

STERLING CONSTRUCTION CO INC  
Form 10-Q  
May 02, 2016  
UNITED STATES

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark one)

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

For the quarterly period ended: March 31, 2016

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 number **1-31993**

**STERLING CONSTRUCTION COMPANY, INC.**

(Exact name of registrant as specified in its charter)

<b>DELAWARE</b>	<b>25-1655321</b>
State or other jurisdiction of incorporation	(I.R.S. Employer
or organization	Identification No.)
<b>1800 Hughes Landing Blvd.</b>	<b>77380</b>

**The Woodlands, Texas**

(Address of principal executive office) (Zip Code)

Registrant's telephone number, including area code (281)  
**214-0800**

(Former name, former address and former fiscal year, if changed from last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

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

Non-accelerated filer  Smaller  
reporting company

(Do not check if a smaller reporting company)

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

At April 29, 2016, there were 19,768,724 shares outstanding of the issuer's common stock, par value \$0.01 per share.

**STERLING CONSTRUCTION COMPANY, INC.**

**QUARTERLY REPORT ON FORM 10-Q**

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**PART I**

## Item 1. Financial Statements

**STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Amounts in thousands, except share and per share data)**

	March 31, 2016 (Unaudited)	December 31, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 14,919	\$ 4,426
Contracts receivable, including retainage	94,758	82,112
Costs and estimated earnings in excess of billings on uncompleted contracts	28,188	26,905
Inventories	2,930	2,535
Receivables from and equity in construction joint ventures	8,316	12,930
Other current assets	4,627	6,013
Total current assets	153,738	134,921
Property and equipment, net	72,481	73,475
Goodwill	54,820	54,820
Other assets, net	2,968	2,949
Total assets	\$ 284,007	\$ 266,165
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 63,389	\$ 58,959
Billings in excess of costs and estimated earnings on uncompleted contracts	39,083	30,556
Current maturities of long-term debt	4,857	4,856
Income taxes payable	67	67
Accrued compensation	9,395	5,977
Other current liabilities	4,572	3,896
Total current liabilities	121,363	104,311
Long-term liabilities:		
Long-term debt, net of current maturities	27,273	15,324
Member's interest subject to mandatory redemption and undistributed earnings	46,211	50,438
Other long-term liabilities	355	338
Total long-term liabilities	73,839	66,100
Commitments and contingencies (Note 5)		
Equity:		
Sterling stockholders' equity:		
Preferred stock, par value \$0.01 per share; 1,000,000 shares authorized, none issued	-	-

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Common stock, par value \$0.01 per share; 28,000,000 shares authorized, 19,768,724 and 19,753,170 shares issued	198	198
Additional paid in capital	188,534	188,147
Retained deficit	(99,828 )	(92,500 )
Total Sterling common stockholders' equity	88,904	95,845
Noncontrolling interests	(99 )	(91 )
Total equity	88,805	95,754
Total liabilities and equity	\$ 284,007	\$ 266,165

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

**STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Amounts in thousands, except share and per share data)**

(Unaudited)

	Three Months Ended March 31,	
	2016	2015
Revenues	\$ 126,567	\$ 117,682
Cost of revenues	(122,737 )	(124,518 )
Gross profit (loss)	3,830	(6,836 )
General and administrative expenses	(10,542 )	(11,603 )
Other operating income, net	246	1,761
Operating loss	(6,466 )	(16,678 )
Interest income	3	363
Interest expense	(873 )	(382 )
Loss before income taxes and earnings attributable to noncontrolling interests	(7,336 )	(16,697 )
Income tax expense	-	(3 )
Net loss	(7,336 )	(16,700 )
Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	8	(292 )
Net loss attributable to Sterling common stockholders	\$(7,328 )	\$(16,992 )
Net loss per share attributable to Sterling common stockholders:		
Basic and diluted	\$(0.37 )	\$(0.90 )
Weighted average number of common shares outstanding used in computing per share amounts:		
Basic and diluted	19,760,221	18,901,739

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

**STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

**(Amounts in thousands)**

(Unaudited)

	Three Months Ended March 31,	
	2016	2015
Net loss attributable to Sterling common stockholders	\$(7,328)	\$(16,992)
Net (loss) income attributable to noncontrolling interests included in equity	(8 )	292
Other comprehensive income (loss), net of tax:		
Realized loss from settlement of derivatives	-	50
Change in the effective portion of unrealized loss in fair market value of derivatives	-	(8 )
Comprehensive loss	\$(7,336)	\$(16,658)

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



**STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

**FOR THE THREE MONTHS ENDED MARCH 31, 2016**

(Amounts in thousands)

(Unaudited)

	STERLING CONSTRUCTION COMPANY, INC. STOCKHOLDERS					
	Common Stock		Additional Paid in	Retained	Noncon-trolling	
	Shares	Amount	Capital	Deficit	Interests	Total
Balance at January 1, 2016	19,753	\$ 198	\$ 188,147	\$(92,500)	\$(91)	\$95,754
Net loss	-	-	-	(7,328 )	(8 )	(7,336 )
Stock-based compensation	20	-	400	-	-	400
Other	(4 )	-	(13 )	-	-	(13 )
Balance at March 31, 2016	19,769	\$ 198	\$ 188,534	\$(99,828)	\$(99)	\$88,805

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

**STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Amounts in thousands)**

(Unaudited)

	Three Months Ended March 31,	
	2016	2015
Cash flows from operating activities:		
Net loss attributable to Sterling common stockholders	\$(7,328 )	\$(16,992)
Plus: Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	(8 )	292
Net loss	(7,336 )	(16,700)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,162	4,274
Loss (gain) on disposal of property and equipment	175	(759 )
Stock-based compensation expense	400	158
Changes in operating assets and liabilities:		
Contracts receivable	(12,646)	(15,712)
Costs and estimated earnings in excess of billings on uncompleted contracts	(1,283 )	7,576
Inventories	(395 )	1,886
Receivables from and equity in construction joint ventures	4,614	(545 )
Other assets	297	2,069
Accounts payable	4,429	4,669
Billings in excess of costs and estimated earnings on uncompleted contracts	8,527	8,710
Accrued compensation and other liabilities	4,123	2,110
Member's interest subject to mandatory redemption and undistributed earnings	(4,227 )	(679 )
Net cash provided by (used in) operating activities	840	(2,943 )
Cash flows from investing activities:		
Additions to property and equipment	(2,818 )	(1,161 )
Proceeds from sale of property and equipment	715	2,864
Net cash (used in) provided by investing activities	(2,103 )	1,703
Cash flows from financing activities:		
Cumulative daily drawdowns – Credit Facility	-	65,840
Cumulative daily repayments – Credit Facility	-	(69,672)
Cumulative repayments – equipment-based term loan and other	(1,298 )	-
Cumulative drawdowns – equipment-based revolver	14,000	-
Cumulative repayments – equipment-based revolver	(900 )	-
Other	(46 )	(575 )
Net cash provided by (used in) financing activities	11,756	(4,407 )
Net increase (decrease) in cash and cash equivalents	10,493	(5,647 )
Cash and cash equivalents at beginning of period	4,426	22,843
Cash and cash equivalents at end of period	\$14,919	\$17,196
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	\$820	\$376
Cash paid during the period for income taxes	\$-	\$437

Non-cash items:

Transportation and construction equipment acquired through financing arrangements	\$81	\$588
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*The accompanying notes are an integral part of these condensed consolidated financial statements.*

**STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

1. Business Summary and Significant Accounting Policies

***Business Summary***

Sterling Construction Company, Inc. (“Sterling” or “the Company”), a Delaware corporation, is a leading heavy civil construction company that specializes in the building and reconstruction of transportation and water infrastructure projects in Texas, Utah, Nevada, Colorado, Arizona, California, Hawaii and other states in which there are construction opportunities. Its transportation infrastructure projects include highways, roads, bridges, airfields, ports and light rail. Its water infrastructure projects include water, wastewater and storm drainage systems.

***Presentation***

The condensed consolidated financial statements included herein have been prepared by Sterling, without audit, in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) and should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2015 (“2015 Form 10-K”). Certain information and note disclosures prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been either condensed or omitted pursuant to SEC rules and regulations. The condensed consolidated financial statements reflect, in the opinion of management, all normal recurring adjustments necessary to present fairly the Company’s financial position at March 31, 2016 and the results of operations and cash flows for the periods presented. The December 31, 2015 condensed consolidated balance sheet data herein was derived from audited financial statements, but as discussed above, does not include all disclosures required by GAAP. Interim results may be subject to significant seasonal variations, and the results of operations for the three months ended March 31, 2016 are not necessarily indicative of the results to be expected for the full year or subsequent quarters.

***Significant Accounting Policies***

The Company’s significant accounting policies are more fully described in Note 1 of the Notes to Consolidated Financial Statements in the 2015 Form 10-K. These accounting policies include, but are not limited to, those related to:

- revenue recognition
- contracts receivable, including retainage
  - valuation of property and equipment, goodwill and other long-lived assets
- income taxes
- segment reporting

There have been no material changes to significant accounting policies since December 31, 2015.

### *Principles of Consolidation*

The accompanying condensed consolidated financial statements include the accounts of subsidiaries and construction joint ventures in which the Company has a greater than 50% ownership interest or otherwise controls such entities. For investments in subsidiaries and construction joint ventures that are not wholly-owned, but where the Company exercises control, the equity held by the remaining owners and their portions of net income (loss) are reflected in the balance sheet line item “Noncontrolling interests” in “Equity” and the statement of operations line item “Noncontrolling owners’ interests in earnings of subsidiaries and joint ventures,” respectively. All significant intercompany accounts and transactions have been eliminated in consolidation. For all years presented, the Company had no subsidiaries where its ownership interests were less than 50%.

Where the Company is a noncontrolling joint venture partner, and otherwise not required to consolidate the joint venture entity, its share of the operations of such construction joint venture is accounted for on a pro rata basis in the condensed consolidated statements of operations and as a single line item (“Receivables from and equity in construction joint ventures”) in the condensed consolidated balance sheets. This method is an acceptable modification of the equity method of accounting which is a common practice in the construction industry. Refer to Note 7 for further information regarding the Company’s construction joint ventures.

Under GAAP, the Company must determine whether each entity, including joint ventures in which it participates, is a variable interest entity (“VIE”). This determination focuses on identifying which owner or joint venture partner, if any, has the power to direct the activities of the entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity disproportionate to its interest in the entity, which could have the effect of requiring the Company to consolidate the entity in which it has a noncontrolling variable interest. Refer to Note 8 for further information regarding the Company’s consolidated VIE.

### *Use of Estimates*

The preparation of the accompanying condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Certain of the Company's accounting policies require higher degrees of judgment than others in their application. These include the recognition of revenue and earnings from construction contracts under the percentage-of-completion method, the valuation of long-term assets (including goodwill) and income taxes. Management continually evaluates all of its estimates and judgments based on available information and experience; however, actual results could differ from these estimates.

### *Reclassification*

Reclassifications have been made to historical financial data on our condensed consolidated financial statements to conform to our current year presentation.

### *Revenue Recognition*

The Company is a general contractor which engages in various types of heavy civil construction projects principally for public (government) owners. Credit risk is minimal with public owners since the Company ascertains that funds have been appropriated by the governmental project owner prior to commencing work on such projects. While most public contracts are subject to termination at the election of the government entity, in the event of termination the Company is entitled to receive the contract price for completed work and reimbursement of termination-related costs. Credit risk with private owners is minimized because of statutory mechanics liens, which give the Company high priority in the event of lien foreclosures following financial difficulties of private owners.

Revenues are recognized on the percentage-of-completion method, measured by the ratio of costs incurred up to a given date to estimated total costs for each contract. This cost to cost measure is used because management considers it to be the best available measure of progress on these contracts. Contract costs include all direct material, labor, subcontract and other costs and those indirect costs related to contract performance, such as indirect salaries and wages, equipment repairs and depreciation, insurance and payroll taxes. Administrative and general expenses are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions and estimated profitability, including those changes arising from contract penalty provisions and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined.

Changes in estimated revenues and gross margin resulted in a net charge of \$1.2 million and \$12.0 million during the three months ended March 31, 2016 and 2015, respectively, included in “operating loss” on the condensed consolidated statements of operations.

Our contracts generally take 12 to 36 months to complete. The Company generally provides a one to two-year warranty for workmanship under its contracts when completed. Warranty claims historically have been insignificant.

### *Financial Instruments and Fair Value*

The fair value of financial instruments is the amount at which the instrument could be exchanged in a current transaction between willing parties. The Company’s financial instruments are cash and cash equivalents, restricted cash used as collateral for a letter of credit and restricted cash maintained in an escrow account, short-term contracts receivable, accounts payable, notes payable, a revolving loan (the “Revolving Loan”) with Nations Fund I, LLC and Nations Equipment Finance, LLC, as administrative agent and collateral agent for the lender (“Nations”), and a term loan (the “Term Loan”) with Nations (combined, the “Equipment-based Facility”).

The recorded values of cash and cash equivalents, restricted cash, short-term contracts receivable and accounts payable approximate their fair values based on their liquidity and/or short-term nature.

Refer to Note 11 regarding the fair value of the Revolving Loan and the Term Loan and notes payable. The Company does not have any off-balance sheet financial instruments other than operating leases (refer to Note 12 of the Notes to Consolidated Financial Statements in the 2015 Form 10-K).

In order to assess the fair value of the Company's financial instruments, the Company uses the fair value hierarchy established by GAAP which prioritizes the inputs used in valuation techniques into the following three levels:

**Level 1 Inputs** – Based upon quoted prices for identical assets in active markets that the Company has the ability to access at the measurement date.

**Level 2 Inputs** – Based upon quoted prices (other than Level 1) in active markets for similar assets, quoted prices for identical or similar assets in markets that are not active, inputs other than quoted prices that are observable for the asset such as interest rates, yield curves, volatilities and default rates and inputs that are derived principally from or corroborated by observable market data.

**Level 3 Inputs** – Based on unobservable inputs reflecting the Company's own assumptions about the assumptions that market participants would use in pricing the asset based on the best information available.

For each financial instrument, the Company uses the highest priority level input that is available in order to appropriately value that particular instrument. In certain instances, Level 1 inputs are not available and the Company must use Level 2 or Level 3 inputs. In these cases, the Company provides a description of the valuation techniques used and the inputs used in the fair value measurement.

#### *Recent Accounting Pronouncements*

In March 2016, the Financial Accounting Standards Board ("FASB") issued its new stock compensation guidance in Accounting Standards Update ("ASU") No. 2016-09 (Topic 718). First, under the new guidance, companies will be required to recognize the income tax effects of share-based awards in the income statement when the awards vest or are settled (i.e., additional paid-in capital ("APIC") or APIC pools will be eliminated). In addition, the new guidance allows a withholding amount of awarded shares with a fair value up to the amount of tax owed using the maximum, instead of the minimum, statutory tax rate without triggering liability classification for the award. Lastly, the new guidance allows companies to elect whether to account for forfeitures of share-based payments by (1) recognizing forfeitures of awards as they occur or (2) estimating the number of awards expected to be forfeited and adjusting the estimate when it is likely to change, as is currently required. The new standard is effective for annual periods beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The Company has chosen to early adopt this guidance and chosen to account for forfeitures of share-based payments by recognizing forfeitures of awards as they occur. The result of adopting this guidance was immaterial to the Company's condensed consolidated financial statements.



In February 2016, the FASB issued its new lease accounting guidance in ASU No. 2016-02, Leases (Topic 842). Under the new guidance, lessees will be required to recognize for all leases (with the exception of short-term leases) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The new standard is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of this ASU to the Company's consolidated financial statements and related disclosures.

## 2. Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with original or remaining maturities of three months or less at the time of purchase to be cash equivalents. Cash and cash equivalents include cash balances held by our wholly-owned and less than wholly-owned subsidiaries and majority-owned joint ventures, as well as the Company's VIE. Refer to Note 8 for more information regarding the Company's consolidated VIE. At March 31, 2016, cash and cash equivalents included \$0.6 million belonging to a majority-owned joint venture which generally cannot be used for purposes outside the joint venture.

Restricted cash of approximately \$3.0 million is included in "other assets, net" on the condensed consolidated balance sheet as of March 31, 2016 and represents cash deposited by the Company into a separate account and designated as collateral for a standby letter of credit in the same amount in accordance with contractual agreements. Refer to Note 5 for more information about our standby letter of credit. In addition, restricted cash of approximately \$2.0 million is included in "other current assets" on the condensed consolidated balance sheet as of March 31, 2016 and represents cash deposited by a customer, for the benefit of the Company, in an escrow account which is restricted until the customer releases the restriction upon the completion of the job.

The Company holds cash on deposit in U.S. banks, at times, in excess of federally insured limits. Management does not believe that the risk associated with keeping cash deposits in excess of federal deposit insurance limits represents a material risk.

## 3. Property and Equipment

Property and equipment are summarized as follows (amounts in thousands):

	March 31, 2016	December 31, 2015
Construction equipment	\$ 119,651	\$ 114,724
Transportation equipment	18,652	18,056
Buildings	12,728	10,860
Office equipment	2,813	2,810
Leasehold improvement	894	894
Construction in progress	89	1,986
Land	3,509	4,257
Water rights	200	200
	158,536	153,787
Less accumulated depreciation	(86,055 )	(80,312 )
Total property and equipment, net	\$72,481	\$73,475

## 4. Income Taxes

The Company and its subsidiaries file U.S. federal and various U.S. state income tax returns. Current income tax expense or (benefit) represents federal and state taxes based on tax paid or expected to be payable or receivable for the periods shown in the condensed consolidated statements of operations.

The Company is not expecting a current federal tax liability due to sufficient net operating loss carry forwards. The Company may incur current state tax liabilities in states in which the Company does not have sufficient net operating loss carry forwards. No current tax expense and a minimal tax expense were recorded for the three months ended March 31, 2016 and 2015, respectively. The effective income tax rate varied from the statutory rate primarily as a result of the change in the valuation allowance, net income attributable to noncontrolling interest owners which is taxable to those owners rather than to the Company, state income taxes, and other permanent differences.

The Company's deferred tax expense or (benefit) reflects the change in deferred tax assets or liabilities. The Company performs an analysis at the end of each reporting period to determine whether it is more likely than not the deferred tax assets are expected to be realized in future years. Based upon this analysis, a full valuation allowance has been applied to our net deferred tax assets as of March 31, 2016 and December 31, 2015. Therefore, there has been no change in net deferred taxes for the three months ended March 31, 2016.

As a result of the Company's analysis, management has determined that the Company does not have any material uncertain tax positions.

5. Commitments and Contingencies

The Company is required by our insurance provider to obtain and hold a standby letter of credit. This letter of credit serves as a guarantee by the banking institution to pay our insurance provider the incurred claim costs attributable to our general liability, workers compensation and automobile liability claims, up to the amount stated in the standby letter of credit, in the event that these claims were not paid by the Company. Due to our Equipment-based Facility, we have cash collateralized the letter of credit, resulting in the cash being designated as restricted. Refer to Note 2 for more information on our restricted cash.

At March 31, 2016, the Company has recorded a legal reserve of \$0.8 million as a result of a dispute between one of the Company's wholly-owned subsidiaries and a subcontractor. The dispute is currently in arbitration and the Company has extended an offer of \$0.8 million to settle the case. This amount was recorded in "other current liabilities" and as "cost of revenues" in our condensed consolidated balance sheets and statements of operations, respectively.

The Company is the subject of certain other claims and lawsuits occurring in the normal course of business. Management, after consultation with legal counsel, does not believe that the outcome of these actions will have a material impact on the condensed consolidated financial statements of the Company.

## 6. Subsidiaries and Joint Ventures with Noncontrolling Owners' Interests

The amended agreements, as described in Note 2 of the Notes to Consolidated Financial Statements in the 2015 Form 10-K, resulted in an obligation to purchase Mr. Buenting's and Myers' 50% members' interest that the Company is certain to incur, either because of Mr. Buenting's or Mr. Myers' death; therefore, the Company has classified the noncontrolling interest as mandatorily redeemable and has recorded a liability in "Members' interest subject to mandatory redemption and undistributed earnings" on the condensed consolidated balance sheets. The liability consists of the following (amounts in thousands):

	March 31, 2016	December 31, 2015
Members' interest subject to mandatory redemption	\$40,000	\$40,000
Net accumulated earnings	6,211	10,438
Total liability	\$46,211	\$50,438

Earnings for the three months ended March 31, 2016 and 2015 were zero and \$0.7 million, respectively, and were included in "Other operating income, net" on the Company's condensed consolidated statements of operations.

***Changes in Noncontrolling Interests***

The following table summarizes the changes in the noncontrolling owners' interests in subsidiaries and joint ventures (amounts in thousands):

	Three Months Ended March 31, 2016 2015	
Balance, beginning of period	\$(91)	\$7,462
Net (loss) income attributable to noncontrolling interest included in equity	(8 )	292
Balance, end of period	\$(99)	\$7,754

Due to the events above, the Company's subsidiaries with noncontrolling interest earnings are minimal.

## 7. Construction Joint Ventures

The Company participates in various construction joint ventures. Generally, each construction joint venture is formed to construct a specific project and is jointly controlled by the joint venture partners. Refer to Note 6 of the Notes to Consolidated Financial Statements in the 2015 Form 10-K for further information about our joint ventures. Condensed combined financial amounts of joint ventures in which the Company has a noncontrolling interest and the Company's share of such amounts which are included in the Company's condensed consolidated financial statements are shown below (amounts in thousands):

	March 31, December	
	2016	31, 2015
Total combined:		
Current assets	\$22,957	\$17,312
Less current liabilities	(49,634)	(49,371)
Net assets	\$(26,677)	\$(32,059)
Backlog	\$123,672	\$35,113
Sterling's noncontrolling interest in backlog	\$53,818	\$11,748
Sterling's receivables from and equity in construction joint ventures	\$8,316	\$12,930

	Three Months	
	Ended	
	March 31,	
	2016	2015
Total combined:		
Revenues	\$8,804	\$13,006
Income before tax	535	2,413
Sterling's noncontrolling interest:		
Revenues	\$3,780	\$4,552
Income before tax	258	335

Approximately \$54 million of the Company's backlog at March 31, 2016 was attributable to projects performed by joint ventures. The majority of this amount is attributable to the Company's joint venture with Granite Construction Corporation, where the Company has a 49% interest.

The caption "Receivables from and equity in construction joint ventures" includes undistributed earnings and receivables owed to the Company. Undistributed earnings are typically released to the joint venture partners after the customer accepts the project as complete and the warranty period, if any, has passed.

8.

Variable Interest Entities

The Company owns a 50% interest in Myers, of which it is the primary beneficiary, and has consolidated Myers into the Company's financial statements. Because the Company exercises primary control over activities of the partnership and it is exposed to the majority of potential losses of the partnership, the Company has consolidated Myers within the Company's financial statements since August 1, 2011, the date of acquisition. Refer to Note 3 of the Notes to Consolidated Financial Statements included in the 2015 Form 10-K for additional information on the acquisition of this limited partnership.

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The condensed financial information of Myers, which is reflected in the Company's condensed consolidated balance sheets and statements of operations, is as follows (amounts in thousands):

	March 31, 2016	December 31, 2015		Three Months Ended March 31, 2016      2015	
Assets:					
Current assets:					
Cash and cash equivalents	\$5,348	\$ 3,226		\$26,943	\$36,268
Contracts receivable, including retainage	18,848	19,941		194	582
Other current assets	6,222	15,887		94	290
Total current assets	30,418	39,054			
Property and equipment, net	10,249	10,080			
Goodwill	1,501	1,501			
Total assets	\$42,168	\$ 50,635			
Liabilities:					
Current liabilities:					
Accounts payable	\$ 16,499	\$ 20,596			
Other current liabilities	11,705	10,986			
Total current liabilities	28,204	31,582			
Long-term liabilities:					
Other long-term liabilities	351	3,370			
Total liabilities	\$28,555	\$ 34,952			
Revenues					
Operating income					
Net income attributable to Sterling common stockholders					

## 9. Stock-Based Compensation

The Company has a stock-based incentive plan which is administered by the Compensation Committee of the Board of Directors. Refer to Note 14 of the Notes to Consolidated Financial Statements included in the 2015 Form 10-K for further information. The Company recorded stock-based compensation expense of \$0.4 million for the three months ended March 31, 2016 and \$0.2 million for the three months ended March 31, 2015.

At March 31, 2016, total unrecognized compensation cost related to unvested common stock awards was \$2.8 million. This cost is expected to be recognized over a weighted average period of 2.1 years. At March 31, 2016, there were 0.8 million shares of common stock covered by outstanding unvested common stock.





## 10. Net Loss per Share Attributable to Sterling Common Stockholders

Basic net loss per share attributable to Sterling common stockholders is computed by dividing net loss attributable to Sterling common stockholders by the weighted average number of common shares outstanding during the period. Diluted net loss per common share attributable to Sterling common stockholders is the same as basic net loss per share attributable to Sterling common stockholders but includes dilutive unvested stock using the treasury stock method. The following table reconciles the numerators and denominators of the basic and diluted per common share computations for net loss attributable to Sterling common stockholders (amounts in thousands, except per share data):

	Three Months Ended March 31, 2016      2015	
Numerator:		
Net loss attributable to Sterling common stockholders	\$(7,328 )	\$(16,992)
Denominator:		
Weighted average common shares outstanding — basic	19,760	18,902
Shares for dilutive unvested stock	-	-
Weighted average common shares outstanding and incremental shares assumed repurchased— diluted	19,760	18,902
Basic and diluted loss per share attributable to Sterling common stockholders	\$(0.37 )	\$(0.90 )

In accordance with the treasury stock method, 0.3 million and no shares of unvested common stock were excluded from the diluted weighted average common shares outstanding for the three months ended March 31, 2016 and 2015, respectively, as the Company incurred a loss during these periods and the impact of such shares would have been antidilutive.

## 11. Debt

Debt consists of the following (in thousands):

	March 31, 2016	December 31, 2015
Equipment-based Facility	\$30,036	\$17,957
Less deferred loan costs	(1,063 )	(1,119 )
Equipment-based Facility, net	28,973	16,838
Notes payable for transportation and construction equipment and other	3,157	3,342
	32,130	20,180

Current maturities of long-term debt	5,193	5,192
Less current deferred loan costs	(336 )	(336 )
Less current maturities of long-term debt, net	(4,857 )	(4,856 )
Total long-term debt	\$27,273	\$15,324

***Equipment-based Facility***

At March 31, 2016, the Company had a borrowing base of \$30.0 million, which was the result of calculating 65% of the appraised value (where appraised value equals net operating liquidated value) of the Company's collateral. At March 31, 2016, the Company had \$13.1 million drawn on the revolving loan and \$16.9 million of its term loan outstanding.

***Fair Value***

The Company's debt is recorded at its carrying amount in the condensed consolidated balance sheets. The Company uses an income approach to determine the fair value of its 12% Term Loan due May 29, 2019 using estimated cash flows, which is a Level 3 fair value measurement. As of March 31, 2016, the carrying values and fair values are as follows (amounts in thousands):

	March 31, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Revolving Loan	\$13,100	\$-	\$-	\$-
Term Loan	16,936	16,863	17,957	17,957
Total Equipment-based Facility debt	\$30,036	\$16,863	\$17,957	\$17,957

The Revolving Loan's fair value was not practicable to estimate at March 31, 2016 as the timing of cash drawdowns and repayments cannot be determined.

***Notes Payable for Transportation and Construction Equipment***

The Company has purchased and financed various transportation and construction equipment to enhance the Company's fleet of equipment. The total long-term notes payable related to the purchase of financed equipment was \$3.2 million and \$3.3 million at March 31, 2016 and December 31, 2015, respectively. The purchases have payment terms ranging from 3 to 5 years and the associated interest rates range from 3.12% to 7.13%. The fair value of these notes payable approximates their book value.

***Interest Expense***

Interest expense related to our Equipment-based Facility and other debt for the three months ended March 31, 2016 and 2015 was \$0.9 million and \$0.4 million, respectively. The increase in interest expense was due to the increased interest rate on the Equipment-based Facility.

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

***Cautionary Comment Regarding Forward-Looking Statements***

This Report includes statements that are, or may be considered to be, "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These forward-looking statements are included throughout this Report, including in this section, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and relate to matters such as our industry, business strategy, goals and expectations concerning our market position, future operations, margins, profitability, capital expenditures, liquidity and capital resources and other financial and operating information. We have used the words "anticipate," "assume," "believe," "budget," "continue," "could," "estimate," "expect," "forecast," "future," "intend," "may," "plan," "potential," "predict," "project," "should," "will," "would" and phrases to identify forward-looking statements in this Report.

Forward-looking statements reflect our current expectations as of the date of this Report regarding future events, results or outcomes. These expectations may or may not be realized. Some of these expectations may be based upon assumptions or judgments that prove to be incorrect. In addition, our business and operations involve numerous risks and uncertainties, many of which are beyond our control, that could result in our expectations not being realized or otherwise could materially affect our financial condition, results of operations and cash flows.

Actual events, results and outcomes may differ materially from our expectations due to a variety of factors. Although it is not possible to identify all of these factors, they include, among others, the following:

- changes in general economic conditions, including recessions, reductions in federal, state and local government funding for infrastructure services and changes in those governments' budgets, practices, laws and regulations;

- delays or difficulties related to the completion of our projects, including additional costs, reductions in revenues or the payment of liquidated damages, or delays or difficulties related to obtaining required governmental permits and approvals;

- actions of suppliers, subcontractors, design engineers, joint venture partners, customers, competitors, banks, surety companies and others which are beyond our control, including suppliers', subcontractors' and joint venture partners' failure to perform;

- factors that affect the accuracy of estimates inherent in our bidding for contracts, estimates of backlog, percentage-of-completion accounting policies, including onsite conditions that differ materially from those assumed in our original bid, contract modifications, mechanical problems with our machinery or equipment and effects of

other risks discussed in this document;

· design/build contracts which subject us to the risk of design errors and omissions;

cost escalations associated with our contracts, including changes in availability, proximity and cost of materials such as steel, cement, concrete, aggregates, oil, fuel and other construction materials and cost escalations associated with subcontractors and labor;

· our dependence on a limited number of significant customers;

adverse weather conditions; although we prepare our budgets and bid contracts based on historical rain and snowfall patterns, the incidence of rain, snow, hurricanes, etc., may differ materially from these expectations;

the presence of competitors with greater financial resources or lower margin requirements than ours and the impact of competitive bidders on our ability to obtain new backlog at reasonable margins acceptable to us;

· our ability to successfully identify, finance, complete and integrate acquisitions;

· citations issued by any governmental authority, including the Occupational Safety and Health Administration;

federal, state and local environmental laws and regulations where non-compliance can result in penalties and/or termination of contracts as well as civil and criminal liability;

· adverse economic conditions in our markets; and

the other factors discussed in more detail in our Annual Report on Form 10-K for the year ended December 31, 2015 (“2015 Form 10-K”) under “Item 1A. — Risk Factors.”

In reading this Report, you should consider these factors carefully in evaluating any forward-looking statements and you are cautioned not to place undue reliance on any forward-looking statements. Although we believe that our plans, intentions and expectations reflected in, or suggested by, the forward-looking statements that we make in this Report are reasonable, we can provide no assurance that they will be achieved.

*The forward-looking statements included in this Report are made only as of the date of this Report and we undertake no obligation to update any information contained in this Report or to publicly release the results of any revisions to any forward-looking statements to reflect events or circumstances that occur, or that we become aware of after the date of this Report, except as may be required by applicable securities laws.*



## *Overview*

Sterling Construction Company, Inc. (“Sterling” or “the Company”), is a leading heavy civil construction company that specializes in building and reconstruction of transportation and water infrastructure projects in Texas, Utah, Nevada, Colorado, Arizona, California, Hawaii and other states in which there are construction opportunities. Its transportation infrastructure projects include highways, roads, bridges, airfields, ports and light rail. Its water infrastructure projects include water, wastewater and storm drainage systems.

Although we describe our business in this Report in terms of the services we provide, our base of customers and the geographic areas in which we operate, we have concluded that our operations consist of one reportable segment, one operating segment and one reporting unit component: heavy civil construction. In making this determination, the Company considered the discrete financial information used by our Chief Operating Decision Maker (“CODM”). Based on this approach, the Company noted that the CODM organizes, evaluates and manages the financial information around each heavy civil construction project when making operating decisions and assessing the Company’s overall performance. Furthermore, we considered that each heavy civil construction project has similar characteristics, includes similar services, has similar types of customers and is subject to similar economic and regulatory environments.

## *Market Outlook and Trends*

Market outlook: Our core business is primarily driven by Federal and state funding. The recent passage of the federally funded five-year \$305 billion surface transportation bill will increase the annual federal highway investment by 15.1% over the five-year period from 2016 to 2020. In addition to the Federal program, several of the states in our key markets have instituted actions to further increase annual spending. In Texas, two constitutional amendments were passed, which will increase the annual funds allocated to transportation projects by \$4.0 billion to \$4.5 billion per year. In Utah, a 20% gas tax increase was put into effect January 1, 2016, which is the first state gas tax increase in 18 years. In addition, California is currently trying to pass a \$3.6 billion per year transportation bill. See “Item 1. Business—Our Markets, Competition and Customers” in our 2015 Form 10-K for a more detailed discussion of our markets and their funding sources.

Bid discipline and project execution: To ensure that we take full advantage of the improved market conditions and maximize profitability we have completed an extensive evaluation of our projects’ historical success based on project size, end customer, product delivered and geography. The knowledge gained has now been incorporated into a more formal and rigorous bid evaluation and approval process, which along with the institution of common processes, we believe will enable us to focus our resources on the most beneficial projects and significantly reduce our risk. In addition, in order to strengthen these processes and capitalize further on the improved market conditions, we appointed a Chief Operating Officer late in the first quarter of 2016.

Backlog, backlog gross margin and gross margin trends:

	Dollars	Gross Margin in Backlog	
	(amounts in thousands)		
First quarter of 2016	\$854,000	7.7	%
Fourth quarter of 2015	\$761,000	7.0	%
Third quarter of 2015	\$718,000	6.5	%
Second quarter of 2015	\$743,000	6.3	%
First quarter of 2015	\$745,000	6.0	%

Our total margin in backlog has increased approximately 170 basis points, from 6.0% at March 31, 2015 to 7.7% at March 31, 2016. During the last two quarters, we have won approximately \$390 million worth of new projects at an average margin of more than 8.5%. In addition, once we complete approximately \$70 million worth of legacy projects with small or zero margins, we expect that our overall backlog margins will be in the 8.5% to 9.0% range by December 31, 2016. The increases noted above are primarily the result of the improving market conditions and actions that we have taken to improv