STERLING CONSTRUCTION CO INC
Form 10-Q
May 09, 2012

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

FORM 10-Q

(Mark one)
xQUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: March 31, 2012
Or
oTRANSITION REPORT PURSUANT TO SECTION13 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)

DELAWARE	25-1655321
State or other jurisdiction of incorporation or organization	(I.R.S. Employer Identification No.)
20810 Fernbush Lane Houston, Texas	77073
(Address of principal executive office)	(Zip Code)

Registrant’s telephone number, including area code (281) 821-9091

(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.
þ Yes o 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). þ Yes o 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 o	Accelerated filer þ
Non-accelerated filer o	Smaller reporting company o
(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).
o Yes þ No

At April 30, 2012, there were 16,324,212 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. FINANCIAL INFORMATION

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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, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 16,610	$ 16,371
Short-term investments	43,582	44,855
Contracts receivable, including retainage	72,893	74,875
Costs and estimated earnings in excess of billings on uncompleted contracts	17,822	16,509
Inventories	3,398	1,922
Deferred tax asset, net	521	1,302
Receivables from and equity in construction joint ventures	7,546	6,057
Deposits and other current assets	3,876	2,132
Total current assets	166,248	164,023
Property and equipment, net	82,680	83,429
Goodwill	54,500	54,050
Other assets, net	5,435	2,329
Total assets	$ 308,863	$ 303,831
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 44,826	$ 40,064
Billings in excess of costs and estimated earnings on uncompleted contracts	21,014	18,583
Current maturities of long-term debt	573	573
Income taxes payable	66	2,013
Accrued compensation	5,385	5,329
Other current liabilities	2,250	2,723
Total current liabilities	74,114	69,285
Long-term liabilities:		
Long-term debt, net of current maturities	245	263
Other long-term liabilities	2,398	2,597
Total long-term liabilities	2,643	2,860
Commitments and contingencies (Note 7)		
Obligation for noncontrolling owners' interests in subsidiaries and joint ventures	24,346	16,848
Equity:		
Sterling stockholders' equity:		
Preferred stock, par value $0.01 per share; 1,000,000 shares authorized, none issued	--	--
Common stock, par value $0.01 per share; 19,000,000 shares authorized, 16,322,912 and 16,321,116 shares issued	163	163
Additional paid in capital	196,240	196,143
Retained earnings	9,310	16,509
Accumulated other comprehensive income	538	496
Total Sterling common stockholders' equity	206,251	213,311

Noncontrolling interests	1,509	1,527
Total equity	207,760	214,838
Total liabilities and equity	$ 308,863	$ 303,831

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

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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, 2012	Three Months Ended March 31, 2011
Revenues	$98,425	$99,242
Cost of revenues	(96,552)	(91,643)
Gross profit	1,873	7,599
General and administrative expenses	(7,666)	(6,056)
Other income	1,231	145
Operating income (loss)	(4,562)	1,688
Gain (loss) on sale of securities and other	750	(204)
Interest income	416	378
Interest expense	(385)	(214)
Income (loss) before income taxes and earnings attributable to noncontrolling interests	(3,781)	1,648
Income tax benefit (expense)	3,976	(166)
Net income	195	1,482
Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	(7,695)	(1,438)
Net income (loss) attributable to Sterling common stockholders	$(7,500)	$44
Net income (loss) per share attributable to Sterling common stockholders:		
Basic	$(0.44)	$0.00
Diluted	$(0.44)	$0.00
Weighted average number of common shares outstanding used in computing per share amounts:		
Basic	16,322,477	16,464,842
Diluted	16,322,477	16,624,459

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

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STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Amounts in thousands)
(Unaudited)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Net income (loss) attributable to Sterling common stockholders	$(7,500)	$44
Net loss attributable to noncontrolling interests included in equity	(18)	--
Net income attributable to noncontrolling interests included in liabilities	7,713	1,438
Add /(deduct) other comprehensive income, net of tax:		
Realized (gain) / loss from available-for-sale securities	(299)	133
Change in unrealized holding gain (loss) on available-for-sale securities	180	(99)
Realized loss from settlement of derivatives	2	--
Change in the effective portion of unrealized gain in fair market value of derivatives	159	--
Comprehensive income	$237	$1,516

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

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STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2012
(Amounts in thousands)
(Unaudited)

	STERLING CONSTRUCTION COMPANY, INC. STOCKHOLDERS								
	Common Stock		Treasury Stock		Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Noncontrolling Interests	Total
	Shares	Amount	Shares	Amount					
Balance at January 1, 2012	16,321	$ 163	--	$ --	$ 196,143	$ 16,509	$ 496	$ 1,527	$ 214,838
Net loss	--	--	--	--	--	(7,500)	--	(18)	(7,518)
Other comprehensive income	--	--	--	--	--	--	42	--	42
Stock issued upon option exercises	2	--	--	--	5	--	--	--	5
Excess tax benefits from exercise of stock options	--	--	--	--	(13)	--	--	--	(13)
Issuance and amortization of restricted stock	--	--	--	--	105	--	--	--	105
Revaluation of noncontrolling interest RLW put/call liability	--	--	--	--	--	301	--	--	301
Balance at March 31, 2012	16,323	$ 163	--	$ --	$ 196,240	$ 9,310	$ 538	$ 1,509	$ 207,760

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

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

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Cash flows from operating activities:		
Net income (loss) attributable to Sterling common stockholders	$(7,500)	$44
Plus: Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	7,695	1,438
Net income	195	1,482
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,530	4,211
Gain on disposal of property and equipment	(1,204)	(145)
Deferred tax (benefit) expense	(2,951)	1,268
Interest expense accreted on discounted liabilities	248	212
Stock-based compensation expense	105	125
Loss (gain) on sale of securities and other	(649)	204
Other	18	--
Changes in operating assets and liabilities:		
Decrease in contracts receivable	1,982	5,403
Increase in costs and estimated earnings in excess of billings on uncompleted contracts	(1,312)	(4,651)
Increase (decrease) in receivables from and equity in construction joint ventures	(1,489)	456
Increase in income tax receivable	(1,079)	(2,866)
Increase in inventories, deposits and other current assets	(1,906)	(113)
Increase (decrease) in accounts payable	4,762	(575)
Increase in billings in excess of costs and estimated earnings on uncompleted contracts	2,431	40
Increase (decrease) in accrued compensation and other liabilities	(2,303)	395
Net cash provided by operating activities	1,378	5,446
Cash flows from investing activities:		
Additions to property and equipment	(5,910)	(8,433)
Purchases of short-term securities, available for sale	(9,779)	(57,516)
Sales of short-term securities, available for sale	11,325	27,364
Proceeds from sales of property and equipment	3,306	182
Net cash used in investing activities	(1,058)	(38,403)
Cash flows from financing activities:		
Cumulative daily drawdowns – Credit Facility	1,000	1,000
Cumulative daily repayments – Credit Facility	(1,000)	(1,000)
Distributions to noncontrolling interest owners	--	(3,900)
Purchases of treasury stock	--	(196)
Other	(81)	(18)
Net cash used in financing activities	(81)	(4,114)
Net increase (decrease) in cash and cash equivalents	239	(37,071)
Cash and cash equivalents at beginning of period	16,371	49,441
Cash and cash equivalents at end of period	$16,610	$12,370
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	$120	$2
Cash paid during the period for income taxes	$2,000	$1,665

Non-cash items:		
Reclassification of amounts payable to noncontrolling interest owner	$--	$1,054
Revaluation of noncontrolling interest – RLW put/call liability, net of tax	301	--

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

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STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Summary of Business and Significant Accounting Policies

Basis of Presentation

Sterling Construction Company, Inc. (“Sterling” or “the Company”), a Delaware corporation, is a leading heavy civil construction company that specializes in the building, reconstruction and repair of transportation and water infrastructure in markets in Texas, Utah, Nevada, Arizona, California and other states in which we see opportunities. Our transportation infrastructure projects include highways, roads, bridges and light and commuter rail foundations and structures, and our water infrastructure projects include water, wastewater and storm drainage systems. Sterling provides general contracting services, including excavating, concrete and asphalt paving, installation of large-diameter water and wastewater distribution systems, construction of bridges and similar large structures, construction of light and commuter rail infrastructure, concrete and asphalt batch plant operations, and concrete crushing and aggregate operations primarily to public sector clients. We purchase the necessary materials for our contracts, and perform the majority of the work required by our contracts with our own crews and equipment.

For a more detailed discussion of the Company’s business, readers of this Report are urged to review “Item 1. Business” of the Annual Report on Form 10-K for the year ended December 31, 2011 (“2011 Form 10-K”) and the sections of this Report entitled “Backlog at March 31, 2012” and “Our Markets” under Item 2.

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, and all significant intercompany accounts and transactions have been eliminated in consolidation. For all periods presented, the Company had no subsidiaries where its ownership interests were less than 50%.

Under accounting principles generally accepted in the United States (“GAAP”), the Company must determine whether each entity, including joint ventures in which it participates, is a variable interest entity. 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 us to consolidate the entity in which we have a non-majority variable interest.

On August 1, 2011, we acquired a 50% interest in a limited partnership which the Company determined to be a variable interest entity. Prior to this, the Company had no participation in an entity determined to be a variable interest entity. As discussed further in Note 3 of the Notes to Consolidated Financial Statements included in the 2011 Form 10-K, the Company determined that it exercises primary control over activities of Myers & Sons Construction, L.P. (“Myers”), and it is exposed to more than 50% of potential losses from the partnership. Therefore, the Company consolidates Myers in the consolidated financial statements and includes the other partners' interests in the equity and net income of the partnership 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.

Where the Company is a noncontrolling joint venture partner, its share of the operations of such construction joint venture is accounted for on a pro rata basis in the consolidated statements of operations and as a single line item (“Receivables from and equity in construction joint ventures”) in the consolidated balance sheets. See Note 6 of the Notes to Consolidated Financial Statements included in the 2011 Form 10-K for further information regarding the Company’s construction joint ventures, including those where the Company does not have a controlling ownership interest.

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 2011 Form 10-K. Certain information and note disclosures prepared in accordance with 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, 2012 and the results of operations and cash flows for the periods presented. The December 31, 2011 condensed consolidated balance sheet data 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, 2012 are not necessarily indicative of the results to be expected for the full year or subsequent quarters.

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Our Markets

Demand for transportation and water infrastructure depends on a variety of factors, including overall population growth, economic expansion and the vitality of the market areas in which we operate, as well as unique local topographical, structural and environmental issues. In addition to these factors, demand for the replacement of infrastructure is driven by the general aging of infrastructure and the need for technical improvements to achieve more efficient or safer use of infrastructure and resources. Funding for this infrastructure depends on federal, state and local governmental resources, budgets and authorizations.

Since the economic downturn in late 2008 and throughout the years 2009, 2010, and 2011, the bidding environment in our markets has been much more competitive than in the past because of the following:

- Reduced federal, state and local spending on transportation and water-related infrastructure.
- Traditional competitors on larger transportation and water infrastructure projects appear to have been bidding at less than normal margins, sometimes at bid levels below our break-even pricing, in order to replenish their backlogs.
- While our business includes only minimal residential and commercial infrastructure work, the severe fall-off in new projects in those markets has resulted in some residential and commercial infrastructure contractors bidding on smaller public sector transportation and water infrastructure projects, sometimes at bid levels below our break-even pricing, thus increasing competition and creating downward pressure on bid prices in our markets.
- The entry of new competitors from other states.

These factors have limited our ability to replenish our backlog through successful bids for new projects and have compressed the profitability on the new projects where we submitted successful bids. While we have been more aggressive in reducing the anticipated margins we use to bid on some projects, we have not bid at anticipated loss margins in order to obtain new backlog.

Significant Accounting Policies

Use of Estimates

The preparation of 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, and income taxes. Management continually evaluates all of its estimates and judgments based on available information and experience; however, actual amounts could differ from those estimates.

Other Accounting Policies

The Company’s significant accounting policies are more fully described in Note 1 of the Notes to Consolidated Financial Statements in the 2011 Form 10-K. These accounting policies include, but are not limited to, those related to:

- contracts receivable, including retainage
- revenue recognition
- valuation of property and equipment, goodwill and other long-lived assets
- construction joint ventures

- income taxes
- segment reporting

There have been no material changes to significant accounting policies since December 31, 2011.

Construction 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.

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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. Our contracts generally take 12 to 36 months to complete.

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 on certain construction projects during the three months ended March 31, 2012 resulted in a net charge of $3.9 million included in the operating results and a $2.4 million after-tax charge or $0.15 per diluted share attributable to Sterling common stockholders.

Financial Instruments

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, short-term investments, contracts receivable, derivatives, accounts payable, mortgage payable, a credit facility with Comerica Bank ("Credit Facility"), $500,000 of demand notes payable, the put related to certain noncontrolling owners' interests in subsidiaries and an earn-out liability related to the acquisition of J. Banicki Construction, Inc. ("JBC"). The recorded values of cash and cash equivalents, short-term investments, contracts receivable and accounts payable approximate their fair values based on their short-term nature. The recorded value of the Credit Facility debt approximates its fair value, as interest approximates market rates. See Note 5 regarding the fair value of derivatives and Note 8 regarding the fair value of the put and the earn-out liability. We had one mortgage outstanding at March 31, 2012 and December 31, 2011 with a remaining balance of $318,000 and $336,000, respectively. The mortgage was accruing interest at 3.50% at both March 31, 2012 and December 31, 2011 and contains pre-payment penalties. At March 31, 2012 and December 31, 2011 the fair value of the mortgage approximated the book value. To determine the fair value of the mortgage, the amount of future cash flows was discounted using the Company's borrowing rate on its Credit Facility. The recorded value of the demand notes payable approximates the fair value as the interest rate approximates market rates and as the notes are due upon demand (i.e., they are short-term in nature). See Note 10 for further information regarding the demand notes payable. The Company does not have any off-balance sheet financial instruments other than operating leases (see Note 13 of the Notes to Consolidated Financial Statements in the 2011 Form 10-K).

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board ("FASB") amended authoritative guidance associated with fair value measurements. This amended guidance defines certain requirements for measuring fair value and for disclosing information about fair value measurement in accordance with U.S. generally accepted accounting principles. The amendments to authoritative guidance associated with fair value measurements were effective for the Company on January 1, 2012 and have been applied prospectively. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

Reclassifications

Balances related to accrued accounts payable which had been included in "Other current liabilities" in the prior year balance sheet have been reclassified to "Accounts payable" to conform to current year presentation.

2. Cash and Cash Equivalents and Short-term Investments

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. At March 31, 2012, $7.6 million of cash and cash equivalents were fully insured by the FDIC under its standard maximum deposit insurance amount guidelines. At March 31, 2012, cash and cash equivalents included $14.2 million belonging to majority-owned joint ventures consolidated in these financial statements, which generally cannot be used for purposes outside the joint ventures.

Short-term investments include mutual funds and government bonds which are considered available-for-sale securities and measured at fair value as required under applicable GAAP. Government bonds have maturity dates of 2014-2041. At March 31, 2012 and December 31, 2011, the Company had short-term investments as follows (in thousands):

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	March 31, 2012				
	Total Fair Value	Level 1	Level 2	Gross Unrealized Gains (pre-tax)	Gross Unrealized Losses (pre-tax)
Mutual funds	$22,925	$22,925	$--	$230	$8
Municipal bonds	20,657	--	20,657	614	34
Total securities available-for-sale	$43,582	$22,925	$20,657	$844	$42

	December 31, 2011				
	Total Fair Value	Level 1	Level 2	Gross Unrealized Gains (pre-tax)	Gross Unrealized Losses (pre-tax)
Mutual funds	$24,851	$24,851	$--	$383	$--
Municipal bonds	20,004	--	20,004	617	15
Total securities available-for-sale	$44,855	$24,851	$20,004	$1,000	$15

The amortized cost basis of the above securities at March 31, 2012 and December 31, 2011 was $42.9 million and $44.3 million, respectively. Municipal bond securities are the only securities held by the Company where fair value does not equal amortized cost. The amortized cost for municipal bond securities was $20.0 million and $19.4 million at March 31, 2012 and December 31, 2011, respectively.

The valuation inputs for Levels 1, 2 and 3 are as follows:

Level 1 Inputs – Valuation 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.

The Company had no short-term investments valued with Level 3 inputs at either of the balance sheet dates.

Gains and losses realized on short-term investment securities are included in "Gains (losses) on sale of securities and other" in the accompanying statements of operations. Unrealized gains (losses) on short-term investments are included in accumulated other comprehensive income (loss) in stockholders' equity, net of tax, as the gains and losses may be temporary. At March 31, 2012, the unrealized gains (losses) on short-term investments included in accumulated other comprehensive income, net of taxes of $281,000, was $521,000. Upon the sale of short-term investments, the cost basis used to determine the gain or loss is based on the specific identification of the security sold. All items included in accumulated other comprehensive income (loss) are at the corporate level, and no portion is attributable to noncontrolling interests.

For the three months ended March 31, 2012 and 2011, the Company earned interest income of $353,000, and $378,000, respectively, on its cash, cash equivalents and short-term investments.

3. Construction Joint Ventures

We participate in various construction joint ventures. Generally, each construction joint venture is formed to accomplish a specific project and is jointly controlled by the joint venture partners. See Note 6 of the Notes to Consolidated Financial Statements in the 2011 Form 10-K for further information. 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 (in thousands):

	March 31, 2012	December 31, 2011
Total combined:		
Current assets	$121,501	$ 108,458
Less current liabilities	(90,522)	(86,023)
Net assets	$30,979	$ 22,435
Backlog	$454,053	$ 539,844
Sterling's noncontrolling interest in backlog	$112,445	$ 127,130
Sterling's receivables from and equity in net assets of construction joint ventures	$7,546	$ 6,057

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	Three Months Ended March 31, 2012	2011
Total combined:		
Revenues	$ 90,374	$ 86,686
Income before tax	8,562	6,927
Sterling's noncontrolling interest:		
Revenues	$ 15,916	$ 10,841
Income before tax	1,413	828

4. Property and Equipment

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

	March 31, 2012	December 31, 2011
Construction equipment	$121,702	$ 125,222
Transportation equipment	16,158	17,963
Buildings	7,260	4,729
Office equipment	1,305	1,077
Construction in progress	484	2,544
Land	4,186	3,026
Water rights	200	200
	151,295	154,761
Less accumulated depreciation	(68,615)	(71,332)
	$82,680	$ 83,429

Construction in progress at March 31, 2012 consisted primarily of expenditures for a new office in San Antonio, Texas. In addition to the expenditures for the new office in San Antonio, construction in progress at December 31, 2011 consisted primarily of expenditures for a new office in Dallas, Texas which was completed during the three months ended March 31, 2012.

5. Derivative Financial Instruments

During the quarter ended June 30, 2011, the Company began entering into various fixed rate commodity swap contracts in an effort to manage its exposure to price volatility of diesel fuel. Historically, fuel prices have been volatile because of supply and demand factors, worldwide political factors and general economic conditions. The objective of the Company in executing the hedge is to mitigate the fuel price volatility that could adversely affect forecasted cash flows and earnings related to construction contracts. Swaps are designed so that the Company receives or makes payments based on a differential between fixed and variable prices for off-road ultra-low sulfur diesel ("ULSD"). The Company has designated its commodity derivative contracts as cash flow hedges designed to achieve more predictable cash flows, as well as to reduce its exposure to price volatility. While the use of derivative instruments limits the downside risk of adverse price movements, they also limit future benefits from reductions in costs as a result of favorable market price movements.

All of the Company's outstanding derivative financial instruments are recognized in the balance sheet at their fair values. All changes in the fair value of outstanding derivatives, except any ineffective portion, are recorded in accumulated other comprehensive income (loss) until earnings are impacted by the hedged transaction. Amounts in accumulated other comprehensive income (loss) are reclassified to earnings when the related hedged items affect earnings or the anticipated transactions are no longer probable. All items included in accumulated other comprehensive income (loss) are at the corporate level, and no portion is attributable to noncontrolling interests.

At March 31, 2012, pre-tax accumulated other comprehensive income (loss), net of related taxes of $9,000, consisted of unrecognized gains of $26,000 representing the unrealized change in mark-to-market value of the effective portion of the Company's commodity contracts, designated as cash flow hedges, as of the balance sheet date. For the three months ended March 31, 2012, the Company recognized pre-tax net realized cash settlement losses on commodity contracts of $3,000.

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At March 31, 2012, the Company had hedged its exposure to the variability in future cash flows from forecasted diesel fuel purchases totaling 660,000 gallons. The monthly volumes hedged range from 10,000 gallons to 30,000 gallons over the period from April 2012 to December 2013 at fixed prices per gallon ranging from $2.99 to $3.33.

The derivative instruments are recorded on the consolidated condensed balance sheet at fair value and include $2,900 in other deposits and other current assets for the March 2012 contract which settled in April 2012. The fair values, excluding the $2,900 settled in 2012, are as follows (in thousands):

Balance Sheet Location	March 31, 2012	December 31, 2011
Derivative assets:		
Deposits and other current assets	$ 27	$ --
Other assets, net	--	--
	$ 27	$ --
Derivative liabilities:		
Other current liabilities	--	$ 147
Other long-term liabilities	1	76
	$ 1	$ 223

The following table summarizes the effects of commodity derivative instruments on the condensed consolidated statements of operations and comprehensive income (loss) for the three months ended March 31, 2012 and 2011 (in thousands):

	March 31, 2012	March 31, 2011
Increase in fair value of derivatives included in other comprehensive income (effective portion)	$ 249	$ --
Realized loss included in cost of revenues (effective portion)	(3)	--
Increase (decrease) in fair value of derivatives included in cost of revenues (ineffective portion)	--	--

The Company's derivative instruments contain certain credit-risk-related contingent features which apply both to the Company and to the counterparties. The counterparty to the Company's derivative contracts is a high credit quality financial institution.

Fair Value

Derivative financial instruments are carried at fair value as required by applicable GAAP. Commodity derivative instruments consist of fixed rate commodity swaps to hedge the price risk associated with changes in the price of diesel fuel. The Company's swaps are valued based on a discounted future cash flow model. The primary input for the model is the forecasted prices for ULSD. The Company's model is validated by the counterparty's mark-to-market statements. The swaps are designated as Level 2 within the valuation hierarchy. Refer to Note 2 for a description of the inputs used to value the information shown above.

At March 31, 2012 and December 31, 2011, the Company did not have any derivative assets or liabilities measured at fair value on a recurring basis that meet the definition of Level 1 or Level 3.

6. Income Taxes

The Company and its subsidiaries file U.S. federal and various state income tax returns. The Company's 2007 through 2009 U.S. federal income tax returns are currently being examined by the I.R.S.; however, management expects there will be no material adjustments, interest or penalties from such examination. The Company's policy is to recognize interest related to any underpayment of taxes as interest expense, and any penalties as administrative expenses.

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The income tax expense in the accompanying condensed consolidated financial statements consists of the following (in thousands):

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Current tax benefit	$ (1,025)	$ (1,102)
Deferred tax expense (benefit)	(2,951)	1,268
Total tax expense (benefit)	$ (3,976)	$ 166

Current income tax expense (benefit) represents federal and state taxes based on income (loss) or a component thereof expected to be included in the tax returns for the years shown. The deferred tax benefit in the three months ended March 31, 2012 reflects, among other temporary timing differences, the tax impact of $2,351,000 related to the $6,717,000 increase in the net income attributable to RLW's noncontrolling interests for the amendment discussed in Note 8. The deferred income tax expense (benefit), based on temporary timing differences, is expected to be payable in future years.

The income tax expense (benefit) for the three months ended March 31, 2012 and 2011 differ from the amounts using the statutory federal income tax rate of 35% of income before taxes and earnings attributable to noncontrolling interests for the following reasons (in thousands, except for percentages):

	2012 Amount	2012 %	2011 Amount	2011 %
Tax expense (benefit) at the U.S. federal statutory rate	$ (1,323)	35.0 %	$ 577	35.0 %
State franchise and income tax based on income, net of refunds and federal benefits	(15)	0.4	201	12.2
Taxes on subsidiaries' and joint ventures' earnings allocated to noncontrolling ownership interests	(2,694)	71.2	(503)	(30.5)
Non-taxable interest income	(122)	3.2	(128)	(7.8)
Other permanent differences	178	(4.6)	19	1.2
Income tax expense (benefit)	$ (3,976)	105.2 %	$ 166	10.1 %

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

7. Contingencies Related to Litigation

In January 2010, a jury trial was held to resolve a dispute between Road and Highway Builders, LLC ("RHB") and a subcontractor. The jury rendered a verdict of $1.0 million against RHB, exclusive of interest, court costs and attorney's fees. While the Company has recorded this verdict as an expense in 2009, the Company has appealed this judgment as it believes that as a matter of law, the jury erred in its decision. The Company has posted a bond of $1.3 million to cover the judgment and estimated court costs and attorney's fees pending the results of the appeal. The appeal was heard by the Nevada Supreme Court on November 3, 2011, and the Company anticipates that the court will make its decision by mid-2012.

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 other actions will have a material impact on the financial statements of the Company.

8. Acquisitions and Subsidiaries and Joint Ventures with Noncontrolling Owners' Interests

In connection with the August 1, 2011, acquisition of J. Banicki Construction, Inc. ("JBC") by 80% owned Ralph L. Wadsworth Construction Company, LLC ("RLW"), RLW agreed to additional purchase price payments of up to $5 million to be paid over a five-year period. The additional purchase price is in the form of an earn-out which is calculated generally as 50% of the amount by which earnings before interest, taxes, depreciation and amortization ("EBITDA") exceeds $2 million for each of the calendar years 2011 through 2015 and $1.2 million for the seven months ended July 31, 2016. The discounted present value of the additional purchase price was estimated to be $2.4 million as of August 1, 2011, the acquisition date. This liability is included in other long-term liabilities in the accompanying condensed consolidated balance sheets.

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On August 1, 2011, the Company purchased a 50% interest in Myers & Sons Construction, L.P. ("Myers"). Myers is a construction limited partnership located in California and was acquired in order to expand the geographic scope of the Company's operations into California.

See Note 10 regarding the determination that Myers' is a variable interest entity and the resulting impact on the condensed consolidated financial statements.

The following table shows the amounts of JBC's and Myers' revenue and earnings included in the Company's condensed consolidated statements of operations and cash flows for the three months ended March 31, 2012 as well as the revenue and earnings of the combined entity for the three months ended March 31, 2011 had the acquisition dates been January 1, 2011 (in thousands):

	Revenue	Net Income Attributable to Sterling Common Stockholders
JBC actual from January 1, 2012 to March 31, 2012	$ 7,375	$ 76
Myers actual from January 1, 2012 to March 31, 2012	4,514	(12)
Supplemental pro forma results of the Company, JBC, and Myers on a combined basis for 1/1/2011 – 3/31/2011 (unaudited)	101,813	(137)

In connection with the December 3, 2009 acquisition of RLW, the noncontrolling interest owners of RLW, who are related and also its executive management, have the right to require the Company to buy their remaining 20.0% interest in RLW in 2013, and concurrently, the Company has the right to require those owners to sell their 20.0% interest to the Company by July 2013 (the "RLW Put/Call"). The purchase price in each case is 20% of the product of the simple average of RLW's EBITDA (income before interest, taxes, depreciation and amortization) for the calendar years 2010, 2011 and 2012 times a multiple of a minimum of 4 and a maximum of 4.5. The noncontrolling owners' interests, including the obligation under the RLW Put/Call, were recorded at their estimated fair value at the date of acquisition as "Obligation for noncontrolling owners' interests in subsidiaries and joint ventures" in the accompanying condensed consolidated balance sheet.

Annual interest is accreted for the RLW Put/Call obligation based on the Company's borrowing rate under its Credit Facility plus two percent. Such accretion amounted to $248,000 and $212,000 for the three months ended March 31, 2012 and 2011 and is recorded in "Interest expense" in the accompanying condensed consolidated statement of operations. In addition, based on the estimated average of RLW's EBITDA for the calendar years 2010, 2011 and 2012 and the expected multiple, the estimated fair value of the RLW Put/Call was decreased by $463,000 during the three months ended March 31, 2012, and this change, net of tax of $162,000, has been reported as a charge to retained earnings.

The obligation associated with the RLW Put/Call as well as any undistributed earnings to the noncontrolling interest owners is included in "Obligation for noncontrolling owners' interests in subsidiaries and joint ventures" in the accompanying condensed consolidated balance sheets.

On October 31, 2007, the Company purchased a 91.67% interest in RHB. The noncontrolling interest owner of RHB had the right to put, or require the Company to buy, his remaining 8.33% interest in the subsidiary and, concurrently, the Company had the right to require that the owner sell his 8.33% interest to the Company, in 2011. On March 17, 2011, the right to put/call the RHB noncontrolling interest was extended to anytime between that date and December 31, 2012. In addition the price was increased from $7.1 million to $8.2 million which settled $1.1 million of accrued amounts due to the noncontrolling interest owner under the October 31, 2007 purchase agreement. In September 2011, the noncontrolling owner exercised his right to put his remaining interest of 8.33% in RHB to the Company for $8.2 million. This transaction was completed in December 2011 under the terms of the agreement.

See Note 2 of the Notes to Consolidated Financial Statements included in the 2011 Form 10-K for further information regarding the acquisitions discussed above.

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Changes in Obligation for Noncontrolling Interests

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

	Three Months Ended March 31, 2012	2011
Balance, beginning of period	$ 16,848	$