Reportable   |
| For the Nine Months Ended September 30, 2008: | Segment        | Segment   | Segments     |
| Revenues (unaffiliated)                       | \$ 2,815,178   | \$ 43,501 | \$ 2,858,679 |
| Operating income from external customers      | \$ 193,619     | \$ 17,916 | \$ 211,535   |
| Capital expenditures                          | \$ 77,609      | \$ 87,690 | \$ 165,299   |

The following is a reconciliation of reportable segment capital expenditures to Quanta's consolidated capital expenditures for the nine months ended September 30, 2008 (in thousands):

**Capital expenditures:**

|                                                    |            |
|----------------------------------------------------|------------|
| Total capital expenditures for reportable segments | \$ 165,299 |
| Elimination of intersegment profits                | (4,910)    |
| Corporate capital expenditures                     | 4,536      |
| Consolidated total capital expenditures            | \$ 164,925 |

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

The following table presents information regarding revenues derived from the various industries served by Quanta aggregated by type of work. The amounts related to the three and nine months ended September 30, 2007 have been changed to identify revenues from electric power services separately from gas services revenues and to segregate revenues from the Dark Fiber segment. Revenues by type of work are as follows (in thousands):

|                                                          | <b>Three Months Ended<br/>September 30,</b> |              | <b>Nine Months Ended<br/>September 30,</b> |              |
|----------------------------------------------------------|---------------------------------------------|--------------|--------------------------------------------|--------------|
|                                                          | <b>2007</b>                                 | <b>2008</b>  | <b>2007</b>                                | <b>2008</b>  |
| Infrastructure Services:                                 |                                             |              |                                            |              |
| Electric power services                                  | \$ 364,636                                  | \$ 597,931   | \$ 1,016,506                               | \$ 1,618,120 |
| Gas services                                             | 85,501                                      | 239,743      | 229,307                                    | 578,231      |
| Telecommunications and cable television network services | 122,825                                     | 126,706      | 283,005                                    | 427,568      |
| Ancillary services                                       | 78,392                                      | 72,146       | 243,715                                    | 191,259      |
| Total Infrastructure Services                            | 651,354                                     | 1,036,526    | 1,772,533                                  | 2,815,178    |
| Dark Fiber                                               | 4,511                                       | 16,829       | 4,511                                      | 43,501       |
| Total Revenues                                           | \$ 655,865                                  | \$ 1,053,355 | \$ 1,777,044                               | \$ 2,858,679 |

*Foreign Operations*

Quanta does not have significant operations or long-lived assets in countries outside of the United States. Quanta derived \$20.2 million and \$49.3 million of its revenues from foreign operations during the three and nine months ended September 30, 2007 and \$27.2 million and \$78.7 million of its revenues from foreign operations during the three and nine months ended September 30, 2008. The majority of revenues from foreign operations was earned in Canada during the three and nine months ended September 30, 2007 and 2008.

**10. COMMITMENTS AND CONTINGENCIES:***Leases*

Quanta leases certain land, buildings and equipment under non-cancelable lease agreements, including related party leases. The terms of these agreements vary from lease to lease, including some with renewal options and escalation clauses. The following schedule shows the future minimum lease payments under these leases as of September 30, 2008 (in thousands):

**Operating  
Leases**

|                              |            |
|------------------------------|------------|
| Year Ending December 31      |            |
| Remainder of 2008            | \$ 17,607  |
| 2009                         | 51,145     |
| 2010                         | 36,816     |
| 2011                         | 29,412     |
| 2012                         | 18,882     |
| Thereafter                   | 26,983     |
| Total minimum lease payments | \$ 180,845 |

Rent expense related to operating leases was approximately \$19.8 million and \$53.5 million for the three and nine months ended September 30, 2007 and approximately \$26.6 million and \$79.3 million for the three and nine months ended September 30, 2008.

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**QUANTA SERVICES INC. AND SUBSIDIARIES**

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

Quanta has guaranteed the residual value on certain of its equipment operating leases. Quanta guarantees the difference between this residual value and the fair market value of the underlying asset at the date of termination of the leases. At September 30, 2008, the maximum guaranteed residual value was approximately \$163.6 million. Although Quanta believes that no significant payments will be made as a result of the difference between the fair market value of the leased equipment and the guaranteed residual value, the recent volatility in the financial markets as well as other changes in business and economic factors may create fluctuations in the fair market value of the underlying assets. Therefore, there can be no assurance that significant payments will not be required in the future.

*Committed Capital Expenditures*

Quanta has committed various amounts of capital for expansion of its dark fiber network. Quanta does not commit capital to new network expansions until it has a committed licensing arrangement in place with at least one customer. The amounts of committed capital expenditures are estimates of costs required to build the networks under contract. The actual capital expenditures related to building the networks could vary materially from these estimates. As of September 30, 2008, Quanta estimates these expenditures to be approximately \$12.2 million for the period October 1, 2008 through December 31, 2008 and \$59.7 million and \$0.1 million for the years ended December 31, 2009 and 2010.

*Litigation*

InfraSource, certain of its officers and directors and various other parties, including David R. Helwig, the former chief executive officer of InfraSource and a former director of Quanta, were defendants in a lawsuit seeking unspecified damages filed in the State District Court in Harris County, Texas on September 21, 2005. The plaintiffs alleged that the defendants violated their fiduciary duties and committed constructive fraud by failing to maximize shareholder value in connection with certain acquisitions by InfraSource Incorporated that closed in 1999 and 2000 and the acquisition of InfraSource Incorporated by InfraSource in 2003 and committed other acts of misconduct following the filing of the petition. The parties to this litigation settled the material claims in January 2008, and the lawsuit was dismissed by the court on March 4, 2008. The amount of the settlement was reserved in 2007, and therefore the payment of the settlement amount had no impact on Quanta's results of operations for the first nine months of 2008.

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

*Concentration of Credit Risk*

Quanta is subject to concentrations of credit risk related primarily to its cash and cash equivalents and accounts receivable. Quanta maintains substantially all of its cash investments with what it believes to be high credit quality financial institutions. In accordance with Quanta's investment policies, these institutions are authorized to invest this cash in a diversified portfolio of what Quanta believes to be high-quality overnight money market funds and

commercial paper with short-term maturities. Although Quanta does not currently believe the principal amount of these investments is subject to any material risk of loss, the recent volatility in the financial markets is likely to significantly impact the interest income Quanta receives from these investments. In addition, Quanta grants credit under normal payment terms, generally without collateral, to its customers, which include electric power and gas companies, telecommunications and cable television system operators, governmental entities, general contractors, and builders, owners and managers of commercial and industrial properties located primarily in the United States.

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**QUANTA SERVICES INC. AND SUBSIDIARIES**

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

Consequently, Quanta is subject to potential credit risk related to changes in business and economic factors throughout the United States, which may be heightened as a result of the current financial crisis and volatility of the markets. However, Quanta generally has certain statutory lien rights with respect to services provided. Under certain circumstances, such as foreclosures or negotiated settlements, Quanta may take title to the underlying assets in lieu of cash in settlement of receivables. Historically, some of Quanta's customers have experienced significant financial difficulties, and others may experience financial difficulties in the future. These difficulties expose Quanta to increased risk related to collectibility of receivables for services Quanta has performed. No customer accounted for more than 10% of accounts receivable as of December 31, 2007 or September 30, 2008 or revenues for the three and nine months ended September 30, 2007 or 2008.

*Self-Insurance*

Quanta is insured for employer's liability claims, subject to a deductible of \$1.0 million per occurrence, and for general liability and auto liability subject to a deductible of \$3.0 million per occurrence. Quanta is also insured for workers compensation claims, subject to a deductible of \$2.0 million per occurrence. Additionally, Quanta is subject to an annual cumulative aggregate liability of up to \$1.0 million on workers' compensation claims in excess of \$2.0 million per occurrence. Quanta also has an employee health care benefits plan for employees not subject to collective bargaining agreements, which is subject to a deductible of \$350,000 per claimant per year.

Losses under all of these insurance programs are accrued based upon Quanta's estimates of the ultimate liability for claims reported and an estimate of claims incurred but not reported, with assistance from third-party actuaries. These insurance liabilities are difficult to assess and estimate due to unknown factors, including the severity of an injury, the determination of Quanta's liability in proportion to other parties, the number of incidents not reported and the effectiveness of our safety program. The accruals are based upon known facts and historical trends and management believes such accruals to be adequate. As of December 31, 2007 and September 30, 2008, the gross amount accrued for insurance claims totaled \$152.0 million and \$148.9 million, with \$110.1 million and \$107.4 million considered to be long-term and included in other non-current liabilities. Related insurance recoveries/receivables as of December 31, 2007 and September 30, 2008 were \$22.1 million and \$15.4 million, of which \$11.9 million and \$4.7 million are included in prepaid expenses and other current assets and \$10.2 million and \$10.7 million are included in other assets, net.

Effective September 29, 2008, Quanta consummated a novation transaction that released its distressed casualty insurance carrier for the policy periods August 1, 2000 to February 28, 2003 from all further obligations in connection with the policies in effect during that period in exchange for the payment to Quanta of an agreed amount. Quanta's current casualty insurance carrier assumed all obligations under the policies in effect during that period; however, Quanta is obligated to indemnify the carrier in full for any liabilities under the policies assumed. At September 30, 2008, Quanta estimated that the total future claim amounts associated with the novated policies was \$6.6 million. The estimate of the potential range of these future claim amounts is between \$2.0 million and \$8.0 million, but the actual amounts ultimately paid by Quanta in connection with these claims, if any, could vary materially from the above range and could be impacted by further claims development. During the second quarter of 2008, Quanta recorded an allowance of \$3.4 million for potentially uncollectible amounts estimated to be ultimately due from the distressed insurer. As a result of the novation transaction, the net receivable balance remaining was written off in the third quarter of 2008, with an immaterial impact to the three and nine month periods ended September 30, 2008.

*Letters of Credit*

Certain of Quanta's vendors require letters of credit to ensure reimbursement for amounts they are disbursing on its behalf, such as to beneficiaries under its self-funded insurance programs. In addition, from time to time some customers require Quanta to post letters of credit to ensure payment to its subcontractors and vendors under those contracts and to guarantee performance under its contracts. Such letters of credit are generally issued by a bank or

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**QUANTA SERVICES INC. AND SUBSIDIARIES**

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

similar financial institution. The letter of credit commits the issuer to pay specified amounts to the holder of the letter of credit if the holder demonstrates that Quanta has failed to perform specified actions. If this were to occur, Quanta would be required to reimburse the issuer of the letter of credit. Depending on the circumstances of such a reimbursement, Quanta may also have to record a charge to earnings for the reimbursement. Quanta does not believe that it is likely that any material claims will be made under a letter of credit in the foreseeable future.

As of September 30, 2008, Quanta had \$197.0 million in letters of credit outstanding under its credit facility primarily to secure obligations under its casualty insurance program. These are irrevocable stand-by letters of credit with maturities generally expiring at various times throughout 2008 and 2009. Upon maturity, it is expected that the majority of these letters of credit will be renewed for subsequent one-year periods.

*Performance Bonds and Parent Guarantees*

In certain circumstances, Quanta is required to provide performance bonds in connection with its contractual commitments. Quanta has indemnified its sureties for any expenses paid out under these performance bonds. As of September 30, 2008, the total amount of outstanding performance bonds was approximately \$979.6 million, and the estimated cost to complete these bonded projects was approximately \$225.3 million.

Quanta, from time to time, guarantees the obligations of its wholly owned subsidiaries, including obligations under certain contracts with customers, certain lease obligations and, in some states, obligations in connection with obtaining contractors licenses.

*Employment Agreements*

Quanta has various employment agreements with certain executives and other employees, which provide for compensation and certain other benefits and for severance payments under certain circumstances. Certain employment agreements also contain clauses that become effective upon a change of control of Quanta. In addition, employment agreements between InfraSource and certain of its executives and employees included provisions that became effective upon termination of employment within a specified time period following the change of control of InfraSource. Upon the occurrence of any of the defined events in the various employment agreements, Quanta will pay certain amounts to the employee, which vary with the level of the employee's responsibility.

*Collective Bargaining Agreements*

Certain of Quanta's subsidiaries are party to various collective bargaining agreements with certain of their employees. The agreements require such subsidiaries to pay specified wages and provide certain benefits to their union employees. These agreements expire at various times and have typically been renegotiated and renewed on terms similar to the ones contained in the expiring agreements.

*Indemnities*

Quanta has indemnified various parties against specified liabilities that those parties might incur in the future in connection with Quanta's previous acquisitions of certain companies. The indemnities under acquisition agreements usually are contingent upon the other party incurring liabilities that reach specified thresholds. Quanta also generally

indemnifies its customers for the services it provides under its contracts, as well as other specified liabilities, which may subject Quanta to indemnity claims and liabilities and related litigation. As of September 30, 2008, Quanta is not aware of circumstances that would lead to future indemnity claims against it for material amounts in connection with these indemnity obligations.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and with our Annual Report on Form 10-K for the year ended December 31, 2007, which was filed with the Securities and Exchange Commission (SEC) on February 29, 2008 and is available on the SEC's website at [www.sec.gov](http://www.sec.gov) and on our website, which is [www.quantaservices.com](http://www.quantaservices.com). The discussion below contains forward-looking statements that are based upon our current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from expectations due to inaccurate assumptions and known or unknown risks and uncertainties, including those identified under the headings "Uncertainty of Forward-Looking Statements and Information" below in this Item 2 and "Risk Factors" in Item 1A of Part II of this Quarterly Report.

### **Introduction**

We are a leading national provider of specialty contracting services. Beginning January 1, 2008, we began reporting our results under two business segments. The infrastructure services (Infrastructure Services) segment provides specialized contracting services, offering end-to-end network solutions to the electric power, gas, telecommunications and cable television industries. Specifically, the comprehensive services provided by the Infrastructure Services segment include designing, installing, repairing and maintaining network infrastructure, as well as certain ancillary services. Additionally, the dark fiber (Dark Fiber) segment designs, procures, constructs and maintains fiber-optic telecommunication infrastructures and licenses the right to use point-to-point fiber-optic telecommunications facilities to our customers. The Dark Fiber segment services large industrial and financial services customers, school districts and other entities with high bandwidth telecommunication needs. The telecommunication services provided through this business are subject to regulation by the Federal Communications Commission and certain state public utility commissions.

On August 30, 2007, we acquired, through a merger transaction (the Merger), all of the outstanding common stock of InfraSource Services, Inc. (InfraSource). Similar to us, InfraSource provided design, procurement, construction, testing and maintenance services to electric power utilities, natural gas utilities, telecommunication customers, government entities and heavy industrial companies, such as petrochemical, processing and refining businesses, primarily in the United States. As a result of the Merger, we enhanced and expanded our position as a leading specialized contracting services company serving the electric power, gas, telecommunications and cable television industries and added the Dark Fiber segment.

We had consolidated revenues for the nine months ended September 30, 2008 of approximately \$2.86 billion, of which 57% was attributable to electric power work, 20% to gas work, 15% to telecommunications and cable television work and 7% to ancillary services, such as inside electrical wiring, intelligent traffic networks, fueling systems, cable and control systems for light rail lines, airports and highways and specialty rock trenching, directional boring and road milling for industrial and commercial customers. In addition, 1% of our consolidated revenues for the nine months ended September 30, 2008 was generated by our Dark Fiber segment.

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

unit price or cost-plus master service agreements that are renewable annually.

We recognize that we and our customers are operating in a challenging business environment with the economic downturn and volatile capital markets. We have currently not been significantly impacted by these conditions, and we believe that our customers, many of whom are regulated utilities, remain financially stable and able to continue with their business plans without substantial constraints. We are, however, closely monitoring our customers and the effect that changes in economic and market conditions may have on them.

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

The Dark Fiber segment constructs and licenses the right to use fiber-optic telecommunications facilities to our customers pursuant to licensing agreements, typically with terms from five to twenty-five years, inclusive of certain renewal options. Under those agreements, customers are provided the right to use a portion of the capacity of a fiber-optic facility, with the facility owned and maintained by us. Revenues earned pursuant to these fiber-optic facility licensing agreements, including any initial fees or advanced billings, are recognized ratably over the expected length of the agreements, including probable renewal periods.

## **Seasonality; Fluctuations of Results**

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

Additionally, our industry can be highly cyclical. As a result, our volume of business may be adversely affected by declines or delays in new projects in various geographic regions in the United States. Project schedules, in particular in connection with larger, longer-term projects, can also create fluctuations in the services provided under projects, which may adversely affect us in a given quarter. The financial condition of our customers and their access to capital, variations in the margins of projects performed during any particular quarter, regional and national economic and market conditions, timing of acquisitions, the timing and magnitude of acquisition assimilation costs and interest rate fluctuations may also materially affect quarterly results. Accordingly, our operating results in any particular quarter or year may not be indicative of the results that can be expected for any other quarter or for any other year. An investor should read *Understanding Gross Margins* and *Outlook* for additional discussion of trends and challenges that may affect our financial condition and results of operations.

## **Understanding Gross Margins**

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

*Seasonal and Geographical.* As discussed above, seasonal patterns can have a significant impact on gross margins. Generally, business is slower in the winter months versus the warmer months of the year. This can be offset somewhat by increased demand for electrical service and repair work resulting from severe weather. In addition, the mix of

business conducted in different parts of the country will affect margins, as some parts of the country offer the opportunity for higher gross margins than others.

*Weather.* Adverse or favorable weather conditions can impact gross margins in a given period. For example, it is typical in the first quarter of any fiscal year that parts of the country may experience snow or rainfall that may negatively impact our revenues and gross margin due to reduced productivity. In many cases, projects may be delayed or temporarily placed on hold. Conversely, in periods when weather remains dry and temperatures are

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accommodating, more work can be done, sometimes with less cost, which would have a favorable impact on gross margins. In some cases, severe weather, such as hurricanes and ice storms, can provide us with higher margin emergency service restoration work, which generally has a positive impact on margins.

*Revenue Mix.* The mix of revenues derived from the industries we serve will impact gross margins, as certain industries provide higher margin opportunities. Additionally, changes in our customers' spending patterns in each of the industries we serve can cause an imbalance in supply and demand and, therefore, affect margins and mix of revenues by the industry we served.

*Service and Maintenance versus Installation.* Installation work is often obtained on a fixed price basis, while maintenance work is often performed under pre-established or negotiated prices or cost-plus pricing arrangements. Gross margins for installation work will vary from project to project, and can be higher than maintenance work, because work obtained on a fixed price basis has higher risk than other types of pricing arrangements. We typically derive approximately 50% of our annual revenues from maintenance work, but a higher portion of installation work in any given period may affect our gross margins for that period.

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

*Materials versus Labor.* Margins may be lower on projects on which we furnish materials as our mark-up on materials is generally lower than on labor costs. In a given period, a higher percentage of work that has a higher materials component may decrease overall gross margin.

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

*Insurance.* Gross margins could be impacted by fluctuations in insurance accruals as additional claims arise and as circumstances and conditions of existing claims change. We are insured for employer's liability claims, subject to a deductible of \$1.0 million per occurrence, and for general liability and auto liability subject to a deductible of \$3.0 million per occurrence. We are also insured for workers' compensation claims, subject to a deductible of \$2.0 million per occurrence. Additionally, we are subject to an annual cumulative aggregate liability of up to \$1.0 million on workers' compensation claims in excess of \$2.0 million per occurrence. We also have an employee health care benefits plan for employees not subject to collective bargaining agreements, which is subject to a deductible of \$350,000 per claimant per year.

*Dark Fiber Segment.* Our Dark Fiber segment typically generates higher margins than our Infrastructure Services segment. As we construct fiber-optic telecommunications infrastructure in new markets, expand in existing markets and renew licenses with existing customers, certain factors may influence the margins obtained from the revenues from our Dark Fiber segment. Some of these factors include the impact of competition by current large, national competitors or new market entrants, breadth of service offerings, pricing, geographic presence, the ability of customers to obtain financing for new projects, changes in the economic and regulatory environments in which our Dark Fiber segment operates, including changes in the federal E-rate subsidy program for telecommunication and internet services for schools, libraries and certain health-care facilities, the magnitude and costs of current and future projects, and our ability to continue to fund significant capital expenditures related to the expansion of the fiber-optic telecommunications infrastructure.

## **Selling, General and Administrative Expenses**

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

**Table of Contents****Results of Operations**

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the results of operations data below does not reflect the operations of Environmental Professional Associates, Limited (EPA) in any periods as EPA's results of operations are reported as a discontinued operation in our accompanying condensed consolidated statements of operations. Accordingly, the 2007 amounts below do not agree to the amounts previously reported. Additionally, the results of operations for the three and nine months ended September 30, 2007 only include one month of results of operations from InfraSource as the Merger did not occur until August 30, 2007.

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

|                                                                | <b>Three Months Ended September 30,</b> |        |              |        | <b>Nine Months Ended September 30,</b> |        |              |        |
|----------------------------------------------------------------|-----------------------------------------|--------|--------------|--------|----------------------------------------|--------|--------------|--------|
|                                                                | <b>2007</b>                             |        | <b>2008</b>  |        | <b>2007</b>                            |        | <b>2008</b>  |        |
| Revenues                                                       | \$ 655,865                              | 100.0% | \$ 1,053,355 | 100.0% | \$ 1,777,044                           | 100.0% | \$ 2,858,679 | 100.0% |
| Cost of services<br>(including depreciation)                   | 540,812                                 | 82.5   | 867,789      | 82.4   | 1,499,172                              | 84.4   | 2,390,546    | 83.6   |
| Gross profit                                                   | 115,053                                 | 17.5   | 185,566      | 17.6   | 277,872                                | 15.6   | 468,133      | 16.4   |
| Selling, general<br>and administrative<br>expenses             | 59,816                                  | 9.1    | 80,126       | 7.6    | 155,793                                | 8.7    | 227,134      | 7.9    |
| Amortization of<br>intangible assets                           | 4,868                                   | 0.7    | 8,998        | 0.9    | 6,332                                  | 0.4    | 29,464       | 1.1    |
| Operating income                                               | 50,369                                  | 7.7    | 96,442       | 9.1    | 115,747                                | 6.5    | 211,535      | 7.4    |
| Interest expense                                               | (5,165)                                 | (0.8)  | (5,223)      | (0.5)  | (16,261)                               | (0.9)  | (15,642)     | (0.5)  |
| Interest income                                                | 5,389                                   | 0.8    | 2,022        | 0.2    | 15,341                                 | 0.8    | 8,105        | 0.3    |
| Loss on early<br>extinguishment of<br>debt                     | (11)                                    |        | (2)          |        | (11)                                   |        | (2)          |        |
| Other income<br>(expense), net                                 | (702)                                   | (0.1)  | (74)         |        | (591)                                  |        | 408          |        |
| Income from<br>continuing<br>operations before<br>income taxes | 49,880                                  | 7.6    | 93,165       | 8.8    | 114,225                                | 6.4    | 204,404      | 7.2    |
| Provision for<br>income taxes                                  | 2,930                                   | 0.4    | 38,307       | 3.6    | 14,626                                 | 0.8    | 84,776       | 3.0    |
| Income from<br>continuing<br>operations                        | \$ 46,950                               | 7.2%   | \$ 54,858    | 5.2%   | \$ 99,599                              | 5.6%   | \$ 119,628   | 4.2%   |

***Three months ended September 30, 2008 compared to the three months ended September 30, 2007***

**Revenues.** Revenues increased \$397.5 million, or 60.6%, to \$1.05 billion for the three months ended September 30, 2008. Electric power services increased by approximately \$233.3 million, or 64%, gas services increased by approximately \$154.2 million, or 180%, and telecommunications and cable television network services increased by approximately \$3.9 million, or 3%. In addition to the contribution of revenues from the InfraSource operating units acquired through the Merger, revenues were favorably impacted by an increase of approximately \$102 million in emergency restoration services, from approximately \$13 million in the third quarter of 2007 to approximately \$115 million in the third quarter of 2008, due to the impact of hurricanes in the Gulf Coast region of the United States. Additionally, revenues increased due to an increased number and size of projects as a result of larger capital budgets for our customers, specifically in connection with electric transmission projects and certain natural gas transmission projects, as well as improved pricing. Lastly, revenues increased due to the impact of \$12.3 million in additional revenues in the third quarter of 2008 from the Dark Fiber segment acquired as part of

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the Merger. Partially offsetting these increases was a decrease in ancillary services revenues of approximately \$6.2 million, or 8%, primarily due to the timing of projects.

*Gross profit.* Gross profit increased \$70.5 million, or 61.3%, to \$185.6 million for the three months ended September 30, 2008. The increase in gross profit results primarily from the contribution of the InfraSource operating units acquired through the Merger coupled with the effect of the increased revenues discussed above. As a percentage of revenues, gross margins were 17.6% and 17.5% for the three months ended September 30, 2008 and 2007, respectively. The gross margin was positively impacted in the third quarter of 2008 as compared to the third quarter of 2007 by improved pricing, an increase in the amount of emergency restoration services, which typically generate higher margins, the contribution of the higher margin Dark Fiber segment acquired as part of the Merger and better fixed costs absorption as a result of higher revenues. These positive factors were partially offset by declines in margins derived from telecommunications and ancillary revenues due to losses on a telecommunication project and certain intelligent traffic network projects during the third quarter of 2008.

*Selling, general and administrative expenses.* Selling, general and administrative expenses increased \$20.3 million, or 34.0%, to \$80.1 million for the three months ended September 30, 2008. The increase in selling, general and administrative expenses was primarily a result of the addition of administrative expenses associated with the InfraSource operating units acquired through the Merger, as well as higher salaries and benefits associated with increased personnel, salary increases and increased performance bonuses. As a percentage of revenues, selling, general and administrative expenses decreased from 9.1% to 7.6% primarily due to improved cost absorption as a result of higher revenues.

*Amortization of intangible assets.* Amortization of intangible assets increased \$4.1 million to \$9.0 million for the three months ended September 30, 2008. This increase is attributable to the amortization of intangible assets associated with acquisitions completed since the beginning of the third quarter of 2007, primarily the acquisition of InfraSource.

*Interest expense.* Interest expense was relatively constant for the three months ended September 30, 2008 as compared to the three months ended September 30, 2007, primarily due to having substantially the same principal amount of convertible subordinated notes outstanding during each period.

*Interest income.* Interest income was \$2.0 million for the quarter ended September 30, 2008, compared to \$5.4 million for the quarter ended September 30, 2007. The decrease results primarily from the lower average cash balance and generally lower interest rates for the quarter ended September 30, 2008 as compared to the quarter ended September 30, 2007.

*Provision for income taxes.* The provision for income taxes was \$38.3 million for the three months ended September 30, 2008, with an effective tax rate of 41.1%. During the three months ended September 30, 2007, the provision for income taxes was \$2.9 million, with an effective tax rate of 5.9%. Quanta recorded tax benefits of \$17.9 million for the three months ended September 30, 2007 due to decreases in reserves for uncertain tax benefits resulting from the expiration of various federal and state tax statutes of limitations.

### ***Nine months ended September 30, 2008 compared to the nine months ended September 30, 2007***

*Revenues.* Revenues increased \$1.08 billion, or 60.9%, to \$2.86 billion for the nine months ended September 30, 2008. Electric power services increased by approximately \$601.6 million, or 59%, gas services increased by approximately \$348.9 million, or 152%, and telecommunications and cable television network services increased by approximately \$144.6 million, or 51%. In addition to the contribution of revenues from the InfraSource operating units acquired through the Merger, revenues were favorably impacted by an increased number and size of projects as a

result of larger capital budgets for our customers, specifically in connection with electric transmission projects, certain natural gas transmission projects and fiber build-out initiatives, as well as improved pricing. Additionally, revenues increased due to an increase of approximately \$83 million in emergency restoration services, from approximately \$77 million in the first nine months of 2007 to approximately \$160 million in the same period of 2008, as well as the impact of \$39.0 million in additional revenues in the first nine months of 2008 from the Dark Fiber segment acquired as part of the Merger. Partially offsetting these increases was a decrease

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of approximately \$52.5 million, or 22%, in ancillary services revenues primarily due to the timing of projects, more selectivity in projects bid as well as resources being utilized for projects in other types of work.

*Gross profit.* Gross profit increased \$190.3 million, or 68.5%, to \$468.1 million for the nine months ended September 30, 2008. The increase in gross profit results primarily from the contribution of the InfraSource operating units acquired through the Merger coupled with the effect of the increased revenues discussed above. As a percentage of revenues, gross margin increased from 15.6% for the nine months ended September 30, 2007 to 16.4% for the nine months ended September 30, 2008. Positively impacting the 2008 gross margin was improved pricing and a higher amount of emergency restoration services, as discussed above, which typically generate higher margins. In addition, gross margins were higher in the 2008 period due to the contribution of the higher margin Dark Fiber segment acquired as part of the Merger and better fixed costs absorption as a result of higher revenues.

*Selling, general and administrative expenses.* Selling, general and administrative expenses increased \$71.3 million, or 45.8%, to \$227.1 million for the nine months ended September 30, 2008. The increase in selling, general and administrative expenses was primarily a result of the addition of administrative expenses associated with the InfraSource operating units acquired through the Merger, as well as higher salaries and benefits associated with increased personnel, salary increases and increased performance bonuses. As a percentage of revenues, selling, general and administrative expenses decreased from 8.7% to 7.9% primarily due to improved cost absorption as a result of higher revenues.

*Amortization of intangible assets.* Amortization of intangible assets increased \$23.1 million to \$29.5 million for the nine months ended September 30, 2008. This increase is attributable to the amortization of intangible assets associated with acquisitions completed since the beginning of 2007, primarily the acquisition of InfraSource.

*Interest expense.* Interest expense for the nine months ended September 30, 2008 decreased \$0.6 million as compared to the nine months ended September 30, 2007, primarily due to the repayment of our 4.0% convertible subordinated notes on July 2, 2007.

*Interest income.* Interest income was \$8.1 million for the nine months ended September 30, 2008, compared to \$15.3 million for the nine months ended September 30, 2007. The decrease results primarily from the lower average cash balance and generally lower interest rates for the nine months ended September 30, 2008 as compared to the nine months ended September 30, 2007.

*Provision for income taxes.* The provision for income taxes was \$84.8 million for the nine months ended September 30, 2008, with an effective tax rate of 41.5%. During the nine months ended September 30, 2007, the provision for income taxes was \$14.6 million, with an effective tax rate of 12.8%. The lower effective tax rate for 2007 results from \$33.2 million of tax benefits recorded in 2007 associated with the reversal of tax contingencies. Excluding these discrete period benefits, the provision for income taxes was \$47.9 million for the nine months ended September 30, 2007, with an effective tax rate of 41.9%.

## **Liquidity and Capital Resources**

### ***Cash Requirements***

We anticipate that our cash and cash equivalents on hand, which totaled \$266.4 million as of September 30, 2008, borrowing capacity under our credit facility, and our future cash flows from operations will provide sufficient funds to enable us to meet our operating needs, debt service requirements and planned capital expenditures and facilitate our ability to grow in the foreseeable future. Initiatives to rebuild the United States electric power grid or momentum in deployment of fiber to the premises may require a significant amount of additional working capital. We also evaluate

opportunities for strategic acquisitions from time to time that may require cash.

Management assesses our liquidity in terms of our ability to generate cash to fund our operating, investing and financing activities. As of September 30, 2008, we continued to generate cash from operating activities and remain in a strong financial position, with resources available for reinvestment in existing businesses, strategic acquisitions and managing our capital structure. We believe that we have adequate cash and availability under our credit facility to meet all such needs.

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Although recent distress in the financial markets has not had a significant impact on our financial position, results of operations or cash flows as of and for the periods ending September 30, 2008, management continues to monitor the financial markets and general global economic conditions. If further changes in financial markets or other areas of the economy adversely impact our ability to access capital markets, we would expect to rely on a combination of available cash and existing committed credit facilities to provide short-term funding. We consider our cash investment policies to be conservative in that we maintain a diverse portfolio of what we believe to be high-quality cash investments with short-term maturities. Accordingly, we do not anticipate that the current volatility in the capital markets will have a material impact on the principal amounts of our cash investments.

Capital expenditures for the remainder of 2008 are expected to be approximately \$25 million, of which \$12 million of these expenditures are targeted for the expansion of our dark fiber network in connection with committed customer arrangements, with the majority of the remaining expenditures for operating equipment in the Infrastructure Services segment.

At September 30, 2008, we had outstanding approximately \$268.8 million aggregate principal amount of 4.5% convertible subordinated notes due 2023 (4.5% Notes), however, as a result of the transactions described in further detail in *Debt Instruments 4.5% Convertible Subordinated Notes*, none of the 4.5% Notes remained outstanding as of October 8, 2008.

Our 3.75% convertible subordinated notes due 2026 (3.75% Notes) are not presently convertible, although they have been convertible in certain prior quarters as a result of the satisfaction of the market price condition described in further detail in *Debt Instruments 3.75% Convertible Notes* below. The 3.75% Notes could become convertible in future periods upon the satisfaction of the market price condition or other conditions. If any holder of the convertible subordinated notes requests to convert their notes, we have the option to deliver cash, shares of our common stock or a combination thereof, with the amount of cash determined in accordance with the terms of the indenture under which the notes were issued.

## **Sources and Uses of Cash**

As of September 30, 2008, we had cash and cash equivalents of \$266.4 million, working capital of \$602.4 million and long-term debt of \$143.8 million, net of current maturities. Subsequent to September 30, 2008, working capital increased by \$268.6 million as a result of the conversion of this principal amount of our 4.5% Notes into our common stock. We also had \$197.0 million of letters of credit outstanding under our credit facility, leaving \$278.0 million available for revolving loans or issuing new letters of credit.

## ***Operating Activities***

Cash flow from operations is primarily influenced by demand for our services, operating margins and the type of services we provide but can also be impacted by working capital needs. Operating activities provided net cash of \$16.8 million during the three months ended September 30, 2008 as compared to \$42.8 million in the three months ended September 30, 2007. Operating activities provided net cash of \$50.1 million during the nine months ended September 30, 2008 as compared to \$115.3 million in the nine months ended September 30, 2007. Working capital needs are generally higher during the summer and fall months due to increased construction in weather affected regions of the country. Conversely, working capital assets are typically converted to cash during the winter months. Operating cash flow for the three and nine months ended September 30, 2008 was negatively impacted by higher working capital requirements as we performed significant emergency restoration work in September 2008 as a result of hurricanes in the Gulf Coast region and the growth in gas work. Additionally, invoice processing issues experienced by certain customers as a result of the rapid ramp-up of fiber to the premises/node and wireless installations over the past year have contributed to the increase in working capital requirements for the three and nine

months ended September 30, 2008 as compared to the three and nine months ended September 30, 2007. The specific telecommunications work being performed has voluminous billing requirements and has been subject to lengthy delays as our invoices are processed through the customer's payment system.

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### *Investing Activities*

In the three months ended September 30, 2008, we used net cash in investing activities of \$54.5 million as compared to \$12.1 million provided by investing activities in the three months ended September 30, 2007. Investing activities in three months ended September 30, 2008 include \$51.8 million used for capital expenditures, \$4.8 million in net cash outlays for acquisitions, partially offset by \$2.1 million of proceeds from the sale of equipment.

During the three months ended September 30, 2007, we had a net cash inflow of \$20.6 million from acquisitions due to the cash on hand at InfraSource when it was acquired on August 30, 2007, partially offset by cash used for acquisitions and certain acquisition expenses. Also during the three months ended September 30, 2007, we used \$19.0 million for capital expenditures, offset partially by \$10.5 million of proceeds from the sale of equipment. The \$32.8 million increase in capital expenditures in the three months ended September 30, 2008 compared to the three months ended September 30, 2007 is related primarily to the growth in our business and the increased capital expenditure requirements as a result of the Merger, primarily from our Dark Fiber segment.

In the nine months ended September 30, 2008, we used net cash in investing activities of \$196.1 million as compared to \$45.4 million in the nine months ended September 30, 2007. Investing activities in the first nine months of 2008 include \$164.9 million used for capital expenditures, \$27.7 million in net cash outlays for acquisitions, and \$14.6 million paid to secure patents and developed technology, partially offset by \$11.1 million of proceeds from the sale of equipment. During the nine months ended September 30, 2007, we used \$61.0 million for capital expenditures, offset partially by \$14.7 million of proceeds from the sale of equipment. The \$103.9 million increase in capital expenditures in the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 is related primarily to the growth in our business and the increased capital expenditure requirements as a result of the Merger, primarily from our Dark Fiber segment. Investing activities in the nine months ended September 30, 2007 included purchases and sales of variable rate demand notes (VRDNs), which are classified as short-term investments, available for sale when held. We did not invest in VRDNs subsequent to the first quarter of 2007.

### *Financing Activities*

In the three months ended September 30, 2008, financing activities provided net cash flow of \$0.6 million as compared to \$90.9 million used in financing activities in the three months ended September 30, 2007. The \$0.6 million provided by financing activities in the three months ended September 30, 2008 resulted primarily from \$0.3 million received from the exercise of stock options and a \$0.3 million tax benefit from the vesting of restricted stock awards and the exercise of stock options. The \$90.9 million used in financing activities in the three months ended September 30, 2007 resulted primarily from a \$60.5 million repayment of debt associated with the Merger and a \$33.3 million repayment of the 4.0% Notes, partially offset by a \$1.6 million tax benefit from stock-based equity awards and \$2.2 million received from the exercise of stock options.

In the nine months ended September 30, 2008, financing activities provided net cash flow of \$7.6 million as compared to \$83.8 million used in financing activities in the nine months ended September 30, 2007. The \$7.6 million provided by financing activities in the nine months ended September 30, 2008 resulted primarily from \$6.0 million received from the exercise of stock options. Also contributing to the inflow was a \$2.6 million tax benefit from the vesting of restricted stock awards and the exercise of stock options, partially offset by a \$1.0 million net repayment of other long-term debt. The \$83.8 million used in financing activities in the nine months ended September 30, 2007 resulted primarily from a \$60.5 million repayment of debt associated with the Merger and a \$33.3 million repayment of the 4.0% Notes, partially offset by a \$7.1 million tax benefit from stock-based equity awards and \$5.4 million received from the exercise of stock options.

### *Debt Instruments*

*Credit Facility*

We have a credit facility with various lenders that provides for a \$475.0 million senior secured revolving credit facility maturing on September 19, 2012. Subject to the conditions specified in the credit facility and receipt of

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additional commitments from new or existing lenders, we have the option to increase the revolving commitments under the credit facility by up to an additional \$125.0 million from time to time, although under current market conditions, it is unlikely we would be able to obtain such additional commitments.

Borrowings under the credit facility are to be used for working capital, capital expenditures and other general corporate purposes. The entire unused portion of the credit facility is available for the issuance of letters of credit.

As of September 30, 2008, we had approximately \$197.0 million of letters of credit issued under the credit facility and no outstanding revolving loans. The remaining \$278.0 million was available for revolving loans or issuing new letters of credit. Amounts borrowed under the credit facility bear interest, at our option, at a rate equal to either (a) the Eurodollar Rate (as defined in the credit facility) plus 0.875% to 1.75%, as determined by the ratio of our total funded debt to consolidated EBITDA (as defined in the credit facility), or (b) the base rate (as described below) plus 0.00% to 0.75%, as determined by the ratio of our total funded debt to consolidated EBITDA. Letters of credit issued under the credit facility are subject to a letter of credit fee of 0.875% to 1.75%, based on the ratio of our total funded debt to consolidated EBITDA. We are also subject to a commitment fee of 0.15% to 0.35%, based on the ratio of our total funded debt to consolidated EBITDA, on any unused availability under the credit facility. The base rate equals the higher of (i) the Federal Funds Rate (as defined in the credit facility) plus 1/2 of 1% or (ii) the bank's prime rate.

The credit facility contains certain covenants, including covenants with respect to maximum funded debt to consolidated EBITDA, maximum senior debt to consolidated EBITDA and minimum interest coverage, in each case as specified in the credit facility. For purposes of calculating the maximum funded debt to consolidated EBITDA ratio and the maximum senior debt to consolidated EBITDA ratio, our maximum funded debt and maximum senior debt are reduced by all cash and cash equivalents (as defined in the credit facility) held by us in excess of \$25.0 million. As of September 30, 2008, we were in compliance with all of its covenants. The credit facility limits certain acquisitions, mergers and consolidations, capital expenditures, asset sales and prepayments of indebtedness and, subject to certain exceptions, prohibits liens on material assets. The credit facility also limits the payment of dividends and stock repurchase programs in any fiscal year except those payments or other distributions payable solely in capital stock. The credit facility provides for customary events of default and carries cross-default provisions with all of our existing subordinated notes, our continuing indemnity and security agreement with our sureties and all of our other debt instruments exceeding \$15.0 million in borrowings. If an event of default (as defined in the credit facility) occurs and is continuing, on the terms and subject to the conditions set forth in the credit facility, amounts outstanding under the credit facility may be accelerated and may become or be declared immediately due and payable.

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

### *4.0% Convertible Subordinated Notes*

During the first half of 2007, we had outstanding \$33.3 million aggregate principal amount of 4.0% convertible subordinated notes (4.0% Notes), which matured on July 1, 2007. The outstanding principal balance of the 4.0% Notes plus accrued interest was repaid on July 2, 2007, the first business day after the maturity date.

### *4.5% Convertible Subordinated Notes*

At September 30, 2008, we had outstanding approximately \$268.8 million aggregate principal amount of 4.5% convertible subordinated notes due 2023 (4.5% Notes). As described below, none of the 4.5% Notes remain outstanding. The resale of the 4.5% Notes and the shares issuable upon their conversion was registered for the benefit

of the holders in a shelf registration statement filed with the SEC. The outstanding 4.5% Notes required semi-annual interest payments on April 1 and October 1 until maturity.

The indenture under which the 4.5% Notes were issued provided the holders of the notes the right to require us to repurchase in cash, on October 1, 2008, all or some of their notes at the principal amount thereof plus accrued and

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unpaid interest. As a result of this repurchase right, we reclassified approximately \$270.0 million outstanding aggregate principal amount of the 4.5% Notes as a current obligation in October 2007.

The indenture also provided that, beginning October 8, 2008, we had the right to redeem for cash some or all of the 4.5% Notes at the principal amount thereof plus accrued and unpaid interest. On August 27, 2008, we notified the registered holders of the 4.5% Notes that we would redeem the notes on October 8, 2008. Upon notification of the redemption and until October 6, 2008, the holders of the 4.5% Notes had the right to convert all or a portion of the principal amount of their notes to shares of our common stock at a conversion rate of 89.7989 shares of common stock for each \$1,000 principal amount of notes converted, which equates to a conversion price of \$11.14 per share.

Following the redemption notice and prior to September 30, 2008, the holders of \$1.2 million aggregate principal amount of the 4.5% Notes elected to convert their notes, resulting in the issuance of 107,846 shares of our common stock in the third quarter of 2008. After September 30, 2008, the holders of an additional \$268.6 million aggregate principal amount of the 4.5% Notes elected to convert their notes, resulting in the issuance of 24,121,935 shares of our common stock in the fourth quarter of 2008. We also repurchased \$106,000 aggregate principal amount of the 4.5% Notes on October 1, 2008 pursuant to the holders' election and redeemed for cash \$49,000 aggregate principal amount of the notes, plus accrued and unpaid interest, on October 8, 2008. As a result of these transactions, none of the 4.5% Notes remain outstanding.

### *3.75% Convertible Subordinated Notes*

At September 30, 2008, we had outstanding \$143.8 million aggregate principal amount of the 3.75% Notes. The resale of the notes and the shares issuable upon conversion thereof was registered for the benefit of the holders in a shelf registration statement filed with the SEC. The 3.75% Notes mature on April 30, 2026 and bear interest at the annual rate of 3.75%, payable semi-annually on April 30 and October 30, until maturity.

The 3.75% Notes are convertible into our common stock, based on an initial conversion rate of 44.6229 shares of our common stock per \$1,000 principal amount of 3.75% Notes (which is equal to an initial conversion price of approximately \$22.41 per share), subject to adjustment as a result of certain events. The 3.75% Notes are convertible by the holder (i) during any fiscal quarter if the closing price of our common stock is greater than 130% of the conversion price for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter, (ii) upon us calling the 3.75% Notes for redemption, (iii) upon the occurrence of specified distributions to holders of our common stock or specified corporate transactions or (iv) at any time on or after March 1, 2026 until the business day immediately preceding the maturity date of the 3.75% Notes. The 3.75% Notes are not presently convertible, although they have been convertible in certain prior quarters as a result of the satisfaction of the market price condition in clause (i) above. If the 3.75% Notes become convertible under any of these circumstances, we have the option to deliver cash, shares of our common stock or a combination thereof, with the amount of cash determined in accordance with the terms of the indenture under which the notes were issued. Conversions that may occur in the future could result in the recording of losses on extinguishment of debt if the conversions are settled in cash for an amount in excess of the principal amount. The holders of the 3.75% Notes who convert their notes in connection with certain change in control transactions, as defined in the indenture, may be entitled to a make whole premium in the form of an increase in the conversion rate. In the event of a change in control, in lieu of paying holders a make whole premium, if applicable, we may elect, in some circumstances, to adjust the conversion rate and related conversion obligations so that the 3.75% Notes are convertible into shares of the acquiring or surviving company.

Beginning on April 30, 2010 until April 30, 2013, we may redeem for cash all or part of the 3.75% Notes at a price equal to 100% of the principal amount plus accrued and unpaid interest, if the closing price of our common stock is equal to or greater than 130% of the conversion price then in effect for the 3.75% Notes for at least 20 trading days in

the 30 consecutive trading day period ending on the trading day immediately prior to the date of mailing of the notice of redemption. In addition, we may redeem for cash all or part of the 3.75% Notes at any time on or after April 30, 2010 at certain redemption prices, plus accrued and unpaid interest. Beginning with the six-month interest period commencing on April 30, 2010, and for each six-month interest period thereafter, we will be required to pay contingent interest on any outstanding 3.75% Notes during the applicable interest period if the average trading price of the 3.75% Notes reaches a specified threshold. The contingent interest payable within any

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applicable interest period will equal an annual rate of 0.25% of the average trading price of the 3.75% Notes during a five trading day reference period.

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

## **Off-Balance Sheet Transactions**

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

## ***Leases***

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

We have guaranteed the residual value of the underlying assets under certain of our equipment operating leases at the date of termination of such leases. We have agreed to pay any difference between this residual value and the fair market value of each underlying asset as of the lease termination date. As of September 30, 2008, the maximum guaranteed residual value was approximately \$163.6 million. We believe that no significant payments will be made as a result of the difference between the fair market value of the leased equipment and the guaranteed residual value. However, there can be no assurance that future significant payments will not be required.

## ***Letters of Credit***

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

As of September 30, 2008, we had \$197.0 million in letters of credit outstanding under our credit facility primarily to secure obligations under our casualty insurance program. These are irrevocable stand-by letters of credit with maturities generally expiring at various times throughout 2008 and 2009. Upon maturity, it is expected that the majority of these letters of credit will be renewed for subsequent one-year periods.

## ***Performance Bonds and Parent Guarantees***

Many customers, particularly in connection with new construction, require us to post performance and payment bonds issued by a financial institution known as a surety. These bonds provide a guarantee to the customer that we will perform under the terms of a contract and that we will pay subcontractors and vendors. If we fail to perform under a contract or to pay subcontractors and vendors, the customer may demand that the surety make payments or provide services under the bond. We must reimburse the surety for any expenses or outlays it incurs.

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Under our continuing indemnity and security agreement with our sureties and with the consent of our lenders under our credit facility, we have granted security interests in certain of our assets to collateralize our obligations to the sureties. In addition, under our agreement with the surety that issued bonds on behalf of InfraSource, which remains in place for bonds outstanding under it at the closing of the Merger, we will be required to transfer to the surety certain of our assets as collateral in the event of a default under the agreement. We may be required to post letters of credit or other collateral in favor of the sureties or our customers in the future. Posting letters of credit in favor of the sureties or our customers would reduce the borrowing availability under our credit facility. To date, we have not been required to make any reimbursements to our sureties for bond-related costs. We believe that it is unlikely that we will have to fund significant claims under our surety arrangements in the foreseeable future. As of September 30, 2008, an aggregate of approximately \$979.6 million in original face amount of bonds issued by our sureties were outstanding. Our estimated cost to complete these bonded projects was approximately \$225.3 million as of September 30, 2008.

From time to time, we guarantee the obligations of our wholly owned subsidiaries, including obligations under certain contracts with customers, certain lease obligations and, in some states, obligations in connection with obtaining contractors licenses.

**Contractual Obligations**

As of September 30, 2008, our future contractual obligations are as follows (in thousands):

|                                                                                       | <b>Total</b>      | <b>Remainder<br/>of 2008</b> | <b>2009</b>       | <b>2010</b>      | <b>2011</b>      | <b>2012</b>      | <b>Thereafter</b> |
|---------------------------------------------------------------------------------------|-------------------|------------------------------|-------------------|------------------|------------------|------------------|-------------------|
| Long-term debt principal                                                              | \$ 412,597        | \$ 268,847                   | \$                | \$               | \$               | \$               | \$ 143,750        |
| Long-term debt interest                                                               | 24,483            | 1,347                        | 5,391             | 5,391            | 5,391            | 5,391            | 1,572             |
| Operating lease obligations                                                           | 180,845           | 17,607                       | 51,145            | 36,816           | 29,412           | 18,882           | 26,983            |
| Committed capital expenditures for dark fiber networks under contracts with customers | 71,938            | 12,220                       | 59,692            | 26               |                  |                  |                   |
| <b>Total</b>                                                                          | <b>\$ 689,863</b> | <b>\$ 300,021</b>            | <b>\$ 116,228</b> | <b>\$ 42,233</b> | <b>\$ 34,803</b> | <b>\$ 24,273</b> | <b>\$ 172,305</b> |

Approximately \$268.8 million of principal related to the 4.5% Notes is included in the above table in the Remainder of 2008 column as Long-term Debt principal. However, as a result of conversions, redemptions and repurchases following September 30, 2008, none of the 4.5% Notes remain outstanding.

The committed capital expenditures for dark fiber networks represent commitments related to signed contracts with customers. The amounts are estimates of costs required to build the networks under contract. The actual capital expenditures related to building the networks could vary materially from these estimates.

Actual maturities of our long-term debt may differ from contractual maturities because convertible note holders may convert their notes prior to the maturity dates or subsequent to optional maturity dates.

We believe that it is reasonably possible that within the next 12 months unrecognized tax benefits will decrease \$16.5 million to \$18.3 million due to the expiration of certain statutes of limitations. We are unable to make reasonably reliable estimates regarding the timing of future cash outflows, if any, associated with the remaining unrecognized tax benefits.

Our multi-employer pension plan contributions are determined annually based on our union employee payrolls, which cannot be determined in advance for future periods. As of September 30, 2008, the total unrecognized tax benefit related to uncertain tax positions was \$56.7 million, of which no significant amounts are anticipated to be paid within the next twelve months.

### **Self-Insurance**

We are insured for employer's liability claims, subject to a deductible of \$1.0 million per occurrence, and for general liability and auto liability subject to a deductible of \$3.0 million per occurrence. We are also insured for workers compensation claims, subject to a deductible of \$2.0 million per occurrence. Additionally, we are subject

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to an annual cumulative aggregate liability of up to \$1.0 million on workers' compensation claims in excess of \$2.0 million per occurrence. We also have an employee health care benefits plan for employees not subject to collective bargaining agreements, which is subject to a deductible of \$350,000 per claimant per year.

Losses under all of these insurance programs are accrued based upon our estimates of the ultimate liability for claims reported and an estimate of claims incurred but not reported, with assistance from third-party actuaries. These insurance liabilities are difficult to assess and estimate due to unknown factors, including the severity of an injury, the determination of our liability in proportion to other parties, the number of incidents not reported and the effectiveness of our safety program. The accruals are based upon known facts and historical trends and management believes such accruals to be adequate. As of December 31, 2007 and September 30, 2008, the gross amount accrued for insurance claims totaled \$152.0 million and \$148.9 million, with \$110.1 million and \$107.4 million considered to be long-term and included in other non-current liabilities. Related insurance recoveries/receivables as of December 31, 2007 and September 30, 2008 were \$22.1 million and \$15.4 million, of which \$11.9 million and \$4.7 million are included in prepaid expenses and other current assets and \$10.2 million and \$10.7 million are included in other assets, net.

Effective September 29, 2008, Quanta consummated a novation transaction that released its distressed casualty insurance carrier for the policy periods August 1, 2000 to February 28, 2003 from all further obligations in connection with the policies in effect during that period in exchange for the payment to us of an agreed amount. Our current casualty insurance carrier assumed all obligations under the policies in effect during that period; however, we are obligated to indemnify the carrier in full for any liabilities under the policies assumed. At September 30, 2008, we estimated that the total future claim amounts associated with the novated policies was \$6.6 million. The estimate of the potential range of these future claim amounts is between \$2.0 million and \$8.0 million, but the actual amounts ultimately paid by us in connection with these claims, if any, could vary materially from the above range and could be impacted by further claims development. During the second quarter of 2008, we recorded an allowance of \$3.4 million for potentially uncollectible amounts estimated to be ultimately due from the distressed insurer. As a result of the novation transaction, the net receivable balance remaining was written off in the third quarter of 2008, with an immaterial impact to the three and nine month periods ended September 30, 2008.

## **Concentration of Credit Risk**

We are subject to concentrations of credit risk related primarily to our cash and cash equivalents and accounts receivable. We maintain substantially all of our cash investments with what we believe to be high credit quality financial institutions. In accordance with our investment policies, these institutions are authorized to invest this cash in a diversified portfolio of what we believe to be high-quality overnight money market funds and commercial paper with short-term maturities. Although we do not currently believe the principal amount of these investments is subject to any material risk of loss, the recent volatility in the financial markets is likely to significantly impact the interest income we receive from these investments. In addition, we grant credit under normal payment terms, generally without collateral, to our customers, which include electric power and gas companies, telecommunications and cable television system operators, governmental entities, general contractors, and builders, owners and managers of commercial and industrial properties located primarily in the United States. Consequently, we are subject to potential credit risk related to changes in business and economic factors throughout the United States, which may be heightened as a result of the current financial crisis and volatility of the markets. However, we generally have certain statutory lien rights with respect to services provided. Under certain circumstances, such as foreclosures or negotiated settlements, we may take title to the underlying assets in lieu of cash in settlement of receivables. Historically, some of our customers have experienced significant financial difficulties, and others may experience financial difficulties in the future. These difficulties expose us to increased risk related to collectibility of receivables for services we have performed. No customer accounted for more than 10% of accounts receivable as of December 31, 2007 or September 30, 2008 or revenues for the three and nine months ended September 30, 2007 or 2008.

## **Litigation**

InfraSource, certain of its officers and directors and various other parties, including David R. Helwig, the former chief executive officer of InfraSource and a former director of Quanta, were defendants in a lawsuit seeking

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unspecified damages filed in the State District Court in Harris County, Texas on September 21, 2005. The plaintiffs alleged that the defendants violated their fiduciary duties and committed constructive fraud by failing to maximize shareholder value in connection with certain acquisitions by InfraSource Incorporated that closed in 1999 and 2000 and the acquisition of InfraSource Incorporated by InfraSource in 2003 and committed other acts of misconduct following the filing of the petition. The parties to this litigation settled the material claims in January 2008 and the lawsuit was dismissed by the court on March 4, 2008. The amount of the settlement was reserved in 2007, and, therefore, the payment of the settlement amount had no impact on our results of operations for the first nine months of 2008.

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

## **Related Party Transactions**

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

## **New Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes methods used to measure fair value and expands disclosure requirements about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal periods, as it relates to financial assets and liabilities, as well as for any non-financial assets and liabilities that are carried at fair value. SFAS No. 157 also requires certain tabular disclosure related to the application of SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets and SFAS No. 142, Goodwill and Other Intangible Assets. On November 14, 2007, the FASB provided a one year deferral for the implementation of SFAS No. 157 for non-financial assets and liabilities. SFAS No. 157 excludes from its scope SFAS No. 123(R) and its related interpretive accounting pronouncements that address share-based payment transactions. We adopted SFAS No. 157 on January 1, 2008 as it applies to our financial assets and liabilities, and based on the November 14, 2007 deferral of SFAS No. 157 for non-financial assets and liabilities, we will begin following the guidance of SFAS No. 157 with respect to our non-financial assets and liabilities in the quarter ended March 31, 2009. We do not currently have any material financial assets and liabilities recognized on our balance sheet that are impacted by the partial adoption of SFAS No. 157. Additionally, we do not currently have any material non-financial assets or liabilities that are carried at fair value on a recurring basis; however, we do have non-financial assets that are evaluated against measures of fair value on a non-recurring or as-needed basis, including goodwill, other intangibles and long-term assets held and used. Based on the financial and non-financial assets and liabilities on our balance sheet as of September 30, 2008, we do not expect the adoption of SFAS No. 157 to have a material impact on our consolidated financial position, results of operations or cash flows. In October 2008, the FASB issued FASB Staff Position FSP FAS 157-3 Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. FSP FAS 157-3 provides clarifying guidance with respect to the application of SFAS No. 157 in determining the fair value of a financial asset when the market for that asset is not active. FSP FAS 157-3 was effective upon its issuance. The application of FSP FAS 157-3 did not have a material impact on our consolidated financial position, results of operations or cash flows.

On January 1, 2008, we adopted SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB No. 115. SFAS No. 159 permits entities to choose to measure at fair value many financial instruments and certain other items at fair value that were not previously required to be measured at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and

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liabilities to be carried at fair value. The adoption of SFAS No. 159 did not have any material impact on our consolidated financial position, results of operations or cash flows.

On January 1, 2008, we adopted EITF Issue No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. EITF 06-11 requires that a realized income tax benefit from dividends or dividend equivalent units paid on unvested restricted shares and restricted share units be reflected as an increase in contributed surplus and as an addition to the company's excess tax benefit pool, as defined under SFAS No. 123(R). Because we did not declare any dividends during the first nine months of 2008 and do not currently anticipate declaring dividends in the near future, the adoption of EITF 06-11 did not have any impact during the first nine months of 2008, and is not expected to have a material impact in the near term, on our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements an amendment of ARB No. 51. SFAS No. 160 addresses the accounting and reporting framework for minority interests by a parent company. SFAS No. 160 is to be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Accordingly, we will adopt SFAS No. 160 on January 1, 2009. As we do not currently have any subsidiaries with non-controlling interests, the adoption of SFAS No. 160 is not anticipated to have a material impact on our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. Earlier application is prohibited. Assets and liabilities that arose from business combinations occurring prior to the adoption of SFAS No. 141(R) cannot be adjusted upon the adoption of SFAS No. 141(R). SFAS No. 141(R) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the business combination; establishes the acquisition date as the measurement date to determine the fair value for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information needed to evaluate and understand the nature and financial effect of the business combination. As it relates to recognizing all (and only) the assets acquired and liabilities assumed in a business combination, costs an acquirer expects but is not obligated to incur in the future to exit an activity of an acquiree or to terminate or relocate an acquiree's employees are not liabilities at the acquisition date but must be expensed in accordance with other applicable generally accepted accounting principles. If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer must report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, which must not exceed one year from the acquisition date, the acquirer will retrospectively adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date. The acquirer will be required to expense all acquisition-related costs in the periods such costs are incurred, other than costs to issue debt or equity securities in connection with the acquisition. We do not expect SFAS No. 141(R) to have an impact on our consolidated financial position, results of operations or cash flows at the date of adoption, but it could have a material impact on our consolidated financial position, results of operations or cash flows in the future when it is applied to acquisitions which occur in 2009 and beyond.

In December 2007, the SEC published Staff Accounting Bulletin (SAB) No. 110 (SAB 110). SAB 110 expresses the views of the SEC staff regarding the use of a simplified method, as discussed in SAB No. 107 (SAB 107), in developing an estimate of expected term of plain vanilla share options in accordance with SFAS No. 123(R). In particular, the SEC staff indicated in SAB 107 that it will accept a company's election to use the simplified method, regardless of whether the company has sufficient information to make more refined estimates of expected term. However, the SEC staff stated in SAB 107 that it would not expect a company to use the simplified method for share option grants after December 31, 2007. In SAB 110, the SEC staff states that they would continue to accept, under

certain circumstances, the use of the simplified method beyond December 31, 2007. Because we currently do not anticipate issuing stock options in the near future, SAB 110 is not anticipated to have a material impact on our consolidated financial position, results of operations or cash flows in the near term.

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In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities An Amendment of FASB No. 133. SFAS No. 161 requires enhanced disclosures to enable investors to better understand how a reporting entity's derivative instruments and hedging activities impact the entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued after November 15, 2008, including interim financial statements. Although, early application is encouraged, we will adopt SFAS No. 161 on January 1, 2009. As we have not entered into any material derivatives or hedging activities, SFAS No. 161 is not anticipated to have a material impact on our consolidated financial position, results of operations, cash flows or disclosures.

In April 2008, the FASB issued FSP 142-3, Determination of the Useful Life of Intangible Assets. FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142. The intent of FSP 142-3 is to improve the consistency between the useful life of an intangible asset and the period of expected cash flows used to measure its fair value and to enhance existing disclosure requirements relating to intangible assets. FSP 142-3 is effective for fiscal years beginning after December 15, 2008 and should be applied prospectively to intangible assets acquired after the effective date. Early adoption is prohibited. Accordingly, we will adopt FSP 142-3 on January 1, 2009. We do not expect FSP 142-3 to have an impact on our consolidated financial position, results of operations or cash flows at the date of adoption, but it could have a material impact on our consolidated financial position, results of operations or cash flows in future periods.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of non-governmental entities that are presented in conformity with generally accepted accounting principles in the United States. SFAS No. 162 will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. We will adopt SFAS No. 162 once it is effective, but we have not yet determined the impact, if any, on our consolidated financial statements.

In May 2008, the FASB issued FSP APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). FSP APB 14-1 will require issuers of convertible debt instruments within its scope to first determine the carrying amount of the liability component of the convertible debt by measuring the fair value of a similar liability that does not have an associated equity component. Issuers will then calculate the carrying amount of the equity component represented by the embedded conversion option by deducting the fair value of the liability component from the initial proceeds ascribed to the convertible debt instrument as a whole. The excess of the principal amount of the liability component over its initial fair value will be amortized to interest expense using the effective interest method. FSP APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Accordingly, we will adopt FSP APB 14-1 on January 1, 2009 and will apply FSP APB 14-1 retrospectively to all periods presented. For the periods prior to those presented, we will record a cumulative effect of the change in accounting principle as of the beginning of the first period presented. The impact of FSP APB 14-1 may be material to our results of operations during certain periods but is not expected to materially impact our cash flows. We are in the process of determining the cumulative effect of change in accounting principle and the impacts to our consolidated financial position, results of operations and cash flows for all periods presented.

In June 2008, the FASB issued Staff Position EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. EITF 03-6-1 states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities under the definition of SFAS No. 128, Earnings per Share and should be included in the computation of both basic and diluted earnings per share. EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after

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December 15, 2008, and interim periods within those years. Accordingly, we will adopt EITF 03-6-1 on January 1, 2009. All prior period earnings per share data presented will be adjusted retrospectively to conform to the provisions of EITF 03-6-1. Early application is not permitted. We have granted unvested share-based payment awards that have non-forfeitable rights to dividends in the form of restricted stock awards, which are currently accounted for under the treasury stock method in diluted earnings per share. The

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treasury stock method specifies that only unvested restricted common shares that are dilutive be included in weighted average diluted shares outstanding. Under EITF 03-6-1, we will retrospectively restate earnings per share data for prior periods beginning in the first quarter of 2009 to include all unvested restricted common shares as participating securities as of the date of grant. The adoption of EITF 03-6-1 is not anticipated to have any material impact on our consolidated financial position, results of operations or cash flows but may lower basic and diluted earnings per share amounts previously reported due to the inclusion of the additional shares in computing these amounts.

In June 2008, the FASB ratified EITF Issue 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock* (EITF 07-5). The primary objective of EITF 07-5 is to provide guidance for determining whether an equity-linked financial instrument or embedded feature within a contract is indexed to an entity's own stock, which is a key criterion of the scope exception to paragraph 11(a) of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This criterion is also important in evaluating whether EITF 00-19,

*Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* applies to certain financial instruments that are not derivatives under SFAS No. 133. An equity-linked financial instrument or embedded feature within a contract that is not considered indexed to an entity's own stock could be required to be classified as an asset or liability and marked-to-market through earnings. EITF 07-5 specifies a two-step approach in evaluating whether an equity-linked financial instrument or embedded feature within a contract is indexed to its own stock. The first step involves evaluating the instrument's contingent exercise provisions, if any, and the second step involves evaluating the instrument's settlement provisions. EITF 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and must be applied to all instruments outstanding as of the effective date. Accordingly, we will adopt EITF 07-5 on January 1, 2009, but have not yet determined the impact, if any, on our consolidated financial position, results of operations and cash flows.

## **Outlook**

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

Over the past two years, many utilities across the country increased or indicated plans to increase spending on their transmission and distribution systems, with a more significant focus on the build-out of the transmission grid. As a result, new construction, extensive pole change-outs, line upgrades and maintenance projects on many systems are occurring. While we expect this trend to continue over the next several quarters, capital constraints impacting our customers as a result of the current economic downturn could slow this spending, particularly in connection with their distribution systems.

Subject to changes in the economy, we also anticipate increased spending over the next decade as a result of the Energy Policy Act of 2005 (the Energy Act), which requires the power industry to meet federal reliability standards for its transmission and distribution systems and provides further incentives to the industry to invest in and improve maintenance on its systems, although rule-making initiatives under the Energy Act could be impacted, both in timing and in scope, by a new presidential administration. Additionally, we expect state and federal renewable energy standards to result in the need for additional transmission lines and substations resulting from the construction of solar and wind electric generating power plants. As a result of these and other factors, we expect a continued shift in our services mix to a greater proportion of high-voltage electric power transmission and substation projects over the long term, as well as opportunities to provide installation services for renewable projects. Many of these projects have a long-term horizon, and timing and scope can be negatively affected by numerous factors, including regulatory permitting and availability of funding.

Several industry and market trends are also prompting customers in the electric power industry to seek outsourcing partners, such as us. These trends include an aging utility workforce, increased spending, increasing costs and labor

issues. The need to ensure available labor resources for larger projects is also driving strategic relationships with customers.

We also see potential growth opportunities in our gas operations, primarily in natural gas gathering pipeline construction and maintenance services. Our gas operations have been challenged by lower margins overall, due in

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part to our gas distribution services that have been impacted by certain lower margin contracts and by recent declines in new housing construction in certain sectors of the country. With the increased focus on natural gas gathering pipelines and other more profitable services, however, we anticipate increased revenues as well as improvement in the margins for these operations in the future, subject to the impact of economic conditions as well as natural gas prices.

In the telecommunications industry, various initiatives are underway by several wireline carriers and government organizations that provide us with opportunities, in particular, initiatives for fiber to the premises (FTTP) and fiber to the node (FTTN). Such initiatives have been underway by Verizon, AT&T and other telecommunications providers, and municipalities and other government jurisdictions have also become active in these initiatives. In the third quarter of 2008, we have seen a slow-down in FTTP and FTTN deployment, which we anticipate will continue through the fourth quarter of 2008. We have not been advised by our customers that this is a change in strategic direction, and we believe we may see the same levels of spending in 2009 as occurred in 2008. In connection with our wireless operations, several wireless companies have announced plans to increase their cell site deployments over the next few years, including the expansion of next generation technology, and we anticipate increased opportunities from these plans over the long-term. Currently, however, we are experiencing decreased spending by our wireless telecommunications customers on their networks, which we expect will affect our business through the fourth quarter of 2008.

We anticipate that the initiatives by the telecom carriers will serve as a catalyst for the cable industry to begin a new network upgrade cycle to expand its service offerings in an effort to retain and attract customers.

Our dark fiber licensing business is also experiencing growth primarily through the expansion into additional geographic markets, with a focus within those markets on education and healthcare customers where secure high-speed networks are important. We continue to see opportunities for growth both in the markets we currently serve and new markets, although we cannot predict the negative impact, if any, of the current economic downturn on these growth opportunities. To support the growth in this business, we anticipate the need for continued increased capital expenditures. Our Dark Fiber segment typically generates higher margins than our Infrastructure Services segment, but we can give no assurance that the Dark Fiber segment margins will continue at historical levels.

Historically, our customers have continued to spend throughout short-term economic softness or weak recessions. A long-term or deep recession, however, would likely have some negative impact on our customers' spending. In addition, the volatility of the capital markets may negatively affect our customers' plans for future projects, which could be delayed, reduced or eliminated if funding is not available. Despite reductions in capital spending by some of our customers, our revenues may not decline, as utilities continue outsourcing more of their work, in part due to their aging workforce issues. Additionally, many of the capital expenditure reductions announced by utilities relate to power generation and areas other than transmission and distribution systems, and therefore, we may not be significantly impacted by these reductions. We believe that we remain the partner of choice for many utilities in need of broad infrastructure expertise, specialty equipment and workforce resources. Furthermore, as new technologies emerge for communications and digital services such as voice, video and data continue to converge, telecommunications and cable service providers are expected to work quickly to deploy fast, next-generation fiber networks, and we are recognized as a key partner in deploying these services.

With the growth in several of our markets and our margin enhancement initiatives, we continue to see our gross margins generally improve, although reductions in spending by our customers, particularly in our telecommunications operations, could negatively affect our margins. We continue to focus on the elements of the business we can control, including cost control, the margins we accept on projects, collecting receivables, ensuring quality service and rightsizing initiatives to match the markets we serve. These initiatives include aligning our workforce with our current revenue base, evaluating opportunities to reduce the number of field offices and evaluating our non-core assets for potential sale. Such initiatives, together with realignments associated with the ongoing integration of the InfraSource

operations and any other future acquisitions, could result in future charges related to, among other things, severance, retention, the shutdown and consolidation of facilities, property disposal and other exit costs.

Capital expenditures for the remainder of 2008 are expected to be approximately \$25 million, of which \$12 million of these expenditures are targeted for dark fiber network expansion with the majority of the remaining

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expenditures for operating equipment in the Infrastructure Services segment. We expect expenditures for the remainder of 2008 to continue to be funded substantially through internal cash flows and cash on hand.

On August 30, 2007, we consummated the Merger with InfraSource, which enhances our resources and expands our service portfolio through InfraSource's complementary businesses, strategic geographic footprint and skilled workforce. We have already begun to realize the benefits of the Merger through additional opportunities, and we continue to expect that the combined company will be able to better serve our customers as demand grows in their respective industries.

We continue to evaluate other potential strategic acquisitions of companies to broaden our customer base, expand our geographic area of operation and grow our portfolio of services. We believe that additional attractive acquisition candidates exist primarily as a result of the highly fragmented nature of the industry, the inability of many companies to expand and modernize due to capital constraints and the desire of owners of acquisition candidates for liquidity. We also believe that our financial strength and experienced management team will be attractive to acquisition candidates.

We believe that we are adequately positioned to capitalize upon opportunities and trends in the industries we serve because of our proven full-service operating units with broad geographic reach, financial capability and technical expertise. Our acquisition of InfraSource further enhanced these strengths. Additionally, we believe that these industry opportunities and trends will increase the demand for our services; however, we cannot predict the actual timing or magnitude of the impact on us of these opportunities and trends.

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

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

Projected operating or financial results;

The effects of any acquisitions and divestitures we may make, including the acquisition of InfraSource;

Expectations regarding our business outlook, growth and capital expenditures;

The effects of competition in our markets;

The benefits of the Energy Policy Act of 2005 and renewable energy initiatives;

The current economic conditions and trends in the industries we serve; and

Our ability to achieve cost savings.

These forward-looking statements are not guarantees of future performance and involve or rely on a number of risks, uncertainties, and assumptions that are difficult to predict or beyond our control. We have based our forward-looking statements on our management's beliefs and assumptions based on information available to our management at the time the statements were made. We caution you that actual outcomes and results may differ materially from what is expressed, implied or forecasted by our forward-looking statements and that any or all of our forward-looking

statements may turn out to be wrong. Those statements can be affected by inaccurate assumptions and by known or unknown risks and uncertainties, including the following:

Quarterly variations in our operating results;

Our ability to achieve anticipated synergies and other benefits from our Merger with InfraSource;

Unexpected costs or liabilities or other adverse impacts that may arise as a result of our acquisition of InfraSource;

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Adverse changes in economic and financial conditions, including the recent volatility in the capital markets, and trends in relevant markets;

Delays, reductions in scope or cancellations of existing projects, including as a result of capital constraints that may impact our customers;

Our ability to effectively compete for new projects;

Our dependence on fixed price contracts and the potential to incur losses with respect to those contracts;

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

Our ability to generate internal growth;

Potential failure of the Energy Policy Act of 2005 or renewable energy initiatives to result in increased spending on the electrical power transmission infrastructure;

Our ability to attract skilled labor and retain key personnel and qualified employees;

The potential shortage of skilled employees;

Our growth outpacing our infrastructure;

Our ability to successfully identify, complete and integrate acquisitions;

The adverse impact of goodwill or other intangible asset impairments;

Estimates and assumptions in determining our financial results and backlog;

Unexpected costs or liabilities that may arise from lawsuits or indemnity claims related to the services we perform;

Liabilities for claims that are not self-insured or for claims that our casualty insurance carrier fails to pay;

Potential liabilities relating to occupational health and safety matters;

The potential inability to realize a return on our capital investments in our dark fiber infrastructure;

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

Our ability to realize our backlog;

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

Beliefs and assumptions about the collectibility of receivables;

Our ability to obtain performance bonds;

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

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

Potential exposure to environmental liabilities;

Risks associated with expanding our business in international markets, including losses that may arise from currency fluctuations;

Requirements relating to governmental regulation and changes thereto, including state and federal telecommunication regulations affecting our dark fiber leasing business and additional regulation relating to existing or potential foreign operations;

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

The cost of borrowing, availability of credit, debt covenant compliance, interest rate fluctuations and other factors affecting our financing and investment activities and thereby our ability to grow our operations;

The potential conversion of our outstanding 3.75% Notes into cash and/or common stock; and

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The other risks and uncertainties as are described elsewhere within this report and under Item 1A Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007 as well may be detailed from time to time in our other public filings with the SEC.

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

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

The information in this section should be read in connection with the information on financial market risk related to changes in interest rates and currency exchange rates in Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our Annual Report on Form 10-K for the year ended December 31, 2007. Our primary exposure to market risk relates to unfavorable changes in concentration of credit risk, interest rates and currency exchange rates. We are currently not exposed to any significant market risks or interest rate risk from the use of derivatives.

*Credit Risk.* We are subject to concentrations of credit risk related to our cash and cash equivalents and accounts receivable. As we grant credit under normal payment terms, we are subject to potential credit risk related to our customers' ability to pay for services provided. This risk may be heightened as a result of the current financial crisis and volatility of the markets. However, we believe the concentration of credit risk related to trade accounts receivable is limited because of the diversity of our customers. We perform ongoing credit risk assessments of our customers and financial institutions and obtain collateral or other security from our customers when appropriate. Most of our cash is invested in a diversified portfolio of overnight money market funds and high-quality, A1/P1 commercial paper with maturities of 90 days or less. We also manage the concentration risk of our commercial paper investments by maintaining a diversification policy. Although we do not currently believe the principal amounts of these investments are subject to any material risk of loss, the recent volatility in the financial markets is likely to significantly impact the interest income we receive from these investments.

*Interest Rate.* Our exposure to market rate risk for changes in interest rates relates to our convertible subordinated notes. The fair market value of our convertible subordinated notes is subject to interest rate risk because of their fixed interest rate and market risk due to the convertible feature of our convertible subordinated notes. Generally, the fair market value of fixed interest rate debt will increase as interest rates fall and decrease as interest rates rise. The fair market value of our convertible subordinated notes will also increase as the market price of our stock increases and decrease as the market price falls. The interest and market value changes affect the fair market value of our convertible subordinated notes but do not impact their carrying value. The fair values of our convertible subordinated notes based upon market prices on or before the dates specified were as follows (in millions):

|             | <b>December 31, 2007</b>         |                   | <b>September 30, 2008</b>        |                   |
|-------------|----------------------------------|-------------------|----------------------------------|-------------------|
|             | <b>Principal<br/>Outstanding</b> | <b>Fair Value</b> | <b>Principal<br/>Outstanding</b> | <b>Fair Value</b> |
| 4.5% Notes  | \$ 270.0                         | \$ 640.2          | \$ 268.8                         | \$ 680.7          |
| 3.75% Notes | 143.8                            | 185.4             | 143.8                            | 187.1             |
| Total       | \$ 413.8                         | \$ 825.6          | \$ 412.6                         | \$ 867.8          |

As a result of certain repurchases, redemptions and conversions, which are described in further detail in Note 7 of our consolidated financial statements included in this report, none of the 4.5% Notes remain outstanding as of October 8, 2008. In addition, the volatility of the credit markets is likely to significantly impact our interest income related to our cash investments.

*Currency Risk.* The business of our Canadian subsidiaries is subject to currency fluctuations. We do not expect any such currency risk to be material.

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**Item 4. *Controls and Procedures.***

Attached as exhibits to this Quarterly Report on Form 10-Q are certifications of Quanta's Chief Executive Officer and Chief Financial Officer that are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the Exchange Act). This *Controls and Procedures* section includes information concerning the controls and controls evaluation referred to in the certifications, and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

***Evaluation of Disclosure Controls and Procedures***

Our management has established and maintains a system of disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, such as this quarterly report, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The disclosure controls and procedures are also designed to provide reasonable assurance that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this quarterly report, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(b) of the Exchange Act. This evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer. Based on this evaluation, these officers have concluded that, as of September 30, 2008, our disclosure controls and procedures were effective to provide reasonable assurance of achieving their objectives.

***Internal Control over Financial Reporting***

There has been no change in our internal control over financial reporting during the quarter ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

***Design and Operation of Control Systems***

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

**PART II OTHER INFORMATION**

**QUANTA SERVICES, INC. AND SUBSIDIARIES**

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

InfraSource, certain of its officers and directors and various other parties, including David R. Helwig, the former chief executive officer of InfraSource and a former director of Quanta, were defendants in a lawsuit seeking unspecified

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damages filed in the State District Court in Harris County, Texas on September 21, 2005. The plaintiffs alleged that the defendants violated their fiduciary duties and committed constructive fraud by failing to maximize shareholder value in connection with certain acquisitions by InfraSource Incorporated that closed in 1999 and 2000 and the acquisition of InfraSource Incorporated by InfraSource in 2003 and committed other acts of misconduct following the filing of the petition. The parties to this litigation settled the material claims in January 2008 and the lawsuit was dismissed by the court on March 4, 2008. The amount of the settlement was reserved in 2007, and therefore the payment of the settlement amount had no impact on our results of operations for the first nine months of 2008.

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

### **Item 1A. Risk Factors.**

Except as provided below, as of the date of this filing, there have been no material changes from the risk factors previously disclosed in Item 1A to Part I of our Annual Report on Form 10-K for the year ended December 31, 2007 (2007 Annual Report). An investment in our common stock involves various risks. When considering an investment in our company, you should carefully consider all of the risk factors described in our 2007 Annual Report. These risks and uncertainties are not the only ones facing us and there may be additional matters that are not known to us or that we currently consider immaterial. All of these risks and uncertainties could adversely affect our business, financial condition or future results and, thus, the value of an investment in our company.

***The recent economic downturn and the financial and credit crisis may adversely impact our customers' future spending as well as payment for our services and, as a result, our operations and growth.***

Based on a number of economic indicators, it appears that growth in economic activity has slowed substantially. At the present time, the rate at which the economy will slow has become increasingly uncertain. Slowing economic growth may adversely impact the demand for our services and potentially result in the delay or cancellation of projects. Many of our customers finance their projects through cash flow from operations, the incurrence of debt or the issuance of equity. Recently, there has been a significant decline in the credit markets and the availability of credit. Additionally, many of our customers' equity values have substantially declined. A reduction in cash flow and the lack of availability of debt or equity financing may result in a reduction in our customers' spending for our services and may also impact the ability of our customers to pay amounts owed to us, which could have a material adverse effect on our operations and our ability to grow at historical levels.

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

#### **Unregistered Sales of Securities**

In July 2008, Quanta completed one acquisition of a helicopter-assisted transmission line construction, maintenance and repair company in which some of the purchase price consideration consisted of the issuance of unregistered securities of Quanta. The aggregate consideration of \$6.4 million paid in this transaction was \$4.1 million in cash and 82,862 shares of common stock. This acquisition was not affiliated with any prior acquisition.

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All securities listed in the following table were shares of common stock. Quanta relied on Section 4(2) of the Securities Act of 1933, as amended (the Securities Act), as the basis for exemption from registration. For all issuances, the purchasers were accredited investors as defined in Rule 501 of the Securities Act. All issuances were to owners of businesses acquired in privately negotiated transactions and not pursuant to public solicitations.

| Period                        | Number of<br>Shares | Purchaser                           | Consideration               |
|-------------------------------|---------------------|-------------------------------------|-----------------------------|
| July 1, 2008    July 31, 2008 | 82,862              | Stockholders of acquired<br>company | Sale of acquired<br>company |

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**Table of Contents****Issuer Purchases of Equity Securities**

The following table contains information about our purchases of equity securities during the three months ended September 30, 2008.

| <b>Period</b>                    | <b>(a) Total<br/>Number of<br/>Shares<br/>Purchased</b> | <b>(b) Average<br/>Price<br/>Paid Per Share</b> | <b>(c) Total<br/>Number<br/>of Shares<br/>Purchased<br/>as Part of<br/>Publicly<br/>Announced<br/>Plans<br/>or Programs</b> | <b>(d) Maximum<br/>Number of<br/>Shares<br/>that may yet be<br/>Purchased<br/>Under<br/>the Plans or<br/>Programs</b> |
|----------------------------------|---------------------------------------------------------|-------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------|
| August 1, 2008 – August 31, 2008 | 8,090(i)                                                | \$ 32.45                                        | None                                                                                                                        | None                                                                                                                  |

(i) Represents shares purchased from employees to satisfy tax withholding obligations in connection with the vesting of restricted stock awards pursuant to the Quanta Services, Inc. 2001 Stock Incentive Plan (as amended and restated March 13, 2003), the Quanta Services, Inc. 2007 Stock Incentive Plan and the InfraSource Services, Inc. 2004 Omnibus Stock Incentive Plan, as amended.

**Item 5. Other Information.**

The following events occurred subsequent to the period covered by this Form 10-Q and are reportable under Form 8-K.

Item 5.02. Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements for Certain Officers.

On November 6, 2008, Quanta entered into amendments to the employment agreements of (i) John R. Colson, the Company's Chief Executive Officer, (ii) James H. Haddox, the Company's Chief Financial Officer, (iii) John R. Wilson, the Company's President – Electric Power and Gas Division and (iv) Kenneth W. Trawick, the Company's Telecommunications and Cable Television Division, to ensure that the timing of any potential severance payments required in the future will satisfy the requirements of Section 409A of the Internal Revenue Code of 1986, as amended. The above description of the employment agreement amendments is qualified in its entirety by reference to the full text of the amendments, each of which is filed as an exhibit to this report.

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

| <b>Exhibit<br/>No</b> | <b>Description</b>                                                                                                                                                                                                    |
|-----------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1                   | Restated Certificate of Incorporation (previously filed as Exhibit 3.3 to the Company's Form 10-Q (No. 001-13831) filed August 14, 2003 and incorporated herein by reference)                                         |
| 3.2                   | Amended and Restated Bylaws (previously filed as Exhibit 3.2 to the Company's 2000 Form 10-K (No. 001-13831) filed April 2, 2001 and incorporated herein by reference)                                                |
| 10.1+*                | Amendment No. 1 to Second Amended and Restated Employment Agreement dated as of November 6, 2008, by and between Quanta Services, Inc. and John R. Colson (filed herewith)                                            |
| 10.2+*                | Amendment No. 1 to Second Amended and Restated Employment Agreement dated as of November 6, 2008, by and between Quanta Services, Inc. and James H. Haddox (filed herewith)                                           |
| 10.3+*                | Amendment No. 2 to Employment Agreement dated as of November 6, 2008, by and between Quanta Services, Inc. and Kenneth W. Trawick (filed herewith)                                                                    |
| 10.4+*                | Amendment No. 1 to Amended and Restated Employment Agreement dated as of November 6, 2008, by and between Quanta Services, Inc. and John R. Wilson (filed herewith)                                                   |
| 31.1*                 | Certification of Periodic Report by Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) and pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)                                       |
| 31.2*                 | Certification of Periodic Report by Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) and pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)                                       |
| 32.1*                 | Certification of Periodic Report by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith) |

+ Management contracts or compensatory plans or arrangements

\* Filed or furnished herewith

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**SIGNATURE**

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

Quanta Services, Inc.

By: /s/ Derrick A. Jensen  
Derrick A. Jensen  
*Vice President, Controller and  
Chief Accounting Officer*

Dated: November 10, 2008

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**INDEX TO EXHIBITS**

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| * Filed or furnished herewith                                |                                                                                                                                                                                                                       |