

Morningstar[®] Document ResearchSM

FORM 10-Q

STERLING CONSTRUCTION CO INC - STRL

Filed: November 08, 2012 (period: September 30, 2012)

Quarterly report with a continuing view of a company's financial position

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: September 30, 2012

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
State or other jurisdiction of incorporation
or organization

25-1655321
(I.R.S. Employer
Identification No.)

20810 Fernbush Lane
Houston, Texas
(Address of principal executive office)

77073
(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 October 31, 2012, there were 16,495,216 shares outstanding of the issuer's common stock, par value \$0.01 per share.

STERLING CONSTRUCTION COMPANY, INC.
QUARTERLY REPORT ON FORM 10-Q
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION	
<u>ITEM 1. FINANCIAL STATEMENTS</u>	<u>3</u>
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	<u>21</u>
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK</u>	<u>31</u>
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	<u>31</u>
PART II – OTHER INFORMATION	
<u>ITEM 1. LEGAL PROCEEDINGS</u>	<u>32</u>
<u>ITEM 1A. RISK FACTORS</u>	<u>32</u>
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	<u>32</u>
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	<u>32</u>
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	<u>32</u>
<u>ITEM 5. OTHER INFORMATION</u>	<u>32</u>
<u>ITEM 6. EXHIBITS</u>	<u>33</u>
<u>SIGNATURES</u>	<u>34</u>

PART I
Item 1. Financial Statements

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

	<u>September 30,</u> <u>2012</u>	<u>December 31,</u> <u>2011</u>
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,034	\$ 16,371
Short-term investments	53,454	44,855
Contracts receivable, including retainage	120,478	74,875
Costs and estimated earnings in excess of billings on uncompleted contracts	17,876	16,509
Inventories	3,945	1,922
Deferred tax asset, net	793	1,302
Receivables from and equity in construction joint ventures	10,767	6,057
Other current assets	5,406	2,132
Total current assets	213,753	164,023
Property and equipment, net	102,326	83,429
Goodwill	54,460	54,050
Other assets, net	4,742	2,329
Total assets	\$ 375,281	\$ 303,831
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	\$ 65,781	\$ 40,064
Billings in excess of costs and estimated earnings on uncompleted contracts	27,031	18,583
Current maturities of long-term debt	73	573
Income taxes payable	214	2,013
Accrued compensation	9,701	5,329
Current obligation for noncontrolling owners' interests in subsidiaries and joint ventures	23,323	--
Other current liabilities	5,006	2,723
Total current liabilities	131,129	69,285
Long-term liabilities:		
Long-term debt, net of current maturities	10,208	263
Deferred tax liability, net	368	--
Other long-term liabilities	2,498	2,597
Total long-term liabilities	13,074	2,860
Commitments and contingencies (Note 7)		
Obligation for noncontrolling owners' interests in subsidiaries and joint ventures	18,686	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, 16,495,216 and 16,321,116 shares issued	165	163
Additional paid in capital	196,495	196,143
Retained earnings	12,047	16,509
Accumulated other comprehensive income	946	496
Total Sterling common stockholders' equity	209,653	213,311
Noncontrolling interests	2,739	1,527
Total equity	212,392	214,838
Total liabilities and equity	\$ 375,281	\$ 303,831

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		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Revenues	\$ 205,283	\$ 159,427	\$ 472,418	\$ 387,167
Cost of revenues	(191,114)	(144,671)	(441,216)	(351,230)
Gross profit	14,169	14,756	31,202	35,937
General and administrative expenses	(10,259)	(7,071)	(26,369)	(19,427)
Other operating income (expense), net	261	76	3,017	226
Operating income	4,171	7,761	7,850	16,736
Gain (loss) on sale of securities and other	617	212	1,700	(33)
Interest income	287	309	1,214	1,252
Interest expense	(159)	(357)	(978)	(945)
Income before income taxes and earnings attributable to noncontrolling interests	4,916	7,925	9,786	17,010
Income tax benefit (expense)	(847)	(1,984)	2,146	(3,295)
Net income	4,069	5,941	11,932	13,715
Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	(3,079)	(2,480)	(15,155)	(5,999)
Net income (loss) attributable to Sterling common stockholders	\$ 990	\$ 3,461	\$ (3,223)	\$ 7,716
Net income (loss) per share attributable to Sterling common stockholders:				
Basic	\$ 0.01	\$ 0.21	\$ (0.27)	\$ 0.47
Diluted	\$ 0.01	\$ 0.21	\$ (0.27)	\$ 0.47
Weighted average number of common shares outstanding used in computing per share amounts:				
Basic	16,404,749	16,385,729	16,362,429	16,444,302
Diluted	16,504,033	16,440,835	16,362,429	16,558,074

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

STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2012	2011
Net income (loss) attributable to Sterling common stockholders	\$ (3,223)	\$ 7,716
Net income attributable to noncontrolling interest included in equity	1,252	80
Net income attributable to noncontrolling interest included in liabilities	13,903	5,919
Add /(deduct) other comprehensive income, net of tax:		
Realized (gain) loss from available-for-sale securities	(431)	20
Change in unrealized holding gain (loss) on available-for-sale securities	705	535
Realized loss from settlement of derivatives	37	41
Change in the effective portion of unrealized gain (loss) in fair market value of derivatives	139	(319)
Comprehensive income	\$ 12,382	\$ 13,992

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 NINE MONTHS ENDED SEPTEMBER 30, 2012
(Amounts in thousands)
(Unaudited)

Sterling Construction Company, Inc. Stockholders									
	Common Stock		Treasury Stock		Addi- tional Paid in Capital	Retained Earnings	Accu- mulated Other Compre- hensive 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 income (loss)	--	--	--	--	--	(3,223)	--	1,252	(1,971)
Other comprehensive income	--	--	--	--	--	--	450	--	450
Stock issued upon option exercises	24	--	--	--	66	--	--	--	66
Tax impact from exercise of stock options	--	--	--	--	(143)	--	--	--	(143)
Issuance and amortization of restricted stock	150	2	--	--	429	--	--	--	431
Revaluation of noncontrolling interest RLW put/call liability and other, net of tax	--	--	--	--	--	(1,239)	--	(40)	(1,279)
Balance at September 30, 2012	<u>16,495</u>	<u>\$ 165</u>	<u>--</u>	<u>\$ --</u>	<u>\$ 196,495</u>	<u>\$ 12,047</u>	<u>\$ 946</u>	<u>\$ 2,739</u>	<u>\$ 212,392</u>

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)

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net income (loss) attributable to Sterling common stockholders	\$ (3,223)	\$ 7,716
Plus: Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	15,155	5,999
Net income	11,932	13,715
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,627	12,775
Gain on disposal of property and equipment	(2,977)	(226)
Deferred tax expense (benefit)	(1,607)	3,834
Stock-based compensation expense	429	382
Interest expense accreted on noncontrolling interests	745	636
Loss (gain) on sale of securities and other	(812)	33
Tax impact from exercise of stock options	143	(68)
Other changes in operating assets and liabilities:		
(Increase) decrease in contracts receivable	(45,603)	(16,101)
(Increase) decrease in costs and estimated earnings in excess of billings on uncompleted contracts	(1,367)	(15,072)
(Increase) decrease in income tax receivable	(1,376)	(1,366)
(Increase) decrease in prepaid expenses and other assets	(3,467)	373
(Increase) decrease in receivables from and equity in construction joint ventures	(4,710)	(1,391)
Increase (decrease) in accounts payable	25,718	14,201
Increase (decrease) in billings in excess of costs and estimated earnings on uncompleted contracts	8,448	(3,155)
Increase (decrease) in accrued compensation and other liabilities	4,923	(3,933)
Net cash provided by operating activities	5,046	4,637
Cash flows from investing activities:		
Net assets of acquired companies, net of cash acquired	--	(3,911)
Additions to property and equipment	(27,818)	(19,592)
Proceeds from sale of property and equipment	11,915	930
Purchases of short-term securities, available-for-sale	(29,910)	(97,719)
Sales of short-term securities, available-for-sale	22,396	84,473
Net cash used in investing activities	(23,417)	(35,819)
Cash flows from financing activities:		
Cumulative daily drawdowns – Credit Facility	20,000	16,000
Cumulative daily repayments – Credit Facility	(10,000)	(8,000)
Repayments under long-term obligations	(73)	(55)
Purchases of treasury stock	--	(3,592)
Issuance of common stock pursuant to warrants and options exercised	68	155
Distributions to noncontrolling interest owners	(6,589)	(6,185)
Utilization of tax impact from exercise of stock options	(143)	68
Other	(229)	--
Net cash provided by (used in) financing activities	3,034	(1,609)
Net increase (decrease) in cash and cash equivalents	(15,337)	(32,791)
Cash and cash equivalents at beginning of period	16,371	49,441
Cash and cash equivalents at end of period	\$ 1,034	\$ 16,650
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	\$ 418	\$ 232
Cash paid during the period for income taxes	\$ 2,905	\$ 2,391
Non-cash items:		
Revaluation of noncontrolling interest – RLW put/call liability, net of tax	\$ 1,239	\$ --
Reclassification of amounts payable to noncontrolling interest owner	\$ --	\$ 1,054
Issuance of noncontrolling interest in RHB in exchange for net assets of acquired companies	\$ 15,196	\$ --
Net liabilities assumed in connection with acquisitions	\$ --	\$ 1,961

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, 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 September 30, 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 September 30, 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 and nine months ended September 30, 2012 are not necessarily indicative of the results to be expected for the full year or subsequent quarters.

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, 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.

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 contracts during the nine months ended September 30, 2012 resulted in a net charge of \$4.6 million included in the operating results and a \$4.5 million after-tax charge or \$0.28 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"), 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 September 30, 2012 and December 31, 2011 with a remaining balance of \$281,000 and \$336,000, respectively. The mortgage was accruing interest at 3.50% at both September 30, 2012 and December 31, 2011 and contains pre-payment penalties. At September 30, 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. At year-end the recorded value of the demand notes payable approximated fair value as the interest rate approximated market rates and as the notes are due upon demand (i.e., they are short-term in nature). During the quarter the demand notes payable has been paid. 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 December 2011, the Financial Accounting Standards Board ("FASB") amended authoritative guidance associated with offsetting assets and liabilities. This amended guidance enhances disclosures by requiring improved information about financial instruments and derivatives instruments that are offset in accordance with current GAAP or subject to an enforceable master netting agreement. The amendment to this authoritative guidance will be placed into effect for the Company on January 1, 2013 and must be applied retrospectively. Except for the additional disclosure requirements, this amendment will have no impact on our consolidated financial statements upon adoption.

In May 2011, the 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 GAAP. 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 consolidated financial statements.

In July 2012, the FASB amended authoritative guidance associated with indefinite-lived intangible assets, other than goodwill. This amended guidance states that an entity would not be required to calculate the fair value of an indefinite-lived intangible asset unless the entity determines, based on a qualitative assessment, that it is not more likely than not, the indefinite-lived intangible asset is impaired. The amendments to this authoritative guidance become effective for the Company after September 15, 2012. The Company does not currently have indefinite-lived intangible assets, other than goodwill; therefore, this guidance will not have a material impact on our 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 September 30, 2012, \$704,000 of cash and cash equivalents were fully insured by the FDIC under its standard maximum deposit insurance amount guidelines. At September 30, 2012, cash and cash equivalents included \$3.9 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. These government bonds have maturity dates of 2013-2046. At September 30, 2012 and December 31, 2011, the Company had short-term investments as follows (in thousands):

September 30, 2012					
	Total Fair Value	Level 1	Level 2	Gross Unrealized Gains (pre-tax)	Gross Unrealized Losses (pre-tax)
Mutual funds	\$ 31,779	\$ 31,779	\$ --	\$ 487	\$ --
Municipal bonds	21,675	--	21,675	984	62
Total securities available-for-sale	<u>\$ 53,454</u>	<u>\$ 31,779</u>	<u>\$ 21,675</u>	<u>\$ 1,471</u>	<u>\$ 62</u>

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	<u>\$ 44,855</u>	<u>\$ 24,851</u>	<u>\$ 20,004</u>	<u>\$ 1,000</u>	<u>\$ 15</u>

The amortized cost basis of the above securities at September 30, 2012 and December 31, 2011 was \$52.2 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 \$20.4 million and \$19.4 million at September 30, 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 in stockholders' equity, net of tax, as the gains and losses may be temporary. For the three and nine months ended September 30, 2012, total proceeds from sales of short-term investments were \$7.7 million and \$22.4 million with gross realized gains of \$163,000 and \$663,000, respectively, and gross realized losses of \$0 for both periods. Accumulated other comprehensive income at September 30, 2012 included unrealized gains (losses) on short-term investments of \$1.4 million less the associated taxes of \$492,000. 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 are at the corporate level.

and no portion is attributable to noncontrolling interests.

For the three and nine months ended September 30, 2012 and 2011, the Company earned interest income of \$432,000 and \$1.1 million, and \$309,000 and \$1.3 million, 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):

	<u>September 30, 2012</u>	<u>December 31, 2011</u>
Total combined:		
Current assets	\$ 120,130	\$ 108,458
Less current liabilities	(65,949)	(86,023)
Net assets	<u>\$ 54,181</u>	<u>\$ 22,435</u>
Backlog	\$ 314,736	\$ 539,844
Sterling's noncontrolling interest in backlog	\$ 100,514	\$ 127,130
Sterling's receivables from and equity in construction joint ventures	\$ 10,767	\$ 6,057

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Total combined:				
Revenues	\$ 121,107	\$ 128,450	\$ 336,317	\$ 328,686
Income before tax	35,349	10,516	55,648	26,921
Sterling's proportionate share:				
Revenues	\$ 21,238	\$ 21,060	\$ 59,123	\$ 46,090
Income before tax	3,686	1,676	7,022	3,688

4. Property and Equipment

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

	September 30, 2012	December 31, 2011
Construction equipment	\$ 133,302	\$ 125,222
Transportation equipment	16,519	17,963
Buildings	7,186	4,729
Office equipment	1,365	1,077
Construction in progress	1,933	2,544
Land	4,886	3,026
Water rights	200	200
	165,391	154,761
Less accumulated depreciation	(63,065)	(71,332)
	<u>\$ 102,326</u>	<u>\$ 83,429</u>

Construction in progress at September 30, 2012 consisted primarily of expenditures for a new office in Dallas, Texas. In addition to the expenditures for the new office in Dallas, construction in progress at December 31, 2011 consisted primarily of expenditures for a new office in San Antonio, Texas, which was completed during the three months ended March 31, 2012.

5. Derivative Financial Instruments

The Company enters 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 until earnings are impacted by the hedged transaction. Amounts in accumulated other comprehensive income 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 are at the corporate level, and no portion is attributable to noncontrolling interests.

At September 30, 2012, pre-tax accumulated other comprehensive income consisted of: unrecognized gains of \$49,000 (representing the unrealized change in mark-to-market value of the effective portion of the Company's commodity contracts, designated as cash flow hedges) and related taxes of \$17,000, as of the balance sheet date. For the three and nine months ended September 30, 2012, the Company recognized pre-tax net realized cash settlement losses on commodity contracts of \$13,000 and \$57,000, respectively.

At September 30, 2012, the Company had hedged its exposure to the variability in future cash flows from forecasted diesel fuel purchases totaling 980,000 gallons. The monthly volumes hedged range from 10,000 gallons to 20,000 gallons over the period from October 2012 to December 2014 at fixed prices per gallon ranging from \$2.79 to \$3.31.

The derivative instruments are recorded on the condensed consolidated balance sheet at fair value as follows (in thousands):

Balance Sheet Location	September 30, 2012	December 31, 2011
Derivative assets:		
Deposits and other current assets	\$ 36	\$ --
Other assets, net	13	--
	<u>\$ 49</u>	<u>\$ --</u>
Derivative liabilities:		
Other current liabilities	\$ --	\$ 147
Other long-term liabilities	--	76
	<u>\$ --</u>	<u>\$ 223</u>

The following table summarizes the effects of commodity derivative instruments on the consolidated statements of operations and comprehensive income for the nine months ended September 30, 2012 and 2011 (in thousands):

	September 30, 2012	September 30, 2011
Increase in fair value of derivatives included in other comprehensive income (effective portion)	\$ 272	\$ (285)
Realized loss included in cost of revenues (effective portion)	(57)	(51)
Increase (decrease) in fair value of derivatives included in cost of revenues (ineffective portion)	--	(31)

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 September 30, 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.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Current tax expense (benefit)	\$ (683)	\$ (185)	\$ (539)	\$ (539)
Deferred tax expense (benefit)	1,530	2,169	(1,607)	3,834
Total tax expense (benefit)	\$ 847	\$ 1,984	\$ (2,146)	\$ 3,295

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 nine months ended September 30, 2012 reflects, among other temporary timing differences, the tax impact of \$2.4 million related to the \$6.7 million 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 nine months ended September 30, 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		2011	
	Amount	%	Amount	%
Tax expense at the federal statutory rate	\$ 3,425	35.0%	\$ 5,954	35.0%
State income tax expense (benefit), net of federal benefit	(51)	(0.5)	(402)	(2.4)
Taxes on subsidiaries' and joint ventures' earnings attributable to noncontrolling ownership interests, which are liabilities of such owners	(5,086)	(52.0)	(2,100)	(12.2)
Interest income not subject to federal tax	(386)	(3.9)	(249)	(1.5)
Other permanent differences	(48)	(0.5)	92	0.5
Income tax expense (benefit)	\$ (2,146)	(21.9)%	\$ 3,295	19.4%

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. The Company appealed this judgment, but recorded an accrual for this verdict as an expense in 2009. The Company 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 during the quarter ended September 30, 2012 the Court upheld the original verdict against RHB. The Company recorded an additional expense of \$156,000 during the three months ended September 30, 2012 to cover court costs and attorney's fees. Payment for the total judgment, court costs and attorney's fees was made in October 2012. This matter is now resolved in its entirety.

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 January 2012, RHB, a wholly owned subsidiary, assumed six construction contracts with \$25.0 million of unearned revenues from Aggregate Industries—SWR, Inc. ("AI"), an unrelated third party. In addition, Aggregate South West Holdings, LLC ("ASWH") and RHB Properties, LLC ("RHBP"), newly formed entities owned by Richard Buenting, the President and Chief Executive Officer of RHB, acquired construction related machinery and equipment and land with quarries from AI. In addition, AI entered into a two-year non-compete agreement with respect to Utah, Idaho and Montana as well as certain areas of Nevada. On April 27, 2012, RHB merged with ASWH and acquired RHBP. In exchange, RHB granted Mr. Buenting a 50% member interest in RHB. These transactions allowed RHB to expand its operations in Nevada.

The Company also agreed with Mr. Buenting to amend and restate the operating agreement for RHB. The amended agreement provides that the Company is the Manager of RHB and retains full, exclusive and complete power, authority and discretion to manage, supervise, operate and control RHB; therefore, the Company consolidates RHB with its other subsidiaries. The Company also entered into a buy/sell and management agreement with Mr. Buenting. Under this agreement, the Company or Mr. Buenting may annually elect to make an offer to buy the other owner's 50% interest in RHB or sell their 50% interest in RHB at a price which they specify. Upon receipt of an offer to buy their interest, the other owner may either accept the offer or elect to buy the other owner's 50% interest. Similarly in the instance of an offer to sell, the other owner may either agree to buy the other owner's 50% interest or require the other owner to buy their 50% interest. The agreement also provides that the Company will provide RHB with a \$5 million line of credit.

The Company has not yet finalized its valuation of the assets acquired, the membership interest granted and the tax related impact of the transaction. Therefore the purchase price for the transaction is preliminary. The transaction has been recorded based on a preliminary valuation of the assets acquired of \$15.2 million, including \$1.2 million associated with machinery and equipment that is held for sale.

Revenues and earnings related to the contracts assumed and the acquired companies from January through September 30, 2012 were \$23.3 million and \$0.5 million, respectively. In connection with this transaction, AI did not agree to provide us with historical information related to the earnings from the acquired operations except for information related to the specific contracts being assumed. Furthermore, we determined that such information was not needed in order to evaluate the transaction based on our knowledge of the assets acquired and the Nevada road and highway construction market. Therefore, we are not able to present pro forma financial information as if the transactions had occurred on January 1, 2011.

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 classified as a Level 3 fair value measurement. In making this valuation, the unobservable input consisted of forecasted earnings before interest, taxes and depreciation and amortization ("EBITDA") for the periods after the period being reported on through July 31, 2016. The additional purchase price 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 yearly excess forecasted EBITDA in our calculation ranged from 0% to 157% of the minimum EBITDA threshold for the years 2012 through 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 and \$2.3 million as of September 30, 2012. The undiscounted earn-out liability as of September 30, 2012 is estimated at \$2.4 million and could increase by \$2.6 if EBITDA during the earn-out period increases \$5.2 million or more and could decrease by the full amount of the liability if EBITDA does not exceed the minimum threshold in any of the periods during the earn-out period. Any significant increase or decrease in actual EBITDA compared to the forecasted amounts would result in a significantly higher or lower fair value measurement of the additional purchase price. This liability is included in other long-term liabilities in the accompanying condensed consolidated balance sheets.

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 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 nine months ended September 30, 2012, as well as the revenue and earnings of the combined entity for the nine months ended September 30, 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 September 30, 2012	\$ 31,621	\$ 1,542
Myers actual from January 1, 2012 to September 30, 2012	63,542	813
Supplemental pro forma results of the Company, JBC, and Myers on a combined basis for 1/1/2011 – 9/30/2011 (unaudited)	401,187	7,411

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 valuation of this purchase price is classified as a Level 3 fair value measurement. In making this valuation, the observable input is RLW’s EBITDA for the period from January 1, 2010 through September 30, 2012 while the unobservable input is the forecasted EBITDA for the period from October 1, 2012 through December 31, 2012. 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 consolidated balance sheet. Any significant increase or decrease in actual EBITDA compared to the forecasted amount would result in a significantly higher or lower fair value measurement of the purchase price. A \$1 million increase (decrease) in RLW’s EBITDA for the three months ended December 31, 2012 from that used in the forecast would result in a \$0.3 million increase (decrease) in the RLW Put/Call liability.

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 \$745,000 and \$636,000 for the nine months ended September 30, 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 increased by \$1.2 million and \$1.9 million during the three months and nine months ended September 30, 2012, respectively, and this change, net of tax of \$411,000 and \$667,000, respectively, has been reported as a charge to retained earnings.

Since the Company may be required to settle the obligation associated with the RLW Put/Call as well as any undistributed earnings to the noncontrolling interest owners within the next year, \$23.3 million is included in current liabilities under “Current 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.

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):

	Nine Months Ended September 30,	
	2012	2011
Balance, beginning of period	\$ 16,848	\$ 28,724
Net income attributable to noncontrolling interest included in liabilities	13,903	5,919
Accretion of interest on RLW Put/Call	745	636
Change in fair value of RLW Put/Call	1,906	--
Change in fair value of RHB put/call	--	1,054
Issuance of noncontrolling interest in RHB in exchange for net assets of acquired companies	15,196	--
Distributions to noncontrolling interest owners	(6,589)	(6,185)
Balance, end of period	<u>\$ 42,009</u>	<u>\$ 30,148</u>

“Noncontrolling owners’ interest in earnings of subsidiaries and joint ventures” for the nine months ended September 30, 2012 shown in the accompanying condensed consolidated statement of operations of \$15.2 million includes \$12.7 million attributable to the RLW noncontrolling interest owners which is reflected in “Current obligation for noncontrolling owners’ interests in subsidiaries and joint ventures,” \$1.2 million is attributable to RHB noncontrolling interest owners which is reflected in “Obligation for noncontrolling owners’ interest in subsidiaries and joint ventures” and income of \$1.3 million attributable to other noncontrolling interest owners which is reflected in equity in “Noncontrolling interests” in the accompanying condensed consolidated balance sheet.

Subsequent to the issuance of the financial statements for December 31, 2011, the members of RLW, including the Company, agreed to amend RLW’s operating agreement effective January 1, 2012 to provide that any goodwill impairment, including the 2011 fourth quarter goodwill impairment of the Company described in Note 8 of the Notes to Consolidated Financial Statements included in the 2011 Form 10-K, is not to be allocated to RLW for the purpose of calculating the distributions to be made to the RLW noncontrolling interest holders. This amendment resulted in an increase in the net income attributable to RLW’s noncontrolling interests of \$6.7 million during the nine months ended September 30, 2012. This increase is included in “Noncontrolling owners’ interests in earnings of subsidiaries and joint ventures” in the accompanying condensed consolidated statement of operations with an increase in the “Current obligation for noncontrolling owners’ interests in subsidiaries and joint ventures” in the condensed consolidated balance sheet. This increase has a related tax impact of \$2.4 million which increased the tax benefit for the period.

9. Stockholders’ Equity

Stock-Based Compensation Plan and Warrants

The Company has a stock-based incentive plan which is administered by the Compensation Committee of the Board of Directors. See Note 14 of the Notes to Consolidated Financial Statements included in the 2011 Form 10-K for further information. We recorded stock-based compensation expense of \$166,000 and \$429,000 for the three months and nine months ended September 30, 2012, respectively, and \$125,000 and \$382,000 for the three months and nine months ended September, 30, 2011, respectively.

At September 30, 2012, total unrecognized compensation expense related to restricted stock awards was \$1.6 million. This cost is expected to be recognized over a weighted average period of 2.2 years. During the three and nine months ended September 30, 2012, 100,000 and 150,000 shares of restricted stock awards were granted, respectively, which have various vesting periods. There was no unrecognized compensation expense related to stock options at September 30, 2012. Proceeds received by the Company from the exercise of options and warrants for the nine months ended September 30, 2012 and 2011 were approximately \$66,000 and \$156,000, respectively. No options were granted in the nine months ended September 30, 2012 or 2011.

At September 30, 2012, there were 199,876 and 22,200 shares of common stock covered by outstanding restricted stock and stock options, respectively. All of the stock options were vested while the restricted stock has not vested.

10. Variable Interest Entities

We own a 50% interest in Myers of which we are the primary beneficiary and have consolidated Myers into our 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 from August 1, 2011, the date of acquisition. See Note 2 of the Notes to Consolidated Financial Statements included in the 2011 Form 10-K for additional information on the acquisition of this limited partnership.

The condensed financial information of Myers which is reflected in our condensed consolidated balance sheets and statements of operations is as follows (in thousands):

	September 30, 2012	December 31, 2011
Assets:		
Current assets:		
Cash and cash equivalents	\$ 4,097	\$ 1,365
Contracts receivable, including retainage	17,222	2,244
Other current assets	1,250	419
Total current assets	22,569	4,028
Property and equipment, net	3,179	926
Goodwill	1,501	1,541
Total assets	<u>\$ 27,249</u>	<u>\$ 6,495</u>
Liabilities:		
Current liabilities:		
Accounts payable	\$ 16,883	\$ 1,134
Other current liabilities	4,890	2,323
Total current liabilities	21,773	3,457
Long-term liabilities:		
Other long-term liabilities	--	--
Total long-term liabilities	--	--
Total liabilities	<u>\$ 21,773</u>	<u>\$ 3,457</u>

	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2012	Three and Nine Months Ended September 30, 2011
Revenues	\$ 39,972	\$ 63,542	\$ 3,515
Operating income	1,917	2,519	162
Net income attributable to Sterling common stockholders	621	813	52

11. Net Income (Loss) per Share Attributable to Sterling Common Stockholders

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Numerator:				
Net income (loss) attributable to Sterling common stockholders	\$ 990	\$ 3,461	\$ (3,223)	\$ 7,716
Revaluation of the RLW noncontrolling interest put/call liability reflected in retained earnings, net of tax	(762)	--	(1,239)	--
	<u>\$ 228</u>	<u>\$ 3,461</u>	<u>\$ (4,462)</u>	<u>\$ 7,716</u>
Denominator:				
Weighted average common shares outstanding — basic	16,405	16,386	16,362	16,444
Shares for dilutive stock options and warrants	99	55	--	114
Weighted average common shares outstanding and assumed conversions— diluted	<u>16,504</u>	<u>16,441</u>	<u>16,362</u>	<u>16,558</u>
Basic net income (loss) per share attributable to Sterling common stockholders	<u>\$ 0.01</u>	<u>\$ 0.21</u>	<u>\$ (0.27)</u>	<u>\$ 0.47</u>
Diluted net income (loss) per share attributable to Sterling common stockholders	<u>\$ 0.01</u>	<u>\$ 0.21</u>	<u>\$ (0.27)</u>	<u>\$ 0.47</u>

There were 2,070 and 695 weighted average options outstanding during the three and nine months ended September 30, 2012, and 119,407 outstanding for both the three and nine months ended September 30, 2011, which were considered antidilutive as the option exercise price exceeded the average share market price and were, therefore, excluded from the denominator used for computing diluted net income (loss) per share attributable to Sterling common stockholders. In addition, and in accordance with the treasury stock method, 119,673 shares of underlying stock options and restricted stock were excluded from the diluted weighted average common shares outstanding for the nine months ended September 30, 2012 as the Company incurred a loss during this period and the impact of such shares would have been antidilutive.

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 similar terms 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;
- the effects of estimates inherent in our 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;
- the instability of certain financial institutions, which could cause losses on our cash and cash equivalents and short-term investments;
- 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, 2011 ("2011 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 is a leading heavy civil construction company that specializes in the building, reconstruction and repair of transportation and water infrastructure. Transportation infrastructure projects include highways, roads, bridges, light rail and commuter rail, foundations and structures. 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, concrete crushing and aggregates operations. Sterling performs the majority of the work required by its contracts with its own crews and equipment.

Sterling has grown its operations by expanding both its service profile and market areas. This involved adding services, such as concrete operations, in order to capture a greater percentage of available work in current and potential markets. It also involved strategically expanding operations, either by establishing a branch office in a new market, often after having successfully bid on and completed a project in that market, or by acquiring a company that gives us an immediate entry into a market. Sterling extended both its service profile and its geographic market reach with the 2009 acquisition of Ralph L. Wadsworth Construction Company, LLC (“RLW”), which has operations primarily in Utah, and the 2011 acquisitions of J. Banicki Construction, Inc. (“JBC”) and Myers & Sons Construction, L.P. (“Myers”) with operations in Arizona and California, respectively.

Sterling operates primarily in Texas, Utah, Nevada, Arizona and California, states that management believes benefit from both positive long-term demographic trends as well as a historical commitment to funding transportation and water infrastructure projects. Currently, the Company also has highway construction contracts in Hawaii, Montana and Louisiana. From 2005 to 2010, the populations of Texas, Utah, Nevada, Arizona and California grew 10.2%, 15.8%, 14.8%, 9.1% and 3.5%, respectively, compared to approximately 4.5% for the national average. While the near-term funding available for infrastructure spending in these markets is currently limited, management anticipates that long-term population growth and increases in required spending for infrastructure in these markets will positively affect business opportunities over the coming years.

For a more detailed discussion of the Company’s business, readers of this report are advised to review “Item 1, Business,” of the 2011 Form 10-K.

For purposes of the discussions which follow, “Current Quarter” refers to the three month period ended September 30, 2012, “Prior Quarter” refers to the three month period ended September 30, 2011, “Current Period” refers to the nine month period ended September 30, 2012 and “Prior Period” refers to the nine month period ended September 30, 2011.

Financial Results for the Current Period, Operational Issues and Outlook for 2012 Financial Results

As discussed further in the 2011 Form 10-K, the Company’s 2011 results were well below those of 2010 as a result of a pre-tax charge of \$67.0 million related to the impairment of goodwill and a decline in our overall margins which were adversely affected by production issues on a number of construction projects, primarily in the fourth quarter of 2011. These declines were in part a result of revisions to estimated profitability on construction projects, both favorable and unfavorable, which resulted in a net pre-tax charge of \$11.8 million in 2011.

In the Current Quarter and Current Period, the Company had operating income of \$4.2 million and \$7.9 million, respectively, and net income (loss) attributable to Sterling common stockholders of \$1.0 million and \$(3.2) million, respectively. Included in the net loss attributable to Sterling common stockholders for the Current Period is additional earnings allocated to noncontrolling interest owners of \$6.7 million, or \$4.4 million net of tax, resulting from an amendment to the RLW member agreement to change the treatment of goodwill impairments for purposes of determining net income distributable to RLW’s members. This is discussed further in Note 8.

Our gross margins have decreased to 6.9% in the Current Quarter from 9.3% in the Prior Quarter and from 9.0% for the three months ended June 30, 2012. Gross margins decreased to 6.6% in the Current Period from 9.3% in the Prior Period. Our gross margins continue to be adversely impacted by downward revisions to estimated profitability on certain projects.

The majority of our revenues and backlog is derived from fixed unit price contracts. Some of our revenues are derived from lump sum contracts. Fixed unit price contracts require us to provide materials and services at a fixed unit price based on approved quantities irrespective of our actual per unit costs. Lump sum contracts require that the total amount of work be performed for a single price irrespective of our actual costs. As discussed in “Item 1A. Risk Factors” in the 2011 Form 10-K, we realize a profit on our contracts only if we accurately estimate our costs and then successfully control actual costs and avoid cost overruns, and our revenues exceed actual costs. If our cost estimates for a contract are inaccurate, or if we do not execute the contract within our cost estimates, then cost overruns may cause the contract not to be as profitable as we expected or result in a loss, negatively affecting our cash flow, earnings and financial position.

In view of the significant revisions to estimated gross profits on contracts identified in the fourth quarter of 2011, management undertook a thorough review and determined that some of these revisions related to prior periods, but the impact of revising these estimates would not have had a material impact on revenues or gross profit reported in those prior periods had the changes been made in the appropriate period. Management also determined that the procedures performed by operating personnel to make periodic revisions in estimates, and the reviews of those estimates by operations management, were not adequate or timely enough in some instances to ensure that a material impact on the financial statements resulting from such revisions in estimates would be recognized in the proper period. Management determined that this deficiency in our internal controls was such that a material misstatement of our annual or interim financial statements would not have been prevented or detected on a timely basis and, therefore, this deficiency constituted a material weakness as of December 31, 2011. Based on certain of the revisions in estimates which were made in the Current Period and Quarter, management has determined that this material weakness continued to exist as of September 30, 2012.

While the risks of cost overruns and changes in estimated contract revenues are an inherent part of the construction business, management believes that there are internal changes that we can make in order to improve the profitability of our projects, reduce the variability in profitability of our projects in the future and strengthen the internal control environment. We are undertaking changes in the following areas:

- changing roles and responsibilities to improve functional support and controls;
- developing management tools designed to improve the estimating process and increase the oversight of that process;
- implementing processes designed to better identify, evaluate and quantify risks for individual projects;
- improving the methodologies for allocating overhead, indirect costs and equipment costs to individual projects; and
- improving the timeliness and content of reporting available to operations management.

Although improvements have been made to the estimation process, there has not yet been an adequate period of time since the changes have been implemented to evaluate the effectiveness of these changes, and based on certain of the revisions in estimates which were made in the Current Period and Quarter, we have determined that the material weakness continues to exist as of September 30, 2012.

In addition to the factors discussed above which impact the profitability on individual projects, there are other factors which have adversely affected our ability to secure construction projects at favorable margins. Contracts for our highway and related bridge work are generally funded through federal and state authorizations. The federal government enacted the SAFETEA-LU bill in 2005, which authorized \$244 billion for transportation spending through 2009. The SAFETEA-LU bill expired on September 30, 2009, and the federal government enacted a number of extensions on an interim basis, most recently through June 30, 2012. In July 2012, the federal government enacted the Moving Ahead for Progress in the 21st Century (“MAP-21”) legislation, a two-year, \$105 billion reauthorization of the federal surface transportation program. This legislation maintains annual federal highway funding close to the previous level of \$41 billion under the SAFETEA-LU bill. While we believe that a longer term bill is needed, the new bill does alleviate some of the uncertainty which has adversely affected the levels of transportation and water infrastructure capital expenditures in our markets, reduced opportunities to replace backlog at reasonable margins and increased competition for new projects.

While we expect that implementation of the internal changes discussed above will improve profitability in the future, we do not expect to see a substantial impact on our 2012 results. In addition, we expect continued pressure on our gross margins on new contract awards. Projects in our backlog generally take 12 to 36 months to complete. Based on our current estimates, the gross margin in our backlog for 2012 is lower than the gross margin of 8.0% realized in 2011, partly as a result of the operational issues discussed above which resulted in the downward revisions of estimated gross profits on a number of construction projects and partly as a result of competitive bidding pressures when the contracts were added to backlog.

Revenues for the Current Period are 22% above the Prior Period as a result of the higher backlog at the end of 2011 as compared to 2010, the impact of a full period of operations for JBC and Myers, both of which were acquired in August 2011, and contract awards of \$512 million from January 1, 2012 through September 30, 2012. However, as discussed above, based on estimated gross margins in our current backlog, we expect our overall gross margins for 2012 to be lower than the 8.0% reported for 2011. As discussed under "Results of Operations - Backlog at September 30, 2012" below, we have revised the definition of backlog to exclude low bids not officially awarded. Contract awards of \$512 million include \$125 million in awards previously reported in 2011 which we were the apparent low bidder on in 2011 but which were officially awarded in 2012 and excludes \$79 million of contracts not officially awarded at September 30, 2012.

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. Each of these factors is discussed more fully in "Item 1. Business—Our Markets" in the 2011 Form 10-K.

According to 2010 U.S. Census Bureau information, Texas, Utah, Nevada, Arizona and California each experienced significant population growth from 2005 to 2010 and over the long-term these states are expected to continue to experience population increases from 25.1 million, 2.8 million, 2.7 million, 6.4 million and 37 million people in 2010, respectively, to populations of over 33 million, 3 million, 4 million, 10 million and 46 million, respectively, by 2030.

The U.S. Department of Transportation ("U.S.DOT") had actual appropriations of \$41.8 billion for federal highway financial assistance to the states for 2011, has authority to spend \$41.5 billion in the fiscal year ending September 30, 2012, \$39.7 billion in fiscal 2013 and \$40.3 billion in fiscal 2014 for highways and bridges.

In January 2009, the 2030 Committee, appointed by the Texas Department of Transportation ("TxDOT") at the request of the Governor of the State of Texas, submitted its draft report of the transportation needs of Texas, which at that time had over 193,000 lane-miles and 50,000 bridges in its state highway system. The report stated that "With [the] population increase expected by 2030, transportation modes, costs and congestion are considered a possible roadblock to Texas's projected growth and prosperity." The report further indicated that Texas needs to spend approximately \$315.0 billion (in 2008 dollars) for the period 2009 through 2030 to prevent worsening congestion and maintain economic competitiveness on its urban highways and roads, improve congestion/safety and partial connectivity on its rural highways, and to replace bridges.

In 2007, the voters of the State of Texas approved \$5.0 billion of bonds for highway construction ("Prop 12 Bonds") to be repaid out of the State's general funds. The transportation construction expenditures for 2010 and 2011 were partially funded by \$2.0 billion of proceeds from the Prop 12 Bonds, and the budget for the biennium 2012-2013 includes the remaining \$3.0 billion of proceeds from the Prop 12 Bonds.

TxDOT contract awards ("lettings") for transportation construction projects are estimated to be \$4.2 billion in 2012 and \$4.1 billion in 2013, including a statewide and local portion of the Prop 12 Bonds discussed above.

In Texas, substantial funds for transportation infrastructure spending are also being provided by toll road and regional mobility authorities for construction of toll roads, which provides Sterling with additional construction contracting opportunities; however, such spending could be limited by federal, state and local funding limitations.

Spending for highway and bridge construction in Utah was \$1.3 billion in 2011, and \$700.9 million has been authorized for 2012. The details of the capital spending for 2013 have not been released; however the Utah Governor's recommendation for total capital spending in 2013 is approximately \$911 million compared with \$1.4 billion recommended for 2012.

Nevada's budget for construction of roadways and facilities is \$377 million in 2012 and \$369 million in 2013 compared with expenditures of between \$300 million and \$400 million in each of the 2010 and 2011 fiscal years.

Arizona's expenditures for transportation construction were \$326 million in 2011, appropriations are \$326 million in 2012 and a budget of \$332 million has been requested for 2013.

California's transportation capital outlays and local assistance were \$5.0 billion in 2011, while such expenditures are estimated to be \$10.2 billion in 2012 and \$6.2 billion in 2013. A substantial portion of the decrease between 2012 and 2013 is due to a reduction in expected Federal Trust highway funds.

Since 2008, 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 many new projects where we submitted successful bids. While we have been more aggressive in bidding for some projects, we have not bid at prices where we anticipated we would incur loss margins in order to obtain new backlog. Nevertheless, in some instances we determined subsequent to the award that a job would most likely have a loss margin. Consistent with our policy, these losses are recorded when they become known.

Recent reductions in miles driven in the U.S. and more fuel efficient vehicles have reduced federal and state gasoline taxes and tolls collected. In addition, until the MAP-21 legislation enacted in July 2012, the federal government had been extending financial assistance to the states on an interim basis which negatively impacted the states' highway and bridge construction contracts awarded through the fiscal year 2012.

Further, the nationwide decline in home sales, the increase in foreclosures and the prolonged recession have resulted in decreases in property taxes and some other local taxes, which are among the sources of funding for municipal road, bridge and water infrastructure construction. Expenditures by municipalities may also be limited due to federal, state and local funding limitations in the current economic environment.

These and other factors have adversely affected the levels of transportation and water infrastructure capital awards and expenditures in our markets, reducing opportunities to replace backlog at reasonable margins and increasing competition for new projects. See "Recent Developments — Financial Results for 2011, Operational Issues and Outlook for 2012 Financial Results" in the 2011 Form 10-K for further discussion of the impact on our financial results.

While we do expect that our markets will ultimately recover from the conditions described above and that our backlog and revenues will grow and gross margins, net income and earnings per share will return to levels more consistent with historical rates of return, we cannot predict the timing of such a return to historical normalcy in our markets. We believe that the Company is in sound financial condition and has the resources and management experience to weather current market conditions and to continue to compete successfully for projects as they become available at acceptable profit margin levels. See "Business—Markets," "Business—Our Customers" and "Business—Competition" in the 2011 Form 10-K for a more detailed discussion of our markets and their funding sources.

Results of Operations

Backlog at September 30, 2012

Backlog is our estimate of the revenues that we expect to earn in future periods on our construction projects. In prior periods we generally added the anticipated revenue value of each new project to our backlog when management reasonably determined that we would be awarded the contract and there were no known impediments to being awarded the contract. However, due to the operating environment of our California subsidiaries in which low bid awards are, at times, contested, management has revised the definition of backlog to exclude low bid awards not officially awarded. The new definition of backlog should be applied whenever backlog is mentioned throughout this document, and we have updated prior period backlog information to conform to our current definition. As the construction on our projects progresses, we also increase or decrease backlog to take into account our estimates of the effects of changes in estimated quantities, changed conditions, change orders and other variations from initially anticipated contract revenues, including completion penalties and incentives. During the Current Quarter, we were awarded \$158 million in contracts, and at September 30, 2012, our backlog of \$704 million excluded approximately \$79 million of expected revenues for which the contracts had not yet been officially awarded.

Substantially all of the contracts in our contract backlog may be canceled at the election of the customer; however, we have not been materially adversely affected by contract cancellations or modifications in the past.

Results of Operations for the Current Quarter as Compared to the Prior Quarter and for the Current Period as compared to the Prior Period

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012	2011	% Change	2012	2011	% Change
Revenues	\$ 205,283	\$ 159,427	28.8%	\$ 472,418	\$ 387,167	22.0%
Gross profit	\$ 14,169	\$ 14,756	(4.0)	\$ 31,202	\$ 35,937	(13.2)
General and administrative expenses, net	(10,259)	(7,071)	45.1	(26,369)	(19,427)	35.7
Other operating income	261	76	NM	3,017	226	NM
Operating income	4,171	7,761	(46.3)	7,850	16,736	(53.1)
Gains (loss) on the sale of securities and other	617	212	NM	1,700	(33)	NM
Interest income	287	309	(7.1)	1,214	1,252	(3.0)
Interest expense	(159)	(357)	(55.5)	(978)	(945)	3.5
Income before taxes	4,916	7,925	(38.0)	9,786	17,010	(42.5)
Income tax benefit (expense)	(847)	(1,984)	(57.3)	2,146	(3,295)	NM
Net income	4,069	5,941	(31.5)	11,932	13,715	(13.0)
Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	(3,079)	(2,480)	24.2	(15,155)	(5,999)	NM
Net income (loss) attributable to Sterling common stockholders	\$ 990	\$ 3,461	(71.4)	\$ (3,223)	\$ 7,716	NM
Gross margin	6.9%	9.3%	(25.8)	6.6%	9.3%	(29.0)
Operating margin	2.0%	4.9%	(59.2)	1.7%	4.3%	(60.5)

	Amount as of		
	September 30, 2012	June 30, 2012	December 31, 2011
Contract Backlog, end of period	\$ 704,000	\$ 754,000	\$ 616,000

Revenues

Revenues for the Current Quarter increased 28.8% compared with the Prior Quarter and 22.0% for the Current Period compared with the Prior Period. Most of the increase for both the Current Quarter and Current Period is attributable to an increase in revenues in Arizona and California of \$48.8 million in the Current Quarter and \$96.6 million in the Current Period. Prior to the August 1, 2011 acquisitions of JBC and Myers, we did not perform any work in these states. Since our acquisition of these entities they have performed well in their respective markets. We also had higher revenues in Utah reflecting higher activity levels and improvements in estimated profitability in certain projects, and we had higher revenues in Nevada reflecting the impact of the contracts assumed from Aggregate Industries, Inc. in January 2012 discussed in Note 8. Revenues from contracts in Texas decreased for the Current Quarter and Period.

Gross Profit

Gross profit decreased \$0.6 million for the Current Quarter compared with the Prior Quarter, and decreased \$4.7 million for the Current Period compared with the Prior Period. Gross margins decreased to 6.9% in the Current Quarter from 9.3% in the Prior Quarter and to 6.6% in the Current Period from 9.3% in the Prior Period. The Current Quarter and Current Period were impacted by downward revisions of estimated revenues and gross profit on a number of construction projects, primarily in Texas. For the Current Quarter, however, upward revisions on projects in Utah substantially offset the downward revisions for Texas projects. While there are a number of factors which cause the costs incurred and gross profit realized on our contracts to vary, sometimes substantially, from our original projections, the primary factors which resulted in downward revisions in estimates in the Current Quarter were:

- conditions or contract requirements that differed from those assumed in the original bid or contract;

- lower than expected productivity levels; and
- delays in quickly identifying and taking measures to address issues which arose during construction.

At September 30, 2012, we had approximately 111 contracts-in-progress which were less than 90% complete of various sizes, of different expected profitability and in various stages of completion. The nearer a contract progresses toward completion, the more visibility we have in refining our estimate of total revenues (including incentives, delay penalties and change orders), costs and gross profit. Thus gross profit as a percent of revenues can increase or decrease from comparable and sequential quarters due to variations among contracts and depending upon the stage of completion of contracts.

General and administrative expenses, net of other income

General and administrative expenses for the Current Quarter and Current Period included general and administrative expenses for JBC and Myers which we acquired on August 1, 2011 as well as an increase in compensation related expenses and professional fees. As a percent of revenues, general and administrative expenses increased to 5.0% in the Current Quarter from 4.4% in the Prior Quarter. General and administrative expenses for the Current Period as a percent of revenues was higher at 5.6% compared to 5.0% for the Prior Period. Both Current Quarter and Current Period's general and administrative expenses were affected by the change in the Company's CEO, and included a signing bonus of \$250,000 paid to our newly appointed CEO and \$670,000 in compensation for our retiring CEO.

Income taxes

Our effective income tax rates for the Current and Prior Quarters were 17.2% and 25.0%, respectively, and for the Current and Prior Periods were (21.9)% and 19.4%, respectively. The effective income tax rates varied from the statutory rate primarily as a result of net income attributable to noncontrolling interest owners which are taxed to those owners rather than Sterling. Excluding the impact of net income attributable to noncontrolling interest owners, our effective income tax rates for the Current and Prior Quarters were 46.1% and 36.4%, respectively, and for the Current and Prior Periods were 40.0% and 29.9%, respectively. The effective rate for each of these periods reflects the impact of nontaxable interest income. In addition, the Current Period reflects the impact of applying the estimated overall effective rate for 2012 to Current Quarter pre-tax income in order to allocate the tax provision within the current annual period.

Net income attributable to noncontrolling interests

The increase in net income attributable to noncontrolling interest owners in the Current Quarter compared with the Prior Quarter is primarily related to net income attributable to the 20% noncontrolling interest owners in RLW, our 80% owned subsidiary. As discussed further in Note 8 to the condensed consolidated financial statements, the members of RLW, including the Company, agreed to amend RLW's operating agreement effective January 1, 2012 to provide that any goodwill impairment, including the 2011 fourth quarter goodwill impairment, is not to be allocated to RLW for the purpose of calculating the distributions to be made to the RLW noncontrolling interest holders. This amendment resulted in an increase in the net income attributable to RLW's noncontrolling interests of \$6.7 million during the three months ended March 31, 2012. This increase is included in "Noncontrolling owners' interests in earnings of subsidiaries and joint ventures" in the accompanying condensed consolidated statement of operations with an increase in the "Current obligation for noncontrolling owners' interests in subsidiaries and joint ventures" in the condensed consolidated balance sheet. This increase has a related tax impact of \$2.4 million which increased the tax benefit for the period.

Historical Cash Flows

The following table sets forth information about our cash flows and liquidity (in thousands):

	Nine Months Ended September 30,	
	2012	2011
Net cash provided by (used in):		
Operating activities	\$ 5,046	\$ 4,637
Capital expenditures	(27,818)	(19,592)
Proceeds from sale of property and equipment	11,915	930
Net purchases of short-term securities	(7,514)	(13,246)
Distributions to noncontrolling interest owners	(6,589)	(6,185)
Purchases of treasury stock	--	(3,592)
Net drawdowns on the Credit Facility	10,000	--
Other	(377)	4,257
Total	\$ (15,337)	\$ (32,791)

	September 30,	December 31,
	2012	2011
Cash and cash equivalents	\$ 1,034	\$ 16,371
Working capital	\$ 82,624	\$ 94,738

Operating Activities

Significant non-cash items for the Current and Prior Periods included in operating activities are:

- depreciation and amortization, which increased from \$12.8 million in the Prior Period to \$14.6 million in the Current Period as a result of an increase in capital expenditures as well as depreciation associated with JBC and Myers which were acquired August 1, 2011; and
- deferred tax expense (benefit); we had a deferred tax benefit of \$1.6 million in the Current Period which is primarily attributable to the \$2.4 million tax impact of the additional earnings to noncontrolling interest owners of \$6.7 million discussed in Note 8; deferred tax of \$3.8 million in the Prior Period is mainly attributable to amortization for tax return purposes of goodwill and accelerated tax depreciation.

Besides the net income in the Current and Prior Periods and the non-cash items discussed above, other significant components of cash flows from operations (which excludes the impact of changes attributable to the net assets of acquired companies) were:

- net working capital attributable to contracts receivable, costs in excess of billings on uncompleted contracts, billings in excess of costs on uncompleted contracts and accounts payable increased \$12.8 million in the Current Period primarily due to increased contract receivables related to our California, Utah and Nevada operations; net working capital attributable to these items increased \$20.1 million in the Prior Period; and
- accrued compensation and other liabilities increased by \$4.9 million in the Current Period and decreased by \$3.9 million in the Prior Period.

Investing Activities

Capital equipment is acquired as needed to support increased levels of production activities and to replace retiring equipment. Expenditures for the replacement of certain equipment and to expand our construction fleet totaled \$27.8 million for the Current Period. Proceeds from the sale of property and equipment totaled \$11.9 million for the Current Period with an associated net gain of \$3.0 million. For the year ended December 31, 2011, capital expenditures totaled \$24.0 million while proceeds from the sale of property and equipment totaled \$1.3 million. Capital expenditures in the Current Period are higher than 2011 to support our higher level of operations and to replace equipment. In addition, proceeds from sales of property and equipment in the Current Period have been higher than in previous periods as management undertook a program to dispose of underutilized and aging equipment.

During the Current Period, the Company had net purchases of short-term securities of \$7.5 million compared to net purchases of short-term securities of \$13.2 million in the Prior Period. The net purchases in both periods were primarily due to the investment of cash generated by operations, after capital expenditures. In addition, cash and cash equivalents at the beginning of the Prior Period were \$49.4 million, and we invested a substantial portion of this balance during such period.

Financing Activities

Financing activities in the Current Period consisted of drawdowns and repayments with a net drawdown of \$10 million on the Credit Facility and distributions to noncontrolling interest owners of \$6.6 million. Financing Activities in the Prior Period primarily reflect a net drawdown of \$8 million on the Credit Facility, distributions to noncontrolling interest owners of \$6.2 million and purchases of treasury stock of \$3.6 million.

Liquidity and Sources of Capital

The need for working capital for our business varies due to fluctuations in:

- customer receivables and contract retentions;
- costs and estimated earnings in excess of billings;
- billings in excess of costs and estimated earnings;
- the size and status of contract mobilization payments and progress billings; and
- the amounts owed to suppliers and subcontractors.

Some of these fluctuations can be significant. As of September 30, 2012, we had working capital of \$82.6 million, a decrease of \$12.1 million from December 31, 2011. The decrease in working capital in the nine months ended September 30, 2012 was the result of the following (in thousands):

Net income	\$ 11,932
Current portion of obligation to noncontrolling interest owners of RLW	(23,323)
Depreciation and amortization	14,627
Deferred tax benefit	(1,607)
Capital expenditures	(27,818)
Proceeds from sales of property and equipment, net of gain (loss)	8,938
Distributions to noncontrolling interest owners	(6,589)
Net drawdowns on the Credit Facility	10,000
Other	1,726
Total decrease in working capital	<u>\$ (12,114)</u>

As discussed further in Note 8, since the Company may be required to settle the obligation associated with the RLW Put/Call as well as any undistributed earnings to the noncontrolling interest owners within the next year, this amount is included in current liabilities under "Current obligation for noncontrolling owners' interests in subsidiaries and joint ventures" in the accompanying condensed consolidated balance sheets.

In addition to our available cash and cash equivalents, short-term investments and cash provided by operations, from time to time, we use borrowings under our \$50.0 million Credit Facility with Comerica Bank to finance our capital expenditures and working capital needs. The Credit Facility has a maturity date of September 30, 2016. Subject to the conditions under the terms of the Credit Facility, including the financial covenants discussed below, up to \$50 million in borrowings and letters of credit is available under the amended Credit Facility with, under certain circumstances, an optional increase of \$50 million. Borrowings under the Credit Facility are secured by all assets of the Company, other than proceeds and other rights under our construction contracts which are pledged to our bond surety. At September 30, 2012, there were borrowings of \$10.0 million outstanding under the Credit Facility and a letter of credit of \$1.8 million outstanding which reduced availability under the Credit Facility to \$38.2 million.

Average borrowings under the Credit Facility for the Current Quarter were \$511,000 and the largest amount of borrowings under the Credit Facility was \$10.0 million on September 30, 2012. Average borrowings under the Credit Facility for the fiscal year 2011 were \$104,000, and the largest amount of borrowings under the Credit Facility was \$8.0 million on September 30, 2011.

The Credit Facility is subject to our compliance with certain covenants, including financial covenants at quarter-end relating to leverage, tangible net worth, and asset coverage. The Credit Facility contains restrictions on our ability to:

- Make distributions or pay dividends;
- Incur liens and encumbrances;
- Incur further indebtedness;
- Guarantee obligations;
- Dispose of a material portion of assets or merge with a third party; and
- Make investments in securities.

To date the Company has not experienced any difficulty in borrowing under the Credit Facility, and the Company was in compliance with all covenants under the Credit Facility as of September 30, 2012.

Management believes that the Company has sufficient liquid financial resources, including the unused portion of its Credit Facility, to fund its requirements for the next twelve months of operations, including its bonding requirements, and the Company expects no material adverse change in its liquidity. Future developments or events, such as an increase in our level of purchases of equipment to support significantly higher backlog or an acquisition of another company could, however, affect our level of working capital and tangible net worth.

Inflation

Until 2008, inflation had not had a material impact on our financial results; however, that year's increases in oil and fuel prices affected our cost of operations. While the prices we have paid for oil and fuel and, generally, for other materials have decreased since 2008, in 2011 we saw the prices of oil and fuel rise once again, and we have seen increases in steel prices in other years. Anticipated cost increases and reductions are considered in our bids to customers on proposed new construction projects.

In order to mitigate our exposure to increases in fuel prices, we have a program to hedge our exposure to increases in diesel fuel prices by entering into swap contracts for diesel fuel. We believe that the gains and losses on these contracts will tend to offset increases and decreases in the price we pay for diesel fuel and reduce the volatility of such fuel costs in our operations. As of September 30, 2012, we had diesel futures contracts for 980,000 gallons with fixed prices at an average of \$2.94 per gallon. This compares to the September 30, 2012 price for off-road ultra-low sulfur diesel published by Platts of \$3.19. We will continue to evaluate this strategy and may increase or decrease our commitments depending on our forecast of the diesel fuel market and other operational considerations. There can be no assurance that this strategy will be successful.

Where we are the successful bidder on a project, we execute purchase orders with material suppliers and contracts with subcontractors covering the prices of most materials and services, other than oil and fuel products, thereby mitigating future price increases and supply disruptions. These purchase orders and subcontracts do not contain quantity guarantees and we have no obligation to the suppliers or subcontractors for materials and services beyond those required to complete the contracts with our customers. There can be no assurance that increases in prices of oil and fuel used in our business will be adequately covered by the estimated escalation we have included in our bids or derivative contracts entered into to hedge against certain such increases, and there can be no assurance that all of our vendors will fulfill their pricing and supply commitments under their purchase orders and contracts with the Company. We adjust our total estimated costs on our projects when we believe it is probable that we will have cost increases which will not be recovered from customers, vendors or through project re-engineering.

Off-Balance Sheet Arrangements and Joint Ventures

As discussed further in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation—Off-Balance Sheet Arrangements and Joint Ventures" in the 2011 Form 10-K, we participate in various construction joint venture partnerships in order to share expertise, risk and resources for certain highly complex projects. The venture's contract with the project owner typically requires joint and several liability among the joint venture partners. Although our agreements with our joint venture partners provide that each party will assume and fund its share of any losses resulting from a project, if one of our partners was unable to pay its share we would be fully liable for such share under our contract with the project owner. Circumstances that could lead to a loss under these guarantee arrangements include a partner's inability to contribute additional funds to the venture in the event that the project incurred a loss or additional costs that we could incur should the partner fail to provide the services and resources toward project completion that had been committed to in the joint venture agreement.

At September 30, 2012, there was approximately \$315 million of construction work to be completed on unconsolidated construction joint venture contracts, of which \$101 million represented our proportionate share. Due to the joint and several liability under our joint venture arrangements, if one of our joint venture partners fails to perform, we and the remaining joint venture partners would be responsible for completion of the outstanding work. As of September 30, 2012, we are not aware of any situation that would require us to fulfill responsibilities of our joint venture partners pursuant to the joint and several liability under our contracts.

Off-balance sheet arrangements related to operating leases are discussed in “Contractual Obligations” in the 2011 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Changes in interest rates are one of our sources of market risks. Outstanding indebtedness under our Credit Facility bears interest at floating rates. The average borrowings under this facility during 2011 were \$104,000. Based on our expected levels of borrowings for 2012, we do not expect that a change in our interest rate would have a material impact on our results from operations.

We are exposed to market risk from changes in commodity prices. In the normal course of business, we enter into derivative transactions, specifically cash flow hedges, to mitigate our exposure to diesel fuel commodity price movements. We do not participate in these transactions for trading or speculative purposes. While the use of these arrangements may limit the benefit to us of decreases in the prices of diesel fuel, it also limits the risk of adverse price movements. The following represents the outstanding contracts at September 30, 2012:

Beginning	Ending	Price Per Gallon			Fair Value of Derivatives at September 30, 2012 (in thousands)
		Range	Weighted Average	Remaining Volume (gallons)	
October 1, 2012	December 31, 2012	\$ 3.03–\$3.31	\$ 3.12	90,000	\$ 2
January 1, 2013	December 31, 2013	\$ 2.80–\$3.29	\$ 2.95	650,000	33
January 1, 2014	December 31, 2014	\$ 2.79–\$2.86	\$ 2.82	240,000	14
					\$ 49

See “Inflation” above regarding risks associated with materials and fuel purchases required to complete our construction contracts.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company’s principal executive officer and principal financial officer reviewed and evaluated the Company’s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of December 31, 2011. Based on the identification of a material weakness in our internal control over financial reporting described in “Management’s Report on Internal Control over Financial Reporting” in the 2011 Form 10-K, the Company’s principal executive officer and principal financial officer concluded that the Company’s disclosure controls and procedures were not effective at December 31, 2011 due to this material weakness. While some improvements have been made to the estimating process, there has not been an adequate period of time to evaluate the effectiveness of these changes, and the Company’s principal executive officer and principal financial officer are continuing to evaluate what, if any, additional changes should be made to the internal controls in order to address the material weakness. Furthermore, the Company’s principal executive officer and principal financial officer have determined that the previously reported material weakness continues to exist as of September 30, 2012 and that no other material weaknesses existed as of September 30, 2012.

Changes in Internal Control over Financial Reporting

We maintain a system of internal control over financial reporting that is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. Based on the most recent evaluation, except for certain changes made related to the estimation of revenues and gross profits on construction projects, we have concluded that no significant changes in our internal control over financial reporting occurred during the three months ended September 30, 2012 that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Internal control over financial reporting may not prevent or detect all errors and all fraud. Also, projections of any evaluation of effectiveness of internal control to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We are and may in the future be involved as a party to various legal proceedings that are incidental to the ordinary course of business. We regularly analyze current information about these proceedings and, as necessary, provide accruals for probable liabilities on the eventual disposition of these matters.

In the opinion of management, after consultation with legal counsel, there are currently no threatened or pending legal matters that would reasonably be expected to have a material adverse impact on our consolidated results of operations, financial position or cash flows.

Item 1A. Risk Factors

There have not been any material changes from the risk factors previously disclosed in Item 1A of the 2011 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

None

Item 5. Other Information

None

Item 6. Exhibits

Exhibit No.	Description
31.1*	Certification of Peter E. MacKenna, Chief Executive Officer of Sterling Construction Company, Inc.
31.2*	Certification of Elizabeth D. Brumley, Chief Financial Officer of Sterling Construction Company, Inc.
32*	Certification pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350) of Peter E. MacKenna, Chief Executive Officer, and Elizabeth D. Brumley, Chief Financial Officer
10.1*#	Employment Agreement dated as of September 1, 2012 between Sterling Construction Company, Inc. and Peter E. MacKenna
10.2*#	Amendment No. 1 to Employment Agreement dated as of August 6, 2012 between Sterling Construction Company, Inc. and Patrick T. Manning
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

** Submitted electronically herewith.

Management contract or compensatory plan or arrangement.

In accordance with Rule 402 of Regulation S-T, the XBRL information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for the purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

STERLING CONSTRUCTION COMPANY, INC.

Date: November 8, 2012

By: /s/ Peter E. MacKenna
Peter E. MacKenna
Chief Executive Officer

Date: November 8, 2012

By: /s/ Elizabeth D. Brumley
Elizabeth D. Brumley
Chief Financial Officer

STERLING CONSTRUCTION COMPANY, INC.
Quarterly Report on Form 10-Q for Period Ended September 30, 2012
Exhibit Index

Exhibit No.	Description
31.1*	Certification of Peter E. MacKenna, Chief Executive Officer of Sterling Construction Company, Inc.
31.2*	Certification of Elizabeth D. Brumley, Chief Financial Officer of Sterling Construction Company, Inc.
32*	Certification pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350) of Peter E. MacKenna, Chief Executive Officer, and Elizabeth D. Brumley, Chief Financial Officer.
10.1*#	Employment Agreement dated as of September 1, 2012 between Sterling Construction Company, Inc. and Peter E. MacKenna
10.2*#	Amendment No. 1 to Employment Agreement dated as of August 6, 2012 between Sterling Construction Company, Inc. and Patrick T. Manning
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

** Submitted electronically herewith.

Management contract or compensatory plan or arrangement.

In accordance with Rule 402 of Regulation S-T, the XBRL information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for the purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such filing.

STERLING CONSTRUCTION COMPANY, INC.
Peter E. MacKenna Employment Agreement

THIS EMPLOYMENT AGREEMENT (this "*Agreement*") is entered into effective as of September 1, 2012, (the "*Effective Date*") by and between you, Peter E. MacKenna, and Sterling Construction Company, Inc. (hereinafter referred to as the "*Company*").

Background

On August 23, 2012 you were elected by the Board of Directors as the Chief Executive Officer of the Company as of the Effective Date. This Agreement is designed to set forth the terms and conditions on which you will serve in that capacity.

THEREFORE, for and in consideration of the foregoing recitals, the mutual covenants contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, it is hereby agreed as follows:

1. **Term.** Your employment under this Agreement shall commence on the Effective Date and will continue until terminated by you or by the Company as provided below.
2. **Title, Reporting Relationship, Responsibilities & Place of Employment.** Your title, position, reporting relationship, duties and responsibilities, and place of employment so long as you are an employee of the Company under this Agreement are all set forth on Exhibit A. You shall devote your full working time to diligently carrying out those duties and responsibilities to the best of your abilities. During your employment, you may participate in charitable activities and personal investment activities so long as such activities and any related directorships do not interfere with the performance of your duties and responsibilities hereunder.
3. **Compensation & Benefits.** So long as you are an employee of the Company under this Agreement —
 - (a) *Salary.* You shall be paid the salary set forth in Exhibit A.
 - (b) *Incentive Compensation.* You shall be eligible to earn the annual incentive compensation in the amounts and pursuant to the terms and conditions set forth in Exhibit B.
 - (c) *Benefits.* You shall be entitled to the same health, life insurance, disability and other like benefits as are made available to the Company's senior managers generally, and on the same terms and conditions, and you shall be entitled to the paid vacation time set forth on Exhibit A. Notwithstanding the foregoing, instead of coverage under the Company's health plan, you may elect to have the Company reimburse to you the cost of maintaining your health coverage of your former employer pursuant to the applicable provisions of the Consolidated Omnibus Budget Reconciliation Act of 1985 ("*COBRA*") as in effect from time to time. At such time as your COBRA rights end or you elect to do so, you may be covered under the Company's health plan.
 - (d) *Business Expense Reimbursement.* You shall be reimbursed in accordance with the Company's business expense reimbursement policy from time to time in effect for all reasonable business expenses incurred by you in the performance of your duties and responsibilities.
 - (e) *Signing Bonus.* Within thirty days of the Effective Date, the Company will pay you in cash \$250,000 to reflect the loss of your 2012 incentive compensation at your prior employer.
 - (f) *Special Restricted Stock Grant.* Within thirty days of the Effective Date, the Company will award you shares of the Company's common stock pursuant to the terms and conditions set forth in Exhibit C. It shall be a condition of such award that you execute a copy of the agreement set forth in Exhibit C and the form of stock assignment attached to it.
 - (g) *Relocation.* In connection with your move from New York to the Houston, Texas area, the Company will —
 - (i) Pay directly (where practical) or reimburse you for the reasonable relocation costs incurred by you upon presentation of appropriate receipts (including but not limited to your travel, shipping, and other costs related to your family's relocation to the Houston, Texas area).
 - (ii) Pay rent for you and your family's temporary housing in Houston, Texas for up to twelve months from the Effective Date. In the event that you obtain permanent housing prior to the expiration of the twelve-month period, the Company will then commence to make the mortgage payments on your New York residence until it is sold or until the expiration of the twelve-month period, whichever occurs first.

- (iii) Guarantee the sale price of your New York residence in an amount equal to the average appraised value thereof. The average appraised value of your New York residence for purposes of this Agreement is the average of the appraised value thereof as determined by a qualified appraiser retained by you, and the appraised value thereof as determined by a qualified appraiser retained by the Company. Both appraisals will be made as of a date not more than thirty days after the Effective Date. If your residence is not sold within twelve months following the Effective Date, the Company will arrange for its sale through a relocation company. The Company shall also pay directly (where practical) or reimburse you for all costs and expenses incurred in connection with the sale of your New York residence and the purchase of a residence in the Houston, Texas area, including but not limited to closing costs, realtor fees, broker fees, mortgage taxes and other costs.
- (iv) Reimburse to you the amount of the income taxes payable by you on any of your relocation payments made by the Company and any reimbursements therefor made to you by the Company that constitute W-2 income to you. For the avoidance of doubt, the Company will not reimburse to you any income taxes payable by you on the foregoing reimbursement of income taxes.

(h) *Legal Fees.* The Company shall pay to your counsel the reasonable legal fees incurred by you in connection with reviewing, drafting and negotiating this Agreement.

4. Indemnification.

- (a) You shall be indemnified by the Company with respect to claims made against you as a director, officer and/or employee of the Company and of any affiliate of the Company (as defined in Section 15(c)(iii), below) to the fullest extent permitted by the Company's charter and by-laws, and by the laws of the State of Delaware.
- (b) So long as the directors of the Company are themselves covered by a directors and officers liability insurance policy, the Company will ensure that in your capacity as an officer of the Company you are similarly covered at no cost to you.

5. Confidential Information.

- (a) During your employment by the Company and thereafter, you shall not disclose to any person or entity Confidential Information (as defined below) except in the proper performance of your duties and responsibilities under this Agreement, or except as may be expressly authorized by the Board of Directors of the Company.
- (b) For purposes of this Agreement, "Confidential Information" is defined as any information of the Company or its affiliates that derives independent economic value from not being generally known or readily ascertainable by proper means, and includes, but is not limited to trade secrets, customer names and lists, vendor names and lists, employee names, titles and lists, business plans, marketing plans, non-public financial data, product specifications, as well as designs, inventions, discoveries, processes, drawings, documents, records, software, and includes, in addition, any information of a third party that is held by the Company and/or its affiliates under an obligation of confidentiality.
- (c) Notwithstanding the above, Confidential Information shall not include any contact information located on your rolodex (whether paper or electronic) prior to the commencement of employment with the Company, any information that is generally known in the industry or in the public domain, or becomes generally known through no fault of your own.

6. **Non-Compete Obligations.** For purposes of this Section 6 only, the term "the Company" shall include the Company's affiliates. Your obligations with respect to competing with the Company and soliciting the Company's employees and customers (together the "*Non-Compete Obligations*") shall be as follows:

- (a) You shall not render services or advice, whether for compensation or without compensation, and whether as an employee, officer, director, principal, consultant or otherwise, to any person or organization with respect to any product or service that is competitive with —
 - (i) A product or service of the Company —
 - (A) With which during your employment by the Company you were actively engaged; or
 - (B) Of which you had detailed knowledge; or

- (ii) Any planned business of the Company in which —
 - (A) You had an active part in the planning; or
 - (B) Of which you had detailed knowledge.
 - (b) You shall not knowingly either directly or indirectly as agent or otherwise in any manner solicit, influence or encourage any customer of the Company to take away or to divert or direct its business to yourself or to any person or entity by or with which you are employed, associated, affiliated or otherwise related (other than the Company.)
 - (c) You shall not knowingly recruit or otherwise solicit or induce any employee of the Company to terminate his or her employment, or otherwise cease his or her relationship with the Company.
 - (d) The Non-Compete Obligations shall continue so long as you are an employee of the Company. After your employment terminates for any reason, the Non-Compete Obligations —
 - (i) Shall continue for a period of twelve months or for the period, if any, with respect to which the Company is obligated to pay you your salary (whether or not payment is in a lump sum) whichever period is longer; and
 - (ii) Shall apply in Texas and in any other state in which the Company received more than 10% of its annual revenues in the calendar year immediately preceding the calendar year in which your employment terminated.
7. **Termination by the Company.** The Company may terminate your employment only pursuant to the following terms and on the following conditions:
- (a) *Termination Without Cause.* The Company may terminate your employment Without Cause (as defined below) by giving you ninety days' prior written notice thereof, in which event —
 - (i) The Company shall to pay you in a lump sum your salary at the rate then in effect for a period of eighteen full calendar months (the "*Severance Amount*;") and
 - (ii) Subject to the terms and conditions set forth in Exhibit B, the Company shall pay you the Annual Incentive Compensation set forth in Section 2 of Exhibit B that you would have earned had you remained an employee of the Company through the end of the calendar year in which your employment terminated and on the assumption that you satisfactorily completed all of your personal goals for such year and that the Company achieved the EPS Goal (as defined in Exhibit B) for such year. The Annual Incentive Compensation amount described herein shall be paid to you according to the payment terms described in Exhibit B except that any of the provisions of Exhibit B to the contrary notwithstanding, any of such Annual Incentive Compensation that would otherwise be payable in shares of common stock of the Company shall be paid in cash.
 - (iii) For the period with respect to which the Company is required to pay the Severance Amount, the Company shall continue to cover you under the medical and dental plans sponsored by the Company for its employees with the same coverage, if any, that you had immediately prior to the termination of your employment, provided that you remit to the Company on a timely basis an amount equal to the applicable monthly COBRA premium (less the COBRA administrative surcharge) for such continued coverage; and the Company shall reimburse you for any medical premium expenses incurred by you hereunder within thirty days after the date of your payment thereof. To the extent that any medical or dental expense or in-kind benefits provided for under this Subsection (iii) are taxable to you in a given year, any such expense shall be reimbursed to you by the Company within thirty days of such expense being incurred, and any expenses reimbursed or in-kind benefits provided hereunder shall not affect the expenses eligible for reimbursement or in-kind benefits provided in any other year.
 - (iv) The Company shall permit you to purchase any insurance maintained by the Company for its own benefit on your life at its then cash surrender value.
 - (v) Except for the severance benefits relating to a change of control of the Company that are set forth in Exhibit D, the foregoing severance benefits are the only benefits and payments to which you are entitled that arise out of the termination of your employment Without Cause.
 - (b) *Definition of Without Cause.* Your employment shall be deemed to have been terminated by the Company Without Cause unless termination is for one of the following reasons:

- (i) Termination by reason of your becoming Permanently Disabled pursuant to Subsection (c), below;
 - (ii) Termination by reason of your death pursuant to Subsection (d), below;
 - (iii) Termination for Cause pursuant to Subsection (f), below; or
 - (iv) Termination by you pursuant to Section 8(a) (Voluntary Resignation), below.
- (c) *Termination for Permanent Disability*. The Company may terminate your employment if you become Permanently Disabled (as defined below) in which event —
- (i) The Company shall pay you your salary then in effect through the date of termination to the extent not already paid; and
 - (ii) Subject to the terms and conditions set forth in Exhibit B, the Company shall pay you a pro-rated amount of the Annual Incentive Compensation (as set forth in Section 2 of Exhibit B) that you would have earned had you remained an employee of the Company through the end of the calendar year in which your employment terminated and on the assumption that you satisfactorily completed all of your personal goals for such year and that the Company achieved the EPS Goal (as defined in Exhibit B) for such year, such pro-ration to be based on the number of days during such year that you were an employee of the Company. The Annual Incentive Compensation amount described herein shall be paid to you according to the payment terms described in Exhibit B except that any of the provisions of Exhibit B to the contrary notwithstanding, any of such Annual Incentive Compensation that would otherwise be payable in shares of common stock of the Company shall be paid in cash.
 - (iii) You shall be considered to have become Permanently Disabled if during any consecutive twelve-month period, because of ill health, or physical or mental disability, you shall have been continuously unable to perform your duties under this Agreement, in whole or in substantial part as determined in good faith by a physician specializing in the disability in question selected jointly by you and the Company (or if you and the Company cannot agree, by two physicians, one selected by you and one by the Company) for one hundred eighty consecutive days. The phrase "substantial part" means your inability to perform and devote at least eight hours per work day to the performance of your duties and responsibilities.
- (d) *Upon Your Death*. In the event of your death during the term of this Agreement, your employment shall thereupon terminate and —
- (i) The Company shall pay your estate your salary then in effect through the date of your death to the extent not already paid; and
 - (ii) Subject to the terms and conditions set forth in Exhibit B, the Company shall pay your estate a pro-rated amount of the Annual Incentive Compensation (as set forth in Section 2 of Exhibit B) that you would have earned had you remained an employee of the Company through the end of the calendar year in which you died and on the assumption that you satisfactorily completed all of your personal goals for such year and that the Company achieved the EPS Goal (as defined in Exhibit B) for such year, such pro-ration to be based on the number of days during such year that you were an employee of the Company. The Annual Incentive Compensation amount described herein shall be paid to you according to the payment terms described in Exhibit B except that any of the provisions of Exhibit B to the contrary notwithstanding, any of such Annual Incentive Compensation that would otherwise be payable in common stock of the Company shall be paid in cash.
- (e) In the event of the termination of your employment Without Cause by reason of your becoming Permanently Disabled, or by reason of your death prior to execution of a contract of sale of your residence in New York State, the Company shall pay directly (where practical) or reimburse the reasonable relocation costs incurred by you and/or your family upon presentation of appropriate receipts (including but not limited to your travel, shipping, and other costs related to relocation back to New York.)
- (f) *Termination for Cause*. The Company may terminate your employment for Cause (as defined below) by giving you written notice of termination. In the event of the termination of your employment for Cause, the Company shall pay you any of your accrued but unpaid salary through the date of termination and any other amounts required to be paid by applicable law through that date. For the avoidance of doubt, no incentive compensation of any kind shall be payable to you that had not already been paid to you on the date your employment is terminated for Cause.

- (i) Definition of Cause. For purposes of this Section 7(f), "Cause" for termination of your employment shall mean any one or more of the following:
 - (A) Your gross neglect of your duties, gross negligence in the performance of your duties, or your refusal to perform your duties.
 - (B) Your unsatisfactory performance of your duties that is not cured within thirty working days after written notice is given to you specifically identifying each reason why your performance is unsatisfactory and what you can do to cure such unsatisfactory performance.
 - (C) Any act of theft or other dishonesty by you, including any intentional misapplication of the Company's or its affiliates' funds or other property.
 - (D) Your conviction of any criminal activity not described in the immediately preceding Subsection (C), or participation in any activity involving moral turpitude that is or could reasonably be expected to be injurious to the business or reputation of the Company.
 - (E) Your immoderate use of alcohol and/or the use of non-prescribed narcotics that adversely and materially affect the performance of your duties.
 - (F) Your material breach of Section 10 (Company Policies), below.

8. Termination by You of Your Employment.

- (a) *Voluntary Resignation*. You may resign your employment with the Company on ninety days' prior written notice to the Company (the "90-Day Notice Period.") Upon receipt of a notice of resignation, the Company may accelerate the effective date of your resignation to any date within the 90-Day Notice Period; and/or may deem your notice of resignation a resignation as a director of the Company and a resignation by you of any one or more of the offices then held by you in the Company, and any one or more of the directorships and offices then held by you in the Company's affiliates, in each case to be effective on any date or dates within the 90-Day Notice Period, but the Company shall nevertheless pay you your then current salary for the ninety-day period.
 - (i) In the event you resign your employment, you will be paid your accrued but unpaid salary through the effective date of your resignation.
 - (ii) In the event your resignation becomes effective before the end of a calendar year, no incentive compensation of any kind shall be paid to you with respect to such year or any subsequent year.
 - (iii) In the event that your resignation becomes effective at or after the end of the calendar year in which you gave notice of your resignation, you shall be entitled to any earned Annual Incentive Compensation for such calendar year without regard to your having given a notice of resignation.
 - (iv) No incentive compensation of any kind shall be payable to you with respect to the calendar year or years following the calendar year in which you give notice of your resignation.
- (b) *Constructive Termination*. You may terminate your employment if (i) the Company commits a Breach (as defined below) of this Agreement; and (ii) you give the Company detailed written notice of the Breach within thirty days after the occurrence thereof; and (iii) the Company fails to cure the Breach within thirty days after the receipt of such notice or, if the nature of the Breach is such that it cannot practicably be cured in thirty days, if the Company shall fail to diligently and in good faith commence a cure of the Breach within such thirty-day period.
 - (i) In the event you terminate your employment by reason of a Breach by the Company, the termination shall be deemed for purposes of this Agreement to be a termination by the Company Without Cause, and the Company shall be required to perform all of its obligations described in Section 7(a)(i) through Section 7(a)(iv), above.

(ii) For purposes of this Section 8(b), "Breach" shall mean the occurrence of any of the following: (A) a material diminution in your duties, responsibilities, title or authority, or a change in your reporting relationship provided for in this Agreement; (B) you are not nominated for election by the stockholders of the Company as a director; (C) you are required by the Company, without your agreement, to relocate your principal office outside of Harris County and its contiguous counties; (D) a material reduction in your then current salary; (E) the methodology and/or computation, (but not the goals) of your Annual Incentive Compensation are materially and adversely changed; or (F) a material breach by the Company of any other material term or condition of this Agreement. For the avoidance of doubt, it shall not be a Breach of this Agreement if all or substantially all of the Company's assets or outstanding shares of capital stock are acquired by one or more third parties and after such acquisition, you retain substantially the same duties, responsibilities and compensation that you had prior to such event, notwithstanding that the Company's common stock is no longer publicly traded or that the Company becomes a subsidiary or division of another entity.

9. **Change of Control.** In the event of a change of control of the Company, you will be entitled, under certain circumstances, to additional severance compensation according to the terms and conditions of Exhibit D.
10. **Company Policies.** In addition to the terms and conditions contained in this Agreement, you shall abide by all of the Company's written policies from time to time in effect provided that you had reasonable notice of any change in such policies.
11. **Notices.** All notices required or permitted under this Agreement shall be in writing and shall be deemed given by a party when hand delivered to the other party against a receipt therefor, or when deposited with a delivery service that provides next-business-day delivery and proof of delivery, in either case, addressed as follows:

If to the Company at:

Sterling Construction Company, Inc.
20810 Fernbush Lane
Houston, Texas 77073
Attention: Board of Directors

With a copy to:

Roger M. Barzun
60 Hubbard Street
Concord, Massachusetts 01742

If to you, at your most recent home address as shown in the Company's employment records.

With a copy to:

Wendi S. Lazar, Esq.
Outten & Golden LLP
3 Park Avenue, 29th Floor
New York, NY 10016

or to such other persons or addresses as may be designated in writing by the party to receive such notice.

12. **Severability.** If any provision or part of a provision of this Agreement is finally declared to be invalid by any tribunal of competent jurisdiction, such part shall be deemed automatically adjusted, if possible, to conform to the requirements for validity, but, if such adjustment is not possible, it shall be deemed deleted from this Agreement as though it had never been included herein. In either case, the balance of any such provision and of this Agreement shall remain in full force and effect. Notwithstanding the foregoing, however, no provision shall be deleted if it is clearly apparent under the circumstances that either or both of the parties would not have entered into this Agreement without such provision.
13. **Survival.** Notwithstanding the expiration or earlier termination of this Agreement or of your employment for any reason, the following shall survive such expiration or termination:
- (a) Section 5 (Confidential Information;)
 - (b) Section 6 (Non-Compete Obligations;)
 - (c) Any right or obligation that accrued prior to such expiration or termination; and
 - (d) Any other obligation of a party that by its terms is to be performed or is to have continued effect after expiration or termination.
14. **Proration.** Any amount payable to you under this Agreement for a period shorter than the period for which it is provided herein shall be pro-rated on a daily basis using a 365-day year.
15. **Miscellaneous.**
- (a) *Withholdings.* All compensation of any kind payable under this Agreement shall be subject to all legally-required withholdings and deductions as determined in good faith by the Company.

- (b) *Entire Agreement.* This Agreement together with the exhibits referred to herein contains the entire understanding of the parties on the subject matter hereof and supersedes all other documents on the subject hereof, including any term sheets; shall not be amended, except by written agreement of the parties signed by each of them; shall be binding upon, and inure to the benefit of, the parties and their personal representatives, successors and permitted assigns; and shall not be assignable by either party without the prior written consent of the other party, except that the Company may assign this Agreement to any entity acquiring substantially all of the stock, business or assets of the Company, provided that the acquiror assumes in writing all of the Company's obligations hereunder.
- (c) *Construction.*
- (i) Each party has read and understood this Agreement and each party has had an opportunity to review this Agreement with counsel. Accordingly, each provision of this Agreement shall be interpreted and enforced without the aid of any canon, custom or rule of law requiring or suggesting construction against the party drafting or causing the drafting of such provision.
 - (ii) The words "herein," "hereof," "hereunder," "hereby," "herewith" and words of similar import when used in this Agreement shall be construed to refer to this Agreement as a whole.
 - (iii) An "affiliate" of the Company is any entity controlling, controlled by, or under common control with, the Company.
 - (iv) The words "include" "includes" "including" and words of similar import shall mean considered as part of a larger group and not limited to any one or more enumerated items.
- (d) *Prior Dealings etc.* No representation, affirmation of fact, course of prior dealings, promise or condition in connection herewith or usage of the trade that is not expressly incorporated herein shall be binding on the parties.
- (e) *Waiver.* The failure to insist upon strict compliance with any term, covenant or condition contained herein shall not be deemed a waiver of such term, nor shall any waiver or relinquishment of any right at any one or more times be deemed a waiver or relinquishment of such right at any other time or times. No term or condition hereof shall be waived unless in writing by the party to be bound by such waiver;
- (f) *Captions.* The captions of the paragraphs herein are for convenience only and shall not be used to construe or interpret this Agreement.
- (g) *Counterparts & Execution.* This Agreement may be executed in multiple counterparts, each of which may be considered an original, but all of which together shall constitute but one and the same instrument. This Agreement when signed by a party may be delivered by facsimile transmission with the same force and effect as if the same were an executed and delivered original, manually-signed counterpart.
- (h) *No Guarantee of Tax Consequences.* You shall be solely responsible for and liable for any taxes (including but not limited to any interest or penalties) as a result of any payments made to you under this Agreement, and the Company makes no commitment or guarantee that any particular federal, state or local tax treatment will apply or be available hereunder. Nothing in this [Section 15\(h\)](#) shall be construed to affect your right to the reimbursement of certain income taxes that are expressly provided for herein.
- (i) *Governing Law & Jurisdiction.* This Agreement shall be governed by, and construed in accordance with, the domestic laws of Texas without giving effect to any choice of law or conflict of law provision or rule (whether of Texas or of any other jurisdiction) that would cause the application hereto of the laws of any jurisdiction other than Texas. Any judicial proceeding brought against a party to this Agreement or any dispute arising out of this Agreement or matter related hereto shall be brought in the state courts of Harris County, Texas, and each party accepts the exclusive jurisdiction of such courts.

16. Compliance with Section 409A of the Code.

- (a) To the extent that any payment to you under this Agreement is deemed to be deferred compensation subject to the requirements of Section 409A of the Internal Revenue Code of 1986 (the "*Code*") this Agreement shall be operated in compliance with the applicable requirements of Section 409A of the Code ("*Section 409A*") and its corresponding regulations and related guidance with respect to the payment in question. Notwithstanding anything in this Agreement to the contrary, any payment under this Agreement that is subject to the requirements of Section 409A may only be made in a manner and upon an event permitted by Section 409A. To the extent that any provision of this Agreement would cause a conflict with the requirements of Section 409A, or would cause the administration of this Agreement to fail to satisfy the requirements of Section 409A, such provision shall be deemed null and void to the extent permitted by applicable law, and the Company may modify this Agreement in such a manner as to comply with such requirements without your consent.

(b) If you are a key employee (as defined in Section 416(i) of the Code (without regard to paragraph 5 thereof)) except to the extent permitted under Section 409A, no benefit or payment that is subject to Section 409A (after taking into account all applicable exceptions to Section 409A, including but not limited to the exceptions for short-term deferrals and for separation pay only upon an involuntary separation from service) shall be made under this Agreement on account of your separation from service (as defined in Section 409A) with the Company until the later of —

(i) The date prescribed for payment in this Agreement; and

(ii) The first day of the seventh calendar month that begins after the date of your separation from service (or, if earlier, the date of your death.)

(c) All payments that were delayed by reason of the application of the date prescribed by Section 16(b)(ii), above (the "*Section 16(b)(ii) Date*") shall be aggregated and paid to you on the Section 16(b)(ii) Date in a lump sum together with interest computed from the date each such payment would have first been paid to you absent the application of the Section 16(b)(ii) Date until paid using the Non-LIBOR rate of interest the Company would have paid had it borrowed the amount of the payment under its revolving line of credit. After the Section 16(b)(ii) Date, the Company shall pay any other amounts provided for herein to the extent and in the manner provided in this Agreement.

(d) To the extent that any payment to you under this Agreement is payable on account of the termination of your employment with the result that the income tax under Section 409A of the Code would apply or be imposed on such payment, but where such tax would not apply or be imposed if the meaning of the term "termination" included and met the requirements of a "separation from service" within the meaning of Treas. Reg. §1.409A-1(h), then the term "termination" herein shall mean, but only with respect to the income so affected, an event, circumstance or condition that constitutes both a "termination" as defined in the preceding sentence and a "separation from service" within the meaning of Treas. Reg. §1.409A-1(h).

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the Effective Date.

Sterling Construction Company, Inc.

By: /s/ Maarten D. Hemsley
Maarten D. Hemsley
Lead Director

/s/ Peter E. MacKenna
Peter E. MacKenna

STERLING CONSTRUCTION COMPANY, INC.
20810 FERNBUSH LANE
HOUSTON, TEXAS 77073

August 6, 2012

Patrick T. Manning
20822 Bending Pines
Spring, Texas 77379

Re: Amendment No. 1 to Employment Agreement

Dear Pat,

As you know, the Company has concluded a search for a new chief executive officer. The purpose of this letter is to set forth our agreement on the amendment of certain terms and conditions of the employment agreement between you and the Company dated as of January 1, 2011 (your "*Employment Agreement*") in contemplation of the election of your successor.

1. By the execution of this amendment to your Employment Agreement, you agree that the election of your successor as Chief Executive Officer of the Company by the Board of Directors of the Company will constitute an automatic, simultaneous resignation by you as Chief Executive Officer of the Company and as an officer and/or director of the Company's subsidiaries and affiliates.
2. Notwithstanding anything in your Employment Agreement to the contrary, subsequent to, and in consideration of, your resignation, you and the Company agree as follows:
 - (a) Your resignation will not be deemed a resignation to which either Section 9.1 or Section 9.2 of your Employment Agreement applies, nor shall your resignation be deemed a termination of your employment by the Company under any other provisions of your Employment Agreement.
 - (b) You will continue as a full-time employee under your Employment Agreement, which will continue in full force, subject to the amendments described herein, and you will retain your current office in the Company's headquarters building.
 - (c) Subject to the provisions of the Company's Certificate of Incorporation, you will remain a director of the Company until your current term expires at the 2014 Annual Meeting of Stockholders.
 - (d) The "Duties & Responsibilities" and "Salary" sections of Exhibit A to your Employment Agreement are amended in their entirety to read as follows:

Duties & Responsibilities:

For the period through and including December 31, 2012 —

Mr. Manning will render such assistance as is reasonably required of him in facilitating the transition of his former duties and responsibilities as Chief Executive Officer of the Company to his successor as Chief Executive Officer. In addition, he shall carry out such additional and appropriate duties and responsibilities as the Board of Directors of the Company shall reasonably request of him.

For so long as Mr. Manning is Chairman of the Board of Directors of the Company, he shall carry out the customary duties and responsibilities of a board chairman of a publicly-traded company.

During calendar year 2013 —

Mr. Manning will render such advisory services to his successor as Chief Executive Officer and/or to the Company in Mr. Manning's areas of expertise as may be requested of him provided that such services do not require, on average, more than five working days per month.

Mr. Manning will be free to pursue other business and personal activities that do not violate the Non-Compete Obligations set forth in Section 7, above, and that do not prevent him from rendering the advisory services described above.

Salary

For the period through and including December 31, 2012, Mr. Manning's annual salary shall be \$550,000, which shall be paid to him commencing as of January 1, 2011 in installments at the same time and in the same manner as other senior executives of the Company are paid their salaries.

On or before January 2, 2013, the Company will pay Mr. Manning in cash \$550,000 in a lump sum in full and complete satisfaction of the salary to which he is entitled for the calendar year 2013.

(e) For calendar year 2012, you shall be entitled to Annual Incentive Compensation as set forth in Exhibit B to your Employment Agreement except that Exhibit B is hereby amended in the following respects:

(i) Section 2(a) of Exhibit B is hereby amended in its entirety to read as follows:

[2](a) For each year that this Agreement is in effect, there is hereby established an Executive Incentive Compensation Pool (the "EICP"). The EICP is equal to four percent of the Company's income before income taxes as set forth in the Company's audited consolidated statements of operations for a given year (i) reduced for earnings attributable to noncontrolling interests; and (ii) after adding back to net income any accrual of incentive compensation for executives who share in the EICP ("*Defined Earnings*.")

(ii) A new Subsection (c) is hereby added to Section 2 of Exhibit B to read as follows:

[2](c) In the event that in a given year there is an extraordinary item or event that has a significant effect on the net earnings of the Company, whether that effect is positive or negative, the Committee shall have the sole discretion to determine whether to exclude some or all of such effect from the calculation of Defined Earnings and/or from the calculation of the three-year AROE (as defined below) for the year in which such item or event is recorded and for any subsequent year.

(iii) In calendar year 2013 you will be entitled to earn Annual Incentive Compensation as set forth in Exhibit B, except that

—
(A) The amount of the Annual Incentive Compensation paid to you for calendar year 2013 will be no less than \$120,000 (the "*Guaranteed Incentive Compensation*"); and

(B) The Guaranteed Incentive Compensation will be paid to you during 2013 in twelve equal monthly installments. Any Annual Incentive Compensation that you are entitled to for 2013 under Exhibit B in excess of the Guaranteed Incentive Compensation will be paid to you at the same time as Annual Incentive Compensation is paid to the Company's executive officers.

(iv) All Annual Incentive Compensation earned by you shall be paid to you in cash.

(v) Your personal goals for 2013 will be the satisfactory performance of the advisory services described in Exhibit A as amended hereby.

In all other respects, your Employment Agreement will remain as originally written.

This amendment of your Employment Agreement may be executed in multiple counterparts, each of which may be considered an original, but all of which together shall constitute but one and the same instrument. When this amendment is signed by a party, it may be delivered by electronic or other facsimile transmission with the same force and effect as if the same were an executed and delivered original, manually-signed counterpart.

If the foregoing accurately sets forth our agreement on the matters covered, please signify your agreement by signing this letter in the space provided below and returning the signed copy to Maarten Hemsley.

Very truly yours,

Sterling Construction Company, Inc.

ACCEPTED AND AGREED:

By: /s/ Maarten D. Hemsley
Maarten D. Hemsley
Lead Director

/s/ Patrick T. Manning
Patrick T. Manning

I, Peter E. MacKenna, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Sterling Construction Company, Inc. for the three and nine months ended September 30, 2012;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2012

By: /s/ Peter E. MacKenna
Peter E. MacKenna
Chief Executive Officer

I, Elizabeth D. Brumley, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Sterling Construction Company, Inc. for the three and nine months ended September 30, 2012;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2012

By: /s/ Elizabeth D. Brumley
Elizabeth D. Brumley
Chief Financial Officer

CERTIFICATION
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), each of the undersigned officers of Sterling Construction Company, Inc., a Delaware corporation (the “Company”), does hereby certify that, to his or her knowledge:

- (i) the Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 (the “Form 10-Q”) of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (ii) the information contained in the Form 10-Q fairly represents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 8, 2012 /s/ Peter E. MacKenna
Peter E. MacKenna
Chief Executive Officer

Dated: November 8, 2012 /s/ Elizabeth D. Brumley
Elizabeth D. Brumley
Chief Financial Officer

