STERLING CONSTRUCTION CO INC
Form 10-Q
August 09, 2013

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

FORM 10-Q

(Mark one)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: June 30, 2013
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)

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.
[√] 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 July 31, 2013, there were 16,652,579 shares outstanding of the issuer's common stock, par value $0.01 per share.

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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)

	June 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,029	$ 3,142
Short-term investments	21,000	49,211
Contracts receivable, including retainage	87,693	70,815
Costs and estimated earnings in excess of billings on uncompleted contracts	23,327	20,592
Inventories	4,603	3,731
Deferred tax asset, net	588	1,803
Receivables from and equity in construction joint ventures	8,543	11,005
Other current assets	10,180	4,459
Total current assets	156,963	164,758
Property and equipment, net	97,498	102,308
Goodwill	54,820	54,820
Long-term deferred tax asset, net	14,197	2,973
Other assets, net	5,591	6,651
Total assets	$ 329,069	$ 331,510
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 55,822	$ 47,796
Billings in excess of costs and estimated earnings on uncompleted contracts	24,441	18,918
Current maturities of long-term debt	232	73
Accrued compensation	6,350	4,909
Current obligation for noncontrolling owners’ interest in subsidiaries and joint ventures	517	2,887
Other current liabilities	4,095	2,691
Total current liabilities	91,457	77,274
Long-term liabilities:		
Long-term debt, net of current maturities	29,469	24,201
Other long-term liabilities	2,482	2,728
Total long-term liabilities	31,951	26,929
Commitments and contingencies (Note 8)		
Obligations for noncontrolling owners’ interests in subsidiaries and joint ventures	15,158	14,721
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, 16,647,604 and 16,495,216 shares issued	166	165
Additional paid in capital	197,573	197,067
Retained earnings (deficit)	(9,735)	12,220
Accumulated other comprehensive income (loss)	(201)	696

Total Sterling common stockholders’ equity	187,803	210,148
Noncontrolling interests	2,700	2,438
Total equity	190,503	212,586
Total liabilities and equity	$ 329,069	$ 331,510

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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues	$133,350	$168,709	$244,385	$267,134
Cost of revenues	(149,985)	(153,550)	(259,632)	(250,103)
Gross profit (loss)	(16,635)	15,159	(15,247)	17,031
General and administrative expenses	(9,486)	(8,444)	(19,097)	(16,110)
Other operating income, net	6	1,525	258	2,756
Operating income (loss)	(26,115)	8,240	(34,086)	3,677
Gain on sale of securities and other	102	333	675	1,083
Interest income	255	511	536	927
Interest expense	(209)	(432)	(308)	(818)
Income (loss) before income taxes and earnings attributable to noncontrolling interests	(25,967)	8,652	(33,183)	4,869
Income tax (expense) benefit	9,747	(984)	12,547	2,992
Net income (loss)	(16,220)	7,668	(20,636)	7,861
Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	(805)	(4,381)	(966)	(12,076)
Net income (loss) attributable to Sterling common stockholders	$(17,025)	$3,287	$(21,602)	$(4,215)
Net income (loss) per share attributable to Sterling common stockholders:				
Basic	$(0.93)	$0.15	$(1.32)	$(0.29)
Diluted	$(0.93)	$0.15	$(1.32)	$(0.29)
Weighted average number of common shares outstanding used in computing per share amounts:				
Basic	16,629,630	16,359,597	16,612,924	16,341,037
Diluted	16,629,630	16,444,324	16,612,924	16,341,037

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

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

	Six Months Ended June 30,	
	2013	2012
Net loss attributable to Sterling common stockholders	$(21,602)	$(4,215)
Net income attributable to noncontrolling owners' interests included in equity	678	296
Net income attributable to noncontrolling owners' interests included in liabilities	288	11,780
Add /(deduct) other comprehensive income, net of tax:		
Realized gain from sale of available-for-sale securities	(309)	(326)
Change in unrealized holding gain (loss) on available-for-sale securities	(498)	312
Realized (gain) loss from settlement of derivatives	(2)	29
Change in the effective portion of unrealized gain in fair market value of derivatives	(88)	(13)
Comprehensive income (loss)	$(21,533)	$7,863

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 SIX MONTHS ENDED JUNE 30, 2013
(Amounts in thousands)
(Unaudited)

	STERLING CONSTRUCTION COMPANY, INC. STOCKHOLDERS							
	Common Stock		Treasury Stock		Additional Paid in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total
	Shares	Amount	Shares	Amount					
Balance at January 1, 2013	16,495	$165	--	$--	$197,067	$12,220	$696	$2,438	$212,586
Net income (loss)	--	--	--	--	--	(21,602)	--	678	(20,924
Other comprehensive loss	--	--	--	--	--	--	(897)	--	(897
Stock issued upon option exercises	9	--	--	--	26	--	--	--	26
Tax impact from exercise of stock options	--	--	--	--	(17)	--	--	--	(17
Issuance and amortization of restricted stock	144	1	--	--	497	--	--	--	498
Revaluation of noncontrolling interest, net of tax	--	--	--	--	--	(353)	--	--	(353
Distribution to owners	--	--	--	--	--	--	--	(416)	(416
Balance at June 30, 2013	16,648	$166	--	$--	$197,573	$(9,735)	$(201)	$2,700	$190,503

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)

	Six Months Ended June 30, 2013	2012
Cash flows from operating activities:		
Net loss attributable to Sterling common stockholders	$ (21,602)	$ (4,215)
Plus: Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	966	12,076
Net income (loss)	(20,636)	7,861
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	9,486	9,384
Gain on disposal of property and equipment	(35)	(2,724)
Deferred tax benefit	(9,280)	(3,136)
Interest expense accreted on discounted liabilities	--	497
Stock-based compensation expense	480	264
Gain on sale of securities and other	(471)	(696)
Tax impact from exercise of stock options	17	129
Changes in operating assets and liabilities:		
Contracts receivable	(16,878)	(13,913)
Costs and estimated earnings in excess of billings on uncompleted contracts	(2,735)	378
Receivables from and equity in construction joint ventures	2,462	(832)
Income tax receivable	(3,383)	--
Inventories, deposits and other current assets	(2,333)	(3,986)
Accounts payable	8,018	22,208
Billings in excess of costs and estimated earnings on uncompleted contracts	5,523	5,854
Accrued compensation and other liabilities	2,819	1,843
Net cash provided by (used in) operating activities	(26,946)	23,131
Cash flows from investing activities:		
Additions to property and equipment	(6,689)	(17,856)
Proceeds from sales of property and equipment	2,086	6,847
Purchases of short-term securities, available-for-sale	(1,160)	(19,083)
Sales of short-term securities, available-for-sale	28,608	14,742
Net cash provided by (used in) investing activities	22,845	(15,350)
Cash flows from financing activities:		
Cumulative daily drawdowns – Credit Facility	94,213	3,000
Cumulative daily repayments – Credit Facility	(88,954)	(3,000)
Distributions to noncontrolling interest owners	(3,244)	(4,885)
Tax impact from exercise of stock options	(17)	(129)
Other	(10)	(26)
Net cash provided by (used) in financing activities	1,988	(5,040)
Net increase (decrease) in cash and cash equivalents	(2,113)	2,741
Cash and cash equivalents at beginning of period	3,142	16,371
Cash and cash equivalents at end of period	$ 1,029	$ 19,112
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	$ 266	$ 534
Cash paid during the period for income taxes	$ 169	$ 2,755
Non-cash items:		

Revaluation of noncontrolling interest obligations, net of tax	$ (353)	$ 476
Issuance of noncontrolling interest in RHB in exchange for net assets of acquired companies	$ --	$ 15,196

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. 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 and reconstruction of transportation and water infrastructure projects in Texas, Utah, Nevada, Arizona, California and other states in which there are construction opportunities. The Company's transportation infrastructure projects include highways, roads, bridges and light rail, and the Company's water infrastructure projects include water, wastewater and storm drainage systems.

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.

We determined that Myers and Sons Construction, L.P., a Company in which we have a 50% limited partner interest ("Myers"), is a variable interest entity. As discussed further in Note 3 of the Notes to Consolidated Financial Statements included in the annual report on Form 10-K for the year ended December 31, 2012 ("2012 Form 10-K"), the Company determined that it exercises primary control over activities of the partnership and it is exposed to more than 50% of potential losses from the partnership. Therefore, the Company consolidates this partnership 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 3 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 2012 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 June 30, 2013 and the results of operations and cash flows for the periods presented. The December 31, 2012 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 and six months ended June 30, 2013 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 2012 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, 2012.

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 (including goodwill), 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.

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.

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. The Company's 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 estimated costs, costs and income and are recognized in the period in which the revisions are determined. Changes in estimated revenues and gross margin during the six months ended June 30, 2013 resulted in a net charge of $20.6 million included in the operating results and a $13.6 million after-tax charge, or $0.82, 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"), 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. We currently have one long-term contract receivable which is discounted at 4.25% and recorded at fair value. Interest earned related to the long-term contract receivable was $94,000 for the year. 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 9 regarding the fair value of certain noncontrolling owners' interests in subsidiaries and the earn-out liability. We had one mortgage outstanding at June 30, 2013 and December 31, 2012 with a remaining balance of $226,000 and $262,000, respectively. The mortgage was accruing interest at 3.50% at both June 30, 2013 and December 31, 2012 and contains pre-payment penalties. At June 30, 2013 and December 31, 2012, the fair value of the mortgage approximated 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 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 2012 Form 10-K).

Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board issued amended authoritative guidance associated with comprehensive income which requires companies to provide information about the amounts that are reclassified out of accumulated other comprehensive income by component. Additionally, companies are required to present significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amendment was effective for the Company on January 1, 2013. The impact of the adoption of this guidance on the Company's condensed consolidated financial statements was limited to the provision of the additional disclosures. We have presented the disclosures required by this amendment in Note 6.

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 June 30, 2013, approximately $1.0 million of cash and cash equivalents was fully insured by the FDIC under its standard maximum deposit insurance amount guidelines. At June 30, 2013, cash and cash equivalents included $566,000 belonging to majority-owned joint ventures that are consolidated in these financial statements which generally cannot be used for purposes outside such joint ventures.

Short-term investments include mutual funds and government bonds which are considered available-for-sale securities. The government bonds held have maturity dates ranging between 2013 and 2050. At June 30, 2013 and December 31, 2012, the Company had short-term investments as follows (amounts in thousands):

	June 30, 2013				
	Total Fair Value	Level 1	Level 2	Gross Unrealized Gains (pre-tax)	Gross Unrealized Losses (pre-tax)
Mutual funds	$--	$--	$--	$ --	$ --
Municipal bonds	21,000	--	21,000	282	(465)
Total securities available-for-sale	$21,000	$--	$21,000	$ 282	$ (465)

December 31, 2012

Total Fair Value	Level 1	Level 2	Gross