3D ADVISORS

This 3DAdvisors Report Covers:
✓ **Insider Trading**: Insider Trading Behavior
✓ **Accounting**: Quality of Earnings Issues
✓ **Governance:** Corporate Governance Issues
✓ **Fundamentals:** Analysis of fundamentals

With Inconsistent Profitability, Insiders Hastily Sell Shaw Group Inc. (NYSE:SGR)

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Business Description

The Shaw Group Inc. offers engineering, technology, construction, fabrication, environmental, and industrial services to various companies worldwide. The Company is organized into 5 operating segments: Fossil and Nuclear, Environmental and Infrastructure, Energy and Chemical, Fabrication and Manufacturing, and Maintenance. The Company's customers include multinational oil companies and industrial corporations, regulated utilities, independent and merchant power producers, governmental agencies, and other equipment manufacturers. It markets its services through an in-house sales force and through independent contractors. The company was founded in 1987 and is headquartered in Baton Rouge, Louisiana.

Key Statistics

Sector:	Last Close:	Market Cap:	Avg Vol (3m):
Industrial Goods	**$54.36**	**$4.53B**	**1,873,600**
Industry:	52 Wk Range:	Trailing P/E:	Shrs Out:
Waste Management	**$28.60-$77.30**	**N/A**	**83.36M**
F/T Employees:	FYE:	Forward P/E:	Short % of Float:
27,000	**31-Aug**	**16.04**	**2.20%**

Summary of 3DAdvisors Findings for SGR

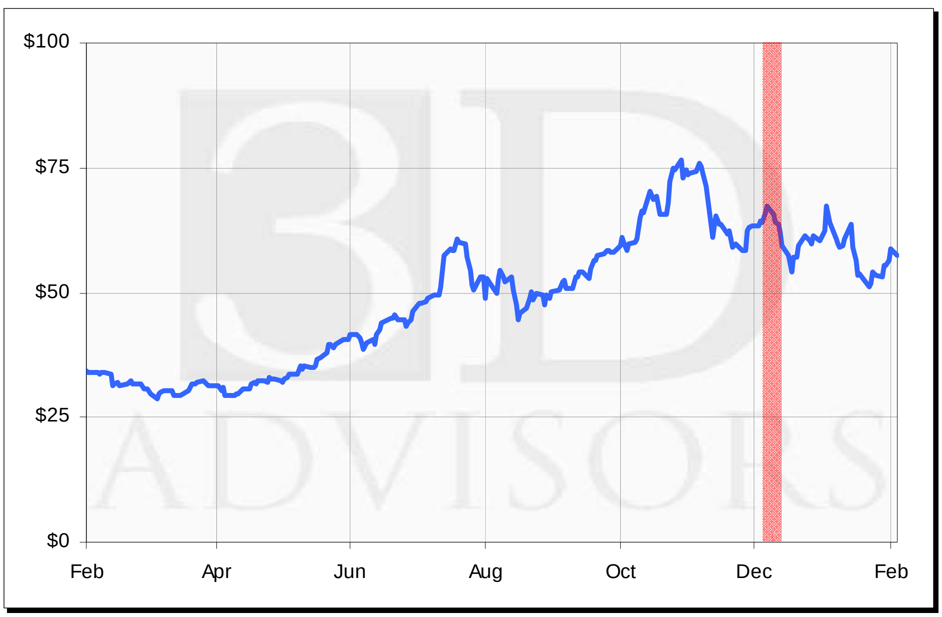
- **Fundamentals:** In most of its businesses, profitability is inconsistent at best
- **Fundamentals:** Increase in fixed price contracts suggests more competition
- **Governance:** Self-serving compensation and related-party dealings
- **Governance:** Executive turnover seems unusually high
- **Insider Trading:** Good timers in the past, insiders now seem in hurry to sell
- **Fundamentals:** Westinghouse deal more like an albatross with each quarter
- **Accounting:** Miscellaneous noteworthy items

Discussion of 3DAdvisors Findings for SGR

Given several major trends in the global energy and chemical sectors, Shaw Group Inc. seems to be in a lot of the right places. The Company is involved in the design, engineering, construction and consulting services to global fossil and nuclear power generation industries, clean coal-fired power generation companies and chemical companies, not to mention air quality control services for related industries both domestic and international. To this mix, add maintenance for related industries (nuclear, fossil and chemical), fabrication of piping systems and a 20% investment in Toshiba's Westinghouse which supplies the domestic and international nuclear electric power industry with advanced nuclear plant designs, licensing, engineering services, equipment and fuel to the owners and operators of nuclear power plants worldwide. Our first glance observation, which is shared by many sell-side analysts, was that Shaw is in the right industries at the right time.

Why then the lumpy financial performance and lack of profitability? In the past five years, Shaw has generated only $36 million in income from continuing operations on revenues of $20 billion. Management insists that its financial performance will stabilize in 2008. Why then have we seen an unprecedented explosion of significant insider selling in December the likes of which would give any tax planner headaches?

Figure 1. SGR Daily Closing Price, 02/01/07 through 02/06/08. Red shaded area is where 9 insiders sold 1,909,516 shares. Source: Reuters and SGR SEC Filings.



With these disconnects piquing our interest, we drilled deeper into the name. Our efforts were not wasted. In addition to numerous issues regarding potential earnings management and profitability issues, we have found a host of governance-related compensation practices reminiscent of the pre-Sarbanes Oxley days. To this, add persistent controls and procedures issues and competitive pressures that have contributed to what seems like a chronic inability to generate consistent profits and it's not hard to see why management would be cashing in its stock. We would be, too.

Fundamentals: In most of its businesses, profitability is inconsistent at best

When one looks at Shaw's revenues by division over the past three years a very lumpy picture emerges. Likewise, margins are difficult to get a handle on given the volatile history of each division. Overall, as shown in the table below, gross margins have actually fallen from about 9% in 2005 to 6.6% in 2007 while EBIT margins have fallen from 1.2% in 2005 to just 0.6% in 2007, and further still in 1Q08. Below is a look at the gross and EBIT margins for each of the Company's operating segments.

SGR Overall Margins	2005	2006	2007	1Q08
Gross Margins	9%	6.7%	6.6%	7.9%
EBIT Margins	1.2%	1.7%	0.6%	0.2%

⇨ Fossil & Nuclear (F&N) Segment: The F&N segment (28.6% of fiscal '07 revenue) has seen an increase in revenues due to Chinese nuclear awards, clean coal power projects and other new awards for Air Quality Control Systems. Margins in 2006 were impacted by litigation claims on the Wolf Hollow project, losses on other projects and cost overruns. In 2007, although margins began to recover as the Wolf Hollow project was settled, settlements on claims and disputed amounts with an owner and major subcontractors on one project as well as losses on transmission grid projects continued to weigh on margins.

Fossil & Nuclear	2005	2006	2007	1Q08
Gross Margins	9.7%	0.5%	4.6%	7.2%
EBIT Margins	6.96%	Loss	2.6%	5.5%

⇨ Environmental & Infrastructure (E&I) Segment: The E&I segment (25.6% of fiscal '07 revenue) saw an increase in 2006 due to Hurricane Katrina and Rita related projects. The SEC Form 10-K states that 2007 represents a more typical year for government related contract work in terms of volume. Investors, no doubt hope that a margin of 1.25% is not more typical as well. The 10-K also states that the E&I division saw a decrease in margin due to additional costs related to two fixed-price contracts as well the consolidation of its military housing privatization joint venture which is now operating on a break-even status and has since been divested.

Environmental & Infrastructure	2005	2006	2007	1Q08
Gross Margins	10.4%	9.3%	6.5%	6.4%
EBIT Margins	4.9%	5.9%	1.25%	2.5%

⇨ Energy & Chemical (E&C) Segment: E&C (18.6% fiscal '07 revenue) has seen increasing demand from a variety of petrochemical projects. The 10-K also states that revenues have increased due to an increase in customer furnished materials. These increases, however, do not flow to the bottom line. It is important to note that there are no gross profits earned on these materials. These customer furnished materials represented $134 million, or 45% of the segment's revenues, in 1Q08 (period ended 11/30/07), versus 31% for the same period a year ago. Consequently, in Q108 gross profit for E&C actually declined 2.4% on a revenue increase of 29.5%.

Margins increased in F/Y 2007 due to increased volumes and due to the fact that one major project was at its peak for nearly the entire year. Nevertheless, this segment was affected by an $11 million charge related to claims on previously completed projects, recorded increases in costs on another completed project and also had $9.6 million in losses on the US Gulf Coast EPC contract. This contract was actually investigated by the SEC and resulted in SGR taking several one-time charges and restating its accounts. CFO **Brian Ferraioli** said on the 4Q07 conference call that backlog margins are better now than they were one year ago. That being said, in the 1Q08 SGR took a $2.5 million write down on doubtful accounts receivable from "several customers" in this segment.

Energy & Chemical	2005	2006	2007	1Q08
Gross Margins	7.7%	3.8%	6.7%	5.5%
EBIT Margins	3.9%	1.1%	3.3%	2.9%

⇨ Maintenance Segment: Maintenance (18.6% fiscal '07 revenue) seemed to increase nicely and management indicates that the demand remains strong in both the petrochemical and power generation market. However, this segment is also heavily influenced by the timing of schedules of nuclear refueling outages, which typically run on an 18-24 month schedule. Margins in this segment have also recently been impacted by disputes with a customer over project incentives as well as losses on two offshore production platform contracts.

Maintenance	2005	2006	2007	1Q08
Gross Margins	3.6%	3.3%	1.8%	5.1%
EBIT Margins	2.4%	2.0%	0.86%	3.9%

⇨ Fabrication & Manufacturing (F&M) Segment: F&M (8.3% of fiscal '07 revenue) demand continues to be strong in this division with new piping awards both domestically and internationally from the petrochemical, refining and power generation industries. SGR is in the midst of a facility expansion program in Mexico that is expected to come on line in the second half of 2008 in order to meet demand.

(Note: in the SEC Form 10-Q for 1Q08 the timing is stated as the 3Q08). Increased volume is driving margin expansion.

An important point is that F&M, at only 8.3% of gross revenue, accounted for 24.3% of Shaw's gross profit in fiscal 2007 (21.1% and 18.2% in 2006 and 2005, respectively). In Q108, the segment contribution here increased to 25.7%.

Fabrication & Manufacturing	2005	2006	2007	1Q08
Gross Margins	18.2%	21.1%	24.3%	25.7%
EBIT Margins	9.6%	15.1%	19.3%	19.8%

Another contributor to the inconsistent margins experienced in some of these segments is the use of Percentage of Completion (POC) accounting, which not only creates earnings management opportunities that must be monitored but can also create havoc when disputes and claims cause profit adjustments in future periods. To this, add cost overruns on fixed price contracts and Shaw seems to routinely experience a steady profit drain as things come out in the wash.

For example, in 2007, gross profit at F&I was reduced by 22% by a $21 million charge due to settlements of claims and disputed amounts and "other cost increases". During the same period, E&C recorded a reduction of gross profit of $11.3 million (14%) due to settlement of claims and "other cost increases". The E&I segment's profit was trimmed by $12.8 million or 12% due to "significant increases in the estimated costs to complete three projects". Maintenance lost $14.4 million in gross profit, or 42% due to disputes.

<u>Fundamentals: Increase in fixed price contracts suggests more competition</u>

As stated above, it is common to see in Shaw's segment disclosures references to losses within each division due to cost overruns with fixed-price contracts or disputes with project incentives. According to the 2007 SEC Form 10-K, work for SGR is performed under "two general types of contracts: cost-reimbursable plus a fee or mark-up contracts and fixed-price contracts, both of which may be modified by cost escalation provisions or other risk sharing mechanisms, and incentive and penalty provisions." Much of the work is recorded using the Percentage of Completion accounting method.

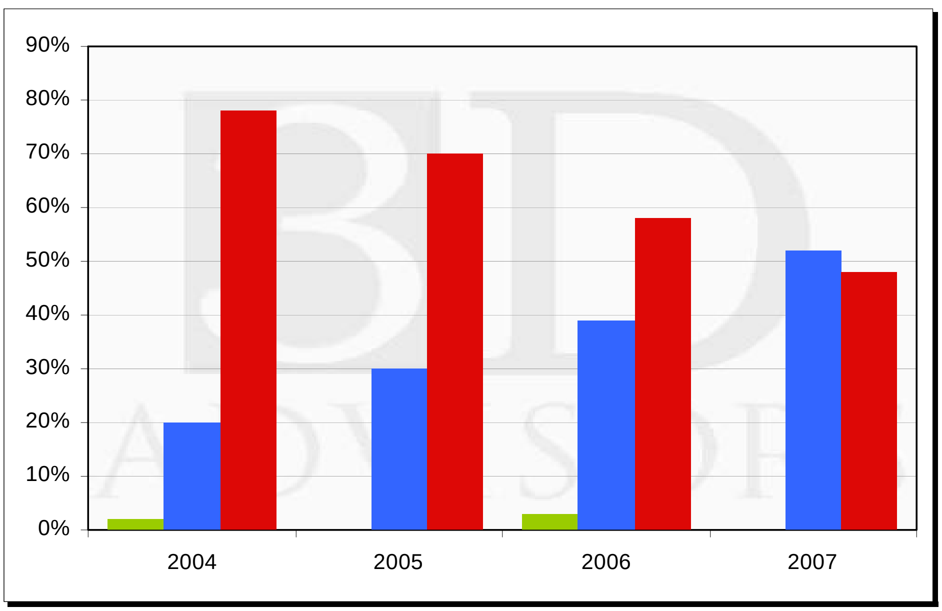
At 08/31/07, 48% of the $14.3 billion backlog was comprised of cost-reimbursable contracts and 52% was fixed-price contracts. There was no update on this mix in Shaw's 1Q08 SEC Form 10-Q. Backlog stood at $14.3 billion in the 3Q07 and remained at $14 billion at the end 1Q08. The SEC Form 10-Q for 1Q08 states that SGR expects the "primary challenge in 2008 to continue to be the successful execution of our backlog of unfilled orders."

The most telling feature to the backlog mix is the linear growth of fixed price contracts, which have steadily risen from just 20% in 2004 to over 52% by FYE 2007.

On the 4Q conference call CFO Brian Ferraioli disclosed that "fixed-price contracts tend to have obviously a little bit better cash flow than reimbursable where you would be incurring the costs, paying the salaries, invoicing the client, waiting whatever the time period is for the contract, say 30 days to collect the money, so you tend to build the working capital more when you have more of a milestone type payment." Later in the call Ferraioli describes the general alignment as follows, "E&I has significant components being reimbursable. I mean most of the government work is all reimbursable. Maintenance as well has some – has a lot I should say and E&I, excuse me, E&C as well has a fair number of reimbursable contracts. Power tends to be more fixed-priced work."

Although Ferraioli states that the cash flows are better with fixed-price contracts, the SEC Form 10-K highlights the nature of the contracts as a risk, "*particularly fixed-price contracts, could adversely affect us*." In fact, when one looks at the trend in fixed-price contracts versus reimbursable contracts it seems the risks are increasing rather quickly.

Figure 2. Percentage of Backlog Orders that are Unit Price (Green), Fixed Price (Blue) and Reimbursable (Red), 2004 to 2007. Source: SGR SEC Filings.



Governance: Self-serving compensation and related-party dealings

Executive Perks

Shaw management has demonstrated a strong proclivity towards taking very good care of itself, up and down the chain of command. In 2005, the Company initiated a "Flexible Perquisites Program" (Flex Program) for some of its executive officers, including CEO Bernhard:

> "The Flex Program provides eligible executive officers with annual grants of "flex dollars" that equate to 4% of the annual base salary of the

executive. Under the Flex Program, the executives are reimbursed for actual out of pocket expenditures for whatever combination of perquisites best suits them while maintaining a common dollar value benefit among the management team. The Flex Program helps reduce administrative costs typically associated with maintaining a fleet of company cars and country club memberships, etc."

The list of perks, include some outside the Flex Program, makes very interesting reading. Here are some of them:

Executive Perk	Cost
Personal use of corporate aircraft - all executives	$ 850,000
Personal security services for CEO Bernhard	$ 233,578
Relocation benefits for Div. President R. Monty Glover	$ 125,000
Country Club Dues & Fees – four executives	$ 45,000
Golf club and hunting rifle gifts to Glover	$ 11,192
CEO Bernhard's personal trainer	$ 8,300
EVP Richard Belk's sporting event tickets	$ 9,400
Christmas gifts for executives' spouses	$ 3,572

Now forgive us, but we have seen aircraft and Country Club perks, but personal trainers and gifts to spouses? Keep in mind that this is a Company that has struggled mightily to deliver consistent profitability over the years.

As over the top these may seem for a profit-starved business, they pale in comparison to some of the new-hire practices that the Company has engaged in. Indeed, we would like to point out two such instances, each of which we have never seen before from any company at any time:

- At the time of Shaw's 2002 acquisition of Turner Industries, the Company entered into a five-year "Watercraft Lease Agreement" with **Dorsey Ron McCall**, who had joined Shaw as a result of the deal. At Turner, McCall served as a Senior V.P. and became President of Shaw's Maintenance Division upon joining the Company. Between August of 2002 and July of 2007, Shaw paid McCall's yacht lease of $10,000/month for a total of $600,000. This in addition to a $300,000 salary and an interesting bonus arrangement whereby he received a three year advance ($750,000) on his $250,000 annual bonus in the deal.

- McCall is not the only management member that Shaw has had to stretch for. A different sort of deal was struck with, **David Chapman**, President of Shaw's Fabrication & Manufacturing Group who joined the Company in 2002. Upon signing his employment agreement Chapman was granted options for 100,000 shares with the most unique kicker we've ever seen. Assuming his division hit 90% of its budget in 2002, the eventual exercise of the options would result in the guaranteed payment of $10.00 per share accretion in stock price. This was in addition to the $1 million loan provided to him at the commencement of his employment which was forgiven in

April 2005. Chapman cashed this out in the recent December round of insider sales (see below).

Such practices, especially extended to newcomers, raise the question as to whether competitive pressures and lack of steady profitability and growth may be causing Shaw problems in both hiring and retention areas.

Related Party Dealings

Shaw's long list of related party dealings is quite revealing from a behavioral standpoint and is consistent with other governance practices outlined here:

- A Company division was awarded a subcontract, in 2003, to perform engineering services for Bernhard Mechanical Contractors "for whom an executive officer and a significant owner is the brother to J.M. Bernhard, Jr., our Chairman, President and chief executive officer." In addition to the deal, Shaw entered into a guaranty agreement with the company to guarantee the payment of "certain sums that may be owed" by Bernhard Mechanical Contractors to certain customers.

- Shaw subcontracted a portion of its construction services work with two companies owned by board member **L. Lane Grigsby**. In 2007 payments of $2.7 million were made.

- During 2007, Shaw had employed both the brother and brother-in-law of one of the Company's officers, the since-departed head of Power Division and named executive officer **Abe Fatemizadeh** (more on him below).

- On July 2, 2007, the Board voted to create a new ninth director position and then appointed Mr. **Thos. E. Capps** to fill this position until he could be formally voted on at the January 2008 Shareholders' meeting. Interestingly, Thos. E. Capps recently retired (April 2007) from his chairman and chief executive positions at Dominion Resources, who is a current client of the Company. In fact, in 3Q07 Shaw won a new project from Dominion. It would seem that there could be a conflict of interest here, although it is not mentioned anywhere in the SEC Form 10-K. Although Shaw does not disclose Dominion to be a 10% client, Dominion is listed as a significant client, however, in JP Morgan's investor presentation from June 11, 2007. Capps still owns a significant position in Dominion stock.

Governance: Executive turnover seems unusually high

Given the long list of perks, combined with such generous compensation, it is a bit difficult to understand Shaw's high management turnover level. Clearly, with the Company's well known controls and procedure problems and other issues, a certain amount of turnover might be expected. Still, some high-level departures have piqued our curiosity.

The first resignation of note came in November 2006, when President, COO **Tim Barfield** unexpectedly resigned after twelve years with Shaw, leaving options and restricted stock valued at more than $5 million on the table. The Company was rather tight-lipped on his departure. Then in July 2007, head of the E&C division, Ebrahim

“Abe” Fatemizadeh, a top three compensated officer, tendered his resignation. This came after the Company had extended his employment term three years at the end of 2006. His settlement and release agreement was deemed “confidential” and the circumstances surrounding his departure are still unknown to the public. He cashed out his entire 217,000 share position shortly after his unvested options were accelerated, as stipulated in his employment agreement.

It would take too long for us to reference all the new officers or those with a new job description, but as it relates to the named executives, only two of the five listed in the 2006 Proxy are currently named in the new filing.

Insider Trading: Good timers in the past, insiders now seem in hurry to sell

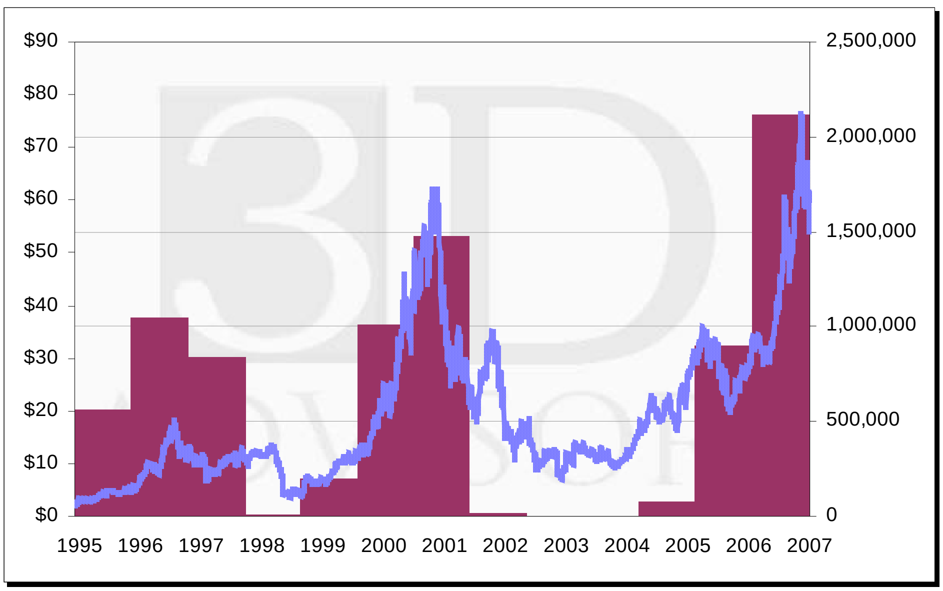
Even given the fact that a window, closed by the Company’s delayed 2007 financials, had opened in December we were surprised to see so many key Company insiders selling the majority of their positions immediately. As mentioned above, it would have seemed prudent, from a tax standpoint and given their high levels of compensation, to defer any related stock sale gains into the following year.

We are not willing to discount the fact that four of the Company’s top officers tapped into multiple option series (upwards of eight) to sell more than 75% of their actionable holdings, including **David Chapman**, president of the Fabrication and Manufacturing group, and Executive V.P. of Corporate Development and Strategy **Gary Graphia**, who liquidated their entire positions. Leading the activity though was Chairman, President, and Chief Executive J.M. Bernhard, an infrequent trader over the last fifteen years, who sold 40% of his ownership, which judging from Company filings, is the touchstone used for setting his annual compensation (more below). Not lost on us is the fact that at the time of the first sales on December 7th, the issue had already traded down from the high of $77 to the $67 to $68 range, and insiders continued selling the weakness all the way down to $59. CEO Bernhard’s behavior suggests a certain degree of urgency as he not only accepted consecutively lower prices with each sale executed over a seven day period but also chose to do so just prior to the close of the calendar year. We doubt his tax planner was impressed. This activity differs from past selling rounds (of three or more insiders acting simultaneously) in April and October of 2000, January 2001 and January 2006, when insiders sold into sustained price rallies, not declines.

The December sales positioned 2007 as a record year for insider selling volume, and by a significant margin we might add. There had been only five other years going back to 1995 in which the volume eclipsed 800,000 shares, and within each year the sales occurred or shortly into the next calendar year, Shaw’s shares fell victim to a substantial correction. With the exception of the 2000 sales, each of the other four rounds preceded a sell-off between 45% and 73% (average: 65%). This is a pattern that should not be ignored, especially as many of the sellers from those earlier rounds are still with the Company and took part in the December profit taking. In the Figure 3 below, the daily closing price going back to January of 1995 is superimposed on the annual selling volume to illustrate insiders’ history of opportune trading.

One obvious result of the recent sell-off is the effect it has had on management’s overall exposure to Company stock. Shaw Group insiders historically have been regarded as having strong ownership, controlling upwards of 30% of the outstanding shares in 2000. This can no longer be said, as their ownership had dropped to 12% by early 2006 and then to 2.9% following the December sales (see Figure 4 below). Shaw's management team no longer shows the commitment it once had to stock retention, which is also indicated by its unwillingness to implement stock ownership guidelines for officers or board members (studies have shown a correlation between stock ownership plans and improvements in firm performance [1]). Without the assistance of guidelines to motivate ownership retention, it will become increasingly more difficult for Shaw insiders to restore their holdings to former levels in view of their increased profit taking and decelerating vesting of derivative equity. For some perspective, we provide some background on their compensation philosophy.

Figure 3. SGR Daily Closing Price, 01/03/95 through 12/31/07 (Blue line and left scale) and Annual Shares Sold by Insiders, 1995 through 2007 (Red bars and right scale). Source: Reuters and SGR SEC Filings.

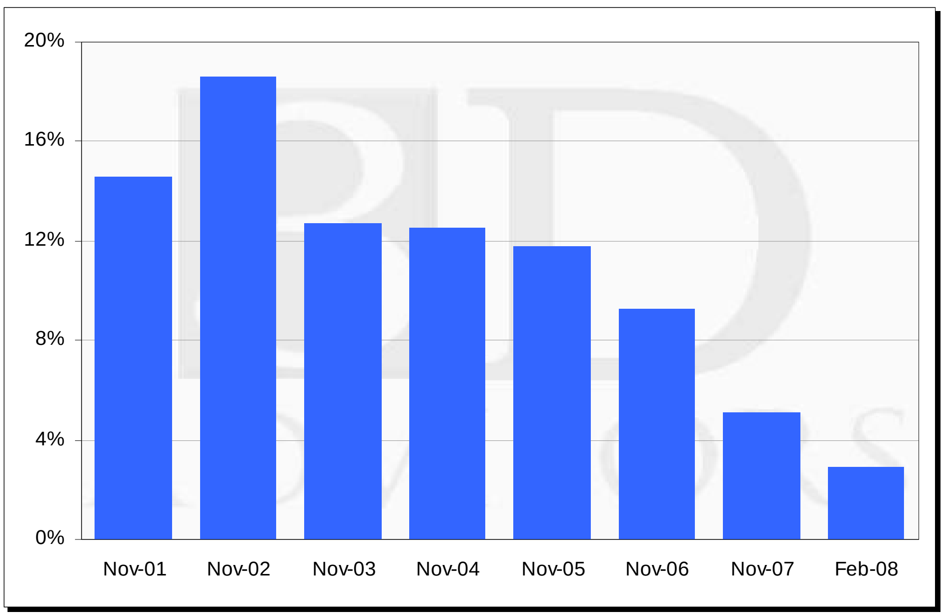


The Compensation Committee has utilized a top down approach to executive compensation, whereas it determined that CEO Bernhard's stock ownership levels are large enough to warrant his receiving a large proportion of his total compensation in base salary and annual cash bonus. To a degree, this makes sense to us, but then they also contend that it is in the "shareholders' interests that compensation for the executive management team be consistent with that of the CEO in order to align executive behavior". Consequently, the cash component for the other executives, regardless of their stock holdings, is provided near the top of Shaw's peer comparator group, while derivative equity is awarded in line with the peer group median. In fact, a number of officers have guaranteed bonuses written into their employment agreements that award a minimum payment threshold regardless of their individual or the Company's performance.

[1] Core, John E. and Larcker, David F., "Performance Consequences of Mandatory Increases in Executive Stock Ownership" (May 2000)

This might make a little more sense to us if ownership guidelines were utilized and the compensation mix included more cash for them to buy stock or exercise their options and retain the shares, but this is not the case. It is disclosed in the Proxy Statement that derivative equity grants declined from fiscal 2007 to fiscal 2008. For example, CEO Barnhard was issued 302,000 options and shares in December 2006 but only 111,000 were awarded in December 2007. This trend is similar for nearly all executive officers. As a result, insiders have a waning amount of derivative equity scheduled to vest over the next few years, extending the amount of time it will take to replenish the equity recently sold.

Figure 4. Beneficial Ownership of Shaw Group Officers and Directors (as a percentage of shares outstanding). Source: SGR SEC Filings.



Here are the trading details for the most noteworthy sellers in the recent round:

- **J.M. Bernhard (53)*** – Chairman, President, Chief Executive Officer. Bernhard has not been a frequent seller over the years, but he makes quite a statement when he does surface. His seven individual or rounds of sales over the last fifteen years covered 520,000 shares on average. After the majority of his prior sales were executed into considerable momentum, we were intrigued when Bernhard surfaced on December 7th, with the issue already having sold off to the $67 range from a high of $77, and by December 14th cashed in a total of 989,000 shares (all common stock) at successively lower prices. Oddly enough, he did not touch any of his 1.5 million vested stock options. **The shares accounted for nearly 40% of his actionable position**, making these sales his largest ever based on percentage of holdings. We note that these trades occurred after Bernhard amended his employment agreement in January 2007, shortening the term from ten to three years. He will have 220,000 options and restricted shares become actionable in 2008, all in the fourth quarter (see Appendix A).

- **David Chapman (61)*** – President, Fabrication & Manufacturing Group. Chapman joined Shaw Group in April 2002 and heads up the smallest division based on revenue, but it also happens to make the second largest contribution to the Company's bottom line. He surfaced for the first time in the fourth quarter, selling 171,306 shares on December 7th at $67. Included in the amount disposed were shares acquired when he exercised all of his available options (four series with expiration dates of April 2012, December 2012, January 2015 and November 2016) and his only common stock, which had just vested in November. **The net result was a 100% reduction in his total actionable holdings** He will have 36,000 options and shares vest in 2008 (see Appendix A).

- **Gary Graphia (45)** – Executive V.P., Corporate Development and Strategy. Graphia was Shaw's head counsel from 1999 until May 2007 and apparently does not seem too thrilled with his reassignment. After having sold only twice in the past eight years, disposing just 32,000 shares, **Graphia liquidated his entire position in December**. On December 7th and December 10th he tapped into eight different option series (expiration dates: July 2009 to November 2017) and sold the remainder of his common stock for a grand total of 258,867 shares. His complete liberation from SGR stock suggests his actions have more to do with the issue's valuation than any possible discontent associated with his change in duties. The 45,000 options and shares he has scheduled to vest in 2008, all between October and December, will replace only a small fraction of what he sold (see Appendix A).

- **Robert Belk (58)** – Executive V.P. Belk was the Company's chief finance officer from 1998 until he took a brief medical leave in July 2007. Upon his return he was provided a new job function that involves responsibility for oversight of government affairs activities, and a three year contract extension to go with it. **Belk responded by selling 75% of his holdings, which had been the second largest position of all executives and directors.** On December 7th and December 14th Belk monetized 322,000 options from eight different series (expiration dates: October 2008 to November 2016) and also sold another 30,000 shares from his common holdings. The trades covered three times the amount he had sold over the last ten years. It is difficult for us to project what goes through the mind of an individual facing a serious health issue, but the fact his peers acted in a similar manner would suggest his sentiment may be quite related to that of the others. Belk has 64,000 options and shares scheduled to vest this year despite not receiving equity awards in 2007 (see Appendix A).

- **Dirk Wild (40)** – Senior V.P., Administration. We are admittedly a little confused by Wild's current role with Shaw. After serving as the chief accounting officer since 2004, and interim CFO for a brief period in 2007, he signed a two year employment agreement dated October 2007 that named him a vice president and chief accounting officer. The corporate website currently lists his title as Senior V.P. of Administration. Regardless, we know from his new employment agreement that he intends to stick around, which makes his recent trades even more compelling. After selling just 850 shares over the past three years, Wild surfaced on December 7th to sell 51,068 shares, **equal to 92% of his ownership**. In addition to the options exercised out of six series (expiration dates: December 2011 to December 2016), he also sold about half of his common stock, which had in part vested in November. We do not anticipate Wild selling during the next few months as he will not have any new equity vest until October, at which time only 17,000 options and shares will become actionable (see Appendix A).

* Indicates individual was a "Named Executive" in the Company's last proxy.

Fundamentals: Westinghouse deal more like an albatross with each quarter

In October of 2006 Shaw acquired a 20% stake in Westinghouse Electric, which is owned by Toshiba (77%) and Ishikawajima-Harima Heavy Industries Co. (3%). The acquisition was funded by $1.1 billion principal amount of Japanese Yen-denominated debt placed in the Japanese market, which propelled Shaw's debt to equity ratio from 15% in 2006 to 89% in 2007 and debt to total capital from 13% in 2006 to 47% in 2007. As one can imagine interest expense has increased significantly.

Furthermore, SGR's investment in Westinghouse has also produced heavy negative foreign currency translation costs for the past two quarters due to the value of the Japanese yen versus the U.S. dollar. In fact, in 4Q07 Shaw recorded a $52 million translation loss, then another $57 million in 1Q08. The Q1 loss wiped out most of that quarter's operating income. In the opening remarks of the 1Q08 conference call, management was quick to highlight the fact that the increase in the value of the put option (offsetting the currency effects) on their investment does not show up in the statements. Shaw has the option to put 97% of its investment in Westinghouse back to Toshiba for 124.7 billion yen. The Westinghouse deal effectively has caused Shaw to have a $1.1 billion short position on the Yen which at the time was trading at around 124 yen to $1 U.S Dollar.

With the yen now 14% higher and seemingly on the rise, Shaw finds itself increasingly downplaying the Westinghouse investment. Indeed, when presenting Shaw's financials management consistently presents the numbers with and without Westinghouse, often stating that for a clearer picture it is necessary to exclude Westinghouse. It seems to be selective presentation in that Shaw completed the acquisition with the intention of growing the nuclear business while touting the nuclear division as one of their brightest opportunities going forward and yet they are somehow trying to say the company should be viewed excluding the debt associated with the Westinghouse acquisition.

Westinghouse contributed only $2.2 million in income in 2007 then $4.8 million in 1Q08, hardly enough to offset the FX penalty. Should the yen's rise continue, causing Shaw to eventually punt and sell its stake back to Toshiba at 97% of original face value, the fact stands that it faces a loss of over $30 million in the process, this in addition to opportunity time and capital lost along the way. This would be a bitter pill to swallow for a company that has generated EBIT averaging just $35 million in each of the past three fiscal years.

Accounting: Miscellaneous noteworthy items

Potential Cash Flow Issues

When discussing liquidity and resources, Shaw states that they generated significant positive cash flow in 2007 "primarily due to collections of accounts receivable related to the 2006 disaster relief and recovery work and the positive performance on several EPC projects." However, two items concern us: 1.) Disaster recovery work is now complete and 2.) In 1Q08 Shaw established reserves in both the E&C division and the E&I division for $2.5 million and $1.9 million, respectively, for problem receivables.

In addition, in the 1Q08 SEC Form 10-Q the Company says, "while markets for our EPC services continue to be strong, our ability to continue to sign incremental major EPC contracts may be dependent on our ability to increase our letter of credit and surety bonding capacity, our ability to achieve timely release of existing letters of credit and surety bonds, and/or our ability to obtain more favorable terms from our customers reducing letter of credit and surety requirements on new work." The risk sections in the last two SEC Form 10-Ks are rife with references to surety bond risks. In addition, the Company states: "…we have entered into indemnity agreements with our sureties that contain cross-default provisions. Accordingly, in the event of a default under our Credit Facility, we would need to obtain a waiver from our sureties or an amendment to our indemnity agreements. We can provide no assurance that we would be successful in obtaining an amendment or waiver."

Controls and Procedures Issues Persist

In 2006 Ernst & Young stated that internal control was not maintained and that there was a material weakness in the following:

- Controls to determine the initial measurement date for stock options issued in 2000
- Revenue recognition for a contract
- Misstatement of the minority interest of a consolidated entity

In 2007, the Company's new external auditor, KPMG, identified five new material weaknesses. They are as follows:

- Control environment over financial reporting – including lacking proper training, job descriptions and expertise to perform and monitor reviews and activities in the financial reporting process
- Complex or non-routine accounting matters
- Period-end financial reporting process
- Energy & Chemical segment control environment
- Energy & Chemical segment project reporting

In 1Q08, KPMG acknowledged that the material weaknesses listed above continued to exist. The corresponding SEC Form 10-Q describes the remediation process for those five material weaknesses including the hiring of additional experienced accounting professionals, the continued introduction of company-wide accounting policies, replacement of senior management of the E&C segment and the continued review of joint venture governance policies.

Appendix A

Option and Restricted Stock Vesting Schedules for Selected The Shaw Group, Inc. Insiders

Grant Date	Equity Type	Options/ Shares	Strike Price (Options)	First Vesting Date	Expiration Date (Options)	Remaining Options/Shares in Series	Unvested Options/Shares in Series	Vesting Dates of Remaining Restricted Shares/Options
Robert Belk, Executive V.P. Common stock holdings: 64,226 shares								
12/19/02	Options	50,000	$15.08	12/19/03	12/19/12	12,500	0	Fully Vested
10/10/03	Options	56,000	$11.20	10/10/04	10/10/13	28,000	0	Fully Vested
10/13/04	Options	64,400	$12.66	10/13/05	10/13/14	32,200	16,100	10/13/08
10/13/04	R. Stock	43,900	N/A	10/13/05	10/13/08	10,975	10,975	10/13/08
10/13/05	Options	49,000	$20.76	10/13/06	10/13/15	24,000	24,000	10/13/08, 10/13/09
10/13/05	R. Stock	25,000	N/A	10/13/06	10/13/09	12,500	12,500	10/13/08, 10/13/09
11/01/06	Options	50,734	$26.70	11/01/07	11/01/16	38,050	38,050	11/01/08, 11/01/09, 11/01/10
11/01/06	R. Stock	23,409	N/A	11/01/07	11/01/10	17,557	17,557	11/01/08, 11/01/09, 11/01/10
J.M. Bernhard Jr., Founder, Chairman, President, Chief Executive Officer. Common stock holdings: 165,350 shares								
02/09/98	Options	70,000	$12.00	02/09/99	02/09/08	70,000	0	Fully Vested
10/19/98	Options	400,000	$4.18	10/19/99	10/19/08	400,000	0	Fully Vested
07/28/00	Options	400,000	$21.00	07/28/01	07/28/10	400,000	0	Fully Vested
10/10/03	Options	304,000	$11.20	10/10/04	10/10/13	304,000	0	Fully Vested
10/13/04	Options	232,800	$12.66	10/13/05	10/13/14	232,800	58,200	Fully Vested
10/13/04	R. Stock	158,700	N/A	10/13/05	10/13/08	39,675	39,675	10/13/08
10/13/05	Options	206,000	$20.76	10/13/06	10/13/15	206,000	103,000	10/13/08, 10/13/09
10/13/05	R. Stock	103,000	N/A	10/13/06	10/13/09	51,500	51,500	10/13/08, 10/13/09
11/01/06	Options	206,991	$26.70	11/01/07	11/01/16	206,991	155,244	11/01/08, 11/01/09, 11/01/10
11/01/06	R. Stock	95,506	N/A	11/01/07	11/01/10	71,630	71,630	11/01/08, 11/01/09, 11/01/10
12/07/07	Options	72,130	$67.19	12/07/08	12/07/17	72,103	72,130	12/07/08, 12/07/09, 12/07/10, 12/07/11
12/07/07	R. Stock	38,862	N/A	12/07/08	12/07/11	38,862	38,862	12/07/08, 12/07/09, 12/07/10, 12/07/11
David Chapman, President-Fabrication & Manufacturing Group. Common stock holdings: 0 shares								
01/06/05	Options	50,000	$15.54	04/01/06	01/06/15	16,670	16,670	04/01/08
11/01/06	Options	35,514	$26.70	11/01/07	11/01/16	26,635	26,635	11/01/08, 11/01/09, 11/01/10
11/01/06	R. Stock	16,386	N/A	11/01/07	11/01/10	12,289	12,289	11/01/08, 11/01/09, 11/01/10
12/07/07	Options	17,265	$67.19	12/07/08	12/07/17	17,265	17,265	12/07/08, 12/07/09, 12/07/10, 12/07/11
12/07/07	R. Stock	9,302	N/A	12/07/08	12/07/11	9,302	9,302	12/07/08, 12/07/09, 12/07/10, 12/07/11
Richard Gill, Executive V.P., President-Power Group. Common stock holdings: 55,288 shares								
07/28/00	Options	160,000	$21.00	07/28/01	07/28/10	60,000	0	Fully Vested

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Grant Date	Equity Type	Options/ Shares	Strike Price (Options)	First Vesting Date	Expiration Date (Options)	Remaining Options/Shares in Series	Unvested Options/Shares in Series	Vesting Dates of Remaining Restricted Shares/Options
12/19/02	Options	100,000	$15.08	12/19/03	12/19/12	18,369	0	Fully Vested
11/01/06	Options	20,294	$26.70	11/01/07	11/01/16	16,531	15,220	11/01/08, 11/01/09, 11/01/10
11/01/06	R. Stock	9,364	N/A	11/01/07	11/01/10	7,023	7,023	11/01/08, 11/01/09, 11/01/10
12/07/07	Options	15,193	$67.19	12/07/08	12/07/17	15,193	15,193	12/07/08, 12/07/09, 12/07/10, 12/07/11
12/07/07	R. Stock	8,186	N/A	12/07/08	12/07/11	8,186	9,302	12/07/08, 12/07/09, 12/07/10, 12/07/11
Gary Graphia, Executive V.P.-Corporate Development and Strategy. Common stock holdings: 0 shares								
10/13/04	Options	41,000	$12.66	10/13/05	10/13/14	10,250	10,250	10/13/08
10/13/04	R. Stock	28,000	N/A	10/13/05	10/13/08	7,000	7,000	10/13/08
10/13/05	Options	34,000	$20.76	10/13/06	10/13/15	17,000	17,000	10/13/08, 10/13/09
10/13/05	R. Stock	17,000	N/A	10/13/06	10/13/09	8,500	8,500	10/13/08, 10/13/09
11/01/06	Options	30,440	$26.70	11/01/07	11/01/16	22,830	22,830	11/01/08, 11/01/09, 11/01/10
11/01/06	R. Stock	14,045	N/A	11/01/07	11/01/10	10,534	10,534	11/01/08, 11/01/09, 11/01/10
12/07/07	Options	11,510	$67.19	12/07/08	12/07/17	11,510	11,510	12/07/08, 12/07/09, 12/07/10, 12/07/11
12/07/07	R. Stock	6,201	N/A	12/07/08	12/07/11	6,201	6,201	12/07/08, 12/07/09, 12/07/10, 12/07/11
Dirk Wild, V.P., Chief Accounting Officer. Common stock holdings: 4,426 shares								
10/13/04	Options	15,600	$12.66	10/13/05	10/13/14	3,900	3,900	10/13/08
10/13/04	R. Stock	10,600	N/A	10/13/05	10/13/08	2,650	2,650	10/13/08
10/13/05	Options	13,000	$20.76	10/13/06	10/13/15	6,500	6,500	10/13/08, 10/13/09
10/13/05	R. Stock	6,500	N/A	10/13/06	10/13/09	3,250	3,250	10/13/08, 10/13/09
11/01/06	Options	11,649	$26.70	11/01/07	11/01/16	8,737	8,737	11/01/08, 11/01/09, 11/01/10
11/01/06	R. Stock	5,375	N/A	11/01/07	11/01/10	4,032	4,032	11/01/08, 11/01/09, 11/01/10
12/07/07	Options	3,837	$67.19	12/07/08	12/07/17	3,837	3,837	12/07/08, 12/07/09, 12/07/10, 12/07/11
12/07/07	R. Stock	2,067	N/A	12/07/08	12/07/11	2,067	2,067	12/07/08, 12/07/09, 12/07/10, 12/07/11