ENGLOBAL CORP
Form 10-K/A
March 29, 2007

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

Form 10-K/A

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

For the fiscal year ended December 31, 2006

or

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

For the transition period from __________ to __________

Commission File No. 001-14217

ENGlobal Corporation
(Exact name of registrant as specified in its charter)

Nevada	88-0322261
(State or other jurisdiction of incorporation or organization)	(I.R.S Employer Identification No.)

654 North Sam Houston Parkway East, Suite 400	77060-5914
(Address of principal executive offices)	(Zip code)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, $0.001 par value	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Exchange Act:
None

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

Yes ___ No X

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

Yes ___ No X

Indicate by check mark whether the registrant: (1) has filed all repo
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of

1934 during the preceding 12 months (or for such shortened period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

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

Yes ___ No X

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

Large accelerated filer ___ Accelerated filer X Non-accelerated filer ___

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

Yes ___ No X

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant on June 30, 2006 was $126,159,307 (based upon the closing price for shares of common stock as reported by the American Stock Exchange on that date).

The number of shares outstanding of the registrant's common stock on March 15, 2007 is as follows:

$0.001 Par Value Common Stock 26,829,090 shares

DOCUMENTS INCORPORATED BY REFERENCE
Responses to Items 10, 11, 12, 13 and 14 of Part III of this report are incorporated herein by reference to certain information contained in the Company's definitive proxy statement for its 2007 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission on or before April 30, 2007.

EXPLANATORY NOTE

This Amendment No. 1 (this "Form 10-K/A") to our Annual Report on Form 10-K for the year ended December 31, 2006 that was originally filed on March 16, 2007 (the "Original Filing"), is being filed to correct certain references and clerical errors.

For the convenience of the reader, this Form 10-K/A sets out the Original Filing in its entirety. However, this Form 10-K/A only amends and restates the following Items of the Original Filing:

Cover Page - A clerical error on the cover page has been corrected; the Original Filing should have indicated that disclosure of delinquent filers pursuant to Item 405 of Regulation S-K will be contained in the definitive proxy statement.

Page 42 - Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting, the last sentence should read: "Our report thereon dated March 15, 2007 expressed an unqualified opinion."

Page 44 - Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements, the last sentence was omitted and should read: "As discussed in Note 11 to the consolidated financial statements, the Company adopted Statement of Accounting Standards No. 123 (revised 2004), "Share-Based Payment", during the year ended December 31, 2006.

Page 81 - Part III, Items 10, 12, 13 and 14 should refer to the 2007 annual meeting of stockholders.

Finally, in order to provide for completeness in our annual report filing, certain exhibits that were not available in a form acceptable for filing with the SEC, have been added. The Exhibit listing is provided in its entirety on pages 82 through 86.

No attempt has been made in this Form 10-K/A to modify or update other disclosures presented in the Original Filing, other than to correct typographical and other immaterial errors. This Form 10-K/A does not reflect events occurring after the filing of the Original Filing or modify or update disclosures affected by subsequent events. None of the additional exhibits filed herewith update or are affected by subsequent events. Accordingly, this Form 10-K/A should be read in conjunction with our filings made with the Securities and Exchange Commission subsequent to the filing of the Original Filing, including our current reports on Form 8-K filed on March 16, 2007.

i

ENGlobal Corporation

2006 ANNUAL REPORT ON FORM 10-K

TABLE OF CONTENTS

PART I

PAGE

ITEM 1.	BUSINESS	5
ITEM 1A.	RISK FACTORS	16
ITEM 1B.	UNRESOLVED STAFF COMMENTS	20
ITEM 2.	PROPERTIES	20
ITEM 3.	LEGAL PROCEEDINGS	21
ITEM 4.	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	21
	PART II	
ITEM 5.	MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	22
ITEM 6.	SELECTED FINANCIAL DATA	25
ITEM 7.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION	27
ITEM 7A.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	40
ITEM 8.	FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	40
ITEM 9.	CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	77
ITEM 9A.	CONTROLS AND PROCEDURES	77
	PART III	
ITEM 10.	DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT	81
ITEM 11.	EXECUTIVE COMPENSATION	81
ITEM 12.	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	81
ITEM 13.	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS	81
ITEM 14.	PRINCIPAL ACCOUNTING FEES AND SERVICES	81
	PART IV	
ITEM 15.	EXHIBITS, FINANCIAL STATEMENTS AND SCHEDULES	82
	SIGNATURES	
	SIGNATURES	87

PART I

CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K ("Report"), including "Management's Discussion and Analysis of Financial Condition and Results of Operations," as well as oral statements made by the Company and its officers, directors or employees, contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such forward-looking statements are based on Management's beliefs, current expectations, estimates and projections about the industries that the Company and its subsidiaries serve, the economy and the Company in general. The words "expect," "anticipate," "intend," "plan," "believe," "seek," "estimate" and similar expressions are intended to identify such forward-looking statements; however, this Report also contains other forward-looking statements in addition to historical information. Although we believe that the expectations reflected in the forward-looking statements are reasonable, such forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to differ materially from historical results or from any results expressed or implied by such forward-looking statements. The Company cautions readers that the following important factors and the risks described in the section of this report entitled "Risk Factors", among others, could cause the Company's actual results to differ materially from the forward-looking statements contained in this Report: (i) our ability to collect accounts receivable in a timely manner; (ii) our ability to accurately estimate costs and fees on fixed-price contracts; (iii) the effect of changes in laws and regulations with which the Company must comply, and the associated costs of compliance with such laws and regulations, either currently or in the future, as applicable; (iv) the effect of changes in accounting policies and practices as may be adopted by regulatory agencies, as well as by the Financial Accounting Standards Board; (v) the effect of changes in the Company's organization, compensation and benefit plans; (vi) the effect on the Company's competitive position within its market area of the increasing consolidation within its services industries, including the increased competition from larger regional and out-of-state engineering services organizations; (vii) the effect of increases and decreases in oil prices; (viii) the availability of parts from vendors; (ix) our ability to increase or renew our line of credit; (x) our ability to identify attractive acquisition candidates, consummate acquisitions on terms that are favorable to the Company and integrate the acquired businesses into the Company's operations; (xi) our ability to hire and retain qualified personnel; (xii) our ability to retain existing customers and get new customers and (xiii) the effect of changes in the business cycle and downturns in local, regional and national economies. The Company cautions that the foregoing list of important factors is not exclusive. We are under no duty and have no plans to update any of the forward-looking statements after the date of this Report to conform such statements to actual results.

ITEM 1. BUSINESS

General

ENGlobal Corporation (which may be referred to as "ENGlobal," the "Company," "we," "us" or "our") is a leading provider of engineering services and systems principally to the petroleum refining, petrochemical, pipeline, production and process industries throughout the United States and internationally. The services provided by our multi-disciplined staff span the lifecycle of a project and include feasibility studies, design, and procurement and construction management. We also supply automation, control and instrumentation systems to our clients worldwide. On May 25, 2006, the Company purchased Denver-based WRC Corporation, expanding our engineering services, by providing integrated land management, engineering, and related services.

The Company was incorporated as Industrial Data Systems Corporation in the State of Nevada in June 1994. In December 2001, we merged with Petrocon Engineering, Inc. ("Petrocon") and in June 2002, we changed the name of the Company from Industrial Data Systems Corporation to ENGlobal Corporation. Effective June 16, 2002, the Company's trading symbol for its common stock, traded on the American Stock Exchange, changed from "IDS" to "ENG".

Since the Company's merger with Petrocon, the net revenue from continuous operations has grown from $89.1 million in 2002 to $303.1 million in 2006, a compounded annual growth rate of approximately 35.8%. We have accomplished this growth by expanding our engineering and systems services and geographic presence through internal growth, including new initiatives and to a lesser extent, through a series of strategic acquisitions. We now have more than 2,100 full-time equivalent employees in offices strategically located in Houston, Beaumont, Clear Lake, Freeport, and Midland, Texas; Baton Rouge and Lake Charles, Louisiana; Tulsa, Cleveland and Blackwell, Oklahoma; Denver, Colorado; and Calgary, Alberta, Canada.

In December 2006, ENGlobal Engineering, Inc. began its plan to cease operations in Dallas, Texas. Some project activities previously performed in the Dallas office have been transferred to other ENGlobal offices. On February 19, 2007, the Company entered into agreements with another firm providing for the sale of the majority of Dallas assets and for the partial sublease of Dallas office space. These actions were the result of a decision to consolidate the Company's Texas-based operations while streamlining or reducing overhead costs. A small number of the Company's former Dallas personnel transferred to other ENGlobal offices and others were asked to remain with the Company through May 31, 2007, to allow for an orderly transfer of on-going projects. However, the majority of the previous Dallas employees are now employed by the firm which purchased certain of the Dallas assets, and the Company expects to utilize some on a subcontract basis for a short period of time and on a discretionary basis to complete projects. Currently the Company has no plans to sell the assets of consolidate any of its other office locations.

Available Information

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). You can read and copy any materials filed with the SEC at its Public Reference Room at 100 F. Street, N.E., Washington, D.C. 20549. You can obtain information about the operations from the SEC Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website, which contains information we file electronically with the SEC, which can be accessed over the Internet at www.sec.gov. Our common stock is listed on the American Stock Exchange (AMEX: ENG), and you can obtain information about ENGlobal at the offices of the American Stock Exchange, 86 Trinity Place, New York, New York 10006-1872 or at their website www.amex.com.

ENGlobal Website

You can find financial and other information about ENGlobal at the Company's website at the URL address www.englobal.com. Copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are provided free of charge through the Company's website and are available as soon as reasonably practicable after filing electronically or otherwise furnishing reports to the SEC.

ITEM 1. BUSINESS (Continued)

Information relating to corporate governance at ENGlobal, including: (i) our Code of Business Conduct and Ethics for all of our employees, including our Chief Executive Officer and Chief Financial Officer; (ii) our Code of Ethics for our Chief Executive Officer and Senior Financial Officers; (iii) information concerning our Directors, and our Board Committees, including Committee charters, and (iv) information concerning transactions in ENGlobal securities by Directors and officers, is available on our website under the Investor Relations link. Our website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K. We will provide any of the foregoing information without charge upon written request to Investor Relations Officer, ENGlobal Corporation, 654 North Sam Houston Parkway East, Suite 400, Houston, Texas 77060-5914.

Business Segments

During 2006, we operated two business segments: engineering and systems. The respective contributions to our total sales in 2006, 2005 and 2004 for the engineering and the systems segments are summarized below.

Note: Previously, within the Systems Segment, ESI provided products and services supporting the advanced automation and integrated controls fields. In January 2006, EAG assumed responsibility for these services, which resulted in a move of this division of ESI to the Engineering Segment. Revenues and expenses have been reclassified between the segments to provide comparative results. Amounts will tie in total to prior reporting, however, individual segments will vary from prior reports.

	Percentage of Revenues		
Segment	2006	2005	2004
Engineering	91.8%	93.9%	90.5%
Systems	8.2%	6.1%	9.5%
	100.0%	100.0%	100.0%

Revenues from the systems segment remained constant from 2004 to 2005, but increased 75.4% from 2005 to 2006 primarily as a result of the acquisition of certain assets of Analyzer Technology International, Inc. ("ATI") in January 2006. Engineering revenues increased 62.8% and 26.8%, respectively, from 2004 to 2005 and from 2005 to 2006.

Engineering Segment

	2006	2005	2004
	(Amounts in thousands)		
Revenues	$278,157	$219,426	$134,778
Operating profit	$ 9,084	$ 18,911	$ 10,437
Total assets	$ 70,549	$ 54,342	$ 46,122

General

Our engineering segment offers engineering consulting services to clients in the petroleum refining, petrochemical, pipeline, production and process industries for the development, management and turnkey execution of engineering projects and provides inspection services throughout the United States. The engineering segment is currently comprised of the following wholly-owned subsidiaries of ENGlobal Corporation: ENGlobal Engineering, Inc. ("EEI"), ENGlobal Construction Resources, Inc. ("ECR"), ENGlobal Technical Services, Inc. ("ETS"), ENGlobal Automation Group, Inc. ("EAG"), ENGlobal Canada ULC ("ENGlobal Canada"), WRC Corporation ("WRC") and WRC Canada. EEI focuses primarily on providing services to the downstream petroleum refining and petrochemical industry, including refineries and processing plants, upstream and midstream pipeline companies and gas processing plants. ECR primarily provides pipeline inspection services to the oil and gas, utility and pipeline industries and turnaround, asset management, and start-up services for the petrochemical industry. ETS primarily provides Automated Fuel Handling Systems and services to branches of the U.S. military and public sector companies. EAG and

ENGlobal Canada provide engineering services relating to the implementation of process controls, instrumentation, advanced automation and information technology projects. Further expanding our services within the pipeline industry, WRC and WRC Canada primarily provide land management, right-of-way services, environmental compliance, and governmental regulatory services to pipeline, utility and telecom companies and other owner/operators of "infrastructure" facilities. The engineering segment derives revenues primarily from cost-plus fees charged for professional and technical services. We also enter into contracts providing for the execution of projects on a fixed-price basis, whereby some or all of the project activities related to engineering, material procurement and construction are performed for a lump sum amount. As a service company, we are more labor than capital intensive. Our income primarily results from our ability to generate revenues and collect cash under both cost-plus and fixed-price contracts that is in excess of any cost for employees, material, equipment and subcontracts and selling, general and administrative (SG&A) expenses.

As of December 31, 2006, the engineering segment had more than one hundred existing blanket service contracts pursuant to which it provides clients either with services on a time and materials basis or

with services on a fixed fee, turnkey basis. Our engineering segment operates out of offices in Baton Rouge and Lake Charles, Louisiana; Beaumont, Clear Lake, Houston, Midland and Freeport, Texas; Tulsa, Cleveland and Blackwell, Oklahoma; Denver, Colorado; and Calgary, Alberta.

During 2004, the engineering segment continued its geographical expansion with new offices in Dallas and Midland, Texas and Cleveland, Oklahoma, plus an additional office in Tulsa, Oklahoma. In January, through ETS, we acquired certain assets of Engineering Design Group, Inc. ("EDGI") located in Tulsa, Oklahoma. As a result of this acquisition, ETS now provides design, installation and maintenance services for various government and public sector facilities, the most active sector being Automated Fuel Handling Systems serving the U.S. military.

In August 2005, we announced the expansion of EEI's operation in the sulfur recovery business in Dallas, Texas. In September 2005, through ECR, we acquired certain assets of AmTech Inspection located in Midland, Texas. The new division's revenues are derived primarily from providing inspectors for regional refining and pipeline operations. In October, again through ECR, we acquired certain assets of Cleveland Inspection Services, Inc. ("CIS") located in Cleveland, Oklahoma. As a result of this acquisition, we now provide inspection and construction management services in support of the oil and gas, utility and pipeline industries.

During 2005, ENGlobal Engineering formed ENGlobal Automation Group, Inc. ("EAG") to provide services relating to the implementation of process control, advance automation and information technology projects providing our clients with a full range of services, including but not limited to, front-end engineering feasibility studies and the execution of turnkey engineering, procurement, and construction projects. By focusing on large-scope projects, EAG intends to pursue distributed control systems (DCS) conversion and new installation projects by utilizing its own resources as well as resources from both ENGlobal Engineering and ENGlobal Systems. EAG will promote our proven capabilities for plant automation services and products to respond to an industry progression toward replacing obsolete technology with newer DCS. In June 2005, we formed ENGlobal Canada, based in Calgary, Alberta, Canada. ENGlobal Canada is a wholly-owned subsidiary of EAG.

In May 2006, ENGlobal Corporation purchased Denver-based WRC Corporation ("WRC") and its subsidiary WRC Canada further expanding our services within the pipeline industry. WRC provides land management, environmental compliance, and governmental regulatory services to the pipeline, utility and telecom companies and other owner/operators of "infrastructure facilities."

In October 2006, ENGlobal Construction Resources acquired selected assets of Watco Management, Inc. located in Clear Lake, Texas. As a result, we now provide turnaround, asset management, and start-up services for the refining and petrochemical industry. The addition of WATCO will provide ECR with opportunities to expand its current

services to existing WATCO clients to a complementary business, allowing expansion of current services to both existing and future clients.

In the first quarter of 2007, the Dallas office was closed with the majority of assets being sold, a major portion of the office lease obligations being assumed by others and remaining operations being transferred to other offices.

Our engineering segment offers its expertise to a broad range of industrial clients. We participate in projects involving both the modification of existing facilities and construction of new facilities. Our predominant type of contract is a blanket services contract that typically provides our clients with engineering, procurement and project management services on a time and materials basis. We also enter into contracts to complete capital projects on a fixed-price, turnkey basis. The engineering staff has the capability of developing a project from the initial planning stages through detailed design and construction management. The engineering services include:

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

We provide services for major energy-related firms at facilities such as chemical plants, crude oil refineries, electric power generation facilities, cross-country pipelines, pipeline facilities and production processing facilities.

The engineering segment offers a wide range of services from a single source provider. The segment uses an internal virtual private network so that employees in one location can work on projects based in other offices. This "work sharing" capability allows us to provide a greater depth and breadth of expertise to our clients and helps stabilize the workload in our various offices.

Competition

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

Competition is primarily centered on performance and the ability to provide the engineering, planning and project execution skills required to complete projects in a timely and cost efficient manner. The technical expertise of our management team and technical personnel and the timeliness and quality of our support services, are key competitive factors. Larger projects, especially international work, typically include pricing alternatives designed to shift risk to the service provider, or at least to cause the service provider to share a portion of the risks associated with cost overruns in service delivery. These alternatives include fixed-price, guaranteed maximum price, incentive fee, competitive bidding and other "value based" pricing arrangements.

ITEM 1. BUSINESS (Continued)

Systems Segment

Note: Previously, within the Systems Segment, ESI provided products and services supporting the advanced automation and integrated controls fields. In January 2006, EAG assumed responsibility for these services, which resulted in a move of this division of ESI to the Engineering Segment. Revenues and expenses have been reclassified between the segments to provide comparative results. Amounts will tie in total to prior reporting, however, individual segments will vary from prior reports.

	2006	2005	2004
	(Amounts in thousands)		
Revenues	$24,933	$ 14,159	$14,110
Operating profit (loss)	$ (14)	$ (852)	$ 660
Total assets	$16,099	$ 6,159	$ 7,806

General

Our systems segment designs, assembles, integrates and services control and instrumentation systems for specific applications in the energy and processing related industries. The systems segment currently consists of ENGlobal Systems, Inc. ("ESI"). Beginning in 2005, the operations of ENGlobal Constant Power, ENGlobal Technologies, Inc. and Senftleber & Associates, LP were merged into ESI. The systems segment derives revenues from fees on contracts for the design, assembly and servicing of control and instrumentation systems. Income from the systems segment is primarily derived from our ability to generate revenues and collect cash on fixed-price contracts in excess of our costs for labor, materials and equipment and transportation costs, plus our SG&A expenses.

ESI's control and instrumentation systems are custom designed and are typically based on electronic, programmable controls, however ESI's work also includes conventional pneumatic and hydraulic systems. Typical applications for ESI's systems include refinery, petrochemical and pipeline facility controls; analyzer packaging; fire and gas detection systems; data acquisition systems; oil and gas production safety systems; and control systems for various processing equipment. We perform all facets of control and instrumentation system design, engineering, assembly and testing in-house. Field installation and technical staff perform start-up and commissioning services, modification to existing systems, on-site training and routine maintenance procedures for client operating personnel.

ESI previously provided products and services supporting the advanced automation and environmental technology fields. Advanced automation services provided by ESI included automation technology audits, consulting, advanced process controls and process computer services, multivariable control, optimization (on-line and off-line), neural net applications, operator training simulators, expert systems and on-site

support. In January 2006, EAG assumed responsibility for the provision of these services.

In January 2006, ESI acquired certain assets of Analyzer Technology International, Inc. ("ATI"), a Houston-based analyzer systems provider of online process analyzer systems. ATI relocated its operation to ESI's Houston facility, which the Company expects will enable ESI's clients to perform a more efficient factory adaptable test by temporarily connecting both control and analyzer systems onsite prior to delivery. The addition of ATI will provide ESI with a greater presence in the process analyzer sector, especially for larger downstream opportunities of foreign grassroots projects.

Competition

The systems segment has been impacted by price variations attributable to cyclical conditions in the oil and gas, petroleum and processing industries. In addition, during 2006, a large percentage of ESI's revenues were derived from fabrication, which has a lower profit margin than other services. ESI's control systems and modular facilities compete with similar systems built by other companies, most of which compete primarily on the basis of pricing. We believe that pricing, technical competence and ability to provide superior service comprise the basis of competition for ESI's marketplace.

ITEM 1. BUSINESS (Continued)

Acquisitions and Sales

We have grown our business over the past several years through both internal initiatives and through strategic mergers and acquisitions. These mergers and acquisitions have allowed us to (i) expand our client base and the range of services that we provide to our clients; and (ii) gain access to new geographic areas. We expect to continue evaluating and assessing acquisition opportunities that will either complement our existing business base or that will provide the Company with additional capabilities or geographical coverage. We believe that strategic acquisitions will enable us to more efficiently serve the technical needs of national and international clients and strengthen our financial performance. The following table lists the businesses we have acquired during the three-year period ended December 31, 2006.

Name/Location/Business Unit	Date Acquired	Primary Services
Engineering Design Group, Inc. Tulsa, OK Operates as ETS, formerly EDG	January 2004	Automated Fuel Handling & Gauging Systems
AmTech Inspection, LLC Midland, TX Operates as a Division of ECR	September 2004	Onsite Inspection and Pl Process Safety Mgt
Cleveland Inspection Services, Inc.	October 2004	Onsite Pipeline Inspecti

Cleveland, OK Operates as a Division of ECR		
Instrument Services Company, LLC Tulsa, OK Operates as a Division of ETS	November 2004	Onsite Instrument and Electrical Technicians
InfoTech Engineering, LLC Baton Rouge, LA Operates as a Division of EAG	December 2004	Advanced Automation Syst Design
Analyzer Technology International, Inc. Houston, TX Operates as s Division of ESI	January 2006	Process Analyzer System
WRC Corporation and WRC Canada Denver, CO	May 2006	Integrated Land Manageme
PEI Investments Beaumont, TX	May 2006	Real Estate
WATCO Management, Inc. Clearlake, TX Operates as a Division of ECR	October 2006	Turnaround Asset Management Project Commissioning Construction Management

Business Strategy

In the past year, the Company has focused considerable attention on streamlining its organizational structure and strengthening its leadership team. It anticipates that these efforts will be ongoing in 2007. In addition, our objective is to strengthen the Company's position as a leading engineering and consulting services provider while enhancing the services we offer and expanding our geographic presence. To achieve this objective, we have developed a strategy comprised of the following key elements:

- Continue to Recruit and Retain Qualified Personnel. We believe recruiting and retaining qualified, skilled professionals is crucial to our success and growth. As a result, we have dedicated staff focused on recruiting personnel with experience in the energy industry. We have also used inter-company recruiting to retain key personnel.

- Improve Utilization of Resources. We have developed a work-sharing program through the use of an internal virtual private network that gives our clients access to technical resources located in any of our offices and allows for higher utilization of our resources. We believe the work-sharing program has reduced employee turnover and provides for a more stable work environment. We are also moving toward standardization of engineering processes and procedures among our offices, which we believe will enhance our work-sharing ability and provide our

clients with more consistent and higher quality services.

- Pursue Foreign Technical Resources. Our engineering operations has partnered with several offshore technical resources to establish longer-term access to professional engineering and design work in lower cost countries such as Mexico, Venezuela, Costa Rica and the Far East. The Company has entered into an agreement with a Malaysian firm that provides for "low cost, high value" engineering and drafting services. We believe these partnerships, both formal and informal, will allow us to lower our contract bid prices and enhance our competitive position.

- Enhance and Strengthen Our Ability to Perform Engineering, Procurement and Construction Projects. We rely heavily on repeat business and referrals from existing customers, industry members and manufacturing representatives. One of the engineering segment's goals is to increase revenues by developing and marketing its ability to perform full service turnkey projects, also called EPC (Engineering, Procurement and Construction) projects, that is expected to emphasize a cost plus contracting strategy. The engineering segment has traditionally been responsible only for the engineering portion of its projects, which usually represents between five to fifteen percent of a project's total installed cost.

- Maintain High Quality Service. To maintain high quality service, we focus on being responsive to our customers, working diligently and responsibly, and maintaining schedules and budgets. The Company has a quality control and assurance program to maintain standards and procedures for performance and documentation. The Company intends to audit and monitor compliance with these procedures and quality standards.

- Expand and Enhance Technical Capabilities. We believe that it is important to develop and enhance our overall technical capabilities in the markets we serve. To achieve this objective in the area of advanced computer-aided process simulation, design and drafting, we have purchased computer hardware and software from several suppliers in order to have the latest platforms for the design of plant systems. This initiative should enhance our marketing position with many of our customers who are currently utilizing these design platforms.

- Pursue Balanced Growth. We continue to pursue balanced growth for our business, utilizing both external acquisitions as well as internal measures as a means of future growth. The internal measures include an active business development program, together with selected initiatives to start new business operations. We also pursue acquisitions that will allow us to offer expanded engineering and control system services

to a broad energy complex, increase our technical capabilities, grow our business geographically and improve our market share.

- Continue to Increase Name Recognition. We intend to continue to

present a more cohesive image and continue to increase name recognition. All of ENGlobal's operating subsidiaries have adopted "ENGlobal" as part of their name, and we anticipate that newly acquired entities will adopt ENGlobal as a part of their name within 12 to 18 months of their acquisition.

Sales and Marketing

Our various subsidiaries derive revenues primarily from two sources: (1) in-house direct sales and (2) referrals from existing customers and industry members. Our in-house sales managers are assigned to industry segments and territories within the United States. Management believes that this method of selling should result in increased account penetration and enhanced customer service, which should, in turn, create and maintain the foundation for long-term customer relationships. Our growth depends in large measure on our ability to attract and retain qualified sales representatives and sales management personnel. Management believes that in-house marketing allows for more accountability and control, thus increasing profitability.

Products and services are also promoted through general and trade advertising, participation in trade shows and through on-line Internet communication via our corporate home page at www.englobal.com. The ENGlobal site provides information about both of our operating segments. We use in-house resources to maintain and update our website and our subsidiaries' web sites on an ongoing basis. Through the ENGlobal website, we seek to provide visitors with a single point of contact for obtaining information on the services and products offered by the ENGlobal family of companies.

Our business development department focuses on building long-term relationships with customers and providing customers with product application, engineering and after-the-sale services. Additionally, we seek to capitalize on cross-selling opportunities between our various subsidiaries. Sales leads are often jointly developed and pursued by the sales personnel from a number of these subsidiaries.

Much of our business is repeat business and we are introduced to new customers in most cases by referrals from existing customers and industry members. The Company also believes that our acquisition program, although small, has provided the benefit of expanding our existing customer base.

We currently employ 25 full-time professional in-house marketers in our business development department who concentrate on both the engineering and systems segments. We have formed alliances, which include marketing activities, with other engineering and construction firms in Mexico City, Central and South America and Malaysia.

Customers

In 2007, the Company will focus substantial attention on improving customer services in certain of its offices in order to enhance satisfaction and increase customer retention. Our customer base consists primarily of Fortune 500 companies representing a variety of industries in the United States. While we do not have continuing dependence on any single client or a limited group of clients, one or a few clients may contribute a substantial portion of our revenues in any given year or over a period of several consecutive years due to major engineering projects. We have had success undertaking new projects for prior clients and providing ongoing services to clients following the completion of the projects.

The Company believes that about two-thirds of our revenue is generated through sources such as in-plant staffing and alliance relationships that

we consider longer-term in nature and that are not typically limited to one project. As an example, our In Plant Staffing division of EEI provides outsourced technical and other personnel that are assigned to work at client locations. The Company's past experience with this activity is that the term of these assignments on average spans multiple projects and multiple years.

ITEM 1. BUSINESS (Continued)

A major long-term trend among our clients and their industry counterparts has been toward outsourcing of engineering services, and more recently, sole-sourcing. This trend has fostered the development of ongoing, longer-term alliance arrangements with clients, rather than one-time limited engagements. These arrangements vary in scope, duration and degree of commitment. While there is typically no guarantee of work that will result from these alliance agreements, often they form the basis for a longer-term relationship with our clients. Despite their variety, we believe that these partnering relationships have a stabilizing influence on our service revenues. At December 31, 2006, we maintained some form of partnering or alliance arrangement with 16 major oil and chemical companies. For example, alliance engagements may provide for:

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

In order to generate revenues in future years, we must continue efforts to obtain new engineering projects. Historically, we have not generated significant revenues from government clients. Also during 2006 we generated $26 million in revenues away from the historical large "owner/operator" type Fortune 500 companies to smaller developer type entities such as smaller refiners and developers of renewable energy.

In the engineering segment, our ten largest customers, who vary from one period to the next, accounted for 71% of our total revenue for 2006, 77% of total revenue for 2005, and 80% of total revenue for 2004. Most of our projects are specific in nature and we generally have multiple projects with the same clients. If we were to lose one or more of our significant clients and were unable to replace them with other customers or other projects, our business would be materially adversely affected. Our top three clients in 2006 were ConocoPhillips, ExxonMobil and Motiva.

In the systems segment, our clients include end-users and operators of facilities relating to oil and gas products, pipelines, refineries, chemical companies and processing plants. Other clients include equipment manufacturers, construction contractors and other engineering firms that incorporate our control systems into facilities and products that they design, construct and manufacture. As in the engineering segment, in any given year, a small number of clients may account for a large percentage of the systems segment's revenues for that year, depending on the number of major projects undertaken. Though the systems segment frequently receives work from repeat clients, its client list may vary significantly from year

to year.

In the systems segment, our ten largest customers, who vary from one period to the next, accounted for 64% of our total revenue for 2006, 70% of total revenue for 2005, and 77% of total revenue for 2004. During 2006, foreign customers accounted for 31% of our systems segment revenue compared to less than 1% during both 2005 and 2004. The increase in revenue from foreign customers is based on the expansion of the analytical division that provides online process analyzer systems, through the acquisition of ATI. Our ability to provide analyzer systems is dependent on fundamental contracts with customers doing business in oil producing regions. The loss of business from anyone of such customers could have a material adverse effect on our systems business or results of operations, but not the company as a whole. Other factors affecting our analyzer systems business that are beyond our control include: political instability or armed conflict, the level of customer demand, the willingness of clients to make payments, and to make those payments timely.

We do not have any long-term commitments from systems segment clients and sales of products from the systems segment are typically made according to the client's specifications on a purchase order basis. Our potential revenues are, therefore, dependent on continuing relationships with these customers.

Contracts

We generally enter into two principal types of contracts with our clients: time and materials contracts and fixed-price contracts. In our engineering segment, in fiscal 2006, 89% and 11% of our net revenue was derived from time and materials and fixed-price contracts, respectively, compared to 95% and 5% of net revenue from time and materials and fixed-price contract respectively in 2005. In our systems segment, in fiscal 2006, 7% and 93% of our net revenue was derived from time and materials and fixed-price contracts, respectively, compared to 3% and 97% of net revenues from time and materials and fixed-price contracts, respectively in 2005. Our clients typically determine the type of contract to be utilized for a particular engagement, with the specific terms and conditions of a contract resulting from a negotiation process between the Company and our client.

- Time and Materials. Under our time and materials contracts, we are paid for labor at either negotiated hourly billing rates or reimbursed for allowable hourly rates and for other expenses. We are paid for material and contracted services at an agreed upon multiplier of our cost, and at times pass these non-labor services through with no profit. Profitability on these contracts is driven by billable headcount, the amount of non-labor related services, and cost control. Some of these contracts may have upper limits, referred to as "not to exceed." If our costs generate billings that exceed the contract ceiling or are not allowable, we will not be able to obtain reimbursement for any excess cost. Further, the continuation of each contract partially depends upon the customer's discretionary periodic assessment of our performance on that contract.

- Fixed-Price. Under a fixed-price contract, we provide the

customer a total project for an agreed-upon price, subject to project circumstances and changes in scope. Fixed-price projects vary in scope, including some engineering activities and related services, and procurement of material and construction responsibility. Fixed-price contracts carry certain inherent risks, including risks of losses from underestimating costs, delays in project completion, problems with new technologies and economic and other changes that may occur over the contract period. Another risk includes our ability to secure written change orders prior to commencing work on such orders, which may prevent our getting paid for work performed. Consequently, the profitability of fixed-price contracts may vary substantially, and we plan to limit the size and scope of fixed-price contracts that we enter into in the future due to significant losses on two fixed-price contracts.

Backlog

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

At December 31, 2006, our backlog was $192.0 million compared to an estimated $170.0 million at December 31, 2005. We expect that a majority of the $192.0 million in backlog to be completed during 2007.

The backlog at December 31, 2006 consists of $187.0 million with commercial customers and $5.0 million with the United States Federal Government. Backlog on the federal programs includes only the portion of the contract award that has been funded by the U.S. Government.

Backlog includes gross revenue under two types of contracts: (1) contracts for which work authorizations have been received on a fixed-price basis and not-to-exceed projects that are well defined, and (2) time and material evergreen contracts at an assumed 12 month run-rate, where we place employees at our clients' site to perform day-to-day project efforts.

There is no assurance as to what percentage of backlog will be recognized.

Customer Service and Support

We provide service and technical support to our customers in varying degrees depending upon the business line and on customer contractual arrangements. The Company's technical staff provides initial telephone support services for its customers. These services include isolating and verifying reported failures and authorizing repair services in support of customer requirements. We also provide on-site engineering support if a

technical issue cannot be resolved over the telephone. On projects for which we have provided engineering systems, we provide worldwide start-up and commissioning services. We also provide the manufacturers' limited warranty coverage for products we re-sell.

Dependence Upon Suppliers

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

For example, all of the product components used by our systems segment are fabricated using components and materials that are available from numerous domestic suppliers. There are approximately 5 principal suppliers of these components, each of whom can be replaced by an equally viable competitor. No one manufacturer or vendor provides products that account for 7% or more of our revenues. Thus, we anticipate little or no difficulty in obtaining components in sufficient quantities and in a timely manner to support our manufacturing and assembly operations. Units produced through the systems segment are normally not produced for inventory and component parts; rather, they are typically purchased on an as-needed basis.

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

Patents, Trademarks, Licenses

Our success depends in part upon our ability to protect our proprietary technology, which we do primarily through protection of our trade secrets and confidentiality agreements. The U.S. Patent and Trademark Office approved our application for the uses of "ENGlobal" and "Integrated Rack" in September 2004 and March 2005, respectively. In addition, we have pending trademark applications on file with the U.S. Patent and Trademark Office for the names "Engineered for Growth" and "ENGlobal CARES - Communicating Appropriate Responses in Emergency Situations", "Flare-Mon" and "Purchased Data". There can be no assurance that the protective measures we currently employ will be adequate to prevent the unauthorized use or disclosure of our technology, or the independent third party development of the same or similar technology. Although our competitive position to some extent depends on our ability to protect our proprietary and trade secret information, we believe that other factors, such as the technical expertise and knowledge base of our management and technical personnel, as well as the timeliness and quality of the support services we provide, will also help us to maintain our competitive position.

Government Regulations

The Company and certain of our subsidiaries are subject to various foreign, federal, state, and local laws and regulations relating to our business and

operations, and various health and safety regulations as established by the Occupational Safety and Health Administration. The Company and members of its professional staff are subject to a variety of state, local and foreign licensing, registration and other regulatory requirements governing the practice of engineering. Currently, we are not aware of any situation or condition relating to the regulation of the

ITEM 1. BUSINESS (Continued)

Company, its subsidiaries, or personnel that we believe is likely to have a material adverse effect on our results of operations or financial condition.

Employees

As of December 31, 2006, the Company and its subsidiaries employed 2,100 individuals. Of these employees, 1,127 were employed in engineering and related positions; 332 were employed as inspectors; 310 were employed as project support staff; 211 were employed in technical production positions; 95 were employed in administration, finance and management information systems and 25 were employed in sales and marketing. We believe that our ability to recruit and retain highly skilled and experienced technical, sales and management personnel has been and will continue to be, critical to our ability to execute our business plan. None of our employees is represented by a labor union or is subject to a collective bargaining agreement. We believe that relations with our employees are good.

ITEM 1A. RISK FACTORS

Set forth below and elsewhere in this Report and in other documents we file with the SEC are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this Report. You should be aware that the occurrence of any of the events described in these risk factors and elsewhere in this Report could have a material adverse effect on our business, financial condition and results of operations and that upon the occurrence of any of these events, the trading price of our common stock could decline.

Our indebtedness could limit our ability to finance future operations or engage in other business activities. As of December 31, 2006, we had $24 million of total outstanding indebtedness against our revolving line of credit currently limited to $30 million. Significant factors that could increase our indebtedness and/or limit our ability to finance future operations include:

- our inability to collect accounts receivable within contractual terms;
- client demands for extending contractual payment terms;
- material losses and/or negative cash flows on significant projects;

- client's ability to pay our invoices due to economic conditions; and
- our ability to meet current credit facility financial ratios and covenants.

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

Force majeure events such as natural disasters have negatively impacted and could further negatively impact the economy and the industries we service, which may affect our financial condition, results of operations and cash flows.
Force majeure events such as Hurricanes Katrina and Rita that affected the Gulf Coast in August and September of 2005 could negatively impact the economies in which we operate. For example, these two hurricanes caused considerable damage along the Gulf Coast not only to the refining and petrochemical industry but also the commercial segment which competes for labor, materials and equipment resources needed throughout the entire United States. We typically remain obligated to perform our services after such a natural disaster and even though our contract may contain force majeure clause. If we are not able to react quickly and/or negotiate contractual relief under a force majeure event, our operations may be affected significantly, which would have a negative impact on our financial condition, results of operation and cash flows.

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

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

major risk factor that could materially impact our operating results.

If we are not able to successfully manage internal growth initiatives, our business and results of operations may be adversely affected.
Our growth strategy is to use our technical expertise in conjunction with industry trends. To support this strategy, the Company may elect to fund internal growth initiatives targeted at markets that the Company believes may have significant potential needs for the Company's services. The downside risks are that such initiatives could have a negative effect on current earnings until they reach critical mass, that industry trends have been misread or delayed or that they Company is unable to successfully execute on these initiatives. In these cases, continued funding could have a negative impact on long term earnings.

If we are not able to successfully manage our growth strategy, our business and results of operations may be adversely affected. We have grown rapidly over the last several years.
Our growth presents numerous managerial, administrative, operational and other challenges. Our ability to manage the growth of our operations will require us to continue to improve our management information systems and maintain discipline in our internal systems and controls. Industry trends and our ability to manage and measure project performance will require us to strengthen our internal project and cost control systems within operations that have traditionally operated in a cost plus environment. In addition, our growth will increase our need to attract, develop, motivate and retain both our management and professional employees. The inability of our management to effectively manage our growth or the inability of our employees to achieve anticipated performance could have a material adverse effect on our business.

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

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

We generally enter into two principal types of contracts with our clients: time and materials contracts and fixed-price contracts. Under our fixed-price contracts, we receive a fixed-price irrespective of the actual costs we incur and, consequently, we are exposed to a

number of risks. These risks include underestimation of costs,

problems with new technologies, unforeseen expenditures or difficulties, delays beyond our control and economic and other changes that may occur during the contract period. Our ability to secure change orders on scope changes and our ability to invoice for such changes poses an additional risk. In fiscal 2006, approximately 17.9% of our net revenue was derived from fixed-price contracts, and we recorded losses of $13 million on two significant fixed-price EPC projects.

Under our time and materials contracts, we are paid for labor at negotiated hourly billing rates or reimbursement at specified mark-up hourly rates and negotiated rates for other expenses. Profitability on these contracts is driven by billable headcount and cost control. Some time and materials contracts are subject to contract ceiling amounts, which may be fixed or performance-based. If our costs generate billings that exceed the contract ceiling or are not allowable under the provisions of the contract or any applicable regulations, we may not be able to obtain reimbursement for all of our costs.

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

Economic downturns could have a negative impact on our businesses. Demand for the services offered by us has been and is expected to continue to be, subject to significant fluctuations due to a variety of factors beyond our control, including demand for engineering services in the petroleum refining, petroleum chemical and pipeline industries and in other industries that we provide services to. During economic downturns in these industries, our customer's need to engage us may decline significantly. We cannot be certain that economic or political conditions will be generally favorable or that there will not be significant fluctuations adversely affecting our industry as a whole or key markets targeted by us.

Our dependence on one or a few customers could adversely affect us. One or a few clients have in the past and may in the future contribute a significant portion of our consolidated revenues in any one year or over a period of several consecutive years. In 2006, approximately 15% of our revenues were from ConocoPhillips, approximately 14% of our revenues were from ExxonMobil and another 10% were from Motiva. As our backlog frequently reflects multiple projects for individual clients, one major customer may comprise a significant percentage of our backlog at any point in time. Because these significant customers generally contract with us for specific projects, we may lose these customers from year to year as their projects with us are completed. If we do not replace them with other customers or other projects, our business could be materially adversely affected. Also, the majority of our contracts can be terminated at will. Additionally, we have long-standing relationships with many of our significant customers. Our contracts with these customers, however, are on a project-by-project basis and the customers may unilaterally reduce or discontinue their purchases at any time. The loss of business from any one of such customers could have a material adverse effect on our business or results of operations.

If the operating result of either segment is adversely affected, an

impairment of goodwill could result in a write down.
Based on factors and circumstances impacting ENGlobal and the business climate in which it operates, the Company may determine that it is necessary to re-evaluate the carrying value of its goodwill by conducting an impairment test in accordance with SFAS No. 142. The Company has assigned goodwill to its two segments based on estimates of the relative fair value of each segment. If changes in the industry, market conditions, or government regulation negatively impact either of the Company's segments resulting in lower operating income, if assets are harmed, if anticipated synergies or cost savings are not realized with newly acquired entities, or if any circumstance occurs which results in the fair value of either segment declining below its carrying value, an impairment to goodwill would be created. In accordance with SFAS No. 142, the Company would be required to write down the carrying value of goodwill.

Our backlog is subject to unexpected adjustments and cancellations and is, therefore, an uncertain indicator of our future revenues or earnings.
As of December 31, 2006, our backlog was approximately $192 million. We cannot assure investors that the revenues projected in our backlog will be realized or, if realized, will result in profits. Projects may remain in our backlog for an extended period of time prior to project execution and, once project execution begins, it may occur unevenly over the current and multiple future periods. In addition, project terminations, suspensions or reductions in scope may occur from time to time with respect to contracts reflected in our backlog, reducing the revenue and profit we actually receive from contracts reflected in our backlog. Future project cancellations and scope adjustments could further reduce the dollar amount of our backlog and the revenues and profits that we actually earn.

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

all.

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

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

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

A small number of stockholders own a significant portion of our outstanding common stock, thus limiting the extent to which other stockholders can effect decisions subject to stockholder vote.
A small number of stockholders own a significant portion of our outstanding common stock, thus limiting the extent to which other stockholders can effect decisions subject to stockholder vote. As of December 31, 2006, directors, executive officers and principal stockholders of ENGlobal and their affiliates, beneficially owned approximately 41% of our outstanding common stock on a fully diluted basis. Accordingly, these stockholders, as a group, are able to affect the outcome of stockholder votes, including votes concerning the adoption or amendment of provisions in our Articles of Incorporation or bylaws and the approval of mergers and other significant corporate transactions. The existence of these levels of ownership concentrated

in a few persons makes it unlikely that any other holder of common stock will be able to affect the management or direction of the Company. These factors may also have the effect of delaying or preventing a change in management or voting control of the Company.

Our Board of Directors may authorize future sales of ENGlobal common stock, which could result in a decrease in value to existing stockholders of the shares they hold.
Our Articles of Incorporation authorize our board of directors to issue up to an additional 47,518,533 shares of common stock and an additional 2,000,000 shares of blank check preferred stock as of the date of filing. These shares may be issued without stockholder approval unless the issuance is 20% or more of our outstanding common stock, in which case the American Stock Exchange requires stockholder approval. We may issue shares of stock in the future in connection with acquisitions or financings. In addition, we may issue options as incentives under our 1998 Incentive Option Plan or under a new equity incentive plan. Future issuances of substantial amounts of common stock, or the perception that these sales could occur, may affect the market price of our common stock. In addition, the ability of the board of directors to issue additional stock may discourage transactions involving actual or potential changes of control of the Company, including transactions that otherwise could involve payment of a premium over prevailing market prices to holders of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Facilities
We lease space in 23 buildings in the U.S. and Canada totaling approximately 458,600 square feet, and we own an office building in Baton Rouge, Louisiana with 27,500 square feet. The leases have remaining terms ranging from monthly to six years and are at what we consider to be commercially reasonable rental rates. On May 26, 2006, the Company entered into an exclusive agreement with a third-party, national real estate firm for tenant representation services that covers most of our facilities.

Our principal office locations are in Houston and Beaumont, Texas, and Tulsa, Oklahoma. We have other offices in Clear Lake, Freeport, and Midland, Texas; Baton Rouge and Lake Charles, Louisiana; Cleveland and Blackwell, Oklahoma; Denver, Colorado; and Calgary, Alberta Canada. Approximately 357,000 square feet of our total office space is designated for our professional, technical and administrative personnel. We believe that our office and other facilities are well maintained and adequate for existing and planned operations at each operating location.

Our systems segment performs fabrication assembly in two shop facilities. One facility is in Houston, Texas with approximately 62,600 square feet of space and a second facility is in Beaumont, Texas with approximately 30,000 square feet of space.

On May 25, 2006, the Company, through its wholly-owned subsidiary ENGlobal Corporate Services, Inc., purchased a one-third partnership interest in PEI Investments, A Texas Joint Venture ("PEI"), from Michael L. Burrow, the Company's President and CEO, and another one-third interest from a stockholder who owns less than 1% of the Company's common stock. The

partnership interests were purchased for a total of $69,000. The

ITEM 2. PROPERTIES (Continued)

remaining one-third interest was already held by the Company through its wholly-owned subsidiary EEI. PEI owns the land on which our Beaumont, Texas office building, destroyed by Hurricane Rita in September 2005, was located. The remains of the building were razed in July 2006. In September 2006, the Company acquired approximately 1.2 acres immediately adjacent to the former facility and is developing plans to construct a new facility utilizing both parcels of land.

On February 16, 2007, the Company, through its wholly-owned subsidiary, RPM Engineering, Inc. ("RPM"), entered into an agreement (the "Agreement") to sell the Company's property located in Baton Rouge, Louisiana. The purchase price is approximately $1.9 million with 20% of the purchase price being paid at closing and the balance self-financed for a period no longer than 60 months, amortized over 180 months, payable in equal monthly installments and one irregular installment consisting of the interest and principal due at the end of the 60 months. The initial interest rate is 8.5% based on an agreed rate of NY prime plus .25%. Under certain conditions, prior to closing and up to 60 days from the last signing of the Agreement, the Purchaser is entitled to terminate the agreement and demand the return in full of any deposit held by RPM. The financed portion of the purchase price is secured by a first mortgage on the property. The Company's basis in the property, together with the building and all improvements, is approximately $1.4 million. The Company expects to close this transaction May 31, 2007. The Company has leased approximately 31,000 square feet of space in two separate facilities to house its EEI and EAG operations in Baton Rouge.

On March 2, 2007, the Company, through its wholly-owned subsidiary, ENGlobal Automation Group, Inc. ("EAG"), entered into a 39 month lease agreement for approximately 4,489 square feet of office space in Alpharetta, Georgia (a suburb of Atlanta).

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are involved in various legal proceedings arising in the ordinary course of business alleging, among other things, breach of contract or tort in connection with the performance of professional services, the outcome of which cannot be predicted with certainty. As of the date of this filing, we are party to several legal proceedings that have been reserved for or are covered by insurance, or that, if determined adversely to us individually or in the aggregate, would not have a material adverse effect on our results of operations or financial position.

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

Not applicable.

PART II

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

Market Information and Holders
The Company's common stock has been quoted on the American Stock Exchange ("AMEX") since June 16, 1998, and is currently traded under the symbol "ENG". From its initial listing on AMEX on June 16, 1998 to June 15, 2002, the Company's stock was traded under the symbol "IDS." Newspaper stock listings identify us as "ENGlobal."

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

	Fiscal Year Ended December 31			
	2006		2005	
	High	Low	High	Low
First Quarter	14.61	9.14	2.87	2.04
Second Quarter	14.70	6.91	4.03	2.01
Third Quarter	8.88	5.71	9.10	3.69
Fourth Quarter	8.15	5.92	8.75	5.87

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

In connection with our December 2001 merger with Petrocon, we issued 2,500,000 shares of Series A Preferred Stock, $0.001 par value per share, to Equus II Incorporated. In 2002 and 2003, we issued dividends to Equus in the form of 234,833 shares of Series A Preferred Stock. Effective August 2003, the Company exercised its right to convert all outstanding Series A Preferred Stock to 1,149,089 shares of common stock. The Series A Preferred Stock had fixed terms that were specific to the 2001 merger with Petrocon. The Company's stockholders at its June, 2006 meeting approved the elimination of the 2,265,167 shares of available and unissued Series A Preferred Stock from its capital structure, and approved the authorization of a like number of "blank check" preferred stock.

The Company's stockholders, at the Company's June, 2006 meeting, approved a new class of capital stock of the Company consisting of 2,000,000 shares of Preferred Stock, par value $0.001 per share (the "Preferred Stock"). The Preferred Stock is referred to as a "blank check" because the Board of Directors, in their discretion, will be authorized to provide for the issuance of all or any shares of the stock in one or more classes or series, specifying the terms of the shares, subject to the limitations of Nevada law. The Board of Directors would make a determination as to whether to approve the terms and issuance of any shares of Preferred Stock based on its judgment as to the best interests of the Company and its stockholders.

As of December 31, 2006, approximately 314 stockholders of record held the Company's common stock. We do not have current information regarding the number of holders of beneficial interest holding our common stock.

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

The following line graph compares the total returns (assuming reinvestment of dividends) to our Common Stock, the AMEX US Index and the S&P 600 SmallCap Index for the five-year period ended December 31, 2006. This comparison assumes the investment of $100 on December 31, 2000 and the reinvestment of all dividends.

	2001	2002	2003	2004	2005	2
ENGlobal (ENG)	100.00	57.14	82.29	136.00	225.14	35
S&P 600 SmallCap Index	100.00	84.68	116.47	141.61	151.03	17
Amex US Index	100.00	81.74	110.63	127.83	138.33	16

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

Equity Compensation Plan Information
The following table sets forth certain information concerning the Company's equity compensation plans as of December 31, 2006. See Note 11 in the attached financial statements.

	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)		Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)
Equity compensation plans approved by security holders	1,422,494	(1)	$5.16

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

Dividends on outstanding shares of Series A Preferred Stock were paid on the last day of May in 2002 and 2003 in shares of stock of Series A Preferred Stock at a rate of 0.08 shares for each outstanding share of Series A Preferred Stock. The Company elected to convert all shares of preferred stock to 1,149,089 shares of common stock in August 2003. The Company's stockholders eliminated this series of preferred stock at its June, 2006 stockholders meeting.

----

(1) Includes options issued through our 1998 Incentive Plan. For a brief description of the material features of the Plan, see Note 11 of the Notes to the Consolidated Financial Statements. Some of these options, also granted through the 1998 Incentive Plan, were options granted as replacement options for outstanding Petrocon incentive options pursuant to the terms of the December 2001 Merger Agreement with Petrocon.

24

ITEM 6. SELECTED FINANCIAL DATA

Summary Selected Historical Consolidated Financial Data

The following tables set forth our selected financial data. The data for the years ended December 31, 2006, 2005, and 2004 have been derived from the audited financial statements appearing elsewhere in this document. The data as of December 31, 2003 and 2002 and for the years ended December 31, 2003 and 2002 have been derived from audited financial statements not appearing in this document. You should read the selected financial data set forth below in conjunction with our financial statements and the notes thereto included in Part II, Item 8, Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and other financial information appearing elsewhere in this document.

Note: Previously, within the Systems Segment, ESI provided products and services supporting the advanced automation and integrated controls fields. In January 2006, EAG assumed responsibility for these services, which resulted in a move of this division of ESI to the Engineering Segment. This, along with the sale of Thermaire in 2003, has caused reclassification to provide comparative results. Revenues and expenses have been reclassified between the segments to provide comparative results. Amounts will tie in total to prior reporting, however, individual segments will vary from prior reports.

	Years Ended De		
	2006	2005	2004
	(in thousands, except		
Statement of Operations			
Revenues			
Engineering	$ 278,157	$ 219,426	$ 134
Systems	24,933	14,159	14
Total revenues	303,090	233,585	148

Costs and expenses			
Engineering	254,031	192,264	118
Systems	22,795	13,048	11
Selling, general and administrative	29,885	19,689	13
Total costs and expenses	306,711	225,001	144
Operating income (loss)	(3,621)	8,584	4
Interest income (expense), net	(1,312)	(800)	
Other income (expense), net	652	116	
Foreign currency gain (loss)	(19)	(2)	
Income (loss) from continuing operations before provision for income taxes	(4,300)	7,898	4
Provision for income taxes	(814)	3,116	1
Income (loss) from operations	(3,486)	4,782	2
Income (loss) from discontinued operations, net of taxes	-	-	
Income (loss) from disposal of discontinued operations	-	-	
Net income (loss)	$ (3,486)	$ 4,782	$ 2

ITEM 6. SELECTED FINANCIAL DATA (Continued)

	Years Ended De		
	2006	2005	2004
	(in thousands, except		
Per Share Data			
Basic earnings (loss) per share			
Continuing operations	$ (0.13)	$ 0.20	$
Discontinued operations	-	-	
Net income per share	$ (0.13)	$ 0.20	$
Weighted average common shares outstanding - basic	26,538	24,300	23
Diluted earnings (loss) per share			
Continuing operations	$ (0.13)	$ 0.19	$
Discontinued operations	-	-	
Net income per share	$ (0.13)	$ 0.19	$
Weighted average common shares outstanding - diluted	26,538	25,250	23

Cash Flow Data

Operating activities, net	$ (8,953)	$ (920)	$ (2
Investing activities, net	(9,330)	(2,417)	(1
Financing activities, net	19,553	3,492	4
Exchange rate changes	(26)	(4)	
Net change in cash and cash equivalents	$ 1,244	$ 151	$
Balance Sheet Data			
Working capital	$ 35,187	$ 21,825	$ 14
Property and equipment, net	$ 8,725	$ 6,861	$ 5
Total assets	$ 106,227	$ 75,936	$ 57
Long-term debt, net of current portion	$ 27,162	$ 5,228	$ 15
Long-term capital leases, net of current portion	$ -	$ -	$
Stockholders' equity	$ 40,862	$ 39,865	$ 20

26

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

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

Overview

We furnish engineering consulting and control system services to the petroleum refining, petrochemical, pipeline, production and processing industries. Our business consists of two segments: engineering and systems. Our engineering segment offers engineering consulting services to clients for the development, management and turnkey execution of engineering projects, construction management, inspection services, land management and environmental compliance services. Our systems segment designs, assembles, integrates and services control and instrumentation systems for specific applications in the energy and process related industries.

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

In the course of providing our services, we routinely provide engineering, materials, and equipment and may provide construction services on a subcontractor basis. Generally, these materials, equipment and subcontractor costs are passed through to our clients and reimbursed, along with fees, which in total are at margins lower than those of our normal core business. In accordance with industry practice and generally accepted accounting principles, all costs and fees are included in revenue. The use of subcontractor services can change significantly from project to project; therefore, changes in revenue may not be indicative of business trends.

For analytical purposes only, we have historically segregated from our total revenue the revenues derived from material assets or companies acquired during the first 12 months following their respective dates of acquisition and referred to such revenue as "Acquisition" revenue. We also

segregate gross profits and SG&A expenses derived from material assets or company acquisitions on the same basis as we segregate revenues. We analyze, for internal purposes only, the percentage of our revenue that comes from staffing services versus the percentage that comes from engineering services, as engineering services have a higher margin than staffing services.

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

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

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

Results of Operations

The following table sets forth, for the periods indicated, certain financial data derived from our consolidated statements of operations and indicates the percentage of total revenue for each item.

Note: Previously, within the Systems Segment, ESI provided products and services supporting the advanced automation and integrated controls fields. In January 2006, EAG assumed responsibility for these services, which resulted in a move of this division of ESI to the Engineering Segment. Revenues and expenses have been reclassified between the segments to provide comparative results. Amounts will tie in total to prior reporting, however, individual segments will vary from prior reports.

	Years Ended Dece		
	2006		2005
	Amount	%	Amount
	(in thousan		
Revenue			
Engineering	$ 261,389	86.3	$ 207,368
Systems	24,933	8.2	14,159
Acquisition	16,768	5.5	12,058
Total revenue	$ 303,090	100.0	$ 233,585
Gross profit			
Engineering	$ 21,737	8.3	$ 25,940
Systems	2,138	8.6	1,111
Acquisition	2,389	14.2	1,222

Total gross profit	$ 26,264	8.7	$ 28,273
Selling, general and administrative			
Non-acquisition	$ 28,211	9.9	$ 18,863
Acquisition	1,674	10.0	826
Total	$ 29,885	9.9	$ 19,689
Net income (loss)	$ (3,486)	(1.2)	$ 4,782

Total revenue increased 29.8% or $69.5 million from 2005 to 2006.

Overall gross profit decreased 7.1%, or $2.0 million from 2005 to 2006.

Total SG&A expense increased 51.8%, or $10.2 million from 2005 to 2006.

Income from continuing operations decreased 172.9%, or $8.3 million from 2005 to 2006.

28

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

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Note: Previously, within the Systems Segment, ESI provided products and services supporting the advanced automation and integrated controls fields. In January 2006, EAG assumed responsibility for these services, which resulted in a move of this division of ESI to the Engineering Segment. Revenues and expenses have been reclassified between the segments to provide comparative results. Amounts will tie in total prior to reporting, however, individual segments will vary from prior reports.

Total Revenue

Engineering revenue accounted for 91.8% of our total revenue for the year, increasing $58.8 million from $219.4 million in 2005 to $278.2 million in 2006.

The increase in engineering revenue was primarily brought about by increased activity in the engineering and construction markets. Refining related activity has been particularly strong, including projects to satisfy environmental mandates, expand existing facilities and utilize heavier sour crude. Capital spending in the pipeline area is also trending higher, with numerous projects in North America currently underway to deliver crude oil, natural gas, petrochemicals and refined products. Renewable energy appears to be an emerging area of activity and potential growth, with the Company currently performing a variety of services for ethanol, biodiesel, coal to liquids, petroleum coke to ammonia, and other biomass processes. The acquisitions of WRC in the second quarter of 2006, together with our clients' increased demand for in-plant and inspection resources, stimulated growth in our staffing services division where revenues

increased 90.6%, or $50.9 million, from $56.2 million in 2005 to $107.1 million in 2006.

Revenue from procurement services decreased 67.6%, or $40.2 million, from $59.5 million in 2005 to $19.3 million in 2006. This significant decrease is primarily related to three projects, two of which began in 2003 and one of which began in 2005 and were materially completed in 2006. The level of procurement services is expected to vary over time depending on the volume of procurement activity our customers choose to do themselves as opposed to using our services on larger EPC contracts.

In 2005, the Company was awarded two significant fixed-price engineering, procurement and construction ("EPC") projects in the refining industry that included procurement and subcontractor activities within our scope of work. This accounts for the higher level in that year. Together these two fixed-price EPC projects accounted for approximately $20.2 million of the engineering segment revenues during 2006 compared to approximately $1.8 million during 2005. The current combined contract value of these two projects is approximately $24.6 million and both are currently scheduled for completion by the end of the second quarter of 2007. As a result of revised estimates of the percentage of completion of these projects, the Company suffered a reversal of $6.6 million in the third quarter of 2006 and $7.1 million in the fourth quarter of 2006. Due to losses incurred in the execution of these contracts, we anticipate that we will enter into this type of contract only on a very limited basis, if at all.

The systems segment contributed 8.2% of our total revenue for the year, as its revenue increased $10.7 million, or 75.4%, from $14.2 million in 2005 to $24.9 million in revenue in 2006. A general turnaround in the oil and gas industry, together with the acquisition of ATI in January 2006 has increased the demand for ESI's services. Another factor positively affecting ESI's business is that the computer-based distributed control systems equipment used for facility plant automation becomes technologically obsolete over time, which supports ongoing replacement of these systems. Backlog for ESI at December 31, 2006 reached $10.0 million, compared to $9.1 million at December 31, 2005.

Gross Profit

Primarily due to losses on two EPC fixed-price contracts in our engineering segment, as discussed above, total gross profit decreased $2.0 million, or 7.1%, from $28.3 million in 2005 to $26.3 million in 2006 and, as a percentage of total revenue, decreased from 12.1% to 8.7% during the same period.

Due to the material financial impact of the losses on two significant fixed-price EPC projects* during 2006, the following "non-GAAP" proforma financial is being presented to demonstrate the performance of the historical core business within the Engineering segment.

Non-GAAP Proforma Financial Information	Years Ended December 31,			
	2006		2005	
	Amount	%	Amount	%
	(in thousands)			
Revenue				
Engineering - Actual	$ 261,389		$ 207,368	
Less fixed-price projects*	20,155		-	
Engineering - Revised	$ 241,234	85.3	$ 207,368	88.8
Systems	24,933	8.8	14,159	6.0
Acquisition	16,768	5.9	12,058	5.2
Total revenue	$ 282,935	100.0	$ 233,585	100.0
Gross profit				
Engineering - Actual	$ 21,737		$ 25,940	
Less fixed-price projects*	(13,740)		-	
Engineering - Revised	$ 35,477	14.7	$ 25,940	12.5
Systems	2,138	8.6	1,111	7.8
Acquisition	2,389	14.2	1,222	10.1
Total gross profit	$ 40,004	14.1	$ 28,273	12.1

* Excluding revenues on two significant fixed-price EPC projects, our Engineering segment, exclusive of acquisition revenue, would have accounted for 85.3% of our total revenue for the year, increasing $33.8 million from $207.4 million in 2005 to $241.2 million in 2006, or an increase of 16.3%.

* Again, excluding the recorded losses on two significant fixed-price EPC projects, our Engineering segment, net of acquisition gross profit, would have reported a gross profit of $35.5 million, an increase of $9.6 million from $25.9 million in 2005, or an increase year-over-year of 37.1%. As a percentage of revenue, the proforma gross profit for our Engineering segment, exclusive of gross profit from acquisitions, would have increased by 17.6%, increasing from 12.5% in 2005 to 14.7% in 2006.

* Also, excluding the recorded losses on the two significant fixed-price EPC projects, our total gross profit would have increased $11.7 million from $28.3 million in 2005 to $40.0 million in 2006, or an increase year-over-year of 41.3%. As a percentage of revenue, total gross profit, again, excluding the recorded losses on two significant fixed-price EPC projects, would have increased 16.5%, increasing from 12.1% in 2005 to 14.1% in 2006.

Due to the significant losses on these two projects the Company plans to limit the size and scope of fixed-price EPC contracts in the future. Both of the significant fixed-price EPC projects are scheduled for completion by the end of the second quarter of 2007.

Also during the past year, the Company has shifted a portion of its

services to developer type work for customers that are typically smaller than its historical customer base. The viability of these projects and the creditworthiness of these types of customers must be carefully analyzed to assure profitable results. In the future, the Company intends to analyze these projects much more carefully before accepting them.

The Company has also engaged in a number of entrepreneurial ventures over the past several years, not all of which have been profitable. In the future, the Company intends to scrutinize these projects much more carefully before engaging in them and exit them more quickly if they are not successful.

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

Gross profit from engineering, including the breakout of acquisitions, decreased $3.1 million, or 11.4%, from $27.2 million in 2005 to $24.1 million in 2006 and, as a percentage of revenue, decreased from 12.4% in 2005 to 8.7% in 2006 primarily due to estimated losses of approximately $13.7 million on two EPC fixed-price contracts. Both projects are currently scheduled for completion by the end of the second quarter of 2007.

The staffing services division , consisting of our in-plant staffing, land management and inspection operations, increased gross profit $7.4 million, or 113.8%, from $6.5 million in 2005 to $13.9 million in 2006.

We earn a lower margin on procurement services as compared to the margin we earn on our core engineering services. As an example, procurement services for 2005 produced a 1.7% gross profit margin. Comparably, in 2006 gross profit margin on core engineering services was 8.3%. Our level of procurement revenue has recently trended down, from $59.5 million or 25.5% of total revenue for 2005 to $19.3 million or 6.4% of total revenue for 2006.

Any shift from engineering only to EPC projects that include material procurement and construction responsibility will negatively impact engineering gross profit as a percentage of revenue. In this case, lower gross profit will occur because higher historical cost plus margins on engineering labor recognized during the period in which it was earned will now be combined with the lower margins on procurement services and construction subcontractor charges and recorded throughout the overall duration and completion of the projects.

At December 31, 2006, we had outstanding unapproved change orders/claims of approximately $17.4 million, net of reserves of $1.2 million associated with ongoing fixed-price EPC projects. If in the future we determine collection of the unapproved change orders/claims is not probable, it will result in a charge to earnings in the period such determination is made.

Gross profit for our systems segment increased $1.0 million, or 90.9%, from $1.1 million in 2005 to $2.1 million in 2006. However, as a percent of revenue, gross profit increased by 0.8% from 7.8% in 2005 to 8.6% in 2006.

Selling, General and Administrative ("SG&A") Expenses
Selling, general and administrative expenses increased $10.2 million, or 51.8%, from $19.7 million in 2005 to $29.9 million in 2006, primarily due to increases in salaries and burdens, facilities and office expenses, amortization expense and travel. As a percent of revenue, SG&A increased 1.5% from 8.4% in 2005 to 9.9% in 2006.

Salaries and burden expenses increased $5.0 million in 2006 over 2005 of which $2.2 million of this increase was related to stock compensation expense recorded during the year. The Company did not record stock compensation expense during 2005, as the Company adopted SFAS No. 123R on January 1, 2006 (see Note 11). An additional $0.6 million of the increase was due to increases in corporate salaries, as employees were added, primarily in Business Development, Accounting and IT, to support Company growth. The remainder of the increase came from increases in operation salaries and burdens primarily due to increases in administrative staffing from acquisitions and EAG's continued growth during the year.

Facilities and office expenses increased $2.4 million in 2006 over 2005 due to the expansion of EEI's offices in Tulsa, Houston, and Beaumont to meet both current and projected growth requirements, plus the additional cost of facilities utilized by acquisitions made throughout the year.

Amortization expense increased approximately $700,000 primarily as a result of our completing the valuation of intangible assets acquired in acquisitions completed during 2006 (see Note 16).

Increased business development activity pushed marketing and travel expenses up by over $600,000 in 2006 over similar expenses in 2005.

Operating Profit

Operating profit decreased $12.2 million to $(3.6) million in 2006 as compared to $8.6 million in 2005, decreasing, as a percentage of total revenue, from 3.7% in 2005 to (1.2)% in 2006. This decrease was primarily the result of the Company's performance on two fixed-price contracts.

Other Income (Expense)

Other income increased from $116,000 in 2005 to $651,500 in 2006. The income in 2005 resulted from a legal settlement. The income in 2006 was derived from distributions from PEI Investments, insurance proceeds from Hurricane Rita losses, and income from the sale of assets, partially offset by a reclassification of financing costs.

RESULTS OF OPERATION (Continued)

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Note: Previously, within the Systems Segment, ESI provided products and services supporting the advanced automation and integrated controls fields. In January 2006, EAG assumed responsibility for these services, which resulted in a move of this division of ESI to the Engineering Segment. Revenues and expenses have been reclassified between the segments to provide comparative results. Amounts will tie in total to prior reporting, however, individual segments will vary from prior reports.

Total Revenue

Engineering revenue accounted for 94.0% of our total revenue for 2005, an increase of $84.6 million from $134.8 million in 2004 to $219.4 million in 2005.

The increase in engineering revenue was primarily brought about by increased activity in the engineering and construction markets. Refining related activity has been particularly strong, including projects to satisfy environmental mandates, expand existing facilities and utilize heavier sour crude. Acquisitions in the fourth quarter of 2004, together with our client's increased demand for in-house technical and inspection resources, stimulated growth in our staffing services division where revenues increased 54.4%, or $19.8 million, from $36.4 million in 2004 to $56.2 million in 2005.

Revenue from procurement services increased 55.8%, or $21.3 million, from 2004 to 2005 and contributed 25.7%, or $21.3 million, of the increase in total engineering revenue during the same period. The level of procurement services varies depending on the volume of procurement activity our customers choose to do themselves as opposed to using our services on the larger EPC contracts.

In 2005, the Company was awarded two significant fixed-price engineering, procurement and construction ("EPC") projects in the refining industry that includes procurement and subcontractor activities within our scope of work.

The systems segment contributed 6.0% of our total revenue for the year, as its revenue increased $0.1 million, or 0.7%, from $14.1 million in 2004 to $14.2 million in revenue in 2005. Projects from one major supplier of distributed control systems ("DCS") equipment, together with projects from a large engineering and construction firm, contributed most of the increase in revenue in 2005. The completion of turnkey remote instrument enclosures ("RIE's") from projects awarded in the fourth quarter of 2004 contributed $4.7 million to ESI's revenue in 2005.

Acquisition revenue, represented only 5.2% of total revenue for 2005, increased 16.3%, or $1.7 million, during the comparable periods, primarily from nine months of revenue generated in 2005 through acquisitions completed in the 4th quarter of 2004.

Gross Profit

Total gross profit increased $10.1 million, or 55.5%, from $18.2 million in 2004 to $28.3 million in 2005 although, as a percentage of total revenue, decreased slightly from 12.2% to 12.1% during the same period.

Gross profit from engineering increased $11.2 million, or 70.0%, from $16.0 million in 2004 to $27.2 million in 2005 and, as a percentage of revenue, increased from 11.5% in 2004 to 12.5% in 2005. Gross profit was negatively impacted by approximately $249,000 during 2005 due to start-up expenses and non-reimbursable proposal activity conducted by two of the Company's internal start-up initiatives, ENGlobal Sulfur Group and ENGlobal Automation Group. The staffing services division increased gross profit $2.2 million, or 51.2%, from $4.3 million in 2004 to $6.5 million in 2005 on margins remaining relatively stable over the comparable periods, although such margins are approximately 1% lower than average margins on all other engineering revenues.

We earn a lower margin on procurement services as compared to the margin we earn on our core engineering services. In 2005, $21.5 million, or 25.1% of the increase in our total revenue was from procurement services, providing a 1.7% gross profit margin. Comparably, gross profit margin on core engineering services was 12.1%. In 2004, procurement services produced a .4% gross profit margin. Due to the increase in procurement services in 2005 over 2004, our overall gross profit, as a percentage of total revenue, was negatively impacted by 4.0% and 3.6%, respectively.

Again, the shift to more fixed-price EPC type projects will negatively impact engineering gross profit as a percentage of revenue because higher historical cost plus margins on engineering labor recognized during the period in which it was earned will now be combined with the lower margins on procurement services and construction subcontractor charges and recorded throughout the overall duration and completion of the projects.

Gross profit for our systems segment decreased $1.1 million, or 50.0%, from $2.2 million in 2004 to $1.1 million in 2005. Also, as a percent of revenue, gross profit decreased by 7.9% from 15.7% in 2004 to 7.8% in 2005. The lower margin in 2005 is a result of several factors. The increase in the workload created a shortage in shop labor which was filled by hiring contract labor leading to inefficiencies and rework. This led to overruns in shop labor on projects, thus dropping margins below already tight budgeted margins. Secondly, with the increase in proposal work, estimates of material and labor cost were underestimated, thus causing lower profit margins. Lastly, market pressures drove down margins on projects overall. Corrective measures were taken during the first quarter of 2006 to replace all contract labor with more stable, direct-hire employees and additional staffing and systems within the estimating and proposal group should improve proposal pricing.

During the fourth quarter of 2005, ESI experienced delays in receiving major components for a project that were being supplied by a third party vendor. As a result, the work ESI expected to perform on such project during 2005 was completed in 2006, resulting in a corresponding delay in our recognition of revenues and profits.

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

Selling, general and administrative expenses increased $6.0 million, or 43.8%, from $13.7 million in 2004 to $19.7 million in 2005, primarily due to increases in salaries and burdens, facilities and office expenses, and travel. However, as a percent of revenue, SG&A decreased 0.8% from 9.2% in 2004 to 8.4% in 2005.

Salaries and burden expenses increased $3.6 million in 2005 over 2004. $1.0 million of this increase was related to additional incentives paid under the 2005 incentive plans. An additional $1.0 million of the increase was due to increases in corporate salaries, primarily in Business Development, Accounting and Project Controls, to support Company growth. The remainder of the increase came from increases in operation salaries and burdens primarily due to increases in administrative staffing from acquisitions, EAG's start-up during the year, ESI's expansion into the Beaumont area, and increases in their administrative support staffing in the Houston facility; plus additional overhead due to the growth of EEI's offices in Beaumont and Tulsa.

Facilities and office expenses increased $1.4 million in 2005 over 2004 due to the expansion of EEI's offices in Tulsa, Houston, Dallas, and Beaumont to meet both current and projected growth requirements, plus the additional cost of facilities utilized by acquisitions made in the fourth quarter of 2004.

Increased business development activity pushed marketing and travel expenses up by almost $500,000 in 2005 over similar expenses in 2004.

Operating Profit

Operating profit increased $4.1 million to $8.6 million in 2005 as compared to $4.5 million in 2004, increasing, as a percentage of total revenue, from 3.0% in 2004 to 3.7% in 2005. Although operating profit for 2005 exceeded operating profit for 2004, our net operating profit for the fourth quarter of 2005 was down approximately $1.2 million, or 39%, over third quarter operating results, primarily due to losses of approximately $659,000 in start-up expenses and non-reimbursable proposal activity conducted by two of the Company's internal start-up initiatives, ENGlobal Sulfur Group and EAG. For 2005, the combined operating loss for both groups was approximately $817,000.

Other Income (Expense)

Other income decreased from $118,000 in 2004 to $116,000 in 2005. The income in 2004 resulted from a legal settlement. The income in 2005 was derived from distributions from PEI Investments, insurance proceeds from Hurricane Rita losses, and income from the sale of assets, partially offset by a reclassification of financing costs.

Liquidity and Capital Resources

Historically, we have satisfied our cash requirements through operations and borrowings under a revolving credit facility. The Company's current credit facility is with Comerica Bank ("Comerica") and consists of a line of credit maturing July 26, 2009. The loan

agreement positions Comerica as senior to all other debt. The line of credit is limited to $30.0 million subject to loan covenant restrictions. The Comerica Credit Facility is collateralized by substantially all the assets of the Company. As of December 31, 2006, the outstanding balance on the line of credit was $24.0 million and we had working capital of $35.2 million. Our total long-term debt outstanding on December 31, 2006 was $27.2 million (see Note 8), an increase from $5.2 million as of December 31, 2005. Under the terms and conditions of our revolving credit facility, as of December 31, 2006, we have additional borrowing capacity of approximately $6.0 million after consideration of borrowing base limitations with no letters of credit outstanding at December 31, 2006.

The following table summarizes our contractual obligations as of December 31, 2006:

	Payments Due by Per			
	2007	2008	2009	201
			(in thousands)	
Long-term debt(1)	$ 4,747	$ 3,683	$ 27,140	$
Operating leases	4,366	2,754	2,165	
Total contractual cash obligations	$ 9,113	$ 6,437	$ 29,305	$

(1)Long-term debt includes future interest payments assuming the existing long-term debt and revolving credit facility remain outstanding with the interest rate in effect at December 31, 2006. The Company's interest rate on its revolving credit facility fluctuates with the prime rate.

Cash Flow

We believe that we have sufficient available cash required for operations for the next 12 months. However, cash and the availability of cash could be materially restricted if circumstances prevent the timely internal processing of invoices, if amounts billed are not collected or are not collected in a timely manner, if project mix shifts from cost reimbursable to fixed costs contracts during significant periods of growth, if the Company was to lose one or more of its major customers, if the Company experiences further costs overruns on fixed- price contract, or if we not able to meet the covenants of the Comerica Credit Facility. If any such event occurs, we would be forced to consider alternative financing options.

Operating Activities:

Operating activities required the use of $9.0 million, $0.9 million, and

$2.4 million in net cash in 2006, 2005 and 2004, respectively. Though a decline in revenues would be likely to adversely impact our cash flow from operations, we believe that future cash flows, our ability to manage the timing of acquisitions, and our borrowing capacity under our line of credit will allow us to meet cash requirements in 2006 and beyond. Future uses of cash in operations will continue to be primarily for labor and material costs required in connection with contract performance.

The primary factors impacting the increase in our need for cash and the year-over-year increase in average accounts receivable days outstanding were:

1) a past due accounts receivable balance of approximately $3.7 million as of December 31, 2006 related to delays in receipts for services on the start-up of a major alliance agreement that began during the second quarter of this year;

2) a decrease in billings in excess of costs from approximately $3.8 million to $540,000 as of December 31, 2005 and 2006 respectively; and

3) an increase in costs and estimated earnings-in-excess of billings from approximately $4.1 million to $5.4 million as of December 31, 2005 and 2006, respectively.

Although the above factors are all within rights and restrictions of contractual terms and conditions within client contracts, we are taking measures to remediate each of these factors and at this time do not expect their impact to continue beyond the first quarter of 2007.

Investing Activities:
Investing activities used cash totaling $9.3 million in 2006, compared to $2.4 million in 2005 and $1.8 million in 2004. In 2006, our investing activities consisted of capital additions of $3.4 million primarily for computers and leasehold improvements to our offices and software implementations. In the fourth quarter, $500,000 was used to complete the acquisition of Watco Management, Inc. Future investing activities are anticipated to remain consistent with prior years and include capital additions for leasehold improvements, technical applications software, and equipment, such as upgrades to computers. On December 31, 2006, we amended our line of credit to permit an increase in annual capital expenditure limits from $3.25 million to $3.5 million.

Financing Activities:
Financing activities provided cash totaling $19.6 million, $3.5 million, and $4.2 million in 2006, 2005, and 2004, respectively. Our primary financing mechanism is our revolving line of credit. The line of credit has been used principally to finance acquisitions and accounts receivable. During 2006, our borrowings, on the line of credit were $143.8 million, and we repaid an aggregate of $123.6 million on our short-term and long-term bank and other debt.

Future cash flows from financing activities are anticipated to be borrowings, payments on the line of credit and payments on long-term debt instruments. Line of credit fluctuations are a function of timing related to operations, obligations and payments received on accounts receivable. Payments on long-term debt, including interest for the coming year, are estimated to be $4.7 million.

In 2006, non-cash transactions included $216,000 notes receivable issued for sale of assets and $3.9 million notes payable issued for acquisitions. Also in 2006, $1.4 million of stock was issued associated with the

acquisition of WRC. There were no significant non-cash transactions in 2005. In 2004, non-cash transactions include $2.6 million notes payable issued related to acquisitions and $592,000 note payable issued for treasury stock. We also acquired insurance with notes payable of $1.3 million, $198,000, and $1.1 million in 2006, 2005, and 2004, respectively.

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

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

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

Asset Management

We typically sell our products and services on short-term credit and seek to minimize our credit risk by performing credit checks and conducting our own collection efforts. Our trade accounts receivable increased to $60.2 million from $46.2 million as of December 31, 2006 and 2005, respectively. The number of days outstanding for trade accounts receivable increased from 59 days at December 31, 2005, to 62 days at December 31, 2006. Our actual bad debt expense has been approximately .03% and .01% of revenues for the years ending December 31, 2006 and 2005. We increased our allowance for doubtful accounts from $503,000 to $670,000 or 1.1% of trade accounts receivable balance for each of the years 2005 and 2006, respectively.

Risk Management

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

Seasonality

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

generally tend to be lower than in the second and third quarters.

Critical Accounting Policies

Revenue Recognition

Because the majority of the Company's revenues are recognized under cost-plus contracts, significant estimates are generally not involved in determining revenue recognition. However, in 2006, the Company suffered reversals due to its failure to accurately estimate revenue recognition on our two significant fixed-price EPC contracts.

Most of our contracts are with Fortune 500 companies. As a result, collection risk is generally not a relevant factor in the recognition of revenue. However, timing of accounts receivable collections has resulted in a serious impact in the Company's liquidity. Also, the Company is engaging in more development contracts with smaller companies. We anticipate that collection risk will be a larger risk on these projects.

Our revenues are largely composed of engineering service revenue and product sales. The majority of our services are provided through time-and-material contracts (also referred to as cost-plus contracts), of which have not-to-exceed provisions that place a cap on the revenue that we may receive under a particular contract.

These time and material billings are produced every two weeks. Most of the contracts with not-to-exceed provisions are minor in nature.

On occasion, we serve as purchasing agent by procuring subcontractors, material and equipment on behalf of a client and passing the cost on to the client with no mark-up or profit. In accordance with Statement of Position ("SOP") 81-1, revenues and costs for these type purchases are not included in total revenues and costs. For financial reporting this "pass-through" type of transaction is reported net.

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

The asset, "costs and estimated earnings in excess of billings on uncompleted contracts," represents revenues recognized in excess of amounts billed on fixed-fee contracts. The liability "billings in excess of costs and estimated profits on uncompleted contracts" represents amounts billed in excess of revenues recognized on fixed-fee contracts.

Goodwill

A change in assumptions in the estimation of the fair market value of the segments would unlikely give rise to an impairment of goodwill without deteriorating operating results in the segments.

In conjunction with each acquisition, we must allocate the cost of the acquired entity to the assets and liabilities assumed based on their estimated fair values at the date of acquisition. As additional information becomes available, adjustments may be made to the original estimates within a short time subsequent to the acquisition. Goodwill is not amortized but instead is periodically assessed for impairment. The impairment testing entails estimating current market value of the segments, based on management's estimate of market conditions including pricing, demand, competition, operating costs and other factors. Determining the fair value of assets and liabilities acquired involves professional judgment and is ultimately based on management's assessment of the value of the assets acquired. We believe our estimates for these items are reasonable, but there is no assurance that actual amounts will not vary significantly from estimated amounts.

Change Orders

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

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

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

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures 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 years. The provisions of SFAS No. 157 should be applied prospectively as of the beginning of the fiscal year in which SFAS

No. 157 is initially applied, except in limited circumstances. The Company expects to adopt SFAS No. 157 beginning January 1, 2008. The Company is currently evaluating the impact that this interpretation may have on its consolidated financial statements.

In September 2006, the SEC released Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB No. 108), which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The provisions of SAB No. 108 are effective for the Company beginning in the first quarter of 2007. The Company does not expect any impact to its consolidated financial statements upon adoption of SAB No. 108.

In June 2006, FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes", an interpretation of FASB Statement 109 Accounting for Income Taxes, was issued. FIN No. 48 describes accounting for uncertainty in income taxes, and includes a recognition threshold and measurement attribute for recognizing the effect of a tax position taken or expected to be taken in a tax return. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN No. 48 on January 1, 2007, and the Company expects that it will not have a material effect on the its' financial condition, results of operations, or cash flows.

In December 2004, SFAS No. 123 "Accounting for Stock-Based Compensation" was revised ("SFAS No. 123R"). SFAS No. 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions and requires that companies record compensation expense for employee stock option awards. SFAS No. 123R is effective for annual periods beginning after June 15, 2005. The Company adopted SFAS No, 123R on January 1, 2006 using the modified prospective method. See Note 11.

In March 2005, FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations - An interpretation of FASB Statement No. 143", was issued. FIN No. 47 clarifies the term conditional asset retirement obligation as used in SFAS No. 143, "Accounting for Asset Retirement Obligations", and clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN No. 47 was effective for the year ended December 31, 2005, but did not have a material effect on the Company's financial condition, results of operations or cash flows.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140". SFAS No. 155 amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". This Statement also resolves issues addressed in Statement No. 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets." SFAS No. 155 permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation and clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133. SFAS No. 140 is amended to eliminate the prohibition on a qualifying special-purpose entity from

holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued during fiscal years beginning after September 15, 2006. The Company does not expect this statement to have a material impact on its consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of December 31, 2005 and 2004, the Company did not participate in any derivative financial instruments or other financial and commodity instruments for which fair value disclosure would be required under SFAS No 107. There are no investments at December 31, 2005. Accordingly, the Company has no quantitative information concerning the market risk of participating in such investments.

As of December 31, 2006 and 2005, the Company did not participate in any derivative financial instruments or other financial and commodity instruments for which fair value disclosure would be required under SFAS No. 133.

The Company's primary interest rate risk relates to its variable-rate line of credit debt obligation, which totaled $24.0 million and $3.8 million as of December 31, 2006 and 2005, respectively. Assuming a 10% increase in the interest rate on this variable-rate debt obligation (i.e., an increase from the actual average interest rate of 8.25% as of December 31, 2006, to an average interest rate of 9.08%, annual interest expense would have been approximately $115,000 higher in 2006 based on the annual average balance. The Company does not have any interest rate swap or exchange agreements.

The Company has no market risk exposure in the areas of interest rate risk from investments because the Company did not have an investment portfolio as of December 31, 2006.

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The audited consolidated balance sheets for ENGlobal Corporation, as of December 31, 2006 and 2005 and statements of income, cash flows and stockholders' equity for the three-year period ended December 31, 2006, are attached hereto and made part hereof.

INDEX

	Page
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING	42
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON CONSOLIDATED FINANCIAL STATEMENTS	44
CONSOLIDATED BALANCE SHEETS December 31, 2006 and 2005	45
CONSOLIDATED STATEMENTS OF OPERATIONS Years Ended December 31, 2006, 2005 and 2004	46
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY Years Ended December 31, 2006, 2005 and 2004	47
CONSOLIDATED STATEMENTS OF CASH FLOW Years Ended December 31, 2006, 2005 and 2004	48
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS	50
SCHEDULE II Valuation and Qualifying Accounts	76

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

Board of Directors
Englobal Corporation
Houston, Texas

We were engaged to audit management's assessment included in the accompanying Management's Report on Internal Control over Financial Reporting that ENGlobal Corporation and Subsidiaries (the "Company") did not maintain effective internal control over financial reporting as of December 31, 2006, because of the effect of material weaknesses described therein, based on criteria established in Internal Control -- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting.

The scope of our audit of management's assessment and the effectiveness of internal control over financial reporting was limited as a result of management's substantial delay in the performance of and delivery to us of its completed assessment. Specifically, we were provided substantially all of the documentation related to management's assessment subsequent to December 31, 2006 and, as a result, we were unable to obtain sufficient evidence that the controls

were designed and operating effectively at December 31, 2006.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management's assessment as of December 31, 2006:

1. Deficiencies in the Company's Control Environment. Our control environment did not sufficiently promote effective internal control over financial reporting throughout the organization. Specifically, the Company had a shortage of support and resources in our accounting department, which resulted in insufficient: (i) documentation and communication of our accounting policies and procedures; and (ii) internal audit processes of our accounting policies and procedures.

2. Deficiencies in the Company's Information Technology Access Controls. The Company did not maintain effective controls over preventing access by unauthorized personnel to end-user spreadsheets and other information technology programs and systems.

3. Deficiencies in the Company's Accounting System Controls. The Company did not effectively and accurately close the general ledger in a timely manner and we did not provide complete and accurate disclosure in our notes to financial statements, as required by generally accepted accounting principles.

4. Deficiencies in the Company's Controls Regarding Purchases and Expenditures. The Company did not maintain effective controls over the tracking of our commitments and actual expenditures with third-party subsidiaries on a timely basis.

5. Deficiencies in the Company's Controls Regarding Fixed-Price Contract Information. The Company did not maintain effective controls over the complete, accurate, and timely processing of information relating to the estimated cost of fixed-price contracts.

6. Deficiencies in the Company's Revenue Recognition Controls. The Company did not maintain effective policies and procedures relating to revenue recognition of fixed price contracts.

7. Deficiencies in the Company's Controls over Income Taxes. The Company did not maintain sufficient internal controls to ensure that amounts provided for in the financial statements for income taxes accurately reflected the Company's income tax position as of December 31, 2006.

8. Deficiency in Completing Management's Assessment of Internal Control over Financial Reporting in a Timely Manner. The Company did not meet the documentation and testing requirements under section 404 of the Sarbanes-Oxley Act of 2002 as of December 31, 2006. As a result, management was unable to assess the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 as required by the

Sarbanes-Oxley Act of 2002 in sufficient time for an audit of management's assessment to be completed as of December 31, 2006.

These material weaknesses were considered in determining the nature, timing, and extent of the audit tests applied in our audit of the 2006 consolidated financial statements, and this report does not affect our report dated March 15, 2007 on those consolidated financial statements.

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

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

Since management failed to provide us with timely documentation of the Company's internal control over financial reporting and we were unable to apply other procedures to satisfy ourselves as to the effectiveness of the Company's internal control over financial reporting, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on either management's assessment or on the effectiveness of the Company's internal control over financial reporting as of December 31, 2006.

We do not express an opinion or any other form of assurance on management's statements referring to any and all remediation steps taken.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of ENGlobal Corporation and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2006. Our report thereon dated March 15, 2007 expressed an unqualified opinion.

Hein & Associates LLP
Houston, Texas

March 15, 2007

ENGLOBAL CORPORATION AND SUBSIDIARIES
Report of Independent Registered Public Accounting Firm on

Consolidated Financial Statements

Board of Directors
ENGlobal Corporation
Houston, Texas

We have audited the accompanying consolidated balance sheets of ENGlobal Corporation and subsidiaries (the"Company") as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2006. We have also audited the schedule listed in the accompanying Item 16. These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ENGlobal Corporation and subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

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

We were also engaged to audit, in accordance with the standards of Public Company Accounting Oversight Board (United States), management's assessment and the effectiveness of ENGlobal Corporation and subsidiaries internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Our report dated March 15, 2007, did not express an opinion on management's assessment and the effectiveness of internal control over financial reporting.

As discussed in Note 11 to the consolidated financial statements, the Company adopted Statement of Accounting Standards No. 123 (revised 2004), "Share-Based Payment", during the year ended December 31, 2006.

Hein & Associates LLP
Houston, Texas
March 15, 2007

See accompanying notes to these consolidated financial statements.

ENGLOBAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2006 AND 2005

ASSETS

Current Assets	
Cash	$
Trade receivables, net	
Prepaid expenses and other current assets	
Current portion of notes receivable	
Costs and estimated earnings in excess of billings on uncompleted contracts	
Deferred tax asset	
Inventories	
Federal income taxes receivable	
Total Current Assets	
Property and Equipment, net	
Goodwill and Other Intangibles	
Other Intangible Assets, net	
Long term notes receivable, net of current portion	
Non-current Deferred Tax Asset	
Other Assets	
Total Assets	$

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities	
Accounts payable	$
Accrued compensation and benefits	
Notes payable	
Current portion of long-term debt	
Deferred rent	
Billings in excess of costs and estimated earnings on uncompleted contracts	
Other liabilities	
Total Current Liabilities	
Long-Term Debt, net of current portion	
Deferred Tax Liability	
Total Liabilities	
Commitments and Contingencies (Notes 9, 10, 12, 16, 19 and 20)	
Stockholders' Equity	
Common stock - $0.001 par value; 75,000,000 shares authorized; 26,807,460 and 26,289,567 shares outstanding and 26,807,460 and 26,941,944 issued at December 31, 2006 and 2005, respectively	
Additional paid-in capital	
Retained earnings	
Treasury stock - 0 and 652,377 shares at cost, at December 31, 2006 and 2005, respectively	
Accumulated other comprehensive income (loss)	

Total Stockholders' Equity	
Total Liabilities and Stockholders' Equity	$

See accompanying notes to these consolidated financial stat

45

ENGLOBAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	2006
Operating Revenues	
Engineering	$ 278,157,053
Systems	24,933,308
Total Revenue	303,090,361
Direct Costs	
Engineering	254,031,157
Systems	22,794,971
Total Direct Costs	276,826,128
Gross Profit	26,264,233
Selling, General, and Administrative Expenses	29,884,682
Operating Income (Loss)	(3,620,449)
Interest Expense	(1,311,794)
Other income	632,880
Income (Loss) before Provision for Income Taxes	(4,299,363)
Provision for Income Taxes	(813,510)
Net Income (Loss)	$ (3,485,853)
Basic Earnings per Share	$ (0.13)
Weighted Average Common Shares Outstanding for Basic	26,538,290
Diluted Earnings per Share	$ (0.13)
Weighted Average Common Shares Outstanding for Diluted	26,538,290

=============

See accompanying notes to these consolidated financial statements.

ENGLOBAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

	Common Stock		Additional Paid-In Capital	Accumulated Comprehensive Translation Gain/(Loss)	Retai Earni
	Shares	Stock			
BALANCES-DECEMBER 31, 2003	24,034,288	24,034	12,094,382	-	6,05
Exercise of options	38,242	38	42,474	-	
Common stock purchased for treasury	(652,377)	-	-	-	
Common stock issued through employee stock purchase plan	46,686	47	61,359	-	
Net income	-	-	-	-	2,36
BALANCES-DECEMBER 31, 2004	23,466,839	24,119	12,198,215	-	8,42
Exercise of options	727,793	728	1,484,981	-	
Common stock issued through employee stock purchase plan	94,935	94	231,044	-	
Common stock issued through private placement	2,000,000	2,000	13,071,092	-	
Tax benefit of non-qualified options exercised	-	-	245,000	-	
Net income	-	-	-	-	4,78
Comprehensive income:					
Foreign currency translation adjustment	-	-	-	(3,631)	
BALANCES-DECEMBER 31, 2005	26,289,567	$ 26,941	$27,230,332	$ (3,631)	$ 13,20
Exercise of options	329,273	329	729,580	-	
Shares issued at acquisition for WRC	175,000	175	1,399,825	-	
Common stock issued through employee stock purchase plan	13,620	14	102,954	-	
Common stock issued through private placement	-	-	(40,000)	-	
Stock based compensation	-	-	2,176,162	-	
Treasury shares retirement			(592,231)		
Tax benefit of non-qualified options exercised	-	-	140,721	-	
Net income	-	-	-	-	(3,48
Rounding difference	-	-	-	-	
Comprehensive income:					
Foreign currency translation adjustment	-	-	-	(26,471)	

BALANCES-DECEMBER 31, 2006	26,807,460	$ 27,459	$31,147,343	$ (30,102)	$ 9,71
	==========	========	===========	===========	=======

See accompanying notes to these consolidated financial statem

ENGLOBAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Ye
	2006
Cash Flows from Operating Activities	
Net income (loss)	$ (3,485,853)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities -	
Depreciation and amortization	3,369,244
Stock based compensation	2,176,162
Deferred income tax expense	(2,317,275)
(Gain) Loss on disposal of property, plant and equipment	42,315
Changes in current assets and liabilities, net of acquisitions -	
Trade receivables	(9,825,423)
Inventories	153,968
Costs and estimated earnings in excess of billings	(1,244,902)
Prepaid expenses and other assets	509,362
Accounts payable	(1,235,758)
Accrued compensation and benefits	2,261,018
Billings in excess of costs and estimated earnings	(3,235,715)
Other liabilities	5,078,829
Income taxes receivable (payable)	(1,198,936)
Net cash provided by (used in) operating activities	(8,952,964)
Cash Flows from Investing Activities	
Purchase of property and equipment	(3,405,141)
Additional consideration for acquisitions	--
Proceeds from insurance	68,317
Partnership distributions	350,000
Acquisitions of businesses, net of cash acquired	(6,528,583)
Proceeds from sale of assets	185,106
Proceeds from sale of Thermaire	--
Net cash used in investing activities	(9,330,301)
Cash Flows from Financing Activities	
Borrowings on line of credit	143,820,724
Payments on line of credit	(123,631,669)
Proceeds from issuance of common stock	933,598
Proceeds from notes receivable	38,119
Short-term borrowings (repayments)	--
Capital lease repayments	--
Long-term debt repayments	(1,607,959)
Net cash provided by (used in) financing activities	19,552,813
Effect of Exchange Rate Changes on Cash	(26,082)

Net Change in Cash and Cash Equivalents	1,243,466
Cash and Cash Equivalents - beginning of year	159,414
Cash and Cash Equivalents - end of year	$ 1,402,880

See accompanying notes to these consolidated financial sta

ENGLOBAL CORPORATION AND SUBSIDIARIES

Supplemental Cash Flow Information

	2006
Non-Cash Transactions	
Issuance of note for insurance	1,347,232
Retirement of treasury stock	592,231
Acceptance of note for Constant Power assets	(216,000)
Issuance of common stock for purchase of WRC Corporation	1,400,000
Acquisition of treasury stock with note payable	--
Issuance of note for ATI assets	1,000,000
Issuance of note for purchase of WRC Corporation	2,400,000
Issuance of note for Watco assets	500,000
Issuance of notes payable for assets of EDG, AmTech, CIS and Infotech	--
Supplemental Cash Flow Information	
Cash paid during the year for -	
Interest	$ 976,841
State and federal income taxes	2,464,848
Refund from state franchise taxes	--

See accompanying notes to these consolidated financial sta

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BACKGROUND AND BASIS OF PRESENTATION

Basis of Presentation

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. Our Company consolidates all of its wholly-owned subsidiaries and all significant inter-company accounts and transactions have been eliminated in the consolidation.

Organization

Brief descriptions of the active companies included in the consolidated group follow:

ENGlobal Corporation ("ENGlobal") - our public holding company.

ENGlobal Corporate Services, Inc. ("ECS") - provides the corporate oversight function.

ENGlobal Engineering, Inc. ("EEI") - provides general engineering, construction and procurement services for industrial customers primarily in the United States with specialties in the areas of distributive control systems, power distribution, process design and process safety management.

ENGlobal Construction Resources, Inc. ("ECR") - provides pipeline inspection services to the oil and gas, utility and pipeline industries and turnaround, asset management, and start-up services for the petrochemical industry.

RPM Engineering, Inc. d/b/a ENGlobal Engineering, Inc. ("RPM") - provides engineering services primarily in southeast Louisiana.

ENGlobal Systems, Inc. ("ESI") - provides design, fabrication, installation, start-up, checkout and maintenance of specialized systems such as programmable logic controller (PLC) systems integration, supervisory controls and data acquisition (SCADA) and triple modular redundancy (TMR) systems, distribution control system (DCS), and analyzer systems.

ENGlobal Automation Group, Inc. ("EAG") - formerly ENGlobal Technologies, Inc. ("ETI") - provides service relating to the implementation of process controls, advanced automation, and information technology projects.

ENGlobal Technical Services, Inc. ("ETS") - formerly ENGlobal Design Group, Inc. ("EDG") - provides design, installation and maintenance of various government and public sector facilities, the most active sector being Automated Fuel Handling Systems serving the U.S. Military.

ENGlobal Canada, ULC - provides engineering services relating to the implementation of process controls, instrumentation, advanced automation and information technology projects.

WRC Corporation ("WRC") - primarily provides land management, right-of-way services, environmental compliance, and governmental regulatory services to pipeline, utility and telecom companies and other owner/operators of "infrastructure" facilities.

WRC Canada - provides land management and inspection services.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash

Cash includes cash in bank at December 31, 2006. The Company's banking system provides for daily replenishment of major bank accounts for check-clearing requirements. Accordingly, there were negative book balances of $2.7 million on December 31, 2006 and $2.0 million on December 31, 2005. Such balances result from outstanding checks that have not yet been paid by the bank and are reclassified to accounts payable in the accompanying consolidated balance sheets.

Revenue Recognition

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

On occasion, the Company, serving as an agent for the client procures materials and equipment on behalf of the client and the cost of such materials and equipment is reimbursed with no mark-up or profit. In accordance with Statement of Position (SOP) 81-1, revenue and cost for these types of purchases are not included in total revenue and cost. For financial reporting, this "pass-through" type of transaction is reported net. During 2006 and 2005, pass-through transactions totaled $8.9 million and $20.6 million, respectively.

Profits and losses on fixed-fee contracts are recorded on the percentage-of-completion method of accounting, measured by the percentage-of-contract cost incurred to date relative to estimated total direct contract cost. Direct contract cost includes professional compensation and related benefits, materials, subcontractor services and other direct cost of projects. Any freight charges and inspection costs are directly charged to the project to which the charges relate. The cost recognized for labor includes all actual employee compensation plus a burden factor to cover estimated variable labor expenses for the year. These variable labor expenses consist of payroll taxes, self-insured medical plan expenses, workers compensation insurance, general liability insurance, and employee benefits for paid time off. The actual periodic cost for these expenses is adjusted at the end of each quarter to provide consistent cost recognition throughout the year.

Variable costs such as travel, repairs and maintenance, supplies and depreciation directly related to producing revenues are included in contract costs to arrive at gross profit.

Under the percentage-of-completion method, revenue recognition is dependent upon the accuracy of a variety of estimates, including the progress of engineering and design efforts, material installation, labor productivity, cost estimates and others. These estimates are based on various professional judgments made with respect to the factors noted and are difficult to accurately determine until projects are significantly underway. Due to uncertainties inherent to the estimation process, it is possible that actual completion costs may vary materially from estimates. Anticipated losses on uncompleted contracts are charged to operations as soon as such losses can be estimated. Changes in job performance, job conditions, estimated profitability and final contract settlements may result in revisions to costs and income and are recognized in the period in

which the revisions are determined.

Selling, general and administrative cost includes management and staff compensation, office cost such as rents and utilities, depreciation, amortization, travel and other expenses that are unrelated to specific client contracts, but directly relate to the support of each segment's operations.

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

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

overall contract. For segmented contracts, we recognize revenue as if they were separate contracts over the performance periods of the individual elements or phases.

We have five major types of contracts:

Cost-Plus, Labor Plus Fixed Mark-up

Under cost-plus, labor plus fixed mark-up contracts, clients are charged based on actual labor rates plus a fixed mark-up that includes estimated recoverable direct and indirect cost and a profit component, which is applied as a percentage of the recoverable labor, to arrive at a total dollar estimate in negotiating a cost-plus, labor plus fixed mark-up contract. We recognize revenue based on a multiple of the actual total number of labor hours completed on a project multiplied by the actual labor rates and multiplied by the negotiated fixed mark-up percentage, plus other non-labor costs at cost plus a fixed mark-up that we negotiate at the time of contract award. Aggregate revenue from cost-plus, labor plus fixed mark-up contracts may vary in scope and we generally must obtain a change order in order to receive additional revenue relating to any additional costs that exceed the original contract estimate (see "Change Orders").

Cost-Plus, Fixed Labor Rate

Under cost-plus, fixed labor rate contracts, clients are charged based on fixed labor rates by work classification (Project Manager, Sr. Engineer, Designer, CADD Operator, etc.) whereby the fixed labor rate includes estimated recoverable direct and indirect cost plus a profit component. In negotiating cost-plus, fixed labor rate contracts the total dollar estimate is a multiple of the fixed labor rates times the recoverable work class labor man-hours estimated to complete the project. We recognize revenues

based on a multiple of the fixed labor rates times the actual total number of labor hours completed on a project, plus other non-labor costs at cost plus a fixed rate negotiated at the time of contract award. Aggregate revenues from cost-plus, fixed labor rate contracts may vary in scope and we generally must obtain a change order in order to receive additional revenues relating to any additional cost that exceed the original contract estimate (see "Change Orders").

Cost-Plus, Not-To-Exceed

Under cost-plus, not-to-exceed contracts, clients are charged on the same basis as either cost-plus, labor plus fixed mark-up, or cost-plus fixed labor rate contracts. The contract is awarded with a set maximum aggregate revenue, referred to as the not-to-exceed amount. The Company does not earn revenue over the not-to-exceed amount unless we obtain a change order. The Company is not obligated to complete the contract once the not-to-exceed amount has been reached.

Fixed-Price

Under fixed-price contracts, clients are charged an agreed amount negotiated in advance of a specific scope of work, be it related to engineering, construction and procurement service revenue or product sales. We recognize revenue on fixed-price contracts using the percentage-of-completion method described above. Prior to completion, gross profit recognition on any fixed-price contract is dependent upon the accuracy of our estimates and will increase to the extent that current estimates of aggregate actual cost are below the amounts previously estimated. Conversely, if the Company's current estimated cost exceeds prior estimates, gross profit will decrease and we may realize a loss on a project. In order to increase aggregate revenue on a contract, we generally must obtain a change order to receive payment for additional cost (see "Change Orders").

Guaranteed Max

Under a guaranteed max contract, clients are charged on the same basis as either cost-plus, labor plus fixed markup or cost-plus fixed labor rate. The contract is awarded with a set maximum aggregate revenue amount referred to as the guaranteed max amount. The Company is required to complete the scope of contract even if they have reached the guaranteed max amount. Therefore, the Company recognizes revenue on guaranteed max contracts using the percentage of completion method described above and commonly treats them the same as fixed-price contracts. In order to

increase aggregate revenue on a contract, we generally must obtain a change order to receive payment for additional cost (see "change orders").

Change Orders

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

Change orders occur when changes are required or requested after work on a contract has begun. Change orders are documented and the terms of change orders are agreed with the client before the work is performed. Circumstances, at times, may require that work progress without the client's written agreement before the work is performed. Cost related to change orders is recognized when they are incurred. Change orders are included in the total estimated contract revenue when it is probable that the change orders will result in a bona fide addition to value that can be reliably estimated.

Inspection and Acceptance (Cost-plus Contracts)

Generally, other than on fixed-price contracts, clients inspect and accept work as executed based on designated milestones or billing cycles, although such acceptance does not waive the client's right to a claim under a warranty provision for work deficiencies that fail to meet industry standards.

Inspection and Acceptance (Fixed-Price Contracts)

Generally, clients inspect and accept work based on designated milestones, although such acceptance does not waive the client's right to a claim under a warranty provision for work deficiencies.

Contract Termination Provisions

Generally, our clients may terminate at any time and for any reason any part of the Company's project work by giving proper notice, specifying the part of the work to be terminated and the effective date of the termination. If any part of the work on a project is terminated, the client, with respect to such work, is required to reimburse the Company for all cost incurred prior to the effective date of termination and for all additional amounts that are directly related to the work performed. The client is required to issue a change order with respect to any termination.

Property and Equipment

All property and equipment is stated at cost, adjusted for accumulated depreciation. Depreciation is calculated using a straight-line method over the estimated useful lives of the related assets. The useful life is estimated to be 3 years for computers and autos, 5 years for software, furniture and fixtures, 10 years for machinery and equipment, and 39 years for buildings. Leasehold improvements are amortized over the term of the related lease.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Intangible Assets and Goodwill

Intangible assets is comprised of non-compete covenants and customer relationships acquired through acquisitions. As of December 31, 2006 and December 31, 2005, the cost and accumulated amortization of our intangible assets were as follows:

	Non-Compete Covenants	Use of Name	Custome Relations
As of December 31, 2006			
Intangible assets	$ 3,846	$ 10	$ 2,
Less: accumulated amortization	704	6	
Intangible assets, net	$ 3,142	$ 4	$ 2,
As of December 31, 2005			
Intangible assets	$ 550	$ 10	$
Less: accumulated amortization	142	4	
Intangible assets, net	$ 408	$ 6	$

Intangible assets are amortized using the straight-line method based on the estimated useful life of the intangible assets. Expected amortization expense of our amortizable intangible assets is as follows:

Years Ending, December 31	Non-Compete Covenants	Use of Name	Customer Relations
2007	$ 683	$ 2	$ 4
2008	671	2	4
2009	650	-	4
2010	570	-	4
2011	568	-	4
	$ 3,142	$ 4	$ 2,2
Weighted Average Amortization Period Remaining at December 31, 2006 (years)	4.8	2.0	5.

Goodwill

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually. SFAS 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values and reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal

of Long-Lived Assets."

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Company adopted SFAS 142 effective January 1, 2002. Upon adoption, the Company tested goodwill for impairment at January 1, 2002 according to the provisions of SFAS 142, which resulted in no impairment identified. The Company tested goodwill for impairment at December 31, 2005 and 2006 resulting in no impairment of goodwill.

In 2004, acquisitions of assets of several companies resulted in an increase of $1,725,000 to goodwill. Acquisitions of the assets of Engineering Design Group, Inc. ("EDGI"), InfoTech, and Cleveland Inspection Services, Inc. ("CIS") resulted in increases to goodwill of $139,000, $270,000 and $1,316,000, respectively. In 2005, goodwill increased $170,000 primarily from earn-outs related to acquisitions. In 2006, goodwill increased $3.0 million primarily from the deferred tax benefit realized on acquisitions of WRC plus additional earn-outs related to acquisitions.

Long-lived Assets

The Company reviews long-lived assets and certain identifiable intangible assets for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. The Company has not identified any such impairment losses.

Software Development Costs

Under the provisions of SOP-98-1 ENGlobal capitalizes costs associated with software developed or obtained for internal use when both the preliminary project stage is completed and when management authorizes funding for the project which is deemed probable of completion. Costs include 1) external direct costs of materials and services incurred in obtaining and developing the software, and 2) payroll and payroll related costs for employees who are directly associated with and devote time to the project. Capitalization of these costs ceases no later than the point at which the project is substantially complete and ready for its intended use. At that time, the costs are reclassified to fixed assets. Amortization of such costs is provided on the straight-line basis over 5 years.

Income Taxes

The Company accounts for deferred income taxes in accordance with the asset and liability method, whereby deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement and tax bases of its existing assets and liabilities. The provision for income taxes represents the current tax payable or refundable for the period plus or minus the tax effect of the net change in the

deferred tax assets and liabilities during the period.

In June 2006, FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes", an interpretation of FASB Statement 109 Accounting for Income Taxes, was issued. FIN No. 48 describes accounting for uncertainty in income taxes, and includes a recognition threshold and measurement attribute for recognizing the effect of a tax position taken or expected to be taken in a tax return. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN No. 48 on January 1, 2007, and will not have a material effect on the Company's financial condition, results of operations, or cash flows.

Stock Based Compensation

The Company currently sponsors a stock-based compensation plan as described below. Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (Revised), "Share-Based Payment" ("SFAS No. 123(R)"). Under the fair value recognition provisions of SFAS No. 123 (R), stock-based compensation is measured at the grant date based on the value of the awards and is recognized as expense over the requisite service period (usually a vesting period). The Company selected the modified prospective method of adoption described in SFAS No. 123(R). The fair values of the stock awards recognized under SFAS No. 123(R) are determined based on the vested portion of the awards; however, the total compensation expense is recognized on a straight-line basis over the vesting period.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Prior to January 1, 2006, the Company accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Under APB Opinion No. 25, no compensation expense was recognized for stock options issued to employees because the grant price equaled, or was above, the market price on the date of grant for options issued by the Company.

Earnings Per Share
Earnings per share was computed as follows:

	Reconciliation of Earnings per S			
	2006		2005	
	Basic	Diluted	Basic	Dilut
Net Income (Loss)	$ (3,485,853)	$(3,485,853)	$ 4,782,381	$ 4,78
Weighted average number of shares outstanding for basic	26,538,290		24,300,114	

Weighted average number of shares outstanding for diluted		26,538,290			25,25
Net income (loss) per share available for common stock					
Net Income (Loss)	$	(0.13)	(0.13)	$ 0.20	$

Diluted earnings per share are computed including the impact of all potentially dilutive securities. The following table sets forth the shares outstanding for the earnings per share calculations for the years ended December 31, 2006, 2005 and 2004.

	2006	
Common stock issued - beginning of year	26,289,567	
Weighted average common stock issued (repurchased)	248,723	
Shares used in computing basic earnings per share	26,538,290	
Assumed conversion of dilutive stock options	-	
Shares used in computing diluted earnings per share	26,538,290	

Use of Estimates

The preparation of the Company's consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company's management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying results. Actual results could differ from these estimates.

Fair Value of Financial Instruments

The fair value of financial instruments, primarily accounts receivable, notes receivable and accounts payable, closely approximate the carrying values of the instruments due to the short-term maturities of such instruments. Based on the borrowing rate currently available to the Company for loans with similar terms, we believe the fair value of the long-term obligations approximate their carrying value.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Comprehensive Income

Comprehensive income is defined as all changes in stockholders' equity, exclusive of transactions with owners, such as capital investments. Comprehensive income includes net income or loss, changes in certain assets and liabilities that are reported directly in equity, such as translation adjustments on investments in foreign subsidiaries, and certain changes in minimum pension liabilities. The cumulative translation adjustment is included in accumulated other comprehensive income. (See Note 4)

Reclassifications

Amounts in prior years' financial statements are reclassified as necessary to conform to the current year's presentation. Such reclassifications had no effect on net income.

NOTE 3 - RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures 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 years. The provisions of SFAS No. 157 should be applied prospectively as of the beginning of the fiscal year in which SFAS No. 157 is initially applied, except in limited circumstances. The Company expects to adopt SFAS No. 157 beginning January 1, 2008. The Company is currently evaluating the impact that this interpretation may have on its consolidated financial statements.

In September 2006, the SEC released Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB No. 108), which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The provisions of SAB No. 108 are effective for the Company beginning in the first quarter of 2007. The Company does not expect any impact to its consolidated financial statements upon adoption of SAB No. 108.

In June 2006, FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes", an interpretation of FASB Statement 109 Accounting for Income Taxes, was issued. FIN No. 48 describes accounting for uncertainty in income taxes, and includes a recognition threshold and measurement attribute for recognizing the effect of a tax position taken or expected to be taken in a tax return. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company is in the process of assessing the impact on its financial statements, but does not expect any material impact on the Company's financial condition, results of operations, or cash flows.

In December 2004, SFAS No. 123 "Accounting for Stock-Based Compensation" was revised ("SFAS No. 123R"). SFAS No. 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions and requires that companies record compensation expense for employee stock option awards. SFAS No. 123R is effective for annual periods beginning after June 15, 2005. The Company adopted SFAS No, 123R on January 1, 2006 using the modified prospective method. See Note 11.

In March 2005, FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations - An interpretation of FASB Statement No. 143", was issued. FIN No. 47 clarifies the term conditional asset retirement obligation as used in SFAS No. 143, "Accounting for Asset Retirement Obligations", and clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN No. 47 was effective for the year ended December 31, 2005, but did not have a material effect on the Company's financial condition,

results of operations or cash flows.

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 - RECENT ACCOUNTING PRONOUNCEMENTS (Continued)

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140". SFAS No. 155 amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". This Statement also resolves issues addressed in Statement No. 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets." SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation and clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133. SFAS No. 140 is amended to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued during fiscal years beginning after September 15, 2006. The Company does not expect this statement to have a material impact on its consolidated financial statements.

NOTE 4 - COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) represents net earnings (loss) and any revenue, expenses, gains and losses that, under accounting principles generally accepted in the United States of America, are excluded from net earnings (loss) and recognized directly as a component of stockholders' equity.

Accumulated other comprehensive income is as follows:

	2006
Net income (loss) Before Foreign Currency Translation	(3,4
Other comprehensive income:	
Foreign Currency Translation Adjustment	(
Comprehensive Income (Loss)	(3,5

NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31, 2006 and 2005:

	2006
Land	$ 41
Building	1,3
Computer equipment and software	9,0
Shop equipment	1,0
Furniture and fixtures	6
Building and leasehold improvement	2,0
Autos and trucks	2
	14,7
Accumulated depreciation and amortization	(6,5
	8,2
Project controls and software upgrade in process	4
Property and equipment, net	$ 8,7

58

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 - DETAIL OF CERTAIN BALANCE SHEET ACCOUNTS

The components of trade receivables as of December 31, 2006 and 2005 are as follows:

	2006
	(
Amounts billed	$ 43,655
Amounts billable billed January of the following year	15,689
Retainage	1,573
Less: Allowance for uncollectible accounts	(670)
Trade receivables, net	$ 60,247

The components of other liabilities as of December 31, 2006 and 2005 are as follows:

	2006
	(
Reserve for known contingencies	$ 4,724
Accrued interest	297
Federal and State Taxes Payable	510
Other	332

Other liabilities	$5,863

NOTE 7 - FIXED-PRICE CONTRACTS

Costs, estimated earnings and billings on uncompleted contracts consisted of the following a

	2006
	(
Costs incurred on uncompleted contracts	$ 75,317
Estimated earnings (losses) on uncompleted contracts	(7,390
Earned revenues	67,927
Less: Billings to date	63,077
Net costs and estimated earnings in excess of billings on uncompleted contracts	$ 4,850
Costs and estimated earnings in excess of billings on uncompleted contracts	$ 5,390
Billings in excess of costs and estimated earnings on uncompleted contracts	(540
Net costs and estimated earnings in excess of billings on uncompleted contracts	$ 4,850

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 - LINE OF CREDIT AND DEBT

The Company has a Credit Facility with Comerica Bank ("Comerica"). Effective July 27, 2006, the Company and Comerica entered into an amendment to the Company's existing Credit Facility (the "Comerica Credit Facility"). The maturity date of the Comerica Credit Facility was extended to July 26, 2009 and the limit on the revolving note was increased from $22 million to $30 million, subject to loan covenant restrictions. The Comerica Credit Facility is collateralized by substantially all the assets of the Company. The outstanding balance on the line of credit as of December 31, 2006 and 2005 was $24.0 million and $3.8 million, respectively. At the election of the Company, the interest rate will be the lesser of prime or a three tiered Eurodollar rate, plus 150, 175, or 200 basis points, respectively, based on the ratio of total funded debt to EBITDA for the trailing 12 months, of less than 2.00, between 2.00 and 2.50, and greater than 2.50, respectively. The commitment fee on the unused line of credit is 0.250%. The remaining borrowings available under the line of credit as of December 31, 2006 and 2005, respectively, were $6.0 and $12.0 million after consideration of loan covenant restrictions.

The Comerica Credit Facility contains covenants requiring the Company, as of the end of each calendar month, to maintain certain ratios, including total average funded debt to EBITDA; total average funded debt to total liabilities, plus net worth; and total funded debt to accounts/unbilled receivables. The Company is also required, as of the end of each quarter, to maintain minimum levels of net worth, and the Company must comply with an annual limitation on capital expenditures. Due to additional losses incurred on two fixed-price projects during the fourth quarter, the Company requested and was successful in obtaining a waiver and subsequent amendment to its credit agreement with Comerica Bank in order to meet the monthly fixed charge ratio. The Company was in compliance with all covenants under the Comerica Credit Facility as of December 31, 2006.

Letters of credit

As of December 31, 2006, the Company had no standby letters of credit outstanding. Standby letters of credit had previously been issued to a refining client to cover contractual obligations funded by the client for progress payments made to equipment manufacturers for major project items. That contractual obligation expired in August 2006.

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 - LINE OF CREDIT AND DEBT (Continued)

Long-term debt consisted of the following at December 31, 2006 and 2005:

	2006
Comerica Credit Facility - Line of credit, prime (8.25% at December 31, 2006), maturing in July 2009	$ 23,
The following notes are subordinate to the credit facility and are unsecured:	
Sterling Planet and EDGI - Notes payable, interest at 5%, principal payment installments of $15,000 plus interest due quarterly, maturing in December 2008	
Significant PEI Shareholders (See Note 19)	
Cleveland Inspection Services, Inc., CIS Technical Services and F.D. Curtis - Notes payable, discounted at 5% interest, principal in installments of $100,000 due quarterly, maturing in October 2009	1,
InfoTech Engineering, Inc. - Note payable, interest at 5%, principal payments in installments of $65,000 plus interest due annually, maturing in December 2007	
ATI Technologies - Note payable, interest at 6%, principal payments in installments of $30,422 including interest due monthly, maturing in	

January 2009	
Michael Lee - Note payable, interest at 5%, principal payments in installments of $150,000 plus interest due quarterly, maturing in July 2010	2,
Watco Management, Inc. - Note payable, interest at 4%, principal payments in installments of $137,745 including interest annually, maturing in October 2010	
Miscellaneous	
Total long-term debt	28,
Less: Current maturities	(1,
Long-term debt, net of current portion	$ 27,

Maturities of long-term debt as of December 31, 2006, are as follows:

	Maturities (in thousands)
Years Ending December 31,	
2007	$ 1,418
2008	1,535
2009	25,109
2010	432
Total long-term debt	$ 28,580

NOTE 9 - OPERATING LEASES

The Company leases equipment and office space under long-term operating lease agreements.

The future minimum rental payments on operating leases (with initial or remaining non-cancelable terms in excess of one year) as of December 31, 2006 are as follows:

	Operating (in thousands)
Years Ending December 31,	
2007	$ 4,366
2008	2,754

2009	2,165
2010	1,938
2011 and after	1,423
Total minimum lease payments	$ 12,646

Rent expense for the years ended December 31, 2006, 2005 and 2004 was $5,502,000, $2,167,000 and $1,754,000, respectively.

NOTE 10 - EMPLOYEE BENEFIT PLANS

The Company sponsors a 401(k) profit sharing plan for its employees. Effective October 1, 2005, the Company amended the Plan to implement a mandatory matching contribution equal to 25% of employee contributions up to 4% of employee compensation for non-regular employees. For regular employees, the Company makes mandatory matching contributions equal to 50% of employee contributions up to 4% of employee compensation. The Company, as determined by the Board of Directors, may make other discretionary contributions. The employees may elect to make contributions pursuant to a salary reduction agreement upon meeting age and length-of-service requirements. The Company made contributions of approximately $1,310,000, $401,000, and $221,000, respectively, for the years ended December 31, 2006, 2005, and 2004. Effective April 1, 2006, the Company increased its matching contributions to the ENGlobal Corporation 401(k) Plan equal to 50% of regular employee contributions up to 6% of employee compensation, and all other employees will be matched at 33.33% of employee contribution up to 6% of compensation, as defined.

On June 17, 2004, ENGlobal shareholders ratified the Company's adoption of the 2004 Employee Stock Purchase Plan ("Plan"). Beginning April 2004, the Company provided eligible employees with the opportunity and a convenient means to purchase shares of the Company's common stock as an incentive to exert maximum efforts for the success of the Company. ENGlobal intended that options to purchase stock granted under the Plan would qualify as options granted under an "employee stock purchase plan" as defined in Section 423(b) of the Code. The Plan was construed so as to be consistent with Section 423 of the Code, including Section 423(b)(5) which requires that all participants have the same rights and privileges with respect to options granted under the Plan. The cash deferred by participants into the plan, although not significant, was used to meet the Company's cash requirements or was applied to the reduction of the Company's long-term debt. Because of requirements of SFAS 123(R), and probable reduction of benefits that would result, the Company elected to terminate the Plan effective December 31, 2005.

NOTE 11 - STOCK OPTION PLAN

The Company has an incentive plan that provides for the issuance of options to acquire up to 2,650,000 shares of common stock. The incentive plan ("Option Plan") provides for grants of non-statutory options, incentive stock options, restricted stock awards and stock appreciation rights. All stock option grants

are for a ten-year term. Stock options issued to executives and management generally vest over a four-year period; one-fifth at grant date and one-fifth at December 31 of each year until they are fully vested. Stock options issued to directors vest one-half on grant date and the remaining half upon the first anniversary of grant date. In 2006 one grant was issued fully vested following termination of a series under which the employee held a similar amount of shares. All stock options grants are issued at the market value of the Company's stock on the date of the grant.

Effective January 1, 2006, the Company adopted SFAS No. 123(R). This statement requires compensation expense relating to share-based payments to be recognized in net income using a fair-value measurement method. Under the fair value method, the estimated fair value of awards is charged over the requisite service period, which is generally the vesting period. The Company elected the modified prospective method as prescribed in SFAS No. 123(R) and therefore, prior periods were not restated. Under the modified prospective method, this statement was applied to new awards granted after the time of adoption.

Options Granted in 2006 Fair Values, Assumptions, and Impact on Net Income

Series	$ 11.97	$ 9.15	$
Grant Date	4/17/2006	6/1/2006	1
Number of Options Granted(1)	205,000	150,000	
Strike Price	$ 11.97	$ 9.15	$
Market Price - Date of Grant	$ 11.97	$ 9.15	$
Total Compensation at Grant Date	1,622,494	906,090	
Compensation Recognized Vesting In 2006	630,079	453,045	
Amount Remaining to Be Recognized in Compensation	992,415	453,045	
Weighted Average Fair Value At Grant Date	$ 7.91	$ 6.04	$
Assumptions			
Expected Life (months)	70.42	63.75	
Risk-Free Rate of Return	4.93%	5.05%	
Expected Volatility	73.75%	74.45%	
Expected Dividend Yield	0.00%	0.00%	
Expected Forfeiture Rate	2.80%	0.00%	

(1) The 11.97 Series had 193,000 options remaining at year end due to employee termination and forfeiture. Compensation recognized for 2006 was adjusted to reflect the forfeitures.

Stock compensation expenses will be recognized over a weighted average remaining life of 2.41 years.

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - STOCK OPTION PLAN (Continued)

Amount of Compensation Expense		2006 Grants	Pre-2006 Grants
	2006	$ 1,837,729	$ 338,433
	2007	758,625	293,095
	2008	305,580	119,862
	2009	305,580	-
		$ 3,207,514	$ 751,389

No compensation cost has been recognized for grants under the Option Plan prior to 2006 because the exercise price of the options granted to employees equaled or exceeded the market price of the stock on the date of the grant. Had the method prescribed by SFAS No. 123 been applied, the Company's net income available to common stockholders for the years ended December 31, 2005 and 2004 would have been changed to the pro forma amount indicated below:

Net income available for common stock-as reported	$
Compensation expenses if the fair value method had been applied to the grants, net of taxes	
Net income available for common stock-pro forma	$
Net income per share-as reported	
Basic	$
Diluted	$
Net income available per share-pro forma	
Basic	$
Diluted	$

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in the pro-forma years 2005 and 2004, dividend yield of 0%, expected volatility of 73.8% to 75.1%, and risk-free interest rates of 4.93% to 5.20%, 5% and 5% for each year presented, and expected lives of two to six years based on the simplified-method calculation. The maximum term of each option is ten years.

The Company's policy for exercising options begins with the option holder submitting an "Exercise Notice" to the Investor Relations Officer ("IRO"). The IRO determines the option holder's eligibility and current employment status. The IRO then prepares the "Option Exercise Notification Form". Options holders at the "Named Executive" level must be approved to exercise their options by the Compensation Committee. Any required notice is then filed with the SEC. The options holder may then purchase shares at the exercise price.

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - STOCK OPTION PLAN (Continued)

The following table summarizes total aggregate stock option activity for the period December 31, 2003 through December 31, 2006:

	Number of Shares Outstanding	Weighte Average Exercise Pr
Balance at December 31, 2003	1,257,168	2.
Granted	386,000	2.
Exercised	(87,332)	1.
Canceled or expired	(28,686)	1.
Balance at December 31, 2004	1,527,150	2.
Granted	425,000	3.
Exercised	(493,019)	.
Canceled or expired	(21,164)	1.
Balance at December 31, 2005	1,437,967	3.
Granted	530,000	9.
Exercised	(329,273)	2.
Canceled or expired	(216,200)	6.
Balance at December 31, 2006	1,422,494	5.

The following table summarizes information concerning outstanding and exercisable Company common stock options at December 31, 2006.

Exercise Prices	Options Outstanding at December 31,2006	Average Exercise Price	Average Remaining Contractual Life	Options Fully-Vested And Exercisable at Dece,ber 31, 2006
$ 0.96	104,656	$ 0.96	3.8	104,656
$ 1.00	20,000	$ 1.00	4.2	20,000
$ 1.25	60,000	$ 1.25	3.0	60,000
$ 1.81	40,000	$ 1.81	7.5	40,000
$ 1.87	34,000	$ 1.87	6.3	34,000
$ 1.97	25,000	$ 1.97	7.2	25,000
$ 2.05	171,650	$ 2.05	7.2	122,250
$ 2.32	40,000	$ 2.32	6.4	40,000
$ 2.39	80,000	$ 2.39	8.1	40,000
$ 2.50	75,000	$ 2.50	8.2	45,000
$ 3.75	150,000	$ 3.75	8.5	150,000
$ 6.24	4,188	$ 6.24	1.0	4,188

$ 6.71	100,000	$ 6.71	8.9	60,000
$ 6.83	175,000	$ 6.83	9.9	175,000
$ 9.15	150,000	$ 9.15	9.4	75,000
$ 11.97	193,000	$ 11.97	9.3	77,200
	1,422,494			1,072,294

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11 - STOCK OPTION PLAN (Continued)

Total intrinsic value of options outstanding at December 31, 2006 (000's)
Total intrinsic value of options exercisable at December 31, 2006 (000's)
Total intrinsic value of options exercised during 2006 (000's)
Available for grant at December 31, 2006
Weighted-average fair value of options at grant date, granted in 2005
Weighted-average fair value of options at grant date, granted in 2004
Weighted-average remaining life of all options outstanding at December 31, 2006

For 2002 through 2004, the summary above does not include 234,774 non-qualified options issued at the time of the Merger to replace existing options issued by Petrocon in consideration for services. Such options had an exercise price of $4.26 per share. In September 2005, these options were exercised.

Replacement warrants of 305,102 (not included in the table above) with an exercise price of $6.24 expired in October 2003.

NOTE 12 - RELATED-PARTY TRANSACTIONS

On May 25, 2006, the Company, through its wholly-owned subsidiary ENGlobal Corporate Services, Inc., purchased a one-third partnership interest in PEI Investments, A Texas Joint Venture ("PEI"), from Michael L. Burrow, the Company's President and CEO, and another one-third interest from a stockholder who owns less than 1% of the Company's common stock. The partnership interests were purchased for a total of $69,000. The remaining one-third interest was already held by the Company through its wholly-owned subsidiary EEI. PEI owns the land on which our Beaumont, Texas office building, destroyed by Hurricane Rita in September 2005, was located. The remains of the building were razed in July 2006. In September 2006, the Company acquired approximately 1.2 acres immediately adjacent to the former facility and is developing plans to construct a new facility utilizing both parcels of land.

NOTE 13 - CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS

The Company provides engineering and fabricated systems and services primarily to major integrated oil and gas companies throughout the world. It also fabricates power systems and battery chargers. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. Management reviews all trade receivable balances that exceed 30 days past due and based on its assessment of current credit worthiness,

estimate what portion, if any seems doubtful for collection. A valuation allowance that reflects management's best estimate of the amounts that will not be collected is established.

For the years ended December 31, 2006, 2005, and 2004, the Company had sales in the engineering segment totaling approximately $42.5 million, $84.8 million and $87.9 million attributable to a single customer. In 2006, approximately 16% of our revenues were from one client, approximately 15% of our revenues were from another client and another 10% were from a third client. During 2005 and 2004, a single customer represented approximately 44% and 59% of total sales, respectively. As of December 31, 2006 the Company had amounts due from 2 customers totaling $11.7 million with 1 customer exceeding 10% of trade receivables. At December 31, 2005, the Company had amounts due from two customer totaling $8.3 million with neither customer exceeding 10% of trade receivables. At December 31, 2004, the Company had amounts due from one customer totaling $7.0 million; no other customer exceeded 10% of trade receivables at that date.

NOTE 14 - RETIREMENT OF TREASURY SHARES AND REDEEMABLE PREFERRED STOCK

Treasury stock was recorded on our books at $592,231. Upon retirement/cancellation of the shares in 2006 our Paid in Capital account was reduced by $592,231 and the treasury stock account was credited to reduce it to zero.

ENGlobal has a class of preferred stock with 5,000,000 shares originally authorized for issuance. The Company issued to Equus II Incorporated 2,500,000 shares of preferred stock in 2001 and stock dividends totaling 88,000 shares in 2002 and 146,833 shares in 2003. Par value for the preferred stock was $0.001 with a fair value of $1.00 per share at the time of issuance. The preferred shares outstanding were converted into 1,149,089 shares of common stock in August 2003. Following the conversion, the Company reduced the authorized shares of preferred stock to 2,265,167. This class of preferred stock was eliminated by a vote of the Company's stockholders in June, 2006.

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

Blank Check Authority

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

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

67

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15 - FEDERAL INCOME TAXES

The components of income tax expense (benefit) from continuing operations for the years ended December 31, 2006, 2005 and 2004 were as follows:

	2006	2005	
		(in thousands)	
Current			
Federal	$ 1,047	$ 3,016	$
Foreign	53	-	
State	403	413	
	1,503	3,429	
Deferred			
Federal	(1,917)	(313)	
Foreign	(38)	-	
State	(362)	-	
	(2,317)	(313)	
Total tax provision	$ (814)	$ 3,116	$

The components of the deferred tax asset (liability) consisted of the following at December 31, 2006 and 2005:

	2006	
	(in thousands)	
Deferred tax asset		
Allowance for doubtful accounts	$ 255	$
Net operating loss carry-forward	665	
Accruals not yet deductible for tax purposes	2,636	
Stock Options	235	
Alternative minimum tax credit carry-forward	-	
Deferred tax assets	3,791	
Less: Valuation Allowance	308	
Deferred tax assets	3,483	
Deferred tax liabilities		
Depreciation	(403)	
Prepaid expenses	(477)	
Goodwill	(1,407)	
Deferred tax liability	(2,287)	
Deferred tax asset, net	$ 1,196	$

NOTE 15 - FEDERAL INCOME TAXES (Continued)

The following is a reconciliation of expected to actual income tax expense from continuing operations:

	2006	
		(in
Federal income tax expense at 34%	$ (1,462)	$
State and foreign taxes, net of tax effect	(16)	
Nondeductible expenses	102	
Stock compensation expense	530	
Valuation allowance	308	
Prior year correction	(169)	
Other	(107)	
	$ (814)	$

The Company has a federal net operating loss carryforward at December 31, 2006 of approximately $1,049,000. Earlier utilization of the net operating

loss on the Company's 2002 and 2003 consolidated tax returns was disallowed by the IRS which resulted in a reinstated carry-forward that will be available for utilization in 2007 through 2010.

The Company also has a foreign net operating loss carryforward at December 31, 2006 of approximately $770,000. This loss is available for utilization in 2007 through 2016.

The Company is unsure of its ability to fully utilize the foreign net operating loss. Therefore, the Company has set up a valuation allowance of $308,000 against the entire net operating loss.

NOTE 16 - ACQUISITIONS

Assets acquired and liabilities assumed by the Company in acquisitions have been recorded on the Company's Consolidated Balance Sheets as of the respective acquisition dates based upon their estimated fair values at such dates. The results of operations of our acquisitions have been included in the Company's Consolidated Statement of Operations since the respective dates of acquisition. The excess of the purchase price over the estimated fair values of the underlying assets acquired and liabilities assumed has been allocated to goodwill.

During 2006, the Company acquired Denver-based WRC Corporation ("WRC") and certain assets of Analyzer Technology International, Inc. ("ATI"), and accounted for the acquisitions using the purchase method of accounting for business combinations. In both cases, the purchase price and costs associated with the acquisitions exceeded the preliminary estimated fair value of net assets acquired by approximately $5.6 million and $1.8 million respectively, which was preliminarily assigned to goodwill. During early 2007, the Company completed the valuation of the intangible assets acquired in both the WRC and the ATI transactions and pursuant to those valuations has re-assigned approximately $4.0 million and $1.8 million respectively from goodwill to non-compete agreements and customer relationships with such assets being amortized over 5-6 years.

On October 6, 2006, the Company, through its wholly-owned subsidiary, ENGlobal Construction Resources, Inc. ("ECR"), acquired certain assets of WATCO Management, Inc. ("WATCO"), a Houston-based business providing construction management, turnaround management, asset management, and project commissioning and start-up services, and related services for projects and facilities located in process plants. The addition of WATCO will provide ECR with opportunities to expand its current services to existing WATCO clients in addition to a complementary business allowing expansion of current services to both existing and future clients. The aggregate purchase price was $1.0 million, including $500,000 in cash and an unsecured promissory note in the principal amount of $500,000 payable in four equal annual installments, bearing interest at the rate of 4% per annum. The estimated fair values of the acquired assets include approximately $800,000 in intellectual property, $52,000 in fixed assets

69

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16 - ACQUISITIONS (Continued)

and $148,000 in goodwill. The Company is in the process of obtaining third-party valuations of the intangible assets; thus the allocation of the purchase price is subject to adjustment.

The Company purchased Denver-based WRC Corporation ("WRC") on May 25, 2006. WRC provides integrated land management, engineering, and related services to the pipeline, power, and transportation industries, among others. WRC has become a wholly-owned subsidiary of ENGlobal and will now serve as the Company's provider of land management, environmental compliance and governmental regulatory services. WRC currently has approximately 200 employees, with revenues in the 12 months prior to the acquisition exceeding $20 million. The Company expects to utilize WRC's Denver facility as a beachhead for expansion of its services into the Rocky Mountain and Western U.S. regions. ENGlobal purchased all of the outstanding capital stock of WRC in exchange for consideration of cash, a promissory note of $2.4 million to be paid over four years, 175,000 shares of ENGlobal common stock and the repayment of certain obligations of WRC as part of the transaction. At June 30, 2006, goodwill from this transaction was estimated to be $1.5 million.

In January 2006, one of the Company's subsidiaries, ENGlobal Systems, Inc. ("ESI") acquired certain assets of Analyzer Technology International, Inc. ("ATI"), a Houston-based analyzer systems provider of online process analyzer systems. ATI relocated its operation to ESI's Houston facility, which the Company expects will enable ESI's clients to perform a more efficient factory adaptable test by temporarily connecting both control and analyzer systems onsite prior to delivery. The addition of ATI will provide ESI with a greater presence in the process anlayzer sector, especially for larger downstream opportunities of foreigh grassroots projects.

In December 2004, ESI purchased contract rights and other assets of InfoTech Engineering Company, LLC, a limited liability company ("InfoTech"), headquartered in Baton Rouge, Louisiana. The Company paid $325,000 in cash, a promissory note in the amount of $225,000 and entered into a non-compete agreement with the former owner in exchange for approximately $55,000 in computer equipment and certain intangible assets. The acquisition resulted in approximately $270,000 in goodwill which is being recorded and amortized over 15 years for tax purposes. The InfoTech acquisition expands ESI's capability in controls system integration in both the automation and process control services. InfoTech's primary experience is in the onshore and offshore oil and gas and petrochemical industries.

In October 2004, one of the Company's subsidiaries, ENGlobal Construction Resources, Inc., purchased the name and certain assets of Cleveland Inspection Services, Inc. ("CIS"). CIS provides inspection and constructionmanagement services in support of the oil and gas, utility, and pipeline industries. The Company paid $2.5 million consisting of cash, discounted promissory notes and the assumption of certain designated contract obligations and entered into non-compete agreements with CIS and its principals in exchange for approximately $1.0 million in machinery and equipment, furniture and fixtures, computer equipment, software and other intangible assets. The acquisition resulted in approximately $1.3 million in goodwill which is being recorded and amortized over 15 years for tax purposes.

One of the Company's subsidiaries, ENGlobal Technical Services, Inc. ("ETS") (formerly known as ENGlobal Design Group, Inc. ("EDG")), purchased certain assets of Tulsa-based Engineering Design Group, Inc. ("EDGI") effective February 1, 2004. The Company believes that the acquisition of these assets enhance its capabilities related to various government and public sector facilities. ETS's most active sector is the Automated Fuel

Handling Systems which serves the U.S. Military. In connection with the purchase, the Company acquired $344,000 in tangible assets including furniture and fixtures, computer equipment and software. The Company also assumed a liability for $44,000 in accrued compensated absences for former EDGI employees hired at the time of the purchase, issued two $150,000 notes bearing interest at 5% per annum maturing in December 2008 and a $2.5 million five-year contingent promissory note, with payments due annually, as part of an earn-out based on revenues of the ETS operations over the five years following the acquisition. ETS did not pay any cash or issue any stock in the transaction. The original consideration given for the purchase of certain EDGI assets approximated the fair value of the net assets acquired; therefore, no goodwill arose from the transaction. Principal

NOTE 16 - ACQUISITIONS (Continued)

and interest on the $2.5 million five-year contingent promissory note is being charged to goodwill. As of December 31, 2005, $218,000 in principal and interest payments on the contingent promissory note has been charged to goodwill and is being amortized over 15 years for tax purposes.

NOTE 17 - SALE OF THERMAIRE

The Company completed its sale of assets of its subsidiary, Thermaire, Inc., d/b/a Thermal Corporation, the only company in the manufacturing segment, to a medium-sized HVAC equipment manufacturer in December 2003. The disposition had been actively pursued since November 2001 in order to permit the Company to strategically focus on its core operations. This discontinued segment had reported losses from operations of $154,000 in 2003. The sale resulted in the receipt of $545,000 in cash and a $26,000 gain, net of tax. The 37,000 square foot office and manufacturing facility owned by Thermaire was not included in the transaction and has been separately listed for sale.

In March 2005, the Company completed the sale of the building formerly occupied by Thermaire, Inc. The Company received proceeds of $823,350. The Company realized a gain on the sale of the building of $119,000.

NOTE 18 - SEGMENT INFORMATION

With the sale of the manufacturing segment, the Company operates in two business segments: engineering and systems. The engineering segment provides services primarily to major integrated oil and gas companies that for the most part are located in the United States. The systems segment operates primarily full-service systems/controls engineering and integration with some uninterruptible power systems and battery chargers that for the most part are located in the United States. Sales, operating income, identifiable assets, capital expenditures and depreciation for each segment are set forth in the following table. The amount in the corporate segment includes those activities that are not allocated to the operating segments and include costs related to business development, executive functions, finance, accounting, safety, human resources and information technology that are not specifically identifiable with the two segments.

The inter-company elimination column includes the amount of administrative costs allocated to the segments. The Corporate function supports both business segments and therefore cannot be specifically assigned to either. A significant portion of Corporate costs are allocated to each segment based on each segment's revenues and subsequently eliminated in consolidation.

Financial information about geographic areas

Revenues from the Company's non-U.S. operations are currently not material. Long-lived assets located in Canada are currently not material.

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18 - SEGMENT INFORMATION (Continued)

Segment information for 2006, 2005 and 2004 was as follows:

Note: Previously, within the Systems Segment, ESI provided products and services supporting the advanced automation and integrated controls fields. In January 2006, EAG assumed responsibility for these services, which resulted in a move of this division of ESI to the Engineering Segment. Revenues and expenses have been reclassified between the segments to provide comparative results. Amounts will tie in total to prior reporting, however, individual segments will vary from prior reports.

	Engineering	Systems	Corporate (in thousands)	Intercompany Eliminations	Tot
2006					
Net sales from external customers	$ 278,157	$ 24,933	$ -	$ -	$ 303
Operating profit (loss)	9,084	(14)	(12,690)	1	(3
Depreciation and amortization	1,419	344	512	-	2
Tangible assets	65,339	15,122	6,563	-	87
Goodwill	18,224	978	-	-	19
Capital expenditures	3,286	185	674	-	4
2005					
Net sales from external customers	$ 219,426	$ 14,159	$ -	$ -	$ 233
Operating profit (loss)	18,911	(851)	733	(10,209)	8
Depreciation and amortization	1,256	101	479	-	1
Tangible assets	52,602	5,460	2,419	-	60

Goodwill	14,756	699	-	-	15
Capital expenditures	2,569	172	489	-	3
2004					

Net sales from external customers	$ 134,778	$ 14,110	$ -	$ -	$ 148
Operating profit (loss)	10,461	636	2,267	(8,872)	4
Depreciation and amortization	706	108	432	-	1
Tangible assets	31,971	6,673	3,332	-	41
Goodwill	14,585	699	-	-	15
Capital expenditures	1,378	20	67	-	1

Tangible assets include cash, accounts receivable, costs in excess of billings, prepaid expenses, income tax receivables, deferred tax assets, property and equipment and deferred financing. Goodwill, investments in subsidiaries, and inter-company accounts receivables and payables are excluded.

ENGLOBAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 - COMMITMENTS AND CONTINGENCIES

In connection with the 2001 merger of Petrocon Engineering, Inc. ("Petrocon") and a wholly-owned subsidiary of ENGlobal Corporation, certain former Petrocon shareholders (the "Significant PEI Shareholders") entered into an Indemnification Escrow Agreement, an Option Escrow Agreement, a Voting Agreement and a Significant PEI Shareholder Voting Agreement (collectively, the "2001 Agreements"). In August 2004, the Company and the requisite percentage of Significant PEI Shareholders entered into a Termination Agreement (the "Termination Agreement") terminating the 2001 Agreements. The 2001 Agreements included the following:

Indemnification Escrow.
Pursuant to the Indemnification Escrow Agreement, 1,000,000 shares of ENGlobal common stock owned by the Significant PEI Shareholders were deposited into an escrow to serve as a fund against which the Company could make claims for indemnity pursuant to the Merger Agreement with Petrocon. Pursuant to the terms of the Termination Agreement, the remaining shares in the Indemnification Escrow agreement have been released pro rata to the Significant PEI Shareholders.

Voting Agreement.
ENGlobal, the Significant PEI Shareholders, and certain other parties entered into a Voting Agreement which obligated the parties thereto to vote for certain persons to serve on the Board of Directors of ENGlobal. Pursuant to the terms of the Termination Agreement, the Voting Agreement has been terminated.

Significant PEI Shareholder Voting Agreement.
The Significant PEI Shareholders entered into a Significant PEI

Shareholders Voting Agreement governing the manner in which they would designate three ENGlobal director nominees under the Voting Agreement and vote shares held in escrow. Pursuant to the terms of the Termination Agreement, the Significant PEI Shareholders Voting Agreement has been terminated.

Option Escrow.
Pursuant to the Option Escrow Agreement, the Significant PEI Shareholders deposited 1,737,473 shares of ENGlobal common stock into an escrow account. The Option Escrow Agreement required that if ENGlobal issued shares of its common stock on the exercise of incentive options granted as replacement options for outstanding Petrocon incentive options ("Replacement Options"), a like number of shares of ENGlobal common stock would be surrendered from the escrow account to ENGlobal. As a result, no dilution to ENGlobal stockholders would occur upon the exercise of Replacement Options.

The Company's management determined that, due to the cost and complexity associated with administering the 2001 Agreements, it would be in the best interest of the Company and its stockholders to terminate the same. Pursuant to the terms of the Termination Agreement, ENGlobal purchased the 652,377 shares being held in escrow underlying the Replacement Options with an exercise price of $0.96 per share for a discounted payment of $592,231, payable over three years to the Significant PEI Shareholders. ENGlobal also terminated its rights to any of the remaining shares held in escrow and those shares were distributed to the Significant PEI Shareholders. The transaction resulted in 652,377 shares of Treasury Stock and a decrease in Shareholders' Equity of $592,231 until such time as the replacement options are exercised and the exercise price is remitted to the Company. As of December 31, 2006, all payments due to Significant PEI Shareholders had been made.

Employment Agreements

The Company has employment agreements with certain of its executive officers and certain other officers, the terms of which expire in January 2009. Such agreements provide for minimum salary levels. If the Company terminates the employment of the employee for any reason other than 1) termination for cause, 2) voluntary resignation, or 3) employee's death, the Company is obligated to provide a severance benefit equal to six months of the employee's salary, and, at its option, an additional six months at 50% to 100% of the employee's salary in exchange for an extension of the non-compete. These agreements are renewable for one year at the Company's option.

NOTE 19 - COMMITMENTS AND CONTINGENCIES (Continued)

Litigation

From time to time, we are involved in various legal proceedings arising in the ordinary course of business alleging, among other things, breach of contract or tort in connection with the performance of professional

services, the outcome of which cannot be predicted with certainty. As of the date of this filing, we are party to several legal proceedings that have been reserved for or are covered by insurance, or that, if determined adversely to us individually or in the aggregate, would not have a material adverse effect on our results of operations or financial position.

Insurance

The Company carries a broad range of insurance coverage, including general and business automobile liability, commercial property, professional errors and omissions, workers' compensation insurance and a general umbrella policy. The Company is not aware of any claims in excess of insurance recoveries. ENGlobal is partially self-funded for health insurance claims. Provisions for expected future payments are accrued based on the Company's experience. Specific stop loss levels provide protection for the Company with $175,000 per occurrence and approximately $12.1million in aggregate in each policy year being covered by a separate insurance policy.

NOTE 20 - SUBSEQUENT EVENTS

In December 2006, ENGlobal Engineering, Inc. began its plan to merge its Dallas, Texas operations with operations being performed at the Tulsa, Oklahoma and Houston, Texas offices. The transfer of activities at the Dallas office was the result of a decision to consolidate the Company's Texas-based operations while streamlining or reducing overhead costs. A large number of the 25 Dallas employees were offered transfers to ENGlobal's Tulsa, Oklahoma or Houston, Texas offices. Certain employees were asked to remain with the Company in Dallas through March 31, 2007 to allow for an orderly transfer of on-going projects.

On February 14, 2007, the Company ceased operations through its Dallas office and transferred all remaining operational support to its Tulsa office. At the same time, the Company entered into a sublease commencing on March 1, 2007, for approximately 75% of the continuing lease obligations and sold a majority of the assets which were valued at approximately $90,000. The Company will calculate the remaining obligations related to the move from the Dallas area and record a charge during the first quarter of 2007. The Company estimates the charge will range from $100,000 to $125,000.

On February 16, 2007, the Company, through its wholly-owned subsidiary, RPM Engineering, Inc. ("RPM"), entered into an Agreement to Purchase and Sell the property (the "Agreement"), together with the building and all improvements thereon located in Baton Rouge, Louisiana for approximately $1.9 million with 20% of purchase price being paid at closing and the balance self-financed for a period no longer than 60 months, amortized over 180 months, payable in equal monthly installments and one irregular installment consisting of the interest and principle due at the end of the 60 months. The interest rate is based on NY prime plus .25%, initially to be 8.5%. Under certain conditions prior to closing and up to sixty days for the last signing of the Agreement, the purchaser may be entitled to the return in full of any deposit held by RPM. The financed portion of the purchase price is secured by a first mortgage on the property. The Company's basis in the property, together with the building and all improvements is approximately $1.4 million at December 31, 2006. It is intended that the closing shall take place on or about April 30, 2007.

NOTE 21 - QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

	For the Quarters Ended - 2006				
	March		June		September
	(in thousands, except per share amoun				
Revenues per segment					
Engineering	$ 62,587	93.9%	$ 69,752	92.9%	$ 76,61
Systems	4,040	6.1%	5,314	7.1%	5,88
Total	$ 66,627	100.0%	$ 75,066	100.0%	$ 82,50
Gross profit per segment					
Engineering	$ 7,796	12.5%	$ 10,189	14.6%	$ 4,42
Systems	426	10.5%	$ 539	10.1%	12
Total	$ 8,222	12.3%	$ 10,728	14.3%	$ 4,54
Net income (loss)	$ 1,234		$ 2,331		$ (1,57
Earnings per share - basic	$ 0.05		$ 0.09		$ (0.0
Earnings per share - diluted	$ 0.05		$ 0.09		$ (0.0

	For the Quarters Ended - 2005				
	March		June		September
	(in thousands, except per share amoun				
Revenues per segment					
Engineering	$ 41,226	92.4%	$ 54,962	92.5%	$ 55,92
Systems	3,403	7.6%	4,457	7.5%	3,34
Total	$ 44,629	100.0%	$ 59,419	100.0%	$ 59,26
Gross profit per segment					
Engineering	$ 5,405	13.1%	$ 6,925	12.6%	$ 7,63
Systems	294	8.6%	354	7.9%	20
Total	$ 5,699	12.8%	$ 7,279	12.3%	$ 7,83
Net income	$ 921		$ 1,520		$ 1,62
Earnings per share - basic	$ 0.04		$ 0.06		$ 0.0
Earnings per share - diluted	$ 0.04		$ 0.06		$ 0.0

Note: Previously, within the Systems Segment, ESI provided products and services supporting the advanced automation and integrated controls fields. In January 2006, EAG assumed responsibility for these services, which resulted in a move of this division of ESI to the Engineering Segment. Revenues and expenses have been reclassified between the segments to provide comparative results. Amounts will tie in total to prior reporting,

however, individual segments will vary from prior reports.

Schedule II

ENGlobal Corporation

VALUATION AND QUALIFYING ACCOUNTS

Description	Balance - Beginning of Period	Additions	Deduction Write of
	(in thousands)		
Allowance for doubtful accounts			
For year ended December 31, 2006	$ 503	$ 251	$
For year ended December 31, 2005	$ 476	$ 53	$
For year ended December 31, 2004	$ 376	$ 134	$

ITEM 9. CHANAGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures of a registrant designed to ensure that information required to be disclosed by the registrant in the reports that it files or submits under the Exchange Act is properly recorded, processed, summarized, and reported, within the time periods specified in the Securities and Exchange Commission's ("SEC") rules and forms. Disclosure controls and procedures include processes to accumulate and evaluate relevant information and communicate such information to a registrant's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosures.

We evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2006, as required by Rule 13a-15 of the Exchange Act. As described below, under "Management's Report on Internal Control Over Financial Reporting," material weaknesses were identified in our internal control over financial reporting as of December 31, 2006, relating to

our control environment, information technology access, accounting system, purchases and expenditures, fixed-price contract information, and revenue recognition. Based on the evaluation described above, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2006, our disclosure controls and procedures were not effective to ensure (1) that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC's rules and forms, and (2) information required to be disclosed by us in our reports that we file or submit under the Exchange Act 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.

(b) Management's Report on Internal Control over Financial Reporting

Effective June 30, 2006, ENGlobal Corporation met the definition of "accelerated filer," as described by Rule 12b-2 of the Exchange Act. As an accelerated filer, we are required by the Sarbanes-Oxley Act of 2002 to include an assessment of our internal control over financial reporting for the year ended December 31, 2006. Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements for external reporting purposes in accordance with generally accepted accounting principles.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

A material weakness in internal control over financial reporting (as defined in Auditing Standard No. 2 of the Public Company Accounting Oversight Board) is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies,

that adversely affects a company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, the end of the fiscal period covered by this report, but management did not complete its assessment until March 2, 2007. Due to the lack of adequate time to permit Hein to audit

management's assessment, Hein is unable to render an opinion on our assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006. Accordingly, management has identified this as a material weakness. Management's assessment process did not conclude in adequate time to permit Hein to audit management's assessment due to a number of factors, including: (i) our failure to prepare and plan for a timely completion of management's assessment, including adding the resources necessary to do so; and (ii) our failure to ensure that our accounting department was adequately staffed and sufficiently trained to meet deadlines.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2006, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control--Integrated Framework. In assessing the effectiveness of our internal control over financial reporting, management identified the following additional material weaknesses in internal control over financial reporting as of December 31, 2006:

1. Deficiencies in the Company's Control Environment. Our control environment did not sufficiently promote effective internal control over financial reporting throughout the organization. Specifically, we had a shortage of support and resources in our accounting department, which resulted in insufficient: (i) documentation and communication of our accounting policies and procedures; and (ii) internal audit processes of our accounting policies and procedures.

2. Deficiencies in the Company's Information Technology Access Controls. We did not maintain effective controls over preventing access by unauthorized personnel to end-user spreadsheets and other information technology programs and systems.

3. Deficiencies in the Company's Accounting System Controls. We did not effectively and accurately close the general ledger in a timely manner and we did not provide complete and accurate disclosure in our notes to financial statements, as required by generally accepted accounting principles.

4. Deficiencies in the Company's Controls Regarding Purchases and Expenditures. We did not maintain effective controls over the tracking of our commitments and actual expenditures with third-party subsidiaries on a timely basis.

5. Deficiencies in the Company's Controls Regarding Fixed-Price Contract Information. We did not maintain effective controls over the complete, accurate, and timely processing of information relating to the estimated cost of fixed-price contracts.

6. Deficiencies in the Company's Revenue Recognition Controls. We did not maintain effective policies and procedures relating to revenue recognition of fixed price contracts, which accounted for approximately 11% of the Company's revenues in 2006.

7. Deficiencies in the Company's Controls over Income Taxes. We did not maintain sufficient internal controls to ensure that amounts provided for in our financial statements for income taxes accurately reflected our income tax position as of December 31, 2006.

ITEM 9A. CONTROLS AND PROCEDURES (continued)

As a result of the material weaknesses described above, our management concluded that we did not maintain effective internal control over financial reporting as of December 31, 2006, based on the criteria established by COSO.

(c) Changes in Internal Controls Over Financial Reporting

No change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during the fourth quarter of fiscal 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Management and the Audit Committee of the Company's Board of Directors have begun to develop remedial measures to address the internal control deficiencies identified above. The Company will monitor the effectiveness of planned actions and will make any other changes and take such other actions as management or the Audit Committee determines to be appropriate.

(d) Remediation Initiatives

During 2007, we plan to implement a number of remediation measures to address the material weaknesses described above. The Company's remediation plans include:

1. We plan to hire additional personnel to assist us with documenting and communicating our accounting policies and procedures to ensure the proper and consistent application of those policies and procedures throughout the Company. Recruitment for this position(s) has begun and the selection process is expected to be completed during the second quarter of 2007.

2. We plan to implement formal processes requiring periodic self-assessments, independent tests, and reporting of our personnel's adherence to our accounting policies and procedures.

3. We plan to design effective policies and procedures to control security of and access to spreadsheet information. If necessary, we will also consider implementing a software solution with automatic control checkpoints for day-to-day business processes.

4. We plan to (i) require additional training for our current accounting personnel; (ii) to hire additional accounting personnel to enable the allocation of job functions among a larger group of accounting staff; (iii) to engage outside consultants with technical accounting expertise, as needed; and (iv) to consider restructuring our accounting department, each to increase the likelihood that our accounting personnel will have the resources, experience, skills, and knowledge necessary to effectively perform the accounting system functions assigned to them.

5. We plan to improve procurement and operational efficiencies by implementing a software system and a matrix organization to more completely, accurately, and timely track commitments on Company-wide purchase and expenditure transactions.

6. We plan to improve revenue recognition policies and procedures relating to fixed-price contracts by evaluating the level of economic success achieved by past fixed-price contracts and by stressing throughout the Company the importance of (i) accurately

estimating costs, (ii) timely updating cost estimates to reflect the accuracy of the cost savings, (iii) accurately estimating expected profit, (iv) timely identifying when a project's scope changes, (v) promptly reporting man hours and costs in excess of those originally estimated; and (vi) closely scrutinizing the bid process.

ITEM 9A. CONTROLS AND PROCEDURES (continued)

7. We plan to train personnel to effectively implement and evaluate the overall design of the Company's fixed-price project control processes. Specifically, we plan to enhance and tighten controls as they relate to the initial bid process and the attendant recognition and management of risk by only bidding on large procurement and construction activities on a cost plus basis.

Management recognizes that many of these enhancements require continual monitoring and evaluation for effectiveness. The development of these actions is an iterative process and will evolve as the Company continues to evaluate and improve our internal controls over financial reporting.

Management will review progress on these activities on a consistent and ongoing basis at the Chief Executive Officer and senior management level in conjunction with our Audit Committee. We also plan to take additional steps to elevate Company awareness about and communication of these important issues through formal channels such as Company meetings, departmental meetings, and training.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information under the captions Election of Directors and Executive Officers Section 16(a) Beneficial Ownership Reporting Compliance and Corporate Code of Conduct, in our definitive proxy statement for our 2007 annual meeting of stockholders to be filed with the SEC pursuant to Regulation 14A under the Exchange Act is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information under the captions Executive Compensation, Director Compensation, Compensation Committee, and Report of the Compensation Committee on Executive Compensation and Comparative Stock Performance Graph contained in our definitive proxy statement for our 2007 annual meeting of stockholders to be filed with the SEC pursuant to Regulation 14A under the Exchange Act is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND

RELATED STOCKHOLDER MATTERS

The information under the caption Security Ownership of Certain Beneficial Owners and Management contained in our definitive proxy statement for our 2007 annual meeting of stockholders to be filed with the SEC pursuant to Regulation 14A under the Exchange Act is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information under the caption Certain Relationships and Related Transactions contained our definitive proxy statement for our 2007 annual meeting of stockholders to be filed with the SEC pursuant to Regulation 14A under the Exchange Act is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information under the caption Principal Accounting Fees and Services in our definitive proxy statement for our 2007 annual meeting of stockholders to be filed with the SEC pursuant to Regulation 14A under the Exchange Act is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENTS SCHEDULES

(a)(1) Financial Statements
The consolidated financial statements filed as part of this Form 10-K are listed and indexed in Part II, Item 8.

(a)(2) Schedules
All schedules have been omitted since the information required by the schedule is not applicable, or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements and notes thereto.

(a)(3) Exhibits

EXHIBIT INDEX

Incorporated

Exhibit No.	Description	Form or Schedule	Exhibit No.	Filin wit
2.1	Agreement and Plan of Merger by and between Industrial Data Systems Corporation, IDS Engineering Management, LC, PEI Acquisition, Inc. and Petrocon Engineering, Inc.	10-QSB	2.23	8/14/
2.2	First Amendment of the Agreement and Plan of Merger	S-4/A	2.24	11/6/
2.3	Letter Agreement of the Agreement and Plan of Merger	S-4/A	2.25	11/6/
3.1	Restated Articles of Incorporation of ENGlobal Corporation	10-Q	3.1	11/14
3.2	Amended and Restated Bylaws of Registrant	S-3	4.4	10/31
4.1	Specimen common stock certificate	S-3	4.1	10/31
4.2	Registration Rights Agreement, dated as of September 29, 2005, by and among ENGlobal Corporation and Certain Investors named therein	S-3	4.2	10/31
4.3	Securities Purchase Agreement, dated September 29, 2005, by and between Tontine Capital Partners, L.P. and Registrant	S-3	4.5	10/31
4.4	Form of Subscription Agreement by and among Registrant, Michael L. Burrow, Alliance 2000, Ltd. and certain subscribers	S-3	4.6	10/31
10.1	Option Pool Agreement between Industrial Data Systems Corporation and Alliance 2000, Ltd. Dated December 21, 2001	10-KSB	10.48	4/1/2
10.2	Guaranty and Suretyship Agreement between Industrial Data Systems Corporation and Corporate Property Associates 4 dated April 26, 2002	10-Q	10.64	8/12/
10.3	1998 Incentive Plan	S-8	10.49	8/24/
10.4	Amendment No. 1 to 1998 Incentive Plan	S-8	10.65A	6/9/0
10.5	Amendment No. 2 to the 1998 Incentive Plan	S-8	10.65A	6/9/0
10.6	Amendment No. 3 to the 1998 Incentive Plan	S-8	10.52	8/24/
10.7	Form of ENGlobal Corporation (f/k/a Industrial Data Systems Corporation) Non-qualified Stock Option Agreement Granted Outside of 1998 Incentive Plan	S-8	10.80	8/24/
10.8	Lease Agreement between Petrocon Engineering, Inc. and Phelan Investments on July 25, 2002	10-Q	10.66	11/14

83

		Incorporated		
Exhibit No.	Description	Form or Schedule	Exhibit No.	Filin wit
10.9	Lease Agreement between Petro-Chem Engineering and ENGlobal Engineering, Inc. dated June 4, 2003	10-Q	10.72	8/14/
10.10	Contract between BASF and ENGlobal Engineering, Inc. dated June 9, 2003	10-Q	10.73	8/14/
10.11	Sublease Agreements between Family Connect, Inc., a tenant of CitiPlex Towers Building and IDS Engineering dated February 2, 2003	10-Q	10.74	11/14
10.12	Lease Agreement between Oral Roberts University and IDS Engineering, dba ENGlobal Engineering, Inc. dated October 20, 2003	10-Q	10.75	11/14
10.13	Second Amendment of the ENGlobal Engineering, Inc. 401(k) Plan dated January 1, 2004 (formerly called the "Petrocon Engineering, Inc. 401(k) Plan")	10-K	10.77	3/30/
10.14	Lease Agreement between ENGlobal Design Group, Inc. and TC Meridian Tower LP dated January 24, 2004	10-K	10.79	3/30/
10.15	Credit Agreement by and between Comerica Bank and ENGlobal Corporation and its subsidiaries dated July 27, 2004	8-K	10.1	8/9/0
10.16	Security Agreement by and between Comerica Bank and ENGlobal Corporation and its subsidiaries dated July 27, 2004	8-K	10.2	8/9/0
10.17	Master Revolving Note by and between Comerica Bank and ENGlobal Corporation and its subsidiaries dated July 27, 2004	8-K	10.3	8/9/0
10.18	Third Amendment of the ENGlobal Engineering, Inc. 401(k) Plan (formerly called the "Petrocon Engineering, Inc. 401(k) Plan") dated March 9, 2005 and effective January 1, 2005	10-K	10.48	3/30/
*10.19	Option to Purchase Share Agreement between Yong Choy Lin @ Yong Chai Lin and ENGlobal Engineering, Inc. effective September 8, 2006			
*10.20	Management Agreement between ENGlobal Engineering, Inc. and SchmArt Technologies Sdn. Bhd effective September 8, 2006			
*10.21	First Amendment of the ENGlobal 401(k) Plan effective December 21, 2001			

Exhibit No.	Description	Form or Schedule	Exhibit No.	Filin wit
*10.22	Amended and Restated ENGlobal 401(k) Plan effective October 1, 2005			
*10.23	Second Amendment to the ENGlobal 401(k) Plan effective April 1, 2006			
*10.24	Third Amendment to the ENGlobal 401(k) Plan effective July 1, 2006			

		Incorporated		
Exhibit No.	Description	Form or Schedule	Exhibit No.	Filin wit
*10.25	Regulations Amendment to the ENGlobal 401(k) Plan effective January 1, 2006			
*10.26	First Amendment to the Lease Agreement between Oral Roberts University and ENGlobal Engineering, Inc. dated April 5, 2005			
*10.27	Second Amendment to the Lease Agreement between Oral Roberts University and ENGlobal Engineering, Inc. dated June 15, 2005			
*10.28	Third Amendment to the Lease Agreement between Oral Roberts University and ENGlobal Engineering, Inc. dated December 28, 2005			
*10.29	Fourth Amendment to the Lease Agreement between Oral Roberts University and ENGlobal Engineering, Inc. dated February 27, 2006			
*10.30	Fifth Amendment to the Lease Agreement between Oral Roberts University and ENGlobal Engineering, Inc. dated July 28, 2006			
*10.31	First Amendment to Credit Agreement by and among Comerica Bank and ENGlobal Corporation and its subsidiaries dated September 30, 2004			
*10.32	Second Amendment to Credit Agreement by and among Comerica Bank and ENGlobal Corporation and its subsidiaries dated April 1, 2005			
*10.33	Third Amendment to Credit Agreement by and among Comerica Bank and ENGlobal Corporation and its subsidiaries dated July 31, 2005			
*10.34	Fourth Amendment to Credit Agreement by and among Comerica Bank and ENGlobal Corporation and its subsidiaries dated December 31, 2005			
*10.35	Fifth Amendment to Credit Agreement by and among Comerica Bank and ENGlobal Corporation and its subsidiaries dated July 26, 2006			
*10.36	Sixth Amendment to Credit Agreement by and among Comerica Bank and ENGlobal Corporation and its subsidiaries effective December 31,			

	2006			
*10.37	ENGlobal Corporation Key Manager Incentive Plan effective January 1, 2006			
*10.38	ENGlobal Corporation Executive Level Incentive Plan effective January 1, 2006			

		Incorporated		
Exhibit No.	Description	Form or Schedule	Exhibit No.	Filin wit
*10.39	ENGlobal Corporation Key Executive Employment Agreement - William A. Coskey effective January 1, 2006			
*10.40	ENGlobal Corporation Key Executive Employment Agreement - Michael L. Burrow effective January 1, 2006			
*10.41	ENGlobal Corporation Key Executive Employment Agreement - Robert W. Raiford effective January 1, 2006			
*10.42	ENGlobal Corporation Key Executive Employment Agreement - Michael M. Patton effective January 1, 2006			
*11.1	Statement Regarding Computation of Per Share Earnings is included as Note 2 to the Notes to Consolidated Financial Statements			
14.1	ENGlobal Corporation Code of Ethics for Chief Executive Officer and Senior Financial Officers dated March 25, 2004	10-K	99.5	3/30/
14.2	ENGlobal Corporation Code of Business Conduct and Ethics dated March 25, 2004	10-K	99.6	3/30/
*21.1	Subsidiaries of the Registrant			
*23.1	Consent of Hein & Associates LLP			
*31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14 or 15d-14			
*31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14 or 15d-14			
*32.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(b) or 15d-14(b) and 18 U.S.C. Section 1350			

*32.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(b) or 15d-14(b) and U.S.C. Section 1350			

* Filed herewith

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

ENGlobal CORPORATION

Dated: March 15, 2007

By: //s// Michael L. Burrow
Michael L. Burrow, P.E.,
Chief Executive Officer, Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

By: //s// Michael L. Burrow
Michael L. Burrow, P.E.
Chief Executive Officer, Director

By: //s// William A. Coskey
William A. Coskey, P.E.
Chairman of the Board, Director

By: //s// Robert W. Raiford
Robert W. Raiford
Chief Financial Officer, Treasurer

By: //s// David W. Gent
David W. Gent, P.E., Director

By: //s// Randall B. Hale
Randall B. Hale, Director

By: //s// David C. Roussel
David C. Roussel, Director