

STERLING CONSTRUCTION CO INC  
Form 10-K  
March 17, 2008

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

annual report pursuant to section 13 or 15(d) of the securities exchange act of 1934  
For the fiscal year ended: December 31, 2007

transition report pursuant to section 13 or 15(d) of the securities exchange act of 1934  
For the transition period from \_\_\_\_\_

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 offices)

77073  
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
None	The NASDAQ Stock Market

Securities registered pursuant to section 12(g) of the Act:  
Common Stock, \$0.01 par value per share  
(Title of Class)

Preferred Share Purchase Rights  
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
 Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  
 Yes  No

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. R Yes £ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K £

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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer £ Accelerated filer R  
Non-accelerated filer £ (Do not check if a smaller reporting company) Smaller reporting company £

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

Aggregate market value of the voting and non-voting common equity held by non-affiliates at June 30, 2007: \$206,642,670.

At March 3, 2008, the registrant had 13,088,692 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE  
None

Sterling Construction Company, Inc.  
Annual Report on Form 10-K  
Table of Contents

<b><u>PART I</u></b>		4
	<u>Cautionary Comment Regarding Forward-Looking Statements</u>	4
<b><u>Item 1.</u></b>	<b><u>Business</u></b>	5
	<u>Access to the Company's Filings</u>	5
	<u>Developments of the Business</u>	5
	<u>Overview of the Company's Business</u>	5
	<u>Our Business Strategy</u>	6
	<u>Our Markets and Customers</u>	6
	<u>Competition</u>	8
	<u>Contract Backlog</u>	8
	<u>Contracts</u>	9
	<u>Employees</u>	12
<b><u>Item 1A.</u></b>	<b><u>Risk Factors</u></b>	12
<b><u>Item 1B.</u></b>	<b><u>Unresolved Staff Comments</u></b>	22
<b><u>Item 2.</u></b>	<b><u>Properties</u></b>	22
<b><u>Item 3.</u></b>	<b><u>Legal Proceedings</u></b>	23
<b><u>Item 4.</u></b>	<b><u>Submission of Matters to a Vote of Security Holders</u></b>	23
<b><u>PART II</u></b>		23
<b><u>Item 5.</u></b>	<b><u>Market for the Registrant's Common Equity, Related Stockholder Matters</u></b>	23
	<u>Dividend Policy</u>	23
	<u>Equity Compensation Plan Information</u>	24
	<u>Performance Graph</u>	24
<b><u>Item 6.</u></b>	<b><u>Selected Financial Data</u></b>	25
<b><u>Item 7.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operation</u></b>	27
	<u>Overview</u>	27
	<u>Critical Accounting Policies</u>	27
	<u>Results of Operations</u>	30
	<u>Historical Cash Flows</u>	35
	<u>Liquidity</u>	36
	<u>Sources of Capital</u>	36
	<u>Uses of Capital</u>	37
	<u>Off-Balance Sheet Arrangements</u>	38
<b><u>Item 7A.</u></b>	<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	39
<b><u>Item 8.</u></b>	<b><u>Financial Statements and Supplementary Data</u></b>	39
<b><u>Item 9.</u></b>	<b><u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u></b>	39
<b><u>Item 9A.</u></b>	<b><u>Controls and Procedures</u></b>	39
	<u>Evaluation of Disclosure Controls and Procedures</u>	39
	<u>Management's Report on Internal Control over Financial Reporting</u>	39
	<u>Changes in Internal Control over Financial Reporting</u>	40
	<u>Inherent Limitations on Effectiveness of Controls</u>	40

<u>Item 9B.</u>	<u>Other Information</u>	40
<u>PART III</u>		40
<u>Item 10.</u>	<u>Directors and Executive Officers of the Registrant</u>	40
	<u>Directors</u>	40
	<u>Executive Officers</u>	42
	<u>Section 16(a) Beneficial Ownership Reporting Compliance</u>	43
	<u>Code of Ethics</u>	43
	<u>The Audit Committee</u>	43
<u>Item 11.</u>	<u>Executive Compensation</u>	43
	<u>Introduction</u>	43
	<u>Compensation Discussion and Analysis</u>	44
	<u>Employment Agreements of Named Executive Officers</u>	52
	<u>Potential Payments Upon Termination or Change-in-Control</u>	54
	<u>Summary Compensation Table for 2007</u>	56
	<u>Grants of Plan-Based Awards for 2007</u>	57
	<u>Option Exercises and Stock Vested for 2006</u>	59
	<u>Outstanding Equity Awards at December 31, 2007</u>	61
	<u>Director Compensation for 2007</u>	62
	<u>Compensation Committee Interlocks and Insider Participation</u>	64
	<u>Compensation Committee Report</u>	64
<u>Item 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	65
	<u>Equity Compensation Plan Information</u>	65
	<u>Security Ownership of Certain Beneficial Owners and Management</u>	65
	<u>Transactions with Related Persons</u>	67
	<u>Policies and Procedures for the Review, Approval or Ratification of Transactions with Related Persons</u>	67
	<u>Director Independence</u>	68
<u>Item 14.</u>	<u>Principal Accountant Fees and Services</u>	69
	<u>Audit and Non-Audit Service Approval Policy</u>	69
	<u>Procedures</u>	70
<u>PART IV</u>		70
<u>Item 15.</u>	<u>Exhibits, Financial Statement Schedules</u>	70
	<u>Financial Statements</u>	70
	<u>Financial Statement Schedules</u>	70
<u>SIGNATURES</u>		74

Table of Contents

PART I

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 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are included throughout this Report, including in the sections entitled "Business," "Risk Factors," and "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 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 and resulting reductions or delays, or uncertainties regarding governmental funding for infrastructure services;

- adverse economic conditions in our markets in Texas and Nevada;

• delays or difficulties related to the commencement or completion of contracts, including additional costs, reductions in revenues or the payment of completion penalties or liquidated damages;

- actions of suppliers, subcontractors, customers, competitors and others which are beyond our control;

- the estimates inherent in our percentage-of-completion accounting policies;

- possible cost increases;

- our dependence on a few significant customers;

- adverse weather conditions;

• the presence of competitors with greater financial resources than we have and the impact of competitive services and pricing;

- our ability to successfully identify, complete and integrate acquisitions; and

- the other factors discussed in more detail in 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 do not undertake 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.

Table of Contents

Item 1. Business

Access to the Company's Filings.

The Company's Website. The Company maintains a website at [www.sterlingconstructionco.com](http://www.sterlingconstructionco.com) on which our latest Annual Report on Form 10-K, recent Quarterly Reports on Form 10-Q, recent Current Reports on Form 8-K, any amendments to those filings, and other filings may be accessed free of charge through a link to the Securities and Exchange Commission's website where those reports are filed. Our website also has recent press releases, the Company's Code of Business Conduct & Ethics and the charters of the Audit Committee, Compensation Committee, and Corporate Governance & Nominating Committee of the Board of Directors. Information is also provided on the Company's "whistle-blower" procedures. Our website content is made available for information purposes only. It should not be relied upon for investment purposes, and none of the information on the website is incorporated into this Report by this reference to it.

The Securities and Exchange Commission (SEC). The public may read and copy any materials filed by the Company with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330 (1-800-732-0330). The SEC also maintains an Internet site at [www.sec.gov](http://www.sec.gov) on which you can obtain reports, proxy and information statements and other information regarding the Company and other issuers that file electronically with the SEC.

Developments of the Business. In December 2007, the Company completed a public offering of 1.840 million shares of common stock at a price to the public of \$20.00 per share that yielded the Company net proceeds (after underwriters' discounts and commissions) of \$ 34.960 million (\$19.00 per share.) Other related direct offering costs reduced the net proceeds to \$34.489 million.

Overview of the Company's Business. Sterling Construction Company, Inc. was founded in 1991 as a Delaware corporation. Our principal executive offices are located at 20810 Fernbush Lane, Houston, Texas 77073, and our telephone number at this address is (281) 821-9091. Our construction business was founded in 1955 by a predecessor company in Michigan and is now operated by our subsidiaries, Texas Sterling Construction Co., a Delaware corporation, or TSC and Road and Highway Builders LLC, a Nevada limited liability company, or "RHB". The terms "Company", "Sterling", and "we" refer to Sterling Construction Company, Inc. and its subsidiaries except when it is clear that those terms mean only the parent company.

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 and light rail. Water infrastructure projects include water, wastewater and storm drainage systems. Sterling provides general contracting services primarily to public sector clients utilizing its own employees and equipment, 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 rail infrastructure; concrete batch plant operations, concrete crushing and aggregates and asphalt paving operations. Sterling performs the majority of the work required by its contracts with its own crews, and generally engages subcontractors only for ancillary services.

Although we describe our business in this report in terms of the services we provide, our base of customers and the geographic areas in which we operate, we have concluded that our operations comprise one reportable segment pursuant to Statement of Financial Accounting Standards No. 131 – Disclosures about Segments of an Enterprise and Related Information. In making this determination, we considered that each project has similar characteristics, includes similar services, has similar types of customers and is subject to the same regulatory environment. We organize, evaluate and manage our financial information around each project when making operating decisions and

assessing our overall performance.

Sterling has a history of profitable growth, which we have achieved by expanding both our service profile and our market areas. This involves adding services, such as concrete operations, in order to capture a greater percentage of available work in current and potential markets. It also involves 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 recent acquisition of RHB, a Nevada construction company.

Sterling operates in Texas and Nevada, two states that management believes benefit from both positive long-term demographic trends as well as an historical commitment to funding transportation and water infrastructure projects. From 2000 to 2006, the population of Texas grew 12.7% and the population of Nevada 24.9%. Budgeted net expenditures for transportation in 2007 totaled more than \$7.6 billion in Texas, an increase of 4% from 2006. In the recent November 2007 election, Texas voters approved the issuance of \$5 billion of bonds for highway improvements. In Nevada, total highway fund revenue in 2006 reached \$1.0 billion, an annual increase of 10.5% from 2001 levels and up 5% from 2005. Several large jobs are scheduled to be let over the next year. Management anticipates that continued population growth and increased spending for infrastructure in these markets will positively affect business opportunities over the coming years.

## Table of Contents

Road and Highway Builders Acquisition. On October 31, 2007, we completed the acquisition of privately-owned RHB, which is headquartered in Reno, Nevada. RHB is a heavy civil construction business focused on the construction of roads and highways throughout the state of Nevada. We paid \$53 million to acquire approximately 91.67% of the equity interest in RHB. The remaining 8.33% interest is owned by Richard Buenting, the chief executive officer of RHB who continues to run RHB as part of our senior management team; and his ownership interest can be put to or called by us in 2011.

RHB's largest customer is the Nevada Department of Transportation, which is responsible for planning, construction, operation and maintenance of the 5,400 miles of highway and over 1,000 bridges that make up the state highway system. RHB is focused on providing timely and profitable execution of construction projects along with high-value deployment of construction materials, such as aggregates and mixes for asphalt paving. RHB has concentrated its business in suburban and rural highway and road system projects requiring high-volume production and materials handling. RHB has not historically pursued municipal work, such as water or storm water systems or high density urban projects. Since its founding in 1999, RHB has experienced profitable growth, capitalizing on strong market conditions and solid long-term demographics in Nevada.

Our Business Strategy. Key features of our business strategy include:

Continue to Add Construction Capabilities. By adding capabilities that augment our core construction competencies, we are able to improve gross margin opportunities, more effectively compete for contracts, and compete for contracts that might not otherwise be available to us.

Increase our Market Leadership in our Core Markets. We have a strong presence in a number of attractive growing markets in Texas and Nevada in which we intend to continue to expand our presence.

Apply Core Competencies Across our Markets. We intend to capitalize on opportunities to export our Texas experience constructing bridges and water and sewer systems into Nevada markets. Similarly, we believe our experience in aggregates and asphalt paving materials in Nevada may open new opportunities for us in our Texas markets.

Expand into Attractive New Markets and Selectively Pursue Strategic Acquisitions. We will continue to seek to identify attractive new markets and opportunities in select western and southeastern U.S. markets. We will also continue to assess opportunities to extend our service capabilities and expand our markets through acquisitions.

Position our Business for Future Infrastructure Spending. We believe there is a growing awareness of the need to build, reconstruct and repair our country's infrastructure, including water, wastewater and storm drainage systems, as well as transportation infrastructure such as bridges, highways and mass transit systems. We will continue to build our expertise to capture this infrastructure spending.

Continue to Develop our Employees. We believe that our employees are key to the successful implementation of our business strategy, and we will continue allocating significant resources in order to attract and retain talented managers and supervisory and field personnel.

Our Markets and Customers.

We operate in the heavy civil construction segment for infrastructure projects, specializing in transportation and water infrastructure. Demand for this infrastructure depends on a variety of factors, including overall population growth, economic expansion and the vitality of a market area, as well as unique local topographical, structural and environmental issues. For example, the City of Houston experiences flooding and subsidence, which has led to various

municipal mandates requiring substantial new construction to reorganize and expand the collection, treatment and distribution of water throughout the area. 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.

## Table of Contents

Our geographic markets have experienced steady and significant growth over the last 10 years. According to the 2006 census, ranked by population, Texas is the second largest state in the United States with 23.5 million people. The population in Texas has grown by 12.7% since 2000, almost double the 6.4% growth rate for the United States as a whole over the same period. According to the 2006 census, Houston ranks as the fourth largest city in the country, San Antonio as the seventh largest, Dallas as the ninth largest, Austin as the sixteenth largest and Fort Worth as the nineteenth largest. Nevada has undergone even more rapid growth, with the state's population expanding 24.9% since 2000 to 2.5 million in 2006. These rapidly growing population bases continue to enhance the need for expanded transportation and water infrastructure.

In addition to our core geographical markets, we operate in large and growing construction sectors that have experienced solid and sustained national growth over the past several years. According to data from the U.S. Census Bureau, the annual value of public construction put-in-place in the United States for transportation, highway, street and water/wastewater infrastructure has grown at a 5.1% compound annual growth rate since 2002 and was \$137 billion in 2006, the last year for which data are available. This includes 4.4% annual growth in the \$99 billion transportation, construction and highway/street market and 7.2% growth in the \$38 billion water/wastewater market. McGraw-Hill, an industry data source, projects that nationwide construction spending on highways and bridges, and environmental public works (which include river/harbor improvements, sewers and water supply systems) is expected to grow by 5% and 3%, respectively, in 2008. Based on dollars spent for construction of highways and bridges and for sewer systems in 2007, Texas was ranked third in the nation in both categories by McGraw-Hill.

Our highway and bridge work is generally funded through federal and state authorizations. The federal government enacted the SAFETEA-LU bill, which authorized \$286 billion for transportation spending through 2009, an average 30% increase from the prior spending bill. Of this total, the Texas Department of Transportation, or TXDOT, and the Nevada Department of Transportation, or NDOT, were originally allocated approximately \$14.5 billion and \$1.3 billion, respectively. Actual SAFETEA-LU appropriations have been somewhat reduced from the original allocations. We are reliant upon TXDOT and NDOT contracts for a significant portion of our revenues. Recent public statements by TXDOT officials indicate potential TXDOT funding shortfalls and reductions in spending. Transportation leaders have identified \$188 billion in needed construction projects to create an acceptable transportation system in Texas by 2030. NDOT expenditures totaled \$740 million in 2006, and have had an annual increase of 9.9% since 2001.

Our water and wastewater, underground utility, light transit and non-highway paving work is generally funded by municipalities and local authorities. The size and growth rates of these markets is difficult to compute as a whole given the number of municipalities, the differences in funding sources and the variations in local budgets. However, management estimates that the municipal markets in which we could potentially do business are in excess of \$1 billion annually.

**Our Markets and Customers.** For decades, we have concentrated our operations in Texas. We are headquartered in Houston, and we serve the top markets in Texas, including Houston, San Antonio, Dallas/Fort Worth and Austin. In 2007, we have expanded our operations into Nevada.

Although we occasionally undertake contracts for private customers, the vast majority of our contracts are for public sector customers. In Texas, these customers include TXDOT, county and municipal public works departments, the Metropolitan Transit Authority of Harris County, Texas (or Metro), the Harris County Toll Road Authority, regional transit authorities, port authorities, school districts and municipal utility districts. In Nevada, our primary public sector customer has been NDOT.

Our largest revenue customer is TXDOT. In 2007, contracts with TXDOT represented 66% of our revenues, and other public sector revenue generated in Texas represented 32% of our revenues. In 2007, contracts with NDOT represented 97% of RHB's revenues, and other public sector revenue generated in Nevada represented 3% of RHB's revenues. In

both Texas and Nevada, we provide services to these customers exclusively pursuant to contracts awarded through competitive bidding processes.

7

---

## Table of Contents

In Texas, our municipal customers in 2007 included the City of Houston (9% of our 2007 revenues) and Harris County, Texas (3% of our 2007 revenues). In the past, we have also completed the construction of certain infrastructure for new light rail systems in Houston, Dallas and Galveston. We anticipate that revenues obtained from the City of Houston will continue to increase due to the metropolitan area's steady gain in population through migration of new residents, the annexation of surrounding communities and the continuing programs to expand storm water and flood control systems and deliver water to suburban communities. We provide services to our municipal customers exclusively pursuant to contracts awarded through competitive bidding processes.

**Competition.** Our competitors are companies that we bid against for construction contracts. We estimate that Sterling has approximately 160 competitors in the Texas and Nevada markets that we primarily serve, and they include large national and regional construction companies as well as many smaller contractors. Historically, the construction business has not typically required large amounts of capital, which can result in relative ease of market entry for companies possessing acceptable qualifications. Factors influencing our competitiveness include price, our reputation for quality, our equipment fleet, our financial strength, surety bonding capacity and prequalification, our knowledge of local markets and conditions, and our project management and estimating abilities. Although some of our competitors are larger than we are and may possess greater resources or provide more vertically-integrated services, we believe that we are well-positioned to compete effectively and favorably in the markets in which we operate on the basis of the foregoing factors.

We are unable to determine the size of many competitors because they are privately owned, but we believe that we are one of the larger participants in our Texas markets and one of the largest contractors in Houston engaged in municipal civil construction work. In Nevada, we believe that we are a leading asphalt paving contractor in suburban and rural highway projects. We believe that being one of the largest firms in the Houston municipal civil construction market provides us with several advantages, including greater flexibility to manage our backlog in order to schedule and deploy our workforce and equipment resources more efficiently; more cost-effective purchasing of materials, insurance and bonds; the ability to provide a broader range of services than otherwise would be provided through subcontractors; and the availability of substantially more capital and resources to dedicate to each of our contracts. Because we own and maintain most of the equipment required for our contracts and have the experienced workforce to handle many types of municipal civil construction, we are able to bid competitively on many categories of contracts, especially complex, multi-task projects.

In the state highway markets, most of our competitors are large regional contractors, and individual contracts tend to be larger and require more specialized skills than those in the municipal markets. Some of these competitors have the advantage of being more vertically-integrated, or they specialize in certain types of projects such as construction over water. However those competitors, particularly in Texas, often have the disadvantage of temporarily using a local workforce to complete each of their state highway contracts. In contrast, we permanently employ the workers who perform our state highway contracts in Texas, although we do rely on a temporary, unionized workforce for performance of a portion of our state highway contracts in Nevada. In 2007, state highway work accounted for 68% of our consolidated revenues, compared with 67% in 2006 and 39% in 2005. During the same period, state highway work accounted for 97% of RHB's revenues, compared with 90% in 2006 and 96% in 2005.

## Contract Backlog

Contract backlog is our estimate of the billings that we expect to make in future periods on our construction contracts. We add the revenue value of new contracts to our contract backlog, when we are the low bidder on a public sector contract and have determined that there are no apparent impediments to award of the contract. As construction on our contracts progresses, we increase or decrease contract backlog to take account of changes in estimated quantities under fixed unit price contracts, as well as to reflect changed conditions, change orders and other variations from initially anticipated contract revenues and costs, including completion penalties and bonuses. We subtract from

contract backlog the amounts we bill on contracts.

8

---

## Table of Contents

At December 31, 2007, our contract backlog of approximately \$450 million was 14% higher than the \$395 million of contract backlog at December 31, 2006. Of the contract backlog at December 31, 2007, approximately \$279 million is scheduled for completion in 2008. At December 31, 2007, we included approximately \$16 million of contracts in backlog on which we were the apparent low bidder and expected to be awarded the contracts, but as of that date, those contracts had not been officially awarded. Historically, subsequent non-awards of such low bids have not materially affected our backlog or financial condition.

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. See the section below entitled "Contract Management Process."

### Contracts.

**Types of Contracts.** We provide our services by using traditional general contracting arrangements, which are predominantly fixed unit price contracts awarded based on the lowest bid. A small amount of our revenue is produced under change orders or emergency contracts arranged on a cost plus basis.

Fixed unit price contracts are generally used in competitively-bid public civil construction contracts and, to a lesser degree, building construction contracts. Contractors under fixed unit price contracts are generally committed to provide all of the resources required to complete a contract for a fixed price per unit. Fixed unit price contracts generally transfer more risk to the contractor but offer the opportunity, under favorable circumstances, for greater profits. These contracts are generally subject to negotiated change orders, frequently due to a differences in site conditions from those anticipated when the bid is placed. Some contracts provide for penalties if the contract is not completed on time, or incentives if it is completed ahead of schedule.

**Contract Management Process.** We identify potential contracts from a variety of sources, including through subscriber services that notify us of contracts out for bid, through advertisements by federal, state and local governmental entities, through our business development efforts and through meetings with other participants in the construction industry. After determining which contracts are available, we decide which contracts to pursue based on such factors as the relevant skills required, contract size and duration, the availability of our personnel and equipment, the size and makeup of our current backlog, our competitive advantages and disadvantages, prior experience, the contracting agency or customer, the source of contract funding, geographic location, likely competition, construction risks, gross margin opportunities, penalties or incentives and the type of contract.

As a condition to pursuing certain contracts, we are sometimes required to complete a prequalification process with the applicable agency or customer. Some customers, such as TXDOT and NDOT, require yearly prequalification, and other customers have experience requirements specific to the contract. The prequalification process generally limits bidders to those companies with operational experience and financial capability to effectively complete the particular contract in accordance with the plans, specifications and construction schedule.

There are several factors that can create variability in contract performance and financial results compared to our bid assumptions on a contract. The most significant of these include the completeness and accuracy of our original bid analysis, recognition of costs associated with added scope changes, extended overhead due to customer and weather delays, subcontractor performance issues, changes in productivity expectations, site conditions that differ from those assumed in the original bid, and changes in the availability and proximity of materials. In addition, each of our original bids is based on the contract customer's estimates of the quantities needed to complete a contract. If the quantities ultimately needed are different, our backlog and financial performance on the contract will change. All of these factors can lead to inefficiencies in contract performance, which can increase costs and lower profits. Conversely, if any of these or other factors is more positive than the assumptions in our bid, contract profitability can

improve.

9

---

## Table of Contents

The estimating process for our contracts in Texas typically involves three phases. Initially, we consider the level of anticipated competition and our available resources for the prospective project. If we then decide to continue considering a project, we undertake the second phase of the contract process and spend up to six weeks performing a detailed review of the plans and specifications, summarize the various types of work involved and related estimated quantities, determine the contract duration and schedule and highlight the unique and riskier aspects of the contract. Concurrent with this process, we estimate the cost and availability of labor, material, equipment, subcontractors and the project team required to complete the contract on time and in accordance with the plans and specifications. Substantially all of our estimates are made on a per-unit basis for each line item, with the typical contract containing 50 to 400 line items. The final phase consists of a detailed review of the estimate by management, including, among other things, assumptions regarding cost, approach, means and methods, productivity, risk and the estimated profit margin. This profit amount will vary according to management's perception of the degree of difficulty of the contract, the current competitive climate and the size and makeup of our backlog. Our project managers are intimately involved throughout the estimating and construction process so that contract issues, and risks, can be understood and addressed on a timely basis.

The contracting process for RHB's contracts in Nevada is primarily the responsibility of its chief executive officer. He reviews all of the plans and specifications for a proposed project, estimates the costs to complete the project and the risks involved, adds an appropriate profit level, and, based on all of that information, determines whether to submit a bid on the project. Prior to submittal of any proposals, estimates are reviewed by Sterling management. As part of our process for integrating RHB into our overall operations, we anticipate that the process used to bid on contracts in Nevada will substantially conform to the process used in Texas described above.

To manage risks of changes in material prices and subcontracting costs used in tendering bids for construction contracts, we obtain firm quotations from our suppliers and subcontractors before submitting a bid. These quotations do not include any quantity guarantees, and we have no obligation for materials or subcontract services beyond those required to complete the respective contracts that we are awarded for which quotations have been provided.

Substantially all of our contracts are entered into with governmental entities and are generally awarded to the lowest bidder after a solicitation of bids by the project owner. Requests for proposals or negotiated contracts with public or private customers are generally awarded based on a combination of technical capability and price, taking into consideration factors such as contract schedule and prior experience.

During the construction phase of a contract, we monitor our progress by comparing actual costs incurred and quantities completed to date with budgeted amounts and the contract schedule and periodically (at a minimum on a monthly basis) prepare an updated estimate of total forecasted revenue, cost and expected profit for the contract.

During the normal course of most contracts, the customer, and sometimes the contractor, initiates modifications or changes to the original contract to reflect, among other things, changes in quantities, specifications or design, method or manner of performance, facilities, materials, site conditions and the period for completion of the work. In many cases, final contract quantities may differ from those specified by the customer. Generally, the scope and price of these modifications are documented in a "change order" to the original contract and reviewed, approved and paid in accordance with the normal change order provisions of the contract. We are often required to perform extra or change order work as directed by the customer even if the customer has not agreed in advance on the scope or price of the work to be performed. This process may result in disputes over whether the work performed is beyond the scope of the work included in the original contract plans and specifications or, even if the customer agrees that the work performed qualifies as extra work, the price that the customer is willing to pay for the extra work. These disputes may not be settled to our satisfaction. Even when the customer agrees to pay for the extra work, we may be required to fund the cost of the work for a lengthy period of time until the change order is approved and funded by the customer. In addition, any delay caused by the extra work may adversely impact the timely scheduling of other work on the

contract (or on other contracts) and our ability to meet contract milestone dates.

10

---

Table of Contents

The process for resolving contract claims varies from one contract to another but, in general, we attempt to resolve claims at the project supervisory level through the normal change order process or, if necessary, with higher levels of management within our organization and the customer's organization. Regardless of the process, when a potential claim arises on a contract, we typically have the contractual obligation to perform the work and must incur the related costs. We do not recoup the costs unless and until the claim is resolved, which could take a significant amount of time.

Most of our construction contracts provide for termination of the contract for the convenience of the customer, with provisions to pay us only for work performed through the date of termination. Our backlog and results of operations have not been materially adversely affected by these provisions in the past.

We act as the prime contractor on almost all of the construction contracts that we undertake. We complete the majority of our contracts with our own resources, and we typically subcontract specialized activities such as traffic control, electrical systems, signage and trucking. As the prime contractor, we are responsible for the performance of the entire contract, including subcontract work. Thus, we are subject to increased costs associated with the failure of one or more subcontractors to perform as anticipated. We manage this risk by reviewing the size of the subcontract, the financial stability of the subcontractor and other factors. Although we generally do not require that our subcontractors furnish a bond or other type of security to guarantee their performance, we require performance and payment bonds on many specialized or large subcontract portions of our contracts. Disadvantaged business enterprise regulations require us to use our best efforts to subcontract a specified portion of contract work performed for governmental entities to certain types of subcontractors, including minority- and women-owned businesses. We have not experienced significant costs associated with subcontractor performance issues.

**Insurance and Bonding.** All of our buildings and equipment are covered by insurance, which our management believes to be adequate. In addition, we maintain general liability and excess liability insurance, all in amounts consistent with our risk of loss and industry practice. We self-insure our workers' compensation and health plan claims subject to stop-loss insurance coverage.

As a normal part of the construction business, we are generally required to provide various types of surety and payment bonds that provide an additional measure of security for our performance under public sector contracts. Typically, a bidder for a contract must post a bid bond, generally for 5% to 10% of the amount bid, and on winning the bid, must post a performance and payment bond for 100% of the contract amount. Upon completion of a contract, before receiving final payment on the contract, a contractor must post a maintenance bond for generally 1% of the contract amount for one to two years. Our ability to obtain surety bonds depends upon our capitalization, working capital, aggregate contract size, past performance, management expertise and external factors, including the capacity of the overall surety market. Surety companies consider such factors in light of the amount of our backlog that we have currently bonded and their current underwriting standards, which may change from time to time. As is customary, we have agreed to indemnify our bonding company for all losses incurred by it in connection with bonds that are issued, and we have granted our bonding company a security interest in certain assets as collateral for such obligation.

## Table of Contents

Employees. At February 15, 2008, we had more than 1,200 employees, including 15 project managers and over 50 superintendents who manage over 125 fully-equipped crews in our construction business. Of such employees, approximately 50 were located in our Houston headquarters, with most of the others being field personnel. Of our Nevada employees, 72 are union members represented by three unions.

Our business is dependent upon a readily available supply of management, supervisory and field personnel. Substantially all of our employees who work on our contracts in Texas are a permanent part of our workforce, and we generally do not rely on temporary employees to complete these contracts. In contrast, many of our employees who work on our contracts in Nevada are temporary employees. In the past, we have been able to attract sufficient numbers of personnel to support the growth of our operations.

We conduct extensive safety training programs, which have allowed us to maintain a high safety level at our worksites. All newly-hired employees undergo an initial safety orientation, and for certain types of projects, we conduct specific hazard training programs. Our project foremen and superintendents conduct weekly on-site safety meetings, and our full-time safety inspectors make random site safety inspections and perform assessments and training if infractions are discovered. In addition, all of our superintendents and project managers are required to complete an OSHA-approved safety course.

### Item 1A. Risk Factors

The risks described below are those we believe to be the material risks we face. Any of the risk factors described below could significantly and adversely affect our business, prospects, financial condition and results of operations.

#### Risks Relating to Our Business.

If we are unable to accurately estimate the overall risks or costs when we bid on a contract that is ultimately awarded to us, we may achieve a lower than anticipated profit or incur a loss on the contract.

Substantially all of our revenues and backlog are typically derived from fixed unit price contracts. Fixed unit price contracts require us to perform the contract for a fixed unit price irrespective of our actual costs. As a result, we realize a profit on these contracts only if we successfully estimate our costs and then successfully control actual costs and avoid cost overruns. 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 us to incur losses or cause the contract not to be as profitable as we expected. This, in turn, could negatively affect our cash flow, earnings and financial position.

The costs incurred and gross profit realized on such contracts can vary, sometimes substantially, from the original projections due to a variety of factors, including, but not limited to:

- onsite conditions that differ from those assumed in the original bid;
- delays caused by weather conditions;
- contract modifications creating unanticipated costs not covered by change orders;
- changes in availability, proximity and costs of materials, including steel, concrete, aggregates and other construction materials (such as stone, gravel, sand and oil for asphalt paving), as well as fuel and lubricants for our equipment;
-

inability to predict the costs of accessing and producing aggregates, and purchasing oil, required for asphalt paving projects;

12

---

Table of Contents

- availability and skill level of workers in the geographic location of a project;
  - our suppliers' or subcontractors' failure to perform;
  - fraud or theft committed by our employees;
  - mechanical problems with our machinery or equipment;
  - citations issued by any governmental authority, including the Occupational Safety and Health Administration;
  - difficulties in obtaining required governmental permits or approvals;
  - changes in applicable laws and regulations; and
- claims or demands from third parties alleging damages arising from our work or from the project of which our work is part.

Many of our contracts with public sector customers contain provisions that purport to shift some or all of the above risks from the customer to us, even in cases where the customer is partly at fault. Our experience has often been that public sector customers have been willing to negotiate equitable adjustments in the contract compensation or completion time provisions if unexpected circumstances arise. If public sector customers seek to impose contractual risk-shifting provisions more aggressively, we could face increased risks, which may adversely affect our cash flow, earnings and financial position.

Economic downturns or reductions in government funding of infrastructure projects could reduce our revenues and profits and have a material adverse effect on our results of operations.

Our business is highly dependent on the amount and timing of infrastructure work funded by various governmental entities, which, in turn, depends on the overall condition of the economy, the need for new or replacement infrastructure, the priorities placed on various projects funded by governmental entities and federal, state or local government spending levels. Spending on infrastructure could decline for numerous reasons, including decreased revenues received by state and local governments for spending on such projects, including federal funding. For example, state spending on highway and other projects can be adversely affected by decreases or delays in, or uncertainties regarding, federal highway funding, which could adversely affect us. We are reliant upon contracts with the Texas Department of Transportation, or TXDOT, and the Nevada Department of Transportation, or NDOT, for a significant portion of our revenues. Recent public statements by TXDOT officials indicate potential TXDOT funding shortfalls and reductions in spending. In addition, the recent nationwide declines in home sales and increases in foreclosures could adversely affect expenditures by state and local governments. Decreases in government funding of infrastructure projects could decrease the number of civil construction contracts available and limit our ability to obtain new contracts, which could reduce our revenues and profits.

The cancellation of significant contracts could reduce our revenues and profits and have a material adverse effect on our results of operations.

Contracts that we enter into with governmental entities can usually be canceled at any time by them with payment only for the work already completed. In addition, we could be prohibited from bidding on certain governmental contracts if we fail to maintain qualifications required by those entities. A sudden cancellation of a contract or our debarment from the bidding process could cause our equipment and work crews to remain idled for a significant period of time until other comparable work became available, which could have a material adverse effect on our

business and results of operations.

13

---

Table of Contents

We operate in Texas and Nevada, and any adverse change to the economy or business environment in Texas or Nevada could significantly affect our operations, which would lead to lower revenues and reduced profitability.

We operate in Texas and Nevada, and our Texas operations are particularly concentrated in the Houston area. Because of this concentration in specific geographic locations, we are susceptible to fluctuations in our business caused by adverse economic or other conditions in these regions, including natural or other disasters. A stagnant or depressed economy in Texas or Nevada could adversely affect our business, results of operations and financial condition.

Our acquisition strategy involves a number of risks.

In addition to organic growth of our construction business, we intend to continue pursuing growth through the acquisition of companies or assets that may enable us to expand our project skill-sets and capabilities, enlarge our geographic markets, add experienced management and increase critical mass to enable us to bid on larger contracts. However, we may be unable to implement this growth strategy if we cannot reach agreements for potential acquisitions on acceptable terms or for other reasons. Moreover, our acquisition strategy involves certain risks, including:

- difficulties in the integration of operations and systems;
- difficulties applying our expertise in one market into another market;
- the key personnel and customers of the acquired company may terminate their relationships with the acquired company;
- we may experience additional financial and accounting challenges and complexities in areas such as tax planning and financial reporting;
- we may assume or be held liable for risks and liabilities (including for environmental-related costs and liabilities) as a result of our acquisitions, some of which we may not discover during our due diligence;
- our ongoing business may be disrupted or receive insufficient management attention; and
- we may not be able to realize cost savings or other financial benefits we anticipated.

Future acquisitions may require us to obtain additional equity or debt financing, as well as additional surety bonding capacity, which may not be available on terms acceptable to us or at all. Moreover, to the extent that any acquisition results in additional goodwill, it will reduce our tangible net worth, which might have an adverse effect on our credit and bonding capacity.

## Table of Contents

Our industry is highly competitive, with a variety of larger companies with greater resources competing with us, and our failure to compete effectively could reduce the number of new contracts awarded to us or adversely affect our margins on contracts awarded.

Essentially all of the contracts on which we bid are awarded through a competitive bid process, with awards generally being made to the lowest bidder, but sometimes recognizing other factors, such as shorter contract schedules or prior experience with the customer. Within our markets, we compete with many national, regional and local construction firms. Some of these competitors have achieved greater market penetration than we have in the markets in which we compete, and some have greater financial and other resources than we do. In addition, there are a number of national companies in our industry that are larger than we are and that, if they so desire, could establish a presence in our markets and compete with us for contracts. In some markets where home building projects have slowed, construction companies that lack available work in the home building market have begun on a limited scale bidding on highway and municipal construction contracts. As a result, we may need to accept lower contract margins in order to compete against competitors that have the ability to accept awards at lower prices or have a pre-existing relationship with a customer. If we are unable to compete successfully in our markets, our relative market share and profits could be reduced.

Our dependence on subcontractors and suppliers of materials (including petroleum-based products) could increase our costs and impair our ability to complete contracts on a timely basis or at all, which would adversely affect our profits and cash flow.

We rely on third-party subcontractors to perform some of the work on many of our contracts. We generally do not bid on contracts unless we have the necessary subcontractors committed for the anticipated scope of the contract and at prices that we have included in our bid, except for trucking arrangements needed for our Nevada operations. Therefore, to the extent that we cannot engage subcontractors, our ability to bid for contracts may be impaired. In addition, if a subcontractor is unable to deliver its services according to the negotiated terms for any reason, including the deterioration of its financial condition, we may suffer delays and be required to purchase the services from another source at a higher price. This may reduce the profit to be realized, or result in a loss, on a contract.

We also rely on third-party suppliers to provide most of the materials (including aggregates, concrete, steel and pipe) for our contracts, except in Nevada where we source and produce most of our own aggregates. We do not own or operate any quarries in Texas, and there are no naturally occurring sources of aggregates in the Houston metropolitan area. We normally do not bid on contracts unless we have commitments from suppliers for the materials required to complete the contract and at prices that we have included in our bid, except for some aggregates we use in our Nevada construction projects. Thus, to the extent that we cannot obtain commitments from our suppliers for materials, our ability to bid for contracts may be impaired. In addition, if a supplier is unable to deliver materials according to the negotiated terms of a supply agreement for any reason, including the deterioration of its financial condition, we may suffer delays and be required to purchase the materials from another source at a higher price. This may reduce the profit to be realized, or result in a loss, on a contract.

Diesel fuel and other petroleum-based products are utilized to operate the plants and equipment on which we rely to perform our construction contracts. In addition, our asphalt plants and suppliers use oil in combination with aggregates to produce asphalt used in our road and highway construction projects. Decreased supplies of such products relative to demand, unavailability of petroleum supplies due to refinery turnarounds, and other factors can increase the cost of such products. Future increases in the costs of fuel and other petroleum-based products used in our business, particularly if a bid has been submitted for a contract and the costs of such products have been estimated at amounts less than the actual costs thereof, could result in a lower profit, or a loss, on a contract.

We may not accurately assess the quality, and we may not accurately estimate the quantity, availability and cost, of aggregates we plan to produce, particularly for projects in rural areas of Nevada, which could have a material adverse effect on our results of operations.

Table of Contents

Particularly for projects in rural areas of Nevada, we typically estimate these factors for anticipated aggregate sources that we have not previously used to produce aggregates, which increases the risk that our estimates may be inaccurate. Inaccuracies in our estimates regarding aggregates could result in significantly higher costs to supply aggregates needed for our projects, as well as potential delays and other inefficiencies. As a result, our failure to accurately assess the quality, quantity, availability and cost of aggregates could cause us to incur losses, which could materially adversely affect our results of operations.

We may not be able to fully realize the revenue anticipated by our reported backlog.

Almost all of the contracts included in backlog are awarded by public sector customers through a competitive bid process, with the award generally being made to the lowest bidder. We add new contracts to our backlog, typically when we are the low bidder on a public sector contract and management determines that there are no apparent impediments to award of the contract. As construction on our contracts progresses, we increase or decrease backlog to take account of changes in estimated quantities under fixed unit price contracts, as well as to reflect changed conditions, change orders and other variations from initially anticipated contract revenues and costs, including completion penalties and bonuses. We subtract from backlog the amounts we bill on contracts.

## Table of Contents

Most of the contracts with our public sector customers can be terminated at their discretion. If a customer cancels, suspends, delays or reduces a contract, we may be reimbursed for certain costs but typically will not be able to bill the total amount that had been reflected in our backlog. Cancellation of one or more contracts that constitute a large percentage of our backlog, and our inability to find a substitute contract, would have a material adverse effect on our business, results of operations and financial condition.

If we are unable to attract and retain key personnel and skilled labor, or if we encounter labor difficulties, our ability to bid for and successfully complete contracts may be negatively impacted.

Our ability to attract and retain reliable, qualified personnel is a significant factor that enables us to successfully bid for and profitably complete our work. This includes members of our management, project managers, estimators, supervisors, foremen, equipment operators and laborers. The loss of the services of any of our management could have a material adverse effect on us. Our future success will also depend on our ability to hire and retain, or to attract when needed, highly-skilled personnel. Competition for these employees is intense, and we could experience difficulty hiring and retaining the personnel necessary to support our business. If we do not succeed in retaining our current employees and attracting, developing and retaining new highly-skilled employees, our reputation may be harmed and our future earnings may be negatively impacted.

In Texas, we rely heavily on immigrant labor. Any adverse changes to existing laws and regulations, or changes in enforcement requirements or practices, applicable to employment of immigrants could negatively impact the availability and cost of the skilled personnel and labor we need, particularly in Texas. We may not be able to continue to attract and retain sufficient employees at all levels due to changes in immigration enforcement practices or compliance standards or for other reasons.

In Nevada, a substantial number of our equipment operators and laborers are unionized. Any work stoppage or other labor dispute involving our unionized workforce would have a material adverse effect on our operations and operating results in Nevada.

Our contracts may require us to perform extra or change order work, which can result in disputes and adversely affect our working capital, profits and cash flows.

Our contracts generally require us to perform extra or change order work as directed by the customer even if the customer has not agreed in advance on the scope or price of the extra work to be performed. This process may result in disputes over whether the work performed is beyond the scope of the work included in the original project plans and specifications or, if the customer agrees that the work performed qualifies as extra work, the price that the customer is willing to pay for the extra work. These disputes may not be settled to our satisfaction. Even when the customer agrees to pay for the extra work, we may be required to fund the cost of such work for a lengthy period of time until the change order is approved by the customer and we are paid by the customer.

To the extent that actual recoveries with respect to change orders or amounts subject to contract disputes or claims are less than the estimates used in our financial statements, the amount of any shortfall will reduce our future revenues and profits, and this could have a material adverse effect on our reported working capital and results of operations. In addition, any delay caused by the extra work may adversely impact the timely scheduling of other project work and our ability to meet specified contract milestone dates.

Our failure to meet schedule or performance requirements of our contracts could adversely affect us.

In most cases, our contracts require completion by a scheduled acceptance date. Failure to meet any such schedule could result in additional costs, penalties or liquidated damages being assessed against us, and these could exceed

projected profit margins on the contract. Performance problems on existing and future contracts could cause actual results of operations to differ materially from those anticipated by us and could cause us to suffer damage to our reputation within the industry and among our customers.

## Table of Contents

Unanticipated adverse weather conditions may cause delays, which could slow completion of our contracts and negatively affect our current and future revenues and cash flow.

Because all of our construction projects are built outdoors, work on our contracts is subject to unpredictable weather conditions, which could become more frequent or severe if general climatic changes occur. For example, evacuations in Texas due to Hurricane Rita resulted in our inability to perform work on all Houston-area contracts for several days. Lengthy periods of wet weather will generally interrupt construction, and this can lead to under-utilization of crews and equipment, resulting in less efficient rates of overhead recovery. For example, during the first nine months of 2007, we experienced an above-average number of days and amount of rainfall across our Texas markets, which impeded our ability to work on construction projects and reduced our gross profit. During the late fall to early spring months of the year, our work on construction projects in Nevada may also be curtailed because of snow and other work-limiting weather. While revenues can be recovered following a period of bad weather, it is generally impossible to recover the inefficiencies, and significant periods of bad weather typically reduce profitability of affected contracts both in the current period and during the future life of affected contracts. Such reductions in contract profitability negatively affect our results of operations in current and future periods until the affected contracts are completed.

Timing of the award and performance of new contracts could have an adverse effect on our operating results and cash flow.

It is generally very difficult to predict whether and when new contracts will be offered for tender, as these contracts frequently involve a lengthy and complex design and bidding process, which is affected by a number of factors, such as market conditions, financing arrangements and governmental approvals. Because of these factors, our results of operations and cash flows may fluctuate from quarter to quarter and year to year, and the fluctuation may be substantial.

The uncertainty of the timing of contract awards may also present difficulties in matching the size of our equipment fleet and work crews with contract needs. In some cases, we may maintain and bear the cost of more equipment and ready work crews than are currently required, in anticipation of future needs for existing contracts or expected future contracts. If a contract is delayed or an expected contract award is not received, we would incur costs that could have a material adverse effect on our anticipated profit.

In addition, the timing of the revenues, earnings and cash flows from our contracts can be delayed by a number of factors, including adverse weather conditions such as prolonged or intense periods of rain, snow, storms or flooding, delays in receiving material and equipment from suppliers and changes in the scope of work to be performed. Such delays, if they occur, could have adverse effects on our operating results for current and future periods until the affected contracts are completed.

Our dependence on a limited number of customers could adversely affect our business and results of operations.

Due to the size and nature of our construction contracts, one or a few customers have in the past and may in the future represent a substantial portion of our consolidated revenues and gross profits in any one year or over a period of several consecutive years. For example, in 2007, approximately 78% of our revenue was generated from three customers, and approximately 97% of RHB's revenue was generated from one customer. Similarly, our backlog frequently reflects multiple contracts for individual customers; therefore, one customer may comprise a significant percentage of backlog at a certain point in time. An example of this is TXDOT, with which we had 23 contracts representing an aggregate of approximately 47% of our backlog at December 31, 2007. The loss of business from any one of such customers could have a material adverse effect on our business or results of operations. Recent public statements by TXDOT officials indicate potential TXDOT funding shortfalls and reductions in spending. Because we do not maintain any reserves for payment defaults, a default or delay in payment on a significant scale could

materially adversely affect our business, results of operations and financial condition.

18

---

Table of Contents

We may incur higher costs to lease, acquire and maintain equipment necessary for our operations, and the market value of our owned equipment may decline.

We have traditionally owned most of the construction equipment used to build our projects. To the extent that we are unable to buy construction equipment necessary for our needs, either due to a lack of available funding or equipment shortages in the marketplace, we may be forced to rent equipment on a short-term basis, which could increase the costs of performing our contracts.

The equipment that we own or lease requires continuous maintenance, for which we maintain our own repair facilities. If we are unable to continue to maintain the equipment in our fleet, we may be forced to obtain third-party repair services, which could increase our costs. In addition, the market value of our equipment may unexpectedly decline at a faster rate than anticipated. Such a decline would reduce the borrowing base under our credit facility, thereby reducing the amount of credit available to us and impeding our ability to continue to expand our business.

An inability to obtain bonding could limit the aggregate dollar amount of contracts that we are able to pursue.

As is customary in the construction business, we are required to provide surety bonds to secure our performance under construction contracts. Our ability to obtain surety bonds primarily depends upon our capitalization, working capital, past performance, management expertise and reputation and certain external factors, including the overall capacity of the surety market. Surety companies consider such factors in relationship to the amount of our backlog and their underwriting standards, which may change from time to time. Events that affect the insurance and bonding markets generally may result in bonding becoming more difficult to obtain in the future, or being available only at a significantly greater cost. Our inability to obtain adequate bonding, and, as a result, to bid on new contracts, could have a material adverse effect on our future revenues and business prospects.

Our operations are subject to hazards that may cause personal injury or property damage, thereby subjecting us to liabilities and possible losses, which may not be covered by insurance.

Our workers are subject to the usual hazards associated with providing construction and related services on construction sites, plants and quarries. Operating hazards can cause personal injury and loss of life, damage to or destruction of property, plant and equipment and environmental damage. We self-insure our workers' compensation claims, subject to stop-loss insurance coverage. We also maintain insurance coverage in amounts and against the risks that we believe are consistent with industry practice, but this insurance may not be adequate to cover all losses or liabilities that we may incur in our operations.

Insurance liabilities are difficult to assess and quantify due to unknown factors, including the severity of an injury, the determination of our liability in proportion to other parties, the number of incidents not reported and the effectiveness of our safety program. If we were to experience insurance claims or costs above our estimates, we might also be required to use working capital to satisfy these claims rather than to maintain or expand our operations. To the extent that we experience a material increase in the frequency or severity of accidents or workers' compensation claims, or unfavorable developments on existing claims, our operating results and financial condition could be materially and adversely affected.

Table of Contents

Environmental and other regulatory matters could adversely affect our ability to conduct our business and could require expenditures that could have a material adverse effect on our results of operations and financial condition.

Our operations are subject to various environmental laws and regulations relating to the management, disposal and remediation of hazardous substances and the emission and discharge of pollutants into the air and water. We could be held liable for such contamination created not only from our own activities but also from the historical activities of others on our project sites or on properties that we acquire or lease. Our operations are also subject to laws and regulations relating to workplace safety and worker health, which, among other things, regulate employee exposure to hazardous substances. Immigration laws require us to take certain steps intended to confirm the legal status of our immigrant labor force, but we may nonetheless unknowingly employ illegal immigrants. Violations of such laws and regulations could subject us to substantial fines and penalties, cleanup costs, third-party property damage or personal injury claims. In addition, these laws and regulations have become, and enforcement practices and compliance standards are becoming, increasingly stringent. Moreover, we cannot predict the nature, scope or effect of legislation or regulatory requirements that could be imposed, or how existing or future laws or regulations will be administered or interpreted, with respect to products or activities to which they have not been previously applied. Compliance with more stringent laws or regulations, as well as more vigorous enforcement policies of the regulatory agencies, could require us to make substantial expenditures for, among other things, pollution control systems and other equipment that we do not currently possess, or the acquisition or modification of permits applicable to our activities.

Our aggregate quarry lease in Nevada could subject us to costs and liabilities. A limited environmental assessment report was inconclusive about potential environmental contamination at the Nevada quarry resulting from various mining activities and landfill operations that may have occurred on or near the property. Due to the limited nature of the report, we are unable to assess the extent of our liability, if any, at the quarry. As lessee and operator of the quarry, we could be held responsible for any contamination or regulatory violations resulting from activities or operations at the quarry. Any such costs and liabilities could be significant and could materially and adversely affect our business, operating results and financial condition.

We may be unable to sustain our historical revenue growth rate.

Our revenue has grown rapidly in recent years. However, we may be unable to sustain these recent revenue growth rates for a variety of reasons, including limits on additional growth in our current markets, less success in competitive bidding for contracts, limitations on access to necessary working capital and investment capital to sustain growth, limitations on access to bonding to support increased contracts and operations, inability to hire and retain essential personnel and to acquire equipment to support growth, and inability to identify acquisition candidates and successfully acquire and integrate them into our business. A decline in our revenue growth could have a material adverse effect on our financial condition and results of operations if we are unable to reduce the growth of our operating expenses at the same rate.

## Table of Contents

Terrorist attacks have impacted, and could continue to negatively impact, the U.S. economy and the markets in which we operate.

Terrorist attacks, like those that occurred on September 11, 2001, have contributed to economic instability in the United States, and further acts of terrorism, violence or war could affect the markets in which we operate, our business and our expectations. Armed hostilities may increase, or terrorist attacks, or responses from the United States, may lead to further acts of terrorism and civil disturbances in the United States or elsewhere, which may further contribute to economic instability in the United States. These attacks or armed conflicts may affect our operations or those of our customers or suppliers and could impact our revenues, our production capability and our ability to complete contracts in a timely manner.

## Risks Related to Our Financial Results and Financing Plans

Actual results could differ from the estimates and assumptions that we use to prepare our financial statements.

To prepare financial statements in conformity with GAAP, management is required to make estimates and assumptions, as of the date of the financial statements, which affect the reported values of assets and liabilities, revenues and expenses, and disclosures of contingent assets and liabilities. Areas requiring significant estimates by our management include: contract costs and profits and application of percentage-of-completion accounting and revenue recognition of contract change order claims; provisions for uncollectible receivables and customer claims and recoveries of costs from subcontractors, suppliers and others; valuation of assets acquired and liabilities assumed in connection with business combinations; and accruals for estimated liabilities, including litigation and insurance reserves. Our actual results could differ from, and could require adjustments to, those estimates.

In particular, as is more fully discussed in Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies," we recognize contract revenue using the percentage-of-completion method. Under this method, estimated contract revenue is recognized by applying the percentage of completion of the contract for the period to the total estimated revenue for the contract. Estimated contract losses are recognized in full when determined. Contract revenue and total cost estimates are reviewed and revised on a continuous basis as the work progresses and as change orders are initiated or approved, and adjustments based upon the percentage of completion are reflected in contract revenue in the accounting period when these estimates are revised. To the extent that these adjustments result in an increase, a reduction or an elimination of previously reported contract profit, we recognize a credit or a charge against current earnings, which could be material.

We may need to raise additional capital in the future for working capital, capital expenditures and/or acquisitions, and we may not be able to do so on favorable terms or at all, which would impair our ability to operate our business or achieve our growth objectives.

Our growth has been funded in part by our utilization of net operating loss carry-forwards, or NOLs, to reduce the amounts that we have paid for income taxes, and we expect our NOLs to be fully utilized in 2008. Paying taxes will reduce cash flows from operations compared to prior periods, as we will be required to fund the payment of taxes in 2008 and future periods. To the extent that cash flow from operations is insufficient to fund future investments, make acquisitions or provide needed additional working capital, we may require additional financing from other sources of funds.

Our ability to obtain such additional financing in the future will depend in part upon prevailing capital market conditions, as well as conditions in our business and our operating results; such factors may adversely affect our efforts to arrange additional financing on terms satisfactory to us. We have pledged the proceeds and other rights under our construction contracts to our bond surety, and we have pledged substantially all of our other assets as

collateral in connection with our credit facility and mortgage debt. As a result, we may have difficulty in obtaining additional financing in the future if such financing requires us to pledge assets as collateral. In addition, under our credit facility, we must obtain the consent of our lenders to incur any amount of additional debt from other sources (subject to certain exceptions). If future financing is obtained by the issuance of additional shares of common stock, our stockholders may suffer dilution. If adequate funds are not available, or are not available on acceptable terms, we may not be able to make future investments, take advantage of acquisitions or other opportunities, or respond to competitive challenges.

Table of Contents

We are subject to financial and other covenants under our credit facility that could limit our flexibility in managing our business.

We have a revolving credit facility that restricts us from engaging in certain activities, including restrictions on the ability (subject to certain exceptions) to:

- make distributions and dividends;
- incur liens or encumbrances;
- incur indebtedness;
- guarantee obligations;
- dispose of a material portion of assets or otherwise engage in a merger with a third party;
- make acquisitions; and
- incur losses for two consecutive quarters.

Our credit facility contains financial covenants that require us to maintain specified fixed charge coverage ratios, asset ratios and leverage ratios, and to maintain specified levels of tangible net worth. Our ability to borrow funds for any purpose will depend on our satisfying these tests. If we are unable to meet the terms of the financial covenants or fail to comply with any of the other restrictions contained in our credit facility, an event of default could occur. An event of default, if not waived by our lenders, could result in the acceleration of any outstanding indebtedness, causing such debt to become immediately due and payable. If such an acceleration occurs, we may not be able to repay such indebtedness on a timely basis. Acceleration of our credit facility could result in foreclosure on and loss of our operating assets. In the event of such foreclosure, we would be unable to conduct our business and forced to discontinue operations.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

We own our 15,000 square-foot headquarters office building in Houston, Texas, which is located on a seven-acre parcel of land on which our Texas equipment repair center is also located. We also own land in Dallas and San Antonio on which we plan to construct regional offices and repair facilities. Pending completion of these regional offices, we lease office facilities in these locations. In order to complete most contracts in Texas, we lease small parcels of real estate near the site of a contract job site to store materials, locate equipment, conduct concrete crushing and pugging operations, and provide offices for the contracting customer, its representatives and our employees.

For our Nevada operations, we lease office space in Reno, Nevada, and we have an office and repair facilities located on a forty-five acre parcel of land in Lovelock, Nevada. We also lease a quarry in Carson City, Nevada. Unlike in Texas where we acquire aggregates from third-party suppliers, in Nevada, we source and produce our own aggregates, whether from the Carson City quarry or from other sources near job sites where we enter into short-term leases to acquire the aggregates necessary for the job. In order to complete most contracts in Nevada, we also lease small parcels of real estate near the site of a contract job site to store materials, locate equipment, and provide offices for the

contracting customer, its representatives and our employees.

22

---

Table of Contents

## Item 3. 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 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 4. Submission of Matters to a Vote of Security Holders

None

## PART II

## Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

The Company's common stock began trading on the Nasdaq National Market on January 20, 2006 under the symbol "STRL" and in June 2006, it was included in the NASDAQ Global Select Market ("NGS"). For approximately two years prior to its Nasdaq listing, the common stock was traded on the American Stock Exchange, or Amex, under the symbol "STV".

The table below shows the market high and low closing sales prices of the common stock for 2006 and 2007 by quarter and for the period from January 1, through February 29, 2008, on Amex or Nasdaq, as the case may be.

	High	Low
Year Ended December 31, 2006		
First Quarter	\$ 23.76	\$ 15.39
Second Quarter	\$ 32.19	\$ 22.00
Third Quarter	\$ 30.13	\$ 16.67
Fourth Quarter	\$ 25.31	\$ 19.54
Year Ended December 31, 2007		
First Quarter	\$ 22.74	\$ 17.42
Second Quarter	\$ 23.86	\$ 18.90
Third Quarter	\$ 23.97	\$ 18.64
Fourth Quarter	\$ 26.60	\$ 20.45
January 1 through February 29, 2008	\$ 21.84	\$ 19.65

On February 29, 2008, there were approximately 1,250 holders of record of our common stock.

**Dividend Policy.** We have never paid any cash dividends on our common stock. For the foreseeable future, we intend to retain any earnings in our business, and we do not anticipate paying any cash dividends. Whether or not we declare any dividends will be at the discretion of the Board of Directors considering then-existing conditions, including the Company's financial condition and results of operations, capital requirements, bonding prospects, contractual restrictions (including those under the Company's Credit Facility) business prospects and other factors that our Board of Directors considers relevant.



Table of Contents

Equity Compensation Plan Information Certain information about the Company's equity compensation plans is set forth in Item 12. — Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Performance Graph The following graph compares the percentage change in the Company's cumulative total stockholder return on its common stock for the last five years with the Dow Jones US Total Market Index, a broad market index, and the Dow Jones US Heavy Construction Index, a group of companies whose marketing strategy is focused on a limited product line, such as civil construction. Both indices are published in The Wall Street Journal.

The returns are calculated assuming that an investment with a value of \$100 was made in the Company's common stock and in each index at the end of 2002 and that all dividends were reinvested in additional shares of common stock; however, the Company has paid no dividends during the periods shown. The graph lines merely connect the measuring dates and do not reflect fluctuations between those dates. The stock performance shown on the graph is not intended to be indicative of future stock performance.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL\*  
Among Sterling Construction Company, Inc. The Dow Jones US Index  
And the Dow Jones US Heavy Construction Index

\*\$100 invested on 12/31/02 in stock or index-including reinvestment of dividends.  
Fiscal year ending December 31.

	December 2002	December 2003	December 2004	December 2005	December 2006	December 2007
Sterling Construction Company, Inc	100.00	258.86	296.57	961.71	1,243.43	1,246.86
Dow Jones US	100.00	130.75	146.45	155.72	179.96	190.77
Dow Jones US Heavy Construction	100.00	136.41	165.42	239.03	298.17	566.39

Table of Contents

## Item 6. Selected Financial Data

The following table sets forth selected financial and other data of the Company and its subsidiaries and should be read in conjunction with both Item 7. —Management’s Discussion and Analysis of Financial Condition and Results of Operations, which follows, and Item 8. — Financial Statements and Supplementary Data.

	Year Ended December 31				
	2007	2006	2005	2004	2003
	(Amounts in thousands except per-share data)				
<b>Operating Results:</b>					
Revenues	\$ 306,220	\$ 249,348	\$ 219,439	\$ 132,478	\$ 149,006
Income from continuing operations before income taxes and minority interest	22,421	19,204	13,329	4,109	8,583
Minority interest	(62)	—	—	(962)	(1,627)
Income tax (expense)/benefit	(7,890)	(6,566)	(2,788)	2,134	(1,752)
Income from continuing operations	14,469	12,638	10,541	5,281	5,204
Income (loss) from discontinued operations, including gain on sale in 2006	(25)	682	559	372	215
Net income	\$ 14,444	\$ 13,320	\$ 11,100	\$ 5,653	\$ 5,419
<b>Basic and diluted per share amounts:</b>					
<b>Basic earnings per share from continuing operations</b>					
	\$ 1.31	\$ 1.19	\$ 1.36	\$ 0.99	\$ 1.02
<b>Basic earnings per share from discontinued operations</b>					
	—\$	0.06	\$ 0.07	\$ 0.07	\$ 0.04
Basic earnings per share	\$ 1.31	\$ 1.25	\$ 1.43	\$ 1.06	\$ 1.06
Basic weighted average shares outstanding	11,044	10,583	7,775	5,343	5,090
<b>Diluted earnings per share from continuing operations</b>					
	\$ 1.22	\$ 1.08	\$ 1.11	\$ 0.75	\$ 0.80
<b>Diluted earnings per share from discontinued operations</b>					
	—\$	0.06	\$ 0.05	\$ 0.05	\$ 0.03
Diluted earnings per share	\$ 1.22	\$ 1.14	\$ 1.16	\$ 0.80	\$ 0.83
Diluted weighted average shares outstanding	11,836	11,714	9,538	7,028	6,489
Cash dividends declared	—	—	—	—	—
<b>Balance Sheet:</b>					
Total assets	\$ 274,515	\$ 167,772	\$ 118,455	\$ 89,544	\$ 75,578
Long-term debt	65,556	30,659	14,570	21,979	19,992
Book value per share of outstanding common stock	\$ 10.66	\$ 8.37	\$ 5.95	\$ 4.77	\$ 3.24
Equity	138,612	90,991	48,612	35,208	16,636
Shares outstanding	13,007	10,875	8,165	7,379	5,140

In January 2006 the Company completed a public offering of approximately 2.0 million shares of its common stock at \$15.00 per share. The Company received proceeds, net of underwriting commissions, of approximately \$28.0 million

(\$13.95 per share) and paid approximately \$907,000 in related offering expenses. In addition, the Company received approximately \$484,000 from the exercise of warrants and options to purchase 321,758 shares. These shares were sold by the option and warrant holders in the offering. From the proceeds of the offering, the Company repaid all its outstanding related party promissory notes in January 2006. Executive management, directors and former directors received proceeds as follows:

25

---

Table of Contents

Name	Principal	Interest	Total Payment
Patrick T. Manning	\$ 318,592	2,867	\$ 321,459
James D. Manning	\$ 1,855,349	16,698	\$ 1,872,047
Joseph P. Harper, Sr.	\$ 2,637,422	23,737	\$ 2,661,159
Maarten D. Hemsley	\$ 181,205	1,631	\$ 182,836
Robert M. Davies	\$ 452,909	4,076	\$ 456,985

During 2006, the Company utilized part of the offering proceeds to purchase additional capital equipment for the construction business, to replenish funds that had been used for the 2006 acquisition of a drill shaft business.

In December 2007, the Company completed an additional public offering of 1.84 million shares of its common stock at \$20.00 per share. The Company received proceeds, net of underwriting commissions, of approximately \$35.0 million (\$19.00 per share) and paid approximately \$0.5 million in related offering expenses. A reconciliation of the use of proceeds through December 31, 2007 is as follows (in thousands, except share data) (unaudited):

Shares issued upon completion of equity offering	1,840,000
Proceeds received from sale of shares	\$ 36,800
Less:	
Underwriters' commission	\$ (1,840)
Expenses (legal, printing, etc.)	\$ (471)
Net proceeds from sale of shares	\$ 34,489
Use of proceeds:	
Repayment of credit line at a bank	\$ 4,951
Purchase of short term securities(1)	\$ 24,708
Total spent through December 31, 2007	\$ 29,659
Balance retained in working capital	\$ 4,830

(1) Between the purchase date of RHB and the 2007 public offering of stock, the Company used the proceeds from the sale of its investments in short-term securities to pay off the Credit Facility borrowings of \$22.4 million used to purchase RHB. The proceeds of the public stock offering were used to replenish the investment in short-term securities.

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

Overview

For an overview of the Company's business and its associated risks, see Item 1. Business and Item 1A. Risk Factors.

Critical Accounting Policies

Our significant accounting policies are described in Note 1 of Notes to Consolidated Financial Statements for the year ended December 31, 2007.

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 and 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. Our business involves making significant estimates and assumptions in the normal course of business relating to our contracts due to, among other things, the one-of-a-kind nature of most of our contracts, the long-term duration of our contract cycle and the type of contract utilized. Therefore, management believes that "Revenue Recognition" is the most important and critical accounting policy. The most significant estimates with regard to these financial statements relate to the estimating of total forecasted construction contract revenues, costs and profits in accordance with accounting for long-term contracts. Actual results could differ from these estimates and such differences could be material.

Our estimates of contract revenue and cost are highly detailed. We believe, based on our experience, that our current systems of management and accounting controls allow management to produce reliable estimates of total contract revenue and cost during any accounting period. However, many factors can and do change during a contract performance period, which can result in a change to contract profitability from one financial reporting period to another. Some of the factors that can change the estimate of total contract revenue, cost and profit include differing site conditions (to the extent that contract remedies are unavailable), the failure of major material suppliers to deliver on time, the performance of subcontractors, unusual weather conditions, our productivity and efficient use of labor and equipment and the accuracy of the original bid estimate. Because we have a large number of contracts in process at any given time, these changes in estimates can sometimes offset each other without affecting overall profitability. However, significant changes in cost estimates on larger, more complex projects can have a material impact on our financial statements and are reflected in our results of operations when they become known.

When recording revenue from change orders on contracts that have been approved as to scope but not price, we include in revenue an amount equal to the amount that we currently expect to recover from customers in relation to costs incurred by us for changes in contract specifications or designs, or other unanticipated additional costs. Revenue relating to change order claims is recognized only if it is probable that the revenue will be realized. When determining the likelihood of eventual recovery, we consider such factors as evaluation of entitlement, settlements reached to date and our experience with the customer. When new facts become known, an adjustment to the estimated recovery is made and reflected in the current period results.

Revenue Recognition.

The majority of our contracts with our customers are "fixed unit price." Under such contracts, we are committed to providing materials or services required by a contract at fixed unit prices (for example, dollars per cubic yard of concrete poured or per cubic yard of earth excavated). To minimize increases in the material prices and

subcontracting costs used in submitting bids, we obtain firm quotations from our suppliers and subcontractors. After we are advised that our bid is the winning bid, we enter into firm contracts with our materials suppliers and sub-contractors, thereby mitigating the risk of future price variations affecting those contract costs. Such quotations do not include any quantity guarantees, and we therefore have no obligation for materials or subcontract services beyond those required to complete the respective contracts that we are awarded for which quotations have been provided. The principal remaining risks under fixed price contracts relate to labor and equipment costs and productivity levels. As a result, we have rarely been exposed to material price or availability risk on contracts in our contract backlog. Most of our state and municipal contracts provide for termination of the contract for the convenience of the owner, with provisions to pay us only for work performed through the date of termination.

## Table of Contents

We use the percentage of completion accounting method for construction contracts in accordance with the American Institute of Certified Public Accountants Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts." Revenue and earnings on construction contracts are recognized on the percentage of completion method in the ratio of costs incurred to estimated final costs. Revenue is recognized as costs are incurred in an amount equal to cost plus the related expected profit. Contract cost consists of direct costs on contracts, including labor and materials, amounts payable to subcontractors and equipment expense (primarily depreciation, fuel, maintenance and repairs). Depreciation is computed using the straight-line method for construction equipment. Contract cost is recorded as incurred, and revisions in contract revenue and cost estimates are reflected in the accounting period when known.

The accuracy of our revenue and profit recognition in a given period is dependent on the accuracy of our estimates of the cost to finish uncompleted contracts. Our cost estimates for all of our significant contracts use a highly detailed "bottom up" approach, and we believe our experience allows us to produce reliable estimates. However, our contracts can be highly complex, and in almost every case, the profit margin estimates for a contract will either increase or decrease to some extent from the amount that was originally estimated at the time of bid. Because we have a large number of contracts of varying levels of size and complexity in process at any given time, these changes in estimates can sometimes offset each other without materially impacting our overall profitability. However, large changes in revenue or cost estimates can have a more significant effect on profitability.

There are a number of factors that can contribute to changes in estimates of contract cost and profitability. The most significant of these include the completeness and accuracy of the original bid, recognition of costs associated with scope changes, extended overhead due to customer-related and weather-related delays, subcontractor performance issues, site conditions that differ from those assumed in the original bid (to the extent contract remedies are unavailable), the availability and skill level of workers in the geographic location of the contract and changes in the availability and proximity of materials. The foregoing factors, as well as the stage of completion of contracts in process and the mix of contracts at different margins, may cause fluctuations in gross profit between periods, and these fluctuations may be significant.

### Valuation of Long-Term Assets.

Long-lived assets, which include property, equipment and acquired identifiable intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment evaluations involve management estimates of useful asset lives and future cash flows. Actual useful lives and cash flows could be different from those estimated by management, and this could have a material effect on operating results and financial position. In addition, we had goodwill with a value of approximately \$57 million at December 31, 2007, which must be reviewed for impairment at least annually in accordance with Statement of Financial Accounting Standards No. 142, or SFAS 142. The impairment testing required by SFAS 142 requires considerable judgment, and an impairment charge may be required in the future. We completed our annual impairment review for goodwill during the 4th quarter of 2007, and it did not result in an impairment.

## Table of Contents

### Income Taxes.

Deferred tax assets and liabilities are recognized based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. We regularly review our deferred tax assets for recoverability and, where necessary, establish a valuation allowance. Reflecting management's assessment of expected future operating profitability and expectation that the Company would utilize all remaining net operating loss carry forwards ("NOLs"), we eliminated our valuation allowance in 2005. We are subject to the alternative minimum tax (AMT). Because we are still utilizing our NOLs to offset taxable income, payment of AMT results in a reduction of our deferred tax liability.

An ownership change, which may occur if there is a transfer of ownership exceeding 50% of our outstanding shares of common stock in any three-year period, may lead to a limitation in the usability of, or a potential loss of some or all of, the NOLs. In order to reduce the likelihood of an ownership change occurring, our restated and amended certificate of incorporation, as amended, prohibits transfers of our common stock resulting in, or increasing, individual holdings in excess of 4.5% of our common stock, unless such transfer is made by us or with the consent of our board of directors.

Because the regulations governing NOLs are highly complex and may be changed from time to time, and because our attempts to prevent an ownership change from occurring may not be successful, the NOLs could be limited or lost. We believe that the NOLs are currently available in full, however, and intend to take all reasonable and appropriate steps to ensure that they will remain available. To the extent the NOLs become unavailable to us, our future taxable income and that of any consolidated affiliate will be subject to federal taxation, thus reducing funds otherwise available for corporate purposes.

Although our NOLs do not expire until 2020, if unused, we estimate that our deferred tax assets related to our NOLs will be fully utilized during 2007. After the expiration or utilization of our NOLs, we have available to us the excess tax benefit resulting from exercise of a significant number of non-qualified in-the-money options amounting to \$1.3 million as of December 31, 2007. Accordingly, because we will no longer have the significant offsets provided by the NOLs, a comparison of our future cash flows to our historic cash flows may not be meaningful.

On January 1, 2007, we adopted the provisions of Financial Interpretation No. 48, (FIN 48) which establishes the criteria that an individual tax position must meet for some or all of the benefits of that position to be recorded. Adoption of FIN 48 did not have a material impact on our consolidated financial statements.

### Discontinued Operations.

In August 2005, our board of directors authorized management to sell our distribution business. In accordance with the provisions of SFAS 144, we determined in the third quarter of 2005 that the distribution business became a long-lived asset held for sale and a discontinued operation. In October 2006, we sold the distribution business to an industry-related buyer for gross proceeds of approximately \$5.4 million. We recognized a pre-tax gain on the sale in 2006 of approximately \$249,000, equal to \$121,000 after taxes.

Table of Contents

## Results of Operations

Fiscal Year Ended December 31, 2007 (2007) Compared with Fiscal Year Ended December 31, 2006 (2006).

	2007	2006	% Change
	(Dollar amounts in thousands)		
Revenues	\$ 306,220	\$ 249,348	22.8%
Gross profit	33,686	28,547	18.0%
Gross margin	11.0%	11.4%	(3.5)%
General and administrative expenses, net	(13,206)	(10,825)	22.0%
Other income	549	276	98.9%
Operating income	21,029	17,998	16.8%
Operating margin	6.9%	7.2%	(4.2)%
Interest income	1,669	1,426	17.0%
Interest expense	(278)	(220)	26.5%
Minority Interest	(62)	—	100.0%
Income from continuing operations before taxes	22,359	19,204	16.4%
Income taxes	7,890	6,566	20.2%
Net income from continuing operations	14,469	12,638	14.5%
Net income (loss) from discontinued operations, including gain on sale	(25)	682	(103.7)%
Net income	\$ 14,444	\$ 13,320	8.4%
Contract backlog, end of year	\$ 450,000	\$ 395,000	13.9%

Revenues. Revenues increased \$57 million, or 23%, from 2006 to 2007 reflecting the effect of continued expansion of our construction fleet, addition of a concrete plant and addition of crews. Our workforce grew by 18% year-over-year, and we purchased over \$36 million in property, plant and equipment, including that acquired in the purchase of RHB, within the twelve month period ending December 31, 2007. The increased revenue came strictly from the state market resulting from the Company being the successful low bidder in the state market which was assisted by an improved bidding climate in 2006 due to a large state highway program and increased total funding in the Dallas and Houston areas. The improvement in the weather in the fourth quarter 2007 offset much of the lower than expected revenue of the first three quarters of 2007 due to heavy rainfall during those months. Due to seasonality of the Nevada market, the contracts of RHB had only a modest effect on revenues for the two months they were included in 2007 revenues. Contract receivables are directly related to revenues and include both amount currently due and retainage. The increase of \$11.6 million in contracts receivable to \$54.4 million at December 31, 2007 versus 2006 is due to the increase in revenue for the year 2007. The days revenue in contract receivables is approximately 64 days and 62 days at December 31, 2007 and 2006, respectively.

Gross Profit. The improvement in gross profits in 2007 was due principally to the increase in revenues. The slight margin reduction was attributable to a decrease of margin in backlog, due to poor weather for the first three quarters of the year, and an increase in sales from the state contracts which have historically had lower gross margin than municipal contracts. State highway contracts generally allow us to achieve greater revenue and gross profit production from our equipment and work crews, although on average the gross margins on this work tend to be slightly lower than on our water infrastructure contracts in the municipal markets. The lower margins reflect proportionally larger material inputs in the state contracts as we typically receive lower margins on materials than on labor. Partially offsetting the margin reduction was our ability to continue to redesign some jobs, achieve incentive awards and maintain good execution levels during dry weather. Due to the large number of contracts in different stages of completion and in different locations, it is not practical to quantify the impact of each of these matters on

revenues and gross profit.

30

---

Table of Contents

**Contract Backlog.** The increase in contract backlog is related to the Nevada acquisition where backlog was \$116 million at December 31, 2007. There was \$16 million included in our 2007 year-end backlog on which we were the apparent low bidder and have subsequently been officially awarded these contracts. Historically, subsequent non-awards of such low bids have not materially affected our backlog or financial condition.

**General and Administrative Expenses, Net of Other Income and Expense.** The increase in general and administrative expenses, or G&A, in 2007 was principally due to higher employee expenses, including an increase in staff, and higher professional fees. Despite these increases in G&A expenses in support of our growing business, our ratio of G&A expenses to revenue remained essentially unchanged from 2006 to 2007, at 4%.

**Operating Income.** The 2007 increase in operating income resulted principally from the higher revenues and gross profits as discussed above.

**Interest Income Net of Interest Expense.** The interest income net of interest expense remained virtually unchanged from 2006 to 2007 given the high cash and short term investments maintained throughout the year and the offering completed in December 2007. A total of \$53,000 of interest expense was capitalized as part of our office and shop expansion.

**Minority Interest.** As discussed in Part I, Item 1. Business, on October 31, 2007, the Company acquired a 91.67% interest in RHB. The minority interest's share of RHB's income before income taxes was \$62,000 for the two months ended December 31, 2007 that was included in the consolidated results of operations.

**Income Taxes.** Income taxes increased due to increased income, the Texas margin tax and increases in the statutory tax rate.

**Net Income from Continuing Operations.** The 2007 increase in net income from continuing operations was the result of the various factors discussed above.

**Discontinued Operations, Net of Tax.** Discontinued operations for 2007 and 2006 represent the results of operations of our distribution business, which was operated by Steel City Products, LLC.

The distribution business was sold on October 27, 2006. The Company recorded proceeds from the sale of approximately \$5.4 million and recorded a pre-tax gain on the sale of approximately \$249,000 and recorded \$128,000 in income tax expense related to that gain in 2006.

Table of Contents

Fiscal Year Ended December 31, 2006 (2006) Compared with Fiscal Year Ended December 31, 2005 (2005).

	2006	2005	% Change
	(Dollar amounts in thousands)		
Revenues	\$ 249,348	\$ 219,439	13.6%
Gross profit	28,547	23,756	20.2%
Gross margin	11.4%	10.8%	5.6%
General and administrative expenses and other	10,549	9,091	15.0%
Operating income	17,998	14,665	22.7%
Operating margin	7.2%	6.7%	7.5%
Interest income	1,426	150	850.6%
Interest expense	220	1,486	(85.2)%
Income from continuing operations before taxes	19,204	13,329	44.1%
Income taxes	6,566	2,788	135.5%
Net income from continuing operations	12,638	10,541	19.9%
Net income from discontinued operations, including gain on sale	682	559	22.0%
Net income	\$ 13,320	\$ 11,100	20.0%
Backlog, end of year	\$ 395,000	\$ 307,000	28.7%

Revenues. Our revenue increase of \$29.9 million, or 14%, from 2005 to 2006 included a substantial increase in revenues from state highway work of \$89.0 million, or 114%, to \$166.3 million as we took advantage of the very strong bidding climate in this sector and the resultant increase in the proportion of state highway contracts in our backlog. In particular, we saw a near-tripling of revenues in the Dallas market, where we won several major contracts in early 2006, and also good growth in the San Antonio market. State highway contracts generally allow us to achieve greater revenue and gross profit production from our equipment and work crews, although on average the gross margins on this work are slightly lower than on our water infrastructure contracts in the municipal markets because of the cost of larger material inputs into the state contracts.

At the same time there was a decrease in our municipal revenues of \$59.0 million, or 41.5%, to \$83 million due to a decrease in the market for large diameter water line infrastructure construction.

The overall revenue expansion was facilitated by an increase of over two hundred employees in 2006, and a significant increase in our equipment fleet. The increase was achieved despite a generally wetter year in 2006 in most of our markets than in 2005, which adversely affected production rates, and the impact of some significant delays in starting certain contracts in the first three quarters of 2006, which were due to factors outside our control.

Gross Profit. The improvement in gross profits in 2006 was due principally to the increase in revenues, combined with the higher gross margins. This margin improvement was attributable principally to a better margin mix in backlog resulting from the improved bidding climate since 2004, and to efficiencies resulting from the higher revenue levels achieved in 2006. These factors overcame the negative impact on gross margins of the wetter weather in 2006 and the delay in starting certain contracts, as described above. They also helped offset the downward pressure on gross margins arising from the increased percentage of state highway work, from 39% in 2005 to 67% in 2006. In both

years, we achieved a number of incentive awards upon the successful completion of contract milestones.

32

---

Table of Contents

**Backlog.** The \$88 million increase in backlog in 2006 reflected the on-going broadening of our service platform and the generally good bidding environment in our markets, especially in the Dallas/Fort Worth area where our backlog expanded significantly during the year.

**General and Administrative Expenses, Net of Other Income and Expense.** The increase in general and administrative expenses, or G&A, in 2006 was principally due to higher employee expenses, including an increase in staff, increased stock-based compensation expense resulting from our higher share price in 2006, and higher legal and accounting fees. Despite these increases in G&A expenses in support of the growing business, our ratio of G&A expenses to revenue remained essentially unchanged from 2005 to 2006, at 4%.

**Operating Income.** The 2006 increase in operating income resulted principally from the higher revenues and gross profits, which led to an increase in operating margin from 6.7% to 7.2%.

**Interest Expense Net of Interest Income.** In 2006, we invested cash raised in our public stock offering on which we earned over \$1.4 million of interest. In 2005, we paid \$1.5 million of interest expense primarily on related party debt which was repaid in January 2006 from the proceeds of our public offering.

**Income Taxes.** In 2005, we recorded a reduction in the valuation allowance related to the deferred tax asset following management's review of the likelihood that tax loss carryforwards would be substantially utilized in the future. This resulted in an effective tax rate of 21% in 2005. In 2006, we recorded a more normal tax charge at 34.2% of income.

**Net Income From Continuing Operations.** The 2006 increase in net income from continuing operations was the result of the various factors discussed above.

**Effect of Income Tax Benefits.** Although we have had the benefit of significant NOLs, which offset most of our income from federal income taxes, we are required to reflect a full tax charge in our financial statements through an adjustment to the deferred tax asset. In addition, certain adjustments resulting from our recovery of the deferred tax asset are recorded in the income statement. Those adjustments resulted in a benefit of \$1.4 million in 2005. Assuming an income tax rate of 34%, and disregarding adjustments to our deferred tax asset and other timing differences, net income would have been \$8.797 million for 2005 so that, on a comparative basis, the income from continuing operations level of \$12.675 million for 2006 represents an increase of approximately 44%. Similarly, basic and fully diluted earnings from continuing operations per common share for 2005, reflecting an effective tax rate of 34%, would have been \$1.13 and \$0.92, respectively, for 2005. A reconciliation of reported income from continuing operations for 2006 and 2005 to net income as if a 34% tax rate had been applied is set forth in the table below.

	2006	2005
	(Amounts in thousands, except per share data)	
Income from continuing operations before income taxes, as reported	\$ 19,204	\$ 13,329
Provision for income taxes (assuming a 34% effective rate)	6,529	4,532
Net income from continuing operations as if a 34% rate had been applied	\$ 12,675	\$ 8,797
Basic income from continuing operations per common share as if a 34% effective tax rate had been applied	\$ 1.20	\$ 1.13
Diluted income from continuing operations per common share as if a 34% effective tax rate had been applied	\$ 1.08	\$ 0.92

Discontinued Operations, Net of Tax. Discontinued operations for 2006 and 2005 represent the results of operations of our distribution business, which was operated by Steel City Products, LLC. The increase in the net income from discontinued operations was primarily due to increases in gross margins from 16% in 2005 to 16.5% in 2006 through the date of sale.

33

---

Table of Contents

The distribution business was sold on October 27, 2006. We recorded proceeds from the sale of approximately \$5.4 million and paid \$3.8 million to retire the Steel City Products, LLC revolving line of credit. We recorded a pre-tax gain on the sale of \$249,000 and recorded \$128,000 in income tax expense related to that gain.

34

---

Table of Contents

## Historical Cash Flows

The following table sets forth information about our cash flows for the years ended December 31, 2007, 2006 and 2005.

	Year Ended December 31,		
	2007	2006	2005
	(Amounts in thousands)		
Cash and cash equivalents (at end of period)	\$ 80,649	\$ 28,466	\$ 22,267
Net cash provided by (used in)			
Continuing operations:			
Operating activities	29,567	23,089	31,266
Investing activities	(47,935)	(52,358)	(10,972)
Financing activities	70,576	35,468	(1,476)
Discontinued operations			
Operating activities	(25)	495	(294)
Investing activities	--	4,739	--
Financing activities	--	(5,357)	349
Supplementary information:			
Capital expenditures	26,319	24,849	11,392
Working capital (at end of period)	82,063	62,874	18,354

## Operating Activities.

Significant non-cash items included in operating activities were:

• depreciation and amortization, which totaled \$9.5 million, an increase of \$2.5 million from 2006, which was \$7.0 million, an increase of \$2.0 million over 2005, as a result of the continued increase in the size of our construction fleet;

• deferred tax expense was \$6.6 million in 2007, an increase of \$0.3 million over 2006. We accelerate the depreciation of our fixed assets for tax purposes. The significant additions to fixed assets in 2007 and 2006 increased our deferred tax liability and certain other timing differences are recorded in the income statement. Such tax expense in 2006 increased \$3.7 million over 2005 due to the increased depreciation and a reduction in the valuation allowance related to the deferred tax asset.

Significant components of the changes in working capital are as follows:

• contracts receivable increased by \$6.6 million in 2007 and \$7.9 million in 2006, principally reflecting the revenue increase and related level of customer retentions;

• billings in excess of costs and estimated earnings on uncompleted contracts increased by \$0.6 million in 2007, while in 2006 there was an increase of \$7.9 million. These changes principally reflect fluctuations in the timing and amount of mobilization payments to assist in the start-up on certain contracts;

• trade payables increased by \$6.1 million in 2007 compared with a decrease of \$3.0 million in 2006, reflecting an increase in our volume of business; and

•

there was a decrease of \$0.6 million in costs and estimated earnings in excess of billings on uncompleted contracts in 2007 compared with an increase of \$1.0 million in 2006. These changes reflect timing differences as contracts progress.

#### Investing Activities.

Expenditures to expand our construction fleet were \$26.3 million in 2007 compared with \$24.8 million in 2006. The much enlarged contract backlog required a significant expansion and upgrade of our fleet in 2007 and 2006. Additionally, in October 2007, we purchased a 91.67% interest in RHB which we acquired for \$53.0 million in order to expand our construction operations into Nevada. In connection with the acquisition, we incurred \$1.1 million of direct costs of the acquisition. In January 2006, we purchased certain assets of Rathole Drilling, Inc. for \$2.2 million also in order to expand our construction capabilities. In 2007 and 2006, we invested a portion of the funds raised in our public sale of common stock in cash and cash equivalents and short-term auction-rate securities, respectively.

## Table of Contents

### Financing Activities.

The increase in cash provided by financing activities in 2007 and 2006 was principally due to the sale of common stock to the public in December 2007 and January 2006, in which our net proceeds were approximately \$34.5 million and \$27.0 million, respectively. In addition, we received proceeds of approximately \$513,000 and \$913,000 in 2007 and 2006, respectively, from the exercise of stock options and warrants. Funds received from the exercise of warrants by North Atlantic Smaller Companies Investment Trust plc, or NASCIT, and the exercise of options by employees and directors totaled \$0.8 million during 2005. In 2006 and 2005 we used approximately \$8.6 million and \$2.8 million, respectively, to pay long-term debt, which included payments on notes to related parties in 2006 and 2005. During 2007, 2006 and 2005, there were net increases in borrowings under the lines of credit of \$35.0 million, \$16.2 million and \$0.5 million, respectively, because capital expenditures, long-term debt repayments and working capital requirements exceeded cash provided by operations.

### Liquidity

The level of working capital for our construction business varies due to fluctuations in the levels of costs and estimated earnings in excess of billings, billings in excess of cost and estimated earnings, the size and status of contract mobilization payments, levels of customer receivables and contract retentions, and the level of amounts owed to suppliers and subcontractors. Some of these fluctuations can be significant. The significant increase in our working capital level in 2007 and 2006 has been an important element in enabling us to expand our bonding facilities and therefore to continue to bid on larger and longer-lived projects. The Company believes that it has sufficient financial resources to fund its requirements for the next twelve months of operations.

### Sources of Capital

In addition to cash provided from operations, we use our revolving lines of credit to finance working capital needs and capital expenditures.

### Lines of Credit

We have a Credit Facility with Comerica Bank entered into on October 31, 2007 which replaced a similar \$35.0 million revolver that had been renewed in April 2006. The Credit Facility has a maturity date of October 31, 2012, borrowing capacity of \$75.0 million and is secured by all assets of the Company, other than proceeds and other rights under our construction contracts which are pledged to our bond surety. Borrowings under the Credit Facility were used to finance the RHB acquisition, repay indebtedness outstanding under the Revolver, and finance working capital. At December 31, 2007, the aggregate borrowings outstanding under the Credit Facility were \$65.0 million, and the aggregate amount of letters of credit outstanding under the new Credit Facility was \$1.5 million, which reduces availability under the Credit Facility.

At our election, the loans under the new Credit Facility bear interest at either a LIBOR-based interest rate or a prime-based interest rate. The unpaid principal balance of each LIBOR-based loan bears interest at a variable rate equal to LIBOR plus an amount ranging from 1.25% to 2.25% depending on the pricing leverage ratio that we achieve. The "pricing leverage ratio" is determined by the ratio of our average total debt, less cash and cash equivalents, to earnings before interest, taxes, depreciation and amortization ("EBITDA") that we achieve on a rolling four-quarter basis. The pricing leverage ratio is measured quarterly. If we achieve a pricing leverage ratio of (a) less than 1.00 to 1.00; (b) equal to or greater than 1.00 to 1.00 but less than 1.75 to 1.00; or (c) greater than or equal to 1.75 to 1.00, then the applicable LIBOR margins will be 1.25%, 1.75% and 2.25%, respectively. Interest on LIBOR-based loans is payable at the end of the relevant LIBOR interest period, which must be one, two, three or six months. The new Credit Facility is subject to our compliance with certain covenants, including financial covenants relating to fixed charges,

leverage, tangible net worth, asset coverage and consolidated net losses.

36

---

Table of Contents

The unpaid principal balance of each prime-based loan will bear interest at a variable rate equal to Comerica's prime rate plus an amount ranging from 0% to 0.50% depending on the pricing leverage ratio that we achieve. If we achieve a pricing leverage ratio of (a) less than 1.00 to 1.00; (b) equal to or greater than 1.00 to 1.00 but less than 1.75 to 1.00; or (c) greater than or equal to 1.75 to 1.00, then the applicable prime margins will be 0.0%, 0.25% and 0.50%. The interest rate on funds borrowed under this revolver during the year ended December 31, 2007 ranged from 7.50% to 7.75%.

In December 2007, Comerica syndicated the Credit Facility with three other financial institutions under the same terms discussed above.

Management believes that the new Credit Facility will provide adequate funding for the Company's working capital, debt service and capital expenditure requirements, including seasonal fluctuations at least through December 31, 2008.

As discussed above, the Credit Facility contains restrictions on the ability to:

- Make distributions and dividends;
- Incur liens and encumbrances;
- Incur further indebtedness;
- Guarantee obligations;
- Dispose of a material portion of assets or merge with a third party;
- Incur negative income for two consecutive quarters.

The Company was in compliance with all covenants under the Credit Facility as of December 31, 2007.

## Other Debt

## Mortgages.

In 2001 we completed the construction of a new headquarters building on land owned by us adjacent to our equipment repair facility in Houston. The building was financed principally through an additional mortgage of \$1.1 million on the land and facilities at a floating interest rate which at December 31, 2007 was 7.5% per annum, repayable over 15 years. This mortgage is cross-collateralized with a prior mortgage on the land and equipment repair facilities, which were purchased in 1998, in the original amount of \$500,000, repayable over 15 years with an interest rate of 9.3% per annum. In addition, we have available to us a long-term facility of up to \$1.5 million repayable over 15 years to finance the expansion of our office building and maintenance facilities.

## Uses of Capital

## Contractual Obligations.

The following table sets forth our fixed, non-cancelable obligations at December 31, 2007.

	Payments due by Period				
	Total	Less Than One Year	1—3 Years	4—5 Years	More Than 5 Years
	(Amounts in thousands)				
Credit Facility	\$ 65,000	\$ —	\$ —	\$ 65,000	\$ —
Operating leases	2,999	920	2,009	70	—
Mortgages	654	98	220	146	190

\$ 68,653 \$ 1,018 \$ 2,229 \$ 65,216 \$ 190

Our obligations for interest are not included in the table above as these amounts vary according to the levels of debt outstanding at any time. Interest on our Credit Facility is paid monthly and fluctuates with the balances outstanding during the year, as well as with fluctuations in interest rates. In 2007 interest on the Credit Facility and Revolver was approximately \$239,000. The mortgages are expected to have future annual interest expense payments of approximately \$47,200 in less than one year, \$106,700 in one to three years, \$43,600 in four to five years and \$23,800 for all years thereafter.

## Table of Contents

To manage risks of changes in the material prices and subcontracting costs used in submitting bids for construction contracts, we generally obtain firm quotations from our suppliers and subcontractors before submitting a bid. These quotations do not include any quantity guarantees, and we have no obligation for materials or subcontract services beyond those required to complete the contracts that we are awarded for which quotations have been provided.

### Capital Expenditures.

Our capital expenditures during 2007 were \$36.0 million, including property, plant and equipment acquired with the purchase of RHB, and during 2006 were \$27.1 million including the purchase of the RDI equipment, and consisted almost exclusively of expenditures to purchase heavy construction equipment. In 2008 we expect that our capital expenditure spending will be less than the 2006 level.

### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

### New Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS 157) which establishes a framework for measuring fair value and requires expanded disclosure about the information used to measure fair value. The statement applies whenever other statements require or permit assets or liabilities to be measured at fair value, and does not expand the use of fair value accounting in any new circumstances. In February 2008, the FASB delayed the effective date by which companies must adopt the provisions of SFAS 157. The new effective date of SFAS 157 defers implementation to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The adoption of this standard is not anticipated to have a material impact on our financial position, results of operations, or cash flows.

In December 2007, the FASB revised Statement of Accounting Standards No. 141, "Business Combinations" (SFAS 141(R)). This Statement establishes principles and requirements for how the acquirer: (a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree; (b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase and (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. Also, under SFAS 141(R), all direct costs of the business combination must be charged to expense on the financial statements of the acquirer at the time of acquisition. SFAS 141(R), revises previous guidance as to the recording of post-combination restricting plan costs by requiring the acquirer to record such costs separately from the business combination. This statement is effective for acquisitions occurring on or after January 1, 2009, with early adoption not permitted. The effect of SFAS 141 (R) on future financial statements cannot be determined at this time; however, had this statement been in effect for 2007, the charge of \$5.4 million to additional paid-in capital related to the acquisition of RHB would have instead been in the costs allocated to nets assets acquired, including goodwill, and \$1.14 million of direct costs related to such acquisition would have been charged to expense instead of being included in the costs of the acquisition.

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment to FASB Statement No. 115" ("SFAS No. 159"). This statement allows a company to irrevocably elect fair value as a measurement attribute for certain financial assets and financial liabilities with changes in fair value recognized in the results of operations. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adoption on its results

of operations and financial position.

In December 2007, the FASB issued Statement of Accounting Standards No. 160, "Non-controlling Interests in Consolidated Financial Statements" (SFAS 160). SFAS 160 clarifies previous guidance on how consolidated entities should account for and report non-controlling (minority) interests in consolidated subsidiaries. The statement standardizes the presentation of non-controlling interests for both the consolidated balance sheet and income statement. The statement also standardizes the accounting for changes in a parent company's interest in a subsidiary for situations where the change results in a deconsolidation and for situations where it does not result in a deconsolidation. This Statement is effective for our fiscal year ending December 31, 2009, and all interim periods within that fiscal year, with early adoption not permitted. When this Statement is adopted by the Company, the Minority Interest in RHB and any similar subsequent acquisitions will be a separate component of stockholders equity instead of a liability and earnings per common share will be segregated between EPS per common share and EPS of Minority Interest.

38

---

Table of Contents

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Changes in interest rates are our primary sources of market risk. At December 31, 2007, \$65 million of our outstanding indebtedness was at floating interest rates. Based on our average debt outstanding during 2007, we estimate that an increase of 1.0% in the interest rate would have resulted in an increase in our interest expense of approximately \$11,000 in 2007.

Item 8. Financial Statements and Supplementary Data

Financial statements start on page F-1.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the issuer's management, including the principal executive and principal financial officers, or persons performing similar functions, as appropriate to all timely decisions regarding required disclosure.

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). Based on that evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were effective at December 31, 2007 to ensure that the information required to be disclosed by the Company in this Annual Report on Form 10-K is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and is accumulated and communicated to the Company's management including the principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Management's Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934). Under the supervision and with the participation of the Company's management, including the principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of internal control over financial reporting at December 31, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. The Company's management has concluded that, at December 31, 2007, the Company's internal control over financial reporting is effective based on these criteria.

Table of Contents

As permitted by guidance provided by the staff of the Securities and Exchange Commission, the scope of management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2007, did not include the internal controls of RHB which are included in the 2007 consolidated financial statements of Sterling Construction Company, Inc. and Subsidiaries. We acquired RHB on October 31, 2007 and its business represents approximately 5.6% and 6.9% of the Company's total assets and liabilities, respectively, as of December 31, 2007, and approximately 2.3% and 3.1% of the Company's total revenues and net income from continuing operations, respectively, for the year then ended. The Company will include the RHB business in the scope of management's assessment of internal control over financial reporting beginning in 2008.

Our internal control over financial reporting has been audited by Grant Thornton LLP, an independent registered public accounting firm, as stated in their report included herein.

## 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, we have concluded that no significant changes in our internal control over financial reporting occurred during the last fiscal quarter 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.

Item Other Information.

9B.

None

## PART III

## Item 10. Directors and Executive Officers of the Registrant

Directors. The following table sets forth the name and age of each of the Company's current directors and the positions each held on February 15, 2008.

Name	Position	Age	Director Since	Year Term of Office Expires
Patrick T. Manning	Chairman of the Board of Directors & Chief Executive Officer	62	2001	2008
Joseph P. Harper, Sr.		62	2001	2008

President, Treasurer & Chief  
Operating Officer, Director

John D. Abernathy	Director	70	1994	2009
Robert W. Frickel	Director	64	2001	2009
Donald P. Fusilli, Jr.	Director	56	2007	2010
Maarten D. Hemsley	Director	58	1998	2010
Christopher H. B. Mills	Director	55	2001	2010
Milton L. Scott	Director	51	2005	2009
David R. A. Steadman	Director	70	2005	2008

Table of Contents

Patrick T. Manning. Mr. Manning joined the predecessor of Texas Sterling Construction Co., the Company's Texas construction subsidiary, which along with its predecessors is referred to as TSC, in 1971 and led its move from Detroit, Michigan into the Houston market in 1978. He has been TSC's President and Chief Executive Officer since 1998 and Chairman of the Board of Directors and Chief Executive Officer of the Company since July 2001. Mr. Manning has served on a variety of construction industry committees, including the Gulf Coast Trenchless Association and the Houston Contractors' Association, where he served as a member of the board of directors and as President from 1987 to 1993. He attended Michigan State University from 1969 to 1972.

Joseph P. Harper, Sr. Mr. Harper has been employed by TSC since 1972. He was Chief Financial Officer of TSC for approximately 25 years until August 2004, when he became Treasurer of TSC. In addition to his financial responsibilities, Mr. Harper has performed both estimating and project management functions. Mr. Harper has been a director and the Company's President and Chief Operating Officer since July 2001, and in May 2006 was elected Treasurer. Mr. Harper is a certified public accountant.

John D. Abernathy. Mr. Abernathy was Chief Operating Officer of Patton Boggs LLP, a Washington D.C. law firm, from January 1995 through May 2004 when he retired. He is also a director of Par Pharmaceutical Companies, Inc., an NYSE-listed company that manufactures generic and specialty drugs, and Neuro-Hitech, Inc., a development-stage drug company. Mr. Abernathy is a certified public accountant. In December 2005, Mr. Abernathy was elected Lead Director by the independent members of the Board of Directors.

Robert W. Frickel. Mr. Frickel is the founder and President of R.W. Frickel Company, P.C., a public accounting firm that provides audit, tax and consulting services primarily to companies in the construction industry. Prior to the founding of R.W. Frickel Company in 1974, Mr. Frickel was employed by Ernst & Ernst. Mr. Frickel is a certified public accountant.

Donald P. Fusilli, Jr. Mr. Fusilli is the Chief Executive Officer of a marine services subsidiary of David Evans and Associates, Inc., a company that provides underwater mapping and analysis services. From May 1973 until September 2006, Mr. Fusilli served in a variety of capacities at Michael Baker Corporation, a public company listed on the American Stock Exchange that provides a variety of professional engineering services spanning the complete life cycle of infrastructure and managed asset projects. Mr. Fusilli joined Michael Baker Corporation as an engineer and over the course of his career rose to president and chief executive officer in April 2001. From September 2006 to January 2008, Mr. Fusilli was an independent consultant providing strategic planning, marketing development and operations management services. Mr. Fusilli is a director of RTI International Metals, Inc., a New York Stock Exchange-listed company that is a leading U.S. producer of titanium mill products and fabricated metal components. He holds a Civil Engineering degree from Villanova University, a Juris Doctor degree from Duquesne University School of Law and attended the Advanced Management Program at the Harvard Business School.

Maarten D. Hemsley. Mr. Hemsley served as the Company's President and Chief Operating Officer from 1988 until 2001, and as Chief Financial Officer from 1998 until August 2007. From January 2001 to May 2002, Mr. Hemsley was also a consultant to, and thereafter has been an employee of, JO Hambro Capital Management Limited, which is part of JO Hambro Capital Management Group Limited, or JOHCMG, an investment management company based in the United Kingdom. Mr. Hemsley has served since 2001 as Fund Manager of JOHCMG's Leisure & Media Venture Capital Trust, plc, and since February 2005, as Senior Fund Manager of its Trident Private Equity II LLP investment fund. Mr. Hemsley is a director of Tech/Ops Sevcon, Inc., a U.S. public company that manufactures electronic controls for electric vehicles and other equipment, and of a number of privately-held companies in the United Kingdom. Mr. Hemsley is a Fellow of the Institute of Chartered Accountants in England and Wales.

Table of Contents

Christopher H. B. Mills. Mr. Mills is a director of JOHCMG. Prior to founding JOHCMG in 1993, Mr. Mills was employed by Montagu Investment Management and its successor company, Invesco MIM, as an investment manager and director, from 1975 to 1993. He is the Chief Executive of North Atlantic Smaller Companies Investment Trust plc, which is a part of JOHCMG and a 3.82% holder of the Company's common stock. Mr. Mills is a director of two U.S. public companies, W-H Energy Services, Inc., a New York Stock Exchange-listed company that is in the oilfield services industry, and SunLink Healthcare Systems, Inc., a non-urban community healthcare provider for seven hospitals and related businesses in four states in the Southwest and Midwest. Mr. Mills also serves as a director of a number of public and private companies outside of the U.S. in which JOHCMG funds have investments.

Milton L. Scott. Mr. Scott is Chairman and Chief Executive Officer of the Tagos Group, a strategic advisory and services company in supply chain management, transportation and logistics, and integrated supply. He was previously associated with Complete Energy Holdings, LLC, a company of which he was Managing Director until January 2006 and which he co-founded in January 2004 to acquire, own and operate power generation assets in the United States. From March 2003 to January 2004, Mr. Scott was a Managing Director of The StoneCap Group, an entity formed to acquire, own and operate power generation assets. From October 1999 to November 2002, Mr. Scott served as Executive Vice President and Chief Administrative Officer at Dynegy Inc., a public company that was a market leader in power distribution, marketing and trading of gas, power and other commodities, midstream services and electric distribution. From July 1977 to October 1999, Mr. Scott was with the Houston office of Arthur Andersen LLP, a public accounting firm, where he served as partner in charge of the Southwest Region Technology and Communications practice. Mr. Scott is currently the lead director and chairman of the audit committee of W-H Energy Services,

David R. A. Steadman. Mr. Steadman is President of Atlantic Management Associates, Inc., a management services and investment group. An engineer by profession, Mr. Steadman served as Vice President of the Raytheon Company from 1980 until 1987 where he was responsible for commercial telecommunications and data systems businesses in addition to setting up a corporate venture capital portfolio. Subsequent to that and until 1989, Mr. Steadman was Chairman and Chief Executive Officer of GCA Corporation, a manufacturer of semiconductor production equipment. Mr. Steadman serves as a director of Aavid Thermal Technologies, Inc., a provider of thermal management solutions for the electronics industry, a privately-held company. Mr. Steadman also serves as Chairman of Tech/Ops Sevcon, Inc., a public company that manufactures electronic controls for electric vehicles and other equipment. Mr. Steadman is a Visiting Lecturer in Business Administration at the Darden School of the University of Virginia.

Executive Officers. In addition to Messrs. Manning and Harper, whose backgrounds are described above, the following are the Company's other executive officers:

James H. Allen, Jr. Mr. Allen became the Company's Senior Vice President & Chief Financial Officer in August 2007. He spent approximately 30 years with Arthur Andersen & Co., including 19 years as an audit and business advisory partner and as head of the firm's Houston office construction industry practice. After being retired for several years, he became chief financial officer of a process chemical manufacturer and served in that position for over three years prior to joining the Company. Mr. Allen is a certified public accountant.

Roger M. Barzun. Mr. Barzun has been the Company's Vice President, Secretary and General Counsel since August 1991. He was elected a Senior Vice President from May 1994 until July 2001 and again in March 2006. Mr. Barzun has been a lawyer since 1968 and is a member of the bar of New York and Massachusetts. Mr. Barzun also serves as general counsel to other corporations from time to time on a part-time basis.

Table of Contents

Section 16(a) Beneficial Ownership Reporting Compliance Section 16(a) of the Exchange Act requires the Company's officers and directors, and persons who own more than 10% of the Company's equity securities, or insiders, to file with the Securities and Exchange Commission (SEC) reports of beneficial ownership of those securities and certain changes in beneficial ownership on Forms 3, 4 and 5, and to give the Company a copy of those reports.

Based solely upon a review of Forms 3 and 4 and amendments to them furnished to the Company during 2007, any Forms 5 and amendments to them furnished to the Company relating to 2007, and any written representations that no Form 5 is required, all Section 16(a) filing requirements applicable to the Company's insiders were satisfied except as follows:

Mr. Fusilli failed to timely file a Form 3, which was required by his election as a director of the Company on March 14, 2007. His Form 3 was filed with the SEC on April 10, 2007.

In September 2007, Mr. Hemsley failed to timely file a Form 4 covering sales on September 10 and September 18, 2007 totaling 14,000 shares of the Company's common stock. A Form 4 reporting those sales was filed with the SEC on October 1, 2007.

In August 2007, Mr. Mills shared voting and investment power over 600,000 shares of the Company's common stock with North Atlantic Smaller Companies Investment Trust plc, or NASCIT, of which he is chief executive officer. Mr. Mills failed to timely file a Form 4 covering sales by NASCIT on August 14, 2007 of 200 shares. A Form 4 reporting that sale was filed with the SEC on August 21, 2007.

Code of Ethics. The Company has adopted a Code of Business Conduct & Ethics that complies with SEC rules. The Code applies to all the officers and in-house counsel of the Company and its subsidiaries, and is posted on the Company's website at [www.sterlingconstructionco.com](http://www.sterlingconstructionco.com).

The Audit Committee. The Company has a standing audit committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934. The members of the Audit Committee are John D. Abernathy, Chairman, Donald P. Fusilli, Jr., Milton L. Scott and David R. A. Steadman.

Each of the members of the Audit Committee is an independent director under the independence standards of both Nasdaq and the SEC. The Board of Directors has determined that each of Messrs. Abernathy and Scott is an audit committee financial expert. The independent members of the Board have appointed Mr. Abernathy Lead Director.

Item 11. Executive Compensation

Introduction

This Item 11 has two main parts, the first contains information about the compensation of certain executive officers of the Company and the second contains information about the compensation of directors who are not also executive officers.

The Company is required under applicable rules and regulations to furnish information about the compensation of five of its executive officers. Because these executive officers are named in the Summary Compensation Table for 2007 in this Item 11, they are sometimes referred to as the named executive officers. The named executive officers are as follows:

Patrick T. Manning, Chairman & Chief Executive Officer  
Joseph P. Harper, Sr., President, Treasurer & Chief Operating Officer

Maarten D. Hemsley, Chief Financial Officer (until August 10, 2007)

James H. Allen, Jr., Chief Financial Officer (since August 10, 2007)

Roger M. Barzun, Senior Vice President, Secretary & General Counsel

Table of Contents

The compensation of these executives is described and discussed in the subsections listed below:

- The Compensation Discussion and Analysis, which covers how and why executive compensation was determined.
- The Employment Agreements of Named Executive Officers, which describes the important terms of the executives' employment agreements.
- The Potential Payments upon Termination and Change-in-Control, which as its name indicates, describes particular provisions of the executives' employment agreements relating to the termination of their employment and a change in control of the Company.
- The Summary Compensation Table for 2007, which shows the cash and equity compensation the Company paid to the named executive officers for 2007.
- The table of Grants of Plan-Based Awards for 2007, which shows details of both equity and non-equity awards made to the named executive officers for 2007 and describes the plans under which the Company made those awards.
  - The table of Option Exercises and Stock Vested for 2007, which shows the number of shares named executive officers purchased under their stock options in 2007 and the dollar value of the difference between the option exercise price and the market value of the shares on the date of exercise.
- The table of Outstanding Equity Awards at December 31, 2007, which as its name indicates, shows the stock options held by the named executive officers at year's end and gives other details of their option awards.

## Table of Contents

### Compensation Discussion and Analysis

**Introduction.** This discussion and analysis of executive compensation is designed to show how and why the compensation of the named executive officers was determined. Their compensation is determined by the Compensation Committee of the Board of Directors, or the Committee, whose members are three independent directors of the Company.

During the first half of 2007, the Company compensated Messrs. Manning and Harper under three-year employment agreements that expired on July 18, 2007, referred to as the prior agreements. During the second half of 2007, the Company compensated Messrs. Manning and Harper under employment agreements entered into as of July 19, 2007, referred to as the new agreements. The Company hired Mr. Allen in July 2007 and has compensated him since then under the terms of his employment agreement, which contains essentially the same basic terms as those of Messrs. Manning and Harper except for compensation levels.

Mr. Hemsley's employment agreement was to expire on July 18, 2007 as well, but the Committee extended its term through October 31, 2007 in order to provide a transition period for Mr. Allen, who became Chief Financial Officer on August 10, 2007. Following the expiration of Mr. Hemsley's employment agreement, he ceased to be an employee, but remains a director of the Company.

**Compensation Objectives.** The Committee's compensation objectives for each of the named executive officers as well as for other management employees is to provide the employee with a rate of pay for the work he does that is appropriate in comparison to similar companies in the industry and that is considered fair by the executive; to give the executive a significant incentive to make the Company financially successful; and to give him an incentive to remain with the Company.

**Employment Agreements.** The Company believes that compensating an executive under an employment agreement has the benefit of assuring the executive of continuity, both as to his employment and the amounts and elements of his compensation. At the same time, an employment agreement gives the Company some assurance that the executive will remain with the Company for the duration of the agreement and enables the Company to budget salary costs over the term of the agreement. All elements of the compensation of the named executive officers are paid according to the terms of their employment agreements.

**The Prior Agreements.** Under the prior agreements, executive compensation has three main elements: a salary paid in cash, an annual cash incentive bonus, in which payment is contingent on the Company's financial performance, and a long-term equity element that the Company provides through the award of options to purchase the Company's common stock.

**Elements of Compensation.** Salary is intended to reward the executive for his current, day-to-day work. The cash incentive bonus is intended to be a reward for the executive's contribution to the financial success of the Company in a given year. Awards of equity are intended to create a longer-term incentive for the executive to remain with the Company because the benefit is realized, if at all, over a multi-year period.

**Compensation Levels.** The Committee based the salary levels under the prior agreements primarily on the executive's prior salary and his level of responsibility in the Company. Before entering into the prior agreements, the Committee made a relatively informal review of publicly-available industry trade publications to ensure that the executives' compensation fell within the range of comparable companies, both as to salary and as to incentive compensation.

The amount of the cash incentive bonus for Messrs. Manning, Harper and Hemsley under the prior agreements is based on the annual budgeted earnings before payment of interest charges, taxes, and charges for depreciation and

amortization, referred to as EBITDA, and the extent to which the budget is achieved or exceeded.

45

---

Table of Contents

EBITDA is defined as annual net income determined in accordance with generally accepted accounting principles —

	Plus	Interest expense for the period;
	Plus	Depreciation and amortization expense for the period;
	Plus	Federal and state income tax expense incurred for the period;
	Plus	Extraordinary items (to the extent negative) if any, for the period;
Plus		Any and all fees paid to Menai Capital, LLC, and any fees paid to non-employee directors;
Plus		Any and all parent-company charges for corporate overhead or similar non-operating charges;
	Minus	Extraordinary items (to the extent positive) if any; and
	Minus	Interest income for the period.

In the case of Messrs. Manning and Harper, the EBITDA of the Company's operating subsidiary Texas Sterling Construction Co., or TSC, is used, and in the case of Mr. Hemsley, the EBITDA of the Company on a consolidated basis is used. The budgeted EBITDA for each year must have been approved by the Board of Directors, which has a majority of directors who are not employees of the Company. The cash incentive bonus plan does not have any portion based on the executive's achievement of personal goals or objectives.

For Messrs. Manning and Harper, the cash incentive bonus plan has a discretionary element that comes into effect if EBITDA exceeds a predetermined percentage of budgeted EBITDA. In exercising this discretion, members of the Committee use their personal judgment of appropriate amounts after taking into account information about the executive's work during the year, his past compensation, his perceived contribution to the Company generally, his level of responsibility, and any notable individual achievements or failings in the year in question.

For Mr. Hemsley, any additional cash incentive bonus above that earned upon the achievement of the budgeted EBITDA target is in the discretion of the Committee. In exercising its discretion, the Committee takes into account the Company's consolidated financial results, the number of non-routine business transactions to which Mr. Hemsley devoted substantial time during the year and any other matters the Committee deems relevant.

The Committee believes that the award of an option to buy the Company's common stock is a long-term element of compensation because on the date of the award, the exercise price, or purchase price, of the shares subject to the option is the same as the price of those shares on the open market. Since the recipient of a stock option will only realize its value if the market price of the shares increases over the life of the option, the award gives the executive an incentive to remain with the Company.

When the prior employment agreements of Messrs. Manning and Harper were negotiated in July 2004, they each agreed to accept stock option awards over the life of the agreement in place of a portion of their salary to save the Company cash. To accomplish this, the prior agreements provide for annual stock option awards that are larger than would otherwise have been made.

Under the prior agreements, the Company paid Messrs. Manning and Harper car allowances to reflect the fact that they use their own automobiles for business purposes, such as visiting construction sites, attending meetings with customers and providing transportation to out-of-town business colleagues. The Company paid their country club dues because the clubs are often used for business purposes and as accommodation for out-of-town business colleagues. The payment of Mr. Hemsley's term life insurance and long-term disability insurance premiums is a benefit that the Company has provided to him for many years and was continued because of that fact.

The New Agreements. In anticipation of the expiration of the prior agreements, in May 2007, the Committee began a discussion of new employment agreements for Messrs. Manning and Harper.

The Committee's starting point was a written salary and cash incentive bonus proposal from Messrs. Manning and Harper for themselves and for the five senior managers of TSC. In connection with the proposal, Messrs. Manning and Harper stressed the importance of a team approach to compensation, which is designed to avoid the disruptive influence of variations in compensation levels between managers of equal importance and responsibility. The Committee discussed management's proposal in the course of several meetings. No member of senior management, including Messrs Manning or Harper, was present at any of the Committee's deliberations and discussions.

Table of Contents

Compensation Principles and Policies. In the course of their discussions, members of the Committee came to a consensus on the following general compensation principles as a guide for their further discussion of the compensation of Messrs. Manning, Harper and Allen as well as of the five senior managers of TSC:

- Compensation should consist of two main elements, base salary and cash incentive bonus for the reasons discussed above.
- Equity compensation should not be an element of compensation for executives who already hold a substantial number of shares of the Company's common stock or options to purchase a substantial number of shares of common stock, or both.
- The cash incentive bonus element of compensation should be divided into two parts: one part, 60%, of the incentive bonus based on the achievement by the Company, on a consolidated basis, of financial goals, and the other part, 40%, based on the achievement by the executive of personal goals and objectives to be established annually by the Committee in consultation with the executive.
- Perquisites such as car allowances, reimbursement of club dues and the like should not be an element of compensation because salaries are designed to be sufficient for the executive to pay these items personally.
- The Committee should determine at the end of each year the extent to which each of Messrs. Manning, Harper and Allen have achieved his personal goals as provided in the committee's charter.
- In determining individual compensation levels, the Committee should take into account, among other things, the following:
  - The elimination of stock options as an element of compensation (except for Mr. Allen, who is a new employee.)
    - The executives' existing salaries.
    - Salaries of comparable executives in the industry.
    - Wage inflation from 2004 through 2007, to the extent applicable.
- The Company's growth since July 2004 when the prior agreements became effective and the resulting increase in senior management responsibilities.
- The total amount that is appropriate for the Company to allocate to the compensation of all seven members of the Company's senior management given the Company's size and industry.
  - The elimination of perquisites.

Compensation Consultant. To assist them in evaluating management's proposed salary and bonus structure, in May 2007, the Committee authorized its Chairman to retain the services of Hay Group, a large firm that performs a number of consulting services, including the benchmarking of executive compensation. The Committee's Chairman instructed Hay Group to prepare an analysis of the levels of compensation payable under the prior agreements to Messrs. Manning, Harper and the five senior managers of TSC, and to compare them to a representative group of similar companies. Mr. Allen joined the Company in July 2007 just before Hay Group's report was finished and as a result, its analysis did not cover his compensation.

The peer group was selected by Hay Group in consultation with the Chairman of the Committee and Messrs. Manning and Harper. The peer group consisted of eight engineering and construction companies with 2006 revenues of between \$85 million and \$651 million. The following is a list of companies in the peer group:

- Devcon International Corp.

Table of Contents

- Furmanite Corporation
- Modtech Holdings Inc.
- Meadow Valley Corporation
- SPARTA, Inc. (Delaware)
- Great Lakes Dredge & Dock Company
- Insituform Technologies Inc.
- Michael Baker Corporation

The Committee determined that although these companies are in different areas of the construction and engineering industry, they present an appropriate range in size and types of construction-related businesses to which to compare the Company.

After distributing its report to members of the Committee, two representatives of Hay Group reviewed its findings in detail at a meeting of the Committee held at the end of July 2007. Hay Group performed no other services for the Committee. Because of the work it did for the Committee, the Corporate Governance & Nominating Committee retained Hay Group to do a similar analysis and report on non-employee director compensation.

The following is a summary of the Hay Group's Executive Compensation Report:

- Except for net income, the Company is at or about the median of the peer group in sales, assets, market capitalization and number of employees. In total shareholder return, growth in income before interest and taxes, and return on investment, the Company is ahead of the peer group.
- The Company's 2006 net income was above the peer group and its stockholders' equity was 135% of the peer-group median.
- Using the peer group, the base salaries of Messrs. Manning and Harper under the prior agreements were 64% and 81%, of the median, respectively; the sum of their base salaries and annual incentive awards were 130% and 150% of the median, respectively; and their total direct compensation (which includes equity compensation) was 86% and 93% of the median, respectively.
- Using Hay Group's so called national general industry database updated to July 2007, the prior agreements' base salaries of Messrs. Manning and Harper were below the median, 91% and 81% respectively, but their total cash compensation was above the median, 144% and 132%, respectively.

These numbers demonstrated to the Committee that it is the financial success of the Company that causes the total compensation of Messrs. Manning and Harper to be above the median.

Compensation Levels. It was the consensus of the Committee that both the salary and cash incentive bonus levels of Messrs. Manning and Harper should be significantly above the peer-group median to reflect the following:

- The Company's excellent, above-median performance in net income and stockholders' equity;

- The growth of the Company since 2004 and the resulting increase in the complexity of the business; and
  - The elimination of equity as an element of compensation.

To account for the elimination of long-standing perquisites, the Committee added \$25,000 to the proposed base salaries of both executives. In addition, the Committee took into account the fact that under the accounting rules of FAS 123R, the elimination of equity compensation causes the proposed \$3.41 million of total compensation for the seven-person management group consisting of Messrs. Manning, Harper and the five TSC senior managers, to be below the total of prior years.

## Table of Contents

Because of management's expressed desire for a team concept of compensation, the Committee agreed with Messrs. Manning's and Harper's proposal that their salaries and cash incentive bonuses be the same, reflecting their belief that each has different but equal levels of responsibility and expertise.

The Committee determined that performance-based compensation should be approximately equal to base salary after disregarding the \$25,000 that represents the elimination of perquisites. In the case of Mr. Allen, his performance-based compensation when combined with his equity compensation is approximately 60% of his base salary.

As noted above, Mr. Allen's compensation was not a subject of Hay Group's report because he joined the Company just before the report was presented. The Committee established his salary based on a number of factors, including Mr. Allen's thirty years of experience in Houston with a major public accounting firm, including nineteen years of concentration in the construction industry; his financial and business experience; the compensation package requested by Mr. Allen; and Committee members' own judgment of what are reasonable levels of compensation. The Committee granted him the stock option described above so that like other members of senior management, he would have a long-term equity interest in the Company. The Committee determined that Mr. Allen would be compensated under the same form of employment agreement as the one eventually agreed upon with Messrs. Manning and Harper.

**Cash Incentive Bonus Performance Goals.** The Committee's first inclination was to have cash incentive bonuses tied solely to a financial measurement found in the Company's annual financial statements. Mr. Harper advised the Committee that EBITDA was used in the past as a measure of financial performance because it was the number on which management believes that its performance has the most direct effect. Mr. Harper also noted that the threshold for bonus achievement was 75% instead of 100% of budgeted EBITDA because base salaries were set at a relatively low level, a fact supported by the Hay Group report. The relatively easily achieved cash incentive bonus together with base salary was intended to yield fair base compensation, but was also intended to conserve cash by keeping salaries low in years in which the Company had especially poor financial performance and did not even achieve 75% of budgeted EBITDA.

The Committee agreed to maintain this concept, but determined that it would be better structured by revising the base salary arrangements. The Committee divided base salary into two parts; the larger part to be paid in periodic installments through the payroll system, or base payroll salary, and the balance to be deferred (base deferred salary) to be paid in a lump sum after year end only if 75% of budgeted EBITDA is achieved. EBITDA is defined in the new agreements in the same way as in the prior agreements, described above.

In keeping with its principle of basing 60% of the cash incentive bonus on the achievement of a financial measurement that can be determined by direct reference to the Company's financial statements, the Committee decided to use budgeted earnings-per-share in the belief that it is a measure that most directly affects a stockholder's investment in the Company.

**2007 Transition Terms.** The new agreements provide that the cash incentive bonuses for 2007 under the prior agreements and the base deferred salaries under the new agreements are to be prorated based on the number of days during 2007 that each agreement was in effect. In 2007, the Company achieved the 75% of budgeted EBITDA goal, so that each of Messrs. Manning and Harper earned a portion of the cash incentive bonus provided for in the prior agreements and a portion of the base deferred salary provided for under the new agreements. No such transition terms are applicable to Mr. Hemsley's bonus. Mr. Allen's base deferred salary is prorated based on the number of days during 2007 that he was an employee.

The new agreements also provide that cash incentive bonuses for 2007 will be based solely on the terms of the new agreements. Although the new employment agreements became effective as of July 19, 2007, they were not

completed and signed until early January 2008. As a result, no 2007 personal goals and objectives were established for Messrs. Manning, Harper or Allen. In light of this, the Committee agreed that the award of any or all of the portion of the cash incentive bonus (40%) that would have been based on the achievement of 2007 personal goals and objectives would be solely in the discretion of the Committee.

Table of Contents

Termination Events. The obligations of the Company under the new employment agreements in the event of the termination of the employment of the named executive officers or a change in control of the Company are described in detail in the section entitled Potential Payments Upon Termination and Change-in-Control, below.

The Committee's principle in setting termination provisions was based on the belief that absent a termination for cause, an employee should at least receive the base deferred salary and cash incentive bonus that he would have earned had his employment not terminated, prorated for the portion of the year that he was an employee. The Committee made an exception to this in the event the executive voluntarily resigns, in which case the Committee determined that payment of any cash incentive bonus is not warranted because incentive bonuses in part are designed to encourage the employee to remain in the Company's employ.

In the event that termination is by the Company without cause or because of an uncured breach by the Company of the employment agreement, the executive should also receive the benefit of his base salary for the balance of the term of the agreement, but at least for twelve months.

The Committee did not believe that any special payments should be made to executives in the event of a change in control of the Company because the protections afforded by their employment agreements against termination without cause are unaffected by a change in control. The executives' stock options by their terms vest in full in the event of a change in control. The acceleration of vesting is based on the assumption that a change in control often results in a change in senior management. Absent accelerated vesting, a termination without cause after a change in control could unfairly reduce or eliminate the benefit of a stock option depending on when the change occurs. If the executive is terminated for cause, all of the executives' stock options immediately terminate.

2007 Cash Bonus and Incentive Awards. In 2007, the Company achieved both its budgeted EBITDA and its earnings-per-share goals. As a result, each of Messrs. Manning and Harper became entitled to the prorated portion of his bonus under the prior agreements and his base deferred salary under the new agreements as well as 60% of the cash incentive bonus under the new agreements. In the exercise of its discretion, the Committee in February, 2007 awarded each of Messrs. Manning and Harper the entire 40% balance of their cash incentive bonuses. Although Mr. Allen's employment agreement provides that for 2007 his maximum base deferred salary and cash incentive bonus are to be prorated based on the 46% of the year in which he was an employee, the Committee nevertheless awarded Mr. Allen two-thirds of his annual base deferred salary and maximum cash incentive bonus.

In exercising its discretion, the Committee took into account the following 2007 accomplishments by the Company, in each of which Messrs. Manning, Harper and Allen played a significant role:

- In spite of adverse weather conditions in 2007, the achievement of budgeted EBITDA and earnings per share goals.
  - The completion of a major acquisition (RHB);
  - The completion of a refinancing of the Company's revolving line of credit; and
  - The completion of a public offering of 1.8 million shares of the Company's common stock.

The Committee awarded Mr. Barzun a discretionary cash incentive bonus of \$75,000 based on the significant role he also played in the acquisition, the refinancing and the public offering, all of those transactions being outside his normal duties as General Counsel, and increased his annual salary to \$75,000.

Table of Contents

Because the Company in 2007 achieved 75% of EBITDA, the Committee awarded Mr. Hemsley a cash incentive bonus of \$50,000 as provided in his employment agreement.

All cash incentive bonuses, including base deferred salary payments for 2007, are more fully described in the following sections:

- Employment Agreements of Named Executive Officers
  - Summary Compensation Table for 2007
  - Grants of Plan-Based Awards for 2007

Table of Contents

## Employment Agreements of Named Executive Officers

During 2007, Messrs. Manning, Harper and Hemsley were compensated under similar employment agreements that expired on July 18, 2007 (the prior agreements) except that in the case of Mr. Hemsley, the Compensation Committee, or the Committee, extended the expiration date of his agreement through October 31, 2007, when he ceased to be an employee of the Company. Mr. Allen became an employee of the Company on July 16, 2007 and was elected Senior Vice President & Chief Financial Officer effective August 10, 2007.

Effective July 2007, Messrs. Manning, Harper and Allen entered into new employment agreements with the Company (the new employment agreements). In the case of Messrs. Manning and Harper, the new agreements became effective with the expiration of their prior agreements.

The Prior Agreements. The following table describes the material financial features of each of the prior employment agreements.

	Mr. Manning	Mr. Harper	Mr. Hemsley
Base Salary	\$ 240,000	\$ 215,000	\$ 135,000
Threshold Cash Incentive Bonus(1)	\$ 125,000	\$ 125,000	\$ 50,000
Maximum Additional Cash Incentive Bonus(1)	\$ 240,000	\$ 215,000	\$ 75,000
Annual Option Grant (Shares) (2)	10,000	10,000	2,800
Vacation Time	(3)	(3)	Not specified
Benefits Paid by the Company(4)			
Car Allowance	\$700/month	\$700/month	No
Country Club Dues	Yes	Yes	No
Payment of Commuting Expenses	Yes	Yes	No
Company-Paid Long-Term Disability Insurance	No	No	\$7,500/month benefit
Company-Paid Term Life Insurance	No	No	\$100,000 death benefit

(1) This cash incentive bonus was based on the financial performance of TSC for Messrs. Manning and Harper, and of the Company for Mr. Hemsley. The calculation of the cash incentive bonus and the additional cash incentive bonus is described below in this Item 11 in footnote (1) to the table of Grants of Plan-Based Awards for 2007.

(2) The terms of these stock options are described below in this Item 11 in footnote (2) to the table of Grants of Plan-Based Awards for 2007.

(3) Mr. Manning was entitled to eight weeks of vacation per year and Mr. Harper was entitled to 18 weeks of vacation each year. Mr. Harper could take additional vacation by forfeiting salary at the rate of \$4,000 per week and he could forfeit his vacation time and be paid for it at the rate of \$4,000 per week.

(4) For the Company's cost of these benefits in 2007, see footnote (3) of the Summary Compensation Table for 2007, below.

Table of Contents

The New Agreements. The new employment agreements of Messrs. Manning, Harper and Allen became effective in July 2007 and expire on December 31, 2010. The following table describes the material financial features of each of the new employment agreements.

	Mr. Manning	Mr. Harper	Mr. Allen
Base Salary	\$ 365,000	\$ 365,000	\$ 250,000
Base Deferred Salary	\$ 162,500	\$ 162,500	\$ 75,000
Maximum Incentive Bonus	\$ 162,500	\$ 162,500	\$ 75,000
Equity Compensation	None	None	13,707-share stock option award (1)
Vacation	Discretionary (2)	Discretionary (2)	5 weeks
Benefits Paid by the Company	None	None	None(3)

- (1) The terms of this August 7, 2007 stock option are described below in the section entitled Grants of Plan-Based Awards for 2007.
- (2) The executive is entitled to take so many days vacation per year as he believes is appropriate in light of the needs of the business.
- (3) When he joined the Company, the Company, at Mr. Allen's request, agreed that he would continue his then current health plan rather than participate in the Company's health plan and would be reimbursed for up to \$1,000 of the monthly premiums. This arrangement is less expensive for the Company than if Mr. Allen had joined the Company's health plan.

Mr. Barzun's Employment Agreement. Mr. Barzun's employment agreement became effective in March 2006 and continues until terminated by the Company or by Mr. Barzun. His base salary in 2007 under the terms of the employment agreement was \$62,500, subject to merit increases, and an annual cash incentive bonus in the discretion of the Committee. Because he is a part-time employee, there is no provision in his agreement for paid vacation time.

All of the foregoing agreements provide for the election of the executive to his current positions with the Company. The new employment agreements of Messrs. Manning, Harper and Allen provide that they may not compete with the Company after termination of employment for a period of twelve months or for the period, if any, during which the Company is obligated to continue to pay him his base payroll salary, whichever period is longer

Table of Contents

Potential Payments upon Termination or Change-in-Control

The following table describes the payment and other obligations of the Company and the named executive officers under the new agreements in the event of a termination of employment or a change in control of the Company. The table also shows the estimated cost to the Company had the executive's employment been terminated on December 31, 2007.

Patrick T. Manning, Joseph P. Harper, Sr. & James H. Allen, Jr.

Event	Payment and/or Other Obligations *
<p>1. Termination by the Company without cause(1)</p>	<p>The Company must —</p> <ul style="list-style-type: none"> <li>· Continue to pay the executive his base salary for the balance of the term of his employment agreement or for one year, whichever period is longer;</li> <li>· Continue to cover him under its medical and dental plans provided the executive reimburses the Company the COBRA cost thereof, in which event the Company must reimburse the amount of the COBRA payments to the executive; and</li> <li>· Pay him a portion of any base deferred salary and cash incentive bonus that he would have earned had he remained an employee of the Company through the end of the calendar year in which his employment is terminated, based on the number of days during the year that he was an employee of the Company.</li> </ul>
<p>Estimated December 31, 2007 termination payments: Messrs. Manning &amp; Harper (each)</p>	<p>\$1,095,000 in monthly installments plus COBRA payment reimbursement, which currently would be approximately \$48,400 for Mr. Manning and \$29,200 for Mr. Harper for the three year period.</p>
<p>2. Mr. Allen Termination by reason of the executive's death</p>	<p>\$786,000 in monthly installments The Company is obligated to pay the executive a portion of any base deferred salary and of any cash incentive bonus that he would have earned had he remained an employee of the Company through the end of the calendar year in which his employment terminated, based on the number of days during the year that he was an employee of the Company.</p>
<p>Estimated termination payments: 3.</p>	<p>None</p>

Edgar Filing: STERLING CONSTRUCTION CO INC - Form 10-K

	Termination by the Company for cause(1)	The Company is required to pay the executive any accrued but unpaid base payroll salary through the date of termination and any other legally-required payments through that date. All of the executive's stock options terminate.
4.	Estimated termination payments: Involuntary resignation of the executive (2)	None An involuntary resignation, also known as a constructive termination, is treated under the agreement as a termination by the Company without cause.
5.	Estimated termination payments: Voluntary resignation by the executive	See Event 1, above. The Company is obligated to pay the executive a portion of any base deferred salary that he would have earned had he remained an employee of the Company through the end of the calendar year in which he resigned, based on the number of days during the year that he was an employee of the Company.
	Estimated December 31, 2007 termination payments:	None
6.	A change in control of the Company.	All the executives' unexercisable in-the-money stock options become exercisable in full and at December 31, 2007, had the following value based upon their market value at that date less their exercise price:
		Mr. Manning \$43,883
		Mr. Harper \$4,536
		Mr. Allen \$38,791
		Mr. Barzun \$3,024

Table of Contents

\*The base payroll salaries, base deferred salaries and cash incentive bonus eligibility of the executives are set forth above under the heading Employment Agreements of Named Executive Officers.

- (1)The term cause is defined in the employment agreements and means what is commonly referred to as cause in employment matters, such as gross negligence, dishonesty, insubordination, inadequate performance of responsibilities after notice and the like. A termination without cause is a termination for any reason other than for cause, death or voluntary resignation.
- (2)The executive is entitled to resign in the event that the Company commits a material breach of a material provision of his employment agreement and fails to cure the breach within thirty days, or, if the nature of the breach is one that cannot practicably be cured in thirty days, if the Company fails to diligently and in good faith commence a cure of the breach within the thirty-day period.

Roger M. Barzun. In the event that Mr. Barzun's employment is terminated for cause, the Company is only obligated to pay him his salary through the date of termination and his outstanding options terminate on that date. In the event that his employment is terminated without cause, or by reason of his death or permanent disability, the Company is obligated to pay him his salary then in effect for a period of six months, which at December 31, 2007 would be \$31,250, and to pay him within thirty days of his termination a portion of any cash incentive bonus to which he would otherwise have been entitled had his employment not been terminated, based on the number of days during the year that he was an employee of the Company. For purposes of determining the amount of the cash incentive bonus to which he would have been entitled, the Company is required to make such reasonable assumptions as it determines in good faith. In the event of a change in control of the Company, all of Mr. Barzun's options become exercisable in full.

Maarten D. Hemsley. As noted elsewhere in this Item 11, Mr. Hemsley's employment terminated on October 31, 2007 by reason of his voluntary resignation with the result that no termination payments were made to him.

Table of Contents

## Summary Compensation Table for 2007

The following table sets forth for calendar years 2006 and 2007 all compensation awarded to, earned by, or paid to, Patrick T. Manning, the Company's principal executive officer; James H. Allen, Jr., its principal financial officer, who joined the Company on July 16, 2007; and Maarten D. Hemsley, its former principal financial officer.

The table also shows the same compensation information of Joseph P. Harper, Sr., the Company's President, Treasurer & Chief Operating Officer, and Roger M. Barzun, its Senior Vice President, Secretary & General Counsel, who are the only other executive officers whose compensation for 2007 exceeded \$100,000.

The Company does not pay Messrs. Manning or Harper additional compensation for service on the Board of Directors. The Company pays compensation to these executive officers according to the terms of their employment agreements. The amounts include any compensation that was deferred by the executive through contributions to his defined contribution plan account under Section 401(k) of the Internal Revenue Code. All amounts are rounded to the nearest dollar.

Name and Principal Position	Year	Salary (\$)	Option Awards(1) (\$)	Non-Equity Incentive Plan Compensation(2) (\$)	All Other Compensation (\$)(3)	Total (\$)
Patrick T. Manning Chairman of the Board & Chief Executive Officer (principal executive officer)	2006	240,000	82,883	341,000	38,950	702,833
	2007	296,500	—	325,000	31,258	652,758
Joseph P. Harper, Sr. President, Treasurer & Chief Operating Officer	2006	235,800*	82,883	318,500	21,150	658,333
	2007	282,500	—	325,000	14,396	621,896
James H. Allen, Jr. Senior Vice President & Chief Financial Officer	2007	115,500	14,553	100,000	865	230,918
Maarten D. Hemsley Chief Financial Officer (former principal financial officer)	2006	129,808	22,862	117,500	12,350	282,520
	2007	106,500	27,640	50,000	6,823	190,963
Roger M. Barzun Senior Vice President & General Counsel, Secretary	2007	62,500	—	75,000		137,500

\*This includes \$20,800 paid to Mr. Harper for foregoing approximately five weeks of the vacation he was entitled to under his prior employment agreement, which expired in July 2007.

(1)The value of these stock option awards is the total dollar cost of the award recognized by the Company in the year of grant for financial reporting purposes in accordance with FAS 123R. No amounts earned by the executive officers have been capitalized on the balance sheet for 2007. The cost does not reflect any estimates made for financial statement reporting purposes of forfeitures by the executive officers related to service-based vesting conditions.

The valuation of these options was made on the equity valuation assumptions described in Note 8 of Notes to Consolidated Financial Statements. None of the awards has been forfeited. The following section, entitled Grants of Plan-Based Awards for 2007, contains a description of the basis on which these stock options were awarded and their full grant date fair market value.

(2) Cash incentive bonuses were calculated and approved by the Committee in March 2007 and February and March 2008. The bonuses for 2006 were determined in part by the application of a formula found in the prior employment agreement of each executive officer and in part by the Committee exercising its discretion as to the amount of additional cash incentive bonus within the range provided for in his employment agreements. Footnotes (1) and (2) to the table in the following section, entitled Grants of Plan-Based Awards for 2007, contain a description of the formula and its application.

Table of Contents

(3) The following table shows a breakdown of the amounts shown above in the All Other Compensation column. The dollar amounts are the costs of the items to the Company.

Type of Other Compensation	Year	Mr. Manning	Mr. Harper	Mr. Hemsley	Mr. Allen
Car allowance	2006	\$ 8,400	\$ 8,400	—	—
	2007	\$ 5,000	\$ 5,000	—	—
Expenses of commuting to work	2006	\$ 2,500	\$ 1,800	—	—
	2007	\$ 2,400	\$ 1,750	—	—
Country club dues	2006	\$ 25,000	\$ 4,500	—	—
	2007	\$ 15,000	\$ 3,420	—	—
Company contribution to 401(k) Plan account	2006	\$ 3,050	\$ 6,450	\$ 7,500	—
	2007	\$ 8,858	\$ 4,226	\$ 6,407	\$ 865
Long-term disability insurance premium	2006	—	—\$	4,502	—
	2007	—	—\$	152	—
Term life insurance premium	2006	—	—\$	348	—
	2007	—	—\$	264	—

## Grants of Plan-Based Awards for 2007

The following table shows each grant of an award for 2007 to a named executive officer under a Company plan. The Company did not award any SAR's, stock, restricted stock, restricted stock units, or similar instruments to any of the named executive officers in 2007.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards(1)			All Other Option Awards: Number of Securities Underlying Options(2) (#)	Exercise or Base Price of Option Awards (3) (\$/share)	Grant Date Fair Value of Option Awards(4) (\$)
		Threshold	Target	Maximum			
Patrick T. Manning	7/19/2007	142,156	239,656	304,656	-0-	N/A	N/A
Joseph P. Harper, Sr.	7/19/2007	142,156	239,656	304,656	-0-	N/A	N/A
James H. Allen, Jr.	8/7/2007	50,000	50,000	100,000	13,707	18.99	\$ 172,692
Maarten D. Hemsley	7/18/2007	50,000	75,000	125,000	2,800	21.60	\$ 27,640
Roger M. Barzun		75,000	75,000	75,000	-0-	N/A	N/A

(1) Non-Equity Incentive Plan Awards.

Messrs. Manning and Harper. Under their prior employment agreements, which expired in July 2007, each of Messrs. Manning and Harper is entitled to an annual bonus of \$125,000 for any year in which TSC achieves 75% or more of its budgeted EBITDA, which is a term defined in their agreements. Under their new employment agreements, which took effect upon the expiration of their prior employment agreements, each of them is entitled to what is referred to as a base deferred salary of \$162,500 for any year in which the Company, on a consolidated basis, achieves 75% or more of its budgeted EBITDA. In 2007, both TSC and the Company reached the 75% EBITDA goal.

The transition terms of the new employment agreements provide for the pro-ration of the prior agreement's bonus and the new agreement's base deferred salary based on the number of days during 2007 that each agreement was in effect. As a result of the pro-ration, the Company paid each executive 54.25% of his bonus under the prior agreement and 45.75% of the base deferred salary under his new agreement. The sum of these two amounts is the Threshold amount in the table above.

Under the new agreements, the Company agrees to pay each of Messrs. Manning and Harper a cash incentive bonus of up to \$162,500. Sixty percent of the cash incentive bonus is payable for a year in which the Company reaches its budgeted earnings-per-share goal, which it did in 2007. The sum of the Threshold amount and the 60% portion of the cash incentive bonus is the Target amount in the table above.

Table of Contents

Under the same transition terms of the new agreements, the Compensation Committee may pay the 40% balance of the cash incentive bonus for 2007 in its sole discretion, which it did. The sum of the Target amount and the 40% portion of the cash incentive bonus is the Maximum amount in the table above.

In subsequent years, the 40% portion of the cash incentive bonus will be payable based on the extent to which the executive achieves his personal goals for the year.

Mr. Allen. Mr. Allen's employment agreement has the same goal for earning a base deferred salary (\$75,000) and a cash incentive bonus (\$75,000) as do the new employment agreements of Messrs. Manning and Harper, except that since Mr. Allen was an employee for slightly less than half of 2007, his employment agreement provides for the pro-ration of his base deferred salary and cash incentive bonus based on the 169 days or 46% of 2007 that he was an employee.

As described above in the Compensation Discussion & Analysis, the Compensation Committee decided to award Mr. Allen two-thirds of his base deferred salary and two-thirds of both the 60% earnings-per-share portion and the 40% discretionary portion of his cash incentive bonus. Accordingly, in the table above, the Threshold amount is two-thirds of Mr. Allen's base deferred salary, the Target amount is the sum of the Threshold amount and two-thirds of the 60% portion of his cash incentive bonus, and the Maximum amount is the sum of the Target amount and two-thirds of the 40% portion of his cash incentive bonus.

Mr. Hemsley. Under his employment agreement, which expired by extension on October 31, 2007, Mr. Hemsley is entitled to a cash incentive bonus of \$50,000 for any year during the term of his agreement in which the Company on a consolidated basis achieves 75% or more of its budgeted EBITDA. He is also eligible for an additional cash incentive bonus not to exceed \$75,000 in the discretion of the Compensation Committee. In exercising their discretion, members of the Committee are to consider the Company's consolidated financial results for the year in question, the number of non-routine business transactions to which Mr. Hemsley devoted substantial time during the year and such other matters as they considered relevant. Accordingly, the Maximum amount is the sum of the Threshold and the Target amounts.

Mr. Barzun. Mr. Barzun's cash incentive bonus for a given year is entirely in the discretion of the Committee and is based on the Company's consolidated financial results for the year, the number of non-routine legal transactions to which he devoted substantial time during the year, and such other matters as the Committee deems relevant. Accordingly, for Mr. Barzun, his Threshold, Target and Maximum in the table above is the bonus amount awarded to him for 2007.

(2) Stock Option Awards. The stock option awards in this column were all granted under the Company's 2001 Stock Incentive Plan. In addition to the vesting dates of these options, described below, they vest in full if there is a change in control of the Company.

The July 18, 2007 Stock Option Award.

- This stock option was granted to Mr. Hemsley pursuant to the terms of his employment agreement.
- The option has a five-year term and vests, or becomes exercisable, in full on the date of grant.
- The exercise or purchase price of the shares subject to this option is the closing price of the common stock on the NASDAQ Global Select Market on the date of grant.



Table of Contents

- Had Mr. Hemsley's employment been terminated by the Company for cause, which is defined in the stock option agreement, or for good cause, which is defined in his employment agreement, all of his options would have immediately terminated.
- Because his employment terminated upon the expiration of his employment agreement, he may exercise this stock option from the date it became exercisable through its expiration date. Mr. Hemsley's employment agreement is described above in the section entitled Employment Agreements of Named Executive Officers.

The August 7, 2007 Stock Option Award.

- This stock option was awarded by the Committee in the exercise of its discretion in connection with Mr. Allen's election as Senior Vice President & Chief Financial Officer of the Company.
- The option has a ten-year term and vests, or becomes exercisable, in three substantially equal installments on each of the first three anniversaries of the date of the grant.
- The exercise price, or purchase price, of the shares subject to this stock option is the closing price of the Company's common stock on August 7, 2007, which was the date of the meeting of the Committee at which the stock option was approved.
- If Mr. Allen's employment terminates by reason of his permanent disability or death, or if he dies within three months after he ceases to be an employee, then he, his legal representative, his estate, or his beneficiaries (depending on the circumstances of the termination) may exercise the option for a period of one year or until the option's expiration date, whichever comes first, but only for the number of shares that had become exercisable on the date his employment terminated.
- If Mr. Allen's employment is terminated for cause, which is defined in the option agreement, the option immediately terminates.
- If Mr. Allen's employment terminates for any other reason, he may exercise the option for a period of ninety days after his employment terminates or until the expiration date of the option, whichever comes first, but only for the number of shares that had become exercisable on the date his employment terminated.

(3) Establishing the Option Exercise Price. It is the Company's policy to use the closing price of the common stock on the date of the meeting at which a stock option award is approved as the option's per-share exercise price. In the case of a stock option awarded on a date specified in an employment agreement, the exercise price is the closing price of the common stock on that date.

(4) The grant date fair value is the value computed for financial reporting purposes in accordance with FAS 123R. The valuation was made on the equity valuation assumptions described in Note 8 of Notes to Consolidated Financial Statements.

Option Exercises and Stock Vested for 2007

The following table contains information on an aggregated basis about each exercise of a stock option during 2007 by each of the named executive officers.

Name

Option Awards

	Number of Shares Acquired on Exercise (#)	Value Realized Upon Exercise(1) (\$)
Patrick T. Manning	—	—
Joseph P. Harper, Sr.	—	—
James H. Allen, Jr.	—	—

Table of Contents

Name	Option Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized Upon Exercise(1) (\$)
Maarten D. Hemsley	128,424	\$ 2,714,821
Roger M. Barzun	9,990	\$ 207,503