STERLING CONSTRUCTION CO INC
Form 10-Q
October 31, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended: September 30, 2016

Or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from___ to ___

Commission file number **1-31993**

STERLING CONSTRUCTION COMPANY, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**25-1655321**
State or other jurisdiction of incorporation	(I.R.S. Employer
or organization	Identification No.)

1800 Hughes Landing Blvd.

The Woodlands, Texas	**77380**
(Address of principal executive office)	(Zip Code)

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

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

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

[√] Yes [ ] No

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

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

Non-accelerated filer [ ] Smaller reporting company [ ]

(Do not check if a smaller reporting company)

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

At October 28, 2016, there were 25,002,964 shares outstanding of the issuer’s common stock, par value $0.01 per share.

STERLING CONSTRUCTION COMPANY, INC.

QUARTERLY REPORT ON FORM 10-Q

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	3
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3. Quantitative and Qualitative Disclosures about Market Risk	26
Item 4. Controls and Procedures	26
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	27
Item 1A. Risk Factors	27
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	27
Item 3. Defaults upon Senior Securities	27
Item 4. Mine Safety Disclosures	27
Item 5. Other Information	27
Item 6. Exhibits	28
SIGNATURES	29

PART I

Item 1. Financial Statements

STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share and per share data)

	September 30, 2016 (Unaudited)	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 43,021	$ 4,426
Contracts receivable, including retainage	105,415	82,112
Costs and estimated earnings in excess of billings on uncompleted contracts	31,989	26,905
Inventories	4,000	2,535
Receivables from and equity in construction joint ventures	9,469	12,930
Other current assets	6,170	6,013
Total current assets	200,064	134,921
Property and equipment, net	70,363	73,475
Goodwill	54,820	54,820
Other assets, net	2,968	2,949
Total assets	$ 328,215	$ 266,165
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 76,861	$ 58,959
Billings in excess of costs and estimated earnings on uncompleted contracts	61,896	30,556
Current maturities of long-term debt	4,653	4,856
Income taxes payable	63	67
Accrued compensation	10,412	5,977
Other current liabilities	5,545	3,896
Total current liabilities	159,430	104,311
Long-term liabilities:		
Long-term debt, net of current maturities	6,952	15,324
Member’s interest subject to mandatory redemption and undistributed earnings	46,466	50,438
Other long-term liabilities	911	338
Total long-term liabilities	54,329	66,100
Commitments and contingencies (Note 5)		
Equity:		
Sterling stockholders’ equity:		
Preferred stock, par value $0.01 per share; 1,000,000 shares authorized, none issued	-	-

Common stock, par value $0.01 per share; 28,000,000 shares authorized, 25,002,964 and 19,753,170 shares issued	250	198
Additional paid in capital	208,435	188,147
Retained deficit	(95,390)	(92,500)
Total Sterling common stockholders' equity	113,295	95,845
Noncontrolling interests	1,161	(91)
Total equity	114,456	95,754
Total liabilities and equity	$ 328,215	$ 266,165

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

3

STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except share and per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues	$205,629	$176,000	$521,778	$471,107
Cost of revenues	(188,597)	(161,542)	(484,827)	(454,374)
Gross profit	17,032	14,458	36,951	16,733
General and administrative expenses	(9,575)	(11,119)	(29,221)	(32,320)
Other operating income (expense), net	(3,785)	(958)	(7,143)	1,128
Operating income (loss)	3,672	2,381	587	(14,459)
Interest income	15	32	19	464
Interest expense	(491)	(1,087)	(2,176)	(2,103)
Loss on extinguishment of debt	-	-	-	(240)
Income (loss) before income taxes and earnings attributable to noncontrolling interests	3,196	1,326	(1,570)	(16,338)
Income tax (expense) benefit	(41)	39	(68)	8
Net income (loss)	3,155	1,365	(1,638)	(16,330)
Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	(740)	(1,109)	(1,252)	(2,948)
Net income (loss) attributable to Sterling common stockholders	$2,415	$256	$(2,890)	$(19,278)
Net income (loss) per share attributable to Sterling common stockholders:				
Basic and diluted	$0.10	$0.01	$(0.12)	$(1.00)
Weighted average number of common shares outstanding used in computing per share amounts:				
Basic	25,002,964	19,627,674	23,914,688	19,269,123
Diluted	25,364,881	19,627,674	23,914,688	19,269,123

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

STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Amounts in thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income (loss) attributable to Sterling common stockholders	$2,415	$256	$(2,890)	$(19,278)
Net income attributable to noncontrolling interests included in equity	740	1,109	1,252	2,948
Other comprehensive income (loss), net of tax:				
Realized loss from settlement of derivatives	-	24	-	107
Change in the effective portion of unrealized loss in fair market value of derivatives	-	(6)	-	(6)
Comprehensive income (loss)	$3,155	$1,383	$(1,638)	$(16,229)

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

STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2016

(Amounts in thousands)

(Unaudited)

	STERLING CONSTRUCTION COMPANY, INC. STOCKHOLDERS					
	Common Stock		Additional Paid in	Retained	Noncon- trolling	
	Shares	Amount	Capital	Deficit	Interests	Total
Balance at January 1, 2016	19,753	$ 198	$ 188,147	$ (92,500)	$ (91)	$ 95,754
Net income (loss)	-	-	-	(2,890)	1,252	(1,638)
Stock-based compensation	79	-	1,211	-	-	1,211
Stock issued in equity offering, net of expense	5,175	52	19,090	-	-	19,142
Other	(4)	-	(13)	-	-	(13)
Balance at September 30, 2016	25,003	$ 250	$ 208,435	$ (95,390)	$ 1,161	$ 114,456

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

STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net loss attributable to Sterling common stockholders	$(2,890)	$(19,278)
Plus: Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	1,252	2,948
Net loss	(1,638)	(16,330)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	12,097	12,479
Gain on disposal of property and equipment	(255)	(1,205)
Stock-based compensation expense	1,211	1,319
Loss on extinguishment of debt	-	240
Changes in operating assets and liabilities:		
Contracts receivable	(23,303)	(20,770)
Costs and estimated earnings in excess of billings on uncompleted contracts	(5,084)	10,116
Inventories	(1,465)	4,821
Receivables from and equity in construction joint ventures	3,461	(1,936)
Other assets	(1,246)	9,318
Accounts payable	17,902	7,291
Billings in excess of costs and estimated earnings on uncompleted contracts	31,340	7,400
Accrued compensation and other liabilities	6,662	4,230
Member's interest subject to mandatory redemption and undistributed earnings	(3,972)	1,101
Net cash provided by operating activities	35,710	3,492
Cash flows from investing activities:		
Additions to property and equipment	(8,852)	(7,086)
Proceeds from sale of property and equipment	2,187	5,859
Restricted cash	-	(4,945)
Net cash used in investing activities	(6,665)	(6,172)
Cash flows from financing activities:		
Cumulative daily drawdowns – Credit Facility	-	112,848
Cumulative daily repayments – Credit Facility	-	(147,450)
Cash received– equipment-based term loan	-	18,980
Cumulative repayments – equipment-based term loan and other	(9,546)	-
Cumulative drawdowns – equipment-based revolver	19,000	13,100
Cumulative repayments – equipment-based revolver	(19,000)	-
Net proceeds from stock issued	19,142	-
Distributions to noncontrolling interest owners	-	(3,402)
Other	(46)	(2,751)
Net cash provided by (used in) financing activities	9,550	(8,675)

Net increase (decrease) in cash and cash equivalents	38,595	(11,355)
Cash and cash equivalents at beginning of period	4,426	22,843
Cash and cash equivalents at end of period	$43,021	$11,488
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	$2,429	$1,893
Cash paid during the period for income taxes	$5	$547
Non-cash items:		
Transportation and construction equipment acquired through financing arrangements	$735	$1,161

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

7

STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Business Summary and Significant Accounting Policies

Business Summary

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

Presentation

The condensed consolidated financial statements included herein have been prepared by Sterling, without audit, in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) and should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2015 (“2015 Form 10-K”). Certain information and note disclosures prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been either condensed or omitted pursuant to SEC rules and regulations. The condensed consolidated financial statements reflect, in the opinion of management, all normal recurring adjustments necessary to present fairly the Company’s financial position at September 30, 2016 and the results of operations and cash flows for the periods presented. The December 31, 2015 condensed consolidated balance sheet data herein was derived from audited financial statements, but as discussed above, does not include all disclosures required by GAAP. Interim results may be subject to significant seasonal variations and the results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the full year or subsequent quarters.

Significant Accounting Policies

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

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

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

Principles of Consolidation

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

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

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

Use of Estimates

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

Reclassification

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

Revenue Recognition

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

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

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

Changes in estimated revenues and gross margin resulted in a net charge of $0.6 million and a net charge of $1.1 million during the three months and nine months ended September 30, 2016, respectively, included in “operating income (loss)” on the condensed consolidated statements of operations. Changes in estimated revenues and gross margin resulted in a net charge of $1.1 million and $12.3 million during the three months and nine months ended September 30, 2015, respectively, included in “operating income (loss)” on the condensed consolidated statements of operations.

Change orders are modifications of an original contract that effectively change the existing provisions of the contract without adding new provisions or terms. Change orders may include changes in specifications or designs, manner of performance, facilities, equipment, materials, sites and period of completion of the work. Either we or our customers may initiate change orders.

The Company considers unapproved change orders to be contract variations for which we have customer approval for a change of scope but a price change associated with the scope change has not yet been agreed upon. Costs associated with unapproved change orders are included in the estimated costs to complete the contracts and are treated as project costs as incurred. The Company recognizes revenue equal to costs incurred on unapproved change orders when realization of price approval is probable. Unapproved change orders involve the use of estimates, and it is reasonably possible that revisions to the estimated costs and recoverable amounts may be required in future reporting periods to reflect changes in estimates or final agreements with customers. Change orders that are unapproved as to both price and scope are evaluated as claims.

The Company considers claims to be amounts in excess of agreed contract prices that we seek to collect from our customers or others for customer-caused delays, errors in specifications and designs, contract terminations, change orders that are either in dispute or are unapproved as to both scope and price, or other causes of unanticipated additional contract costs. Claims are included in the calculation of revenue when realization is probable and amounts can be reliably determined to the extent costs are incurred. To support these requirements, the existence of the following items must be satisfied: 1. The contract or other evidence provides a legal basis for the claim; or a legal opinion has been obtained, stating that under the circumstances there is a reasonable basis to support the claim; 2. Additional costs are caused by circumstances that were unforeseen at the contract date and are not the result of deficiencies in the contractor’s performance; 3. Costs associated with the claim are identifiable or otherwise determinable and are reasonable in view of the work performed; and 4. The evidence supporting the claim is objective and verifiable, not based on management’s feel for the situation or on unsupported representations. Revenues in excess of contract costs incurred on claims is recognized when an agreement is reached with customers as to the value of the claims, which in some instances may not occur until after completion of work under the contract. Costs associated with claims are included in the estimated costs to complete the contracts and are treated as project costs when incurred.

The Company has projects where we are in the process of negotiating, or awaiting final approval of, unapproved change orders and claims with our customers. The Company is proceeding with its contractual rights to recoup additional costs incurred from its customers based on completing work associated with change orders with pending change order pricing or claims related to significant changes in scope which resulted in substantial delays and additional costs in completing the work. Unapproved change order and claim information has been provided to our customers and negotiations with the customers are ongoing. If additional progress with an acceptable resolution is not reached, legal action will be taken.

Based upon our review of the provisions of our contracts, specific costs incurred and other related evidence supporting the unapproved change orders, claims and our entitled unpaid project price, together with the views of the Company's outside claim consultants, we concluded that including the unapproved change order, claim and entitled unpaid project price amounts of $2.4 million, $9.1 million and $3.9 million, respectively, at September 30, 2016, and $1.6 million, $5.2 million and $3.9 million, respectively, at December 31, 2015, in "Costs and estimated earnings in excess of billings on uncompleted contracts" on our condensed consolidated balance sheets was in accordance with GAAP. We expect these matters will be resolved without a material adverse effect on our financial statements. However, unapproved change order and claim amounts are subject to negotiations which may cause actual results to differ materially from estimated and recorded amounts.

Financial Instruments and Fair Value

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

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

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

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

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

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

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

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

Recent Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board ("FASB") issued guidance in Accounting Standards Update ("ASU") No. 2016-15 (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This update addresses specific cash flow issues with the objective of reducing existing diversity in practice. Early adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the impact of the adoption of this guidance to the Company's consolidated financial statements and related disclosures.

In June 2016, the FASB issued guidance in ASU No. 2016-13 Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. Among other things, these amendments require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts (forward-looking). Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. This new guidance is effective for public entities for annual reporting periods, beginning after December 15, 2019, including interim reporting periods therein. Early adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the impact of the adoption of this guidance to the Company's consolidated financial statements and related disclosures.

In April and May 2016, the FASB issued additional revenue recognition guidance in ASU No. 2016-12, No. 2016-11 and 2016-10 (Topic 606). All three of these standards provide implementation guidance and clarifications of ASU 2014-09, "Revenue from Contracts with Customers." ASU 2016-10 provides additional guidance on identifying performance obligations and licensing, ASU 2016-11 rescinds SEC guidance based on the previous revenue recognition standards and ASU 2016-12 relates to narrow-scope improvements and practical expedients. All of these amendments are effective for public entities for annual reporting periods beginning after December 15, 2017, including interim reporting periods therein. The Company is currently evaluating the impact of the adoption of this guidance to the Company's consolidated financial statements and related disclosures.

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

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

2. Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with original or remaining maturities of three months or less at the time of purchase to be cash equivalents. Cash and cash equivalents include cash balances held by our wholly owned subsidiaries, as well as cash held by majority owned subsidiaries, construction joint ventures, and the Company’s VIE that we consolidate. Refer to Note 8 for more information regarding the Company’s consolidated VIE. Joint venture cash balances are limited to joint venture activities and are not available for other projects, general cash needs or distribution to us without approval of the board of directors, or equivalent body, of the respective joint ventures. At September 30, 2016 and December 31, 2015, cash and cash equivalents included $14.1 million and a minimal amount, respectively, belonging to a majority-owned joint venture which generally cannot be used for purposes outside the joint venture.

Restricted cash of approximately $3.0 million is included in “other assets, net” on the condensed consolidated balance sheets as of September 30, 2016 and December 31, 2015, and represents cash deposited by the Company into a separate account and designated as collateral for a standby letter of credit in the same amount in accordance with contractual agreements. Refer to Note 5 for more information about our standby letter of credit. In addition, restricted cash of approximately $2.0 million is included in “other current assets” on the condensed consolidated balances sheet as of September 30, 2016 and December 31, 2015, which represents cash deposited by a customer, for the benefit of the Company, in an escrow account which is restricted until the customer releases the restriction upon the completion of the job.

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

3. Property and Equipment

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

	September 30, 2016	December 31, 2015
Construction equipment	$121,371	$114,724
Transportation equipment	18,924	18,056
Buildings	12,771	10,860
Office equipment	3,041	2,810
Leasehold improvement	915	894
Construction in progress	96	1,986
Land	3,509	4,257
Water rights	200	200
	160,827	153,787
Less accumulated depreciation	(90,464)	(80,312)
Total property and equipment, net	$70,363	$73,475

4. Income Taxes

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

The Company is not expecting a current federal tax liability due to sufficient net operating loss carry forwards. The Company may incur current state tax liabilities in states in which the Company does not have sufficient net operating loss carry forwards. A minimal tax expense was recorded for the three and nine months ended September 30, 2016 and a minimal tax benefit was recorded for the three and nine months ended September 30, 2015. The effective income tax rate varied from the statutory rate primarily as a result of the change in the valuation allowance, net income attributable to noncontrolling interest owners which is taxable to those owners rather than to the Company, state income taxes and other permanent differences.

The Company's deferred tax expense (or benefit) reflects the change in deferred tax assets or liabilities. The Company performs an analysis at the end of each reporting period to determine whether it is more likely than not the deferred tax assets are expected to be realized in future years. Based upon this analysis, a full valuation allowance has been applied to our net deferred tax assets as of September 30, 2016 and December 31, 2015. Therefore, there has been no change in net deferred taxes for the three and nine months ended September 30, 2016.

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

5. Commitments and Contingencies

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

During the first six months of 2016, the Company recorded a legal reserve of $1.0 million as a result of a dispute between one of the Company's wholly-owned subsidiaries and a subcontractor. This amount was recorded as "cost of revenues" in our condensed statements of operations and was settled for $1.0 million during the second quarter of 2016. This matter is now resolved in its entirety.

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

6. Subsidiaries and Joint Ventures with Noncontrolling Owners' Interests

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

	September 30, 2016	December 31, 2015
Members' interest subject to mandatory redemption	$ 40,000	$ 40,000
Net accumulated earnings	6,466	10,438
Total liability	$ 46,466	$ 50,438

Earnings for the three and nine months ended September 30, 2016 were $3.4 million and $7.3 million, respectively and $1.5 million and $0.8 million for the three and nine months ended September 30, 2015. These amounts were included in "Other operating income, net" on the Company's condensed consolidated statements of operations.

Changes in Noncontrolling Interests

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

	Nine Months Ended September 30, 2016	2015
Balance, beginning of period	$ (91)	$ 7,462
Net income attributable to noncontrolling interest included in equity	1,252	2,948
Distributions to noncontrolling interest owners	-	(3,402)
Balance, end of period	$ 1,161	$ 7,008

Net income attributable to noncontrolling interests for the nine months ended September 30, 2016, is primarily from the Company’s majority-owned construction joint venture. Due to the events described in Note 2 of the Notes to Consolidated Financial Statements in the 2015 Form 10-K, the Company’s subsidiaries with noncontrolling interest earnings are less than the earnings in the prior year period.

7. Construction Joint Ventures

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

	September 30, 2016	December 31, 2015
Total combined:		
Current assets	$ 26,893	$ 17,312
Less current liabilities	(51,181)	(49,371)
Net assets	$ (24,288)	$ (32,059)
Backlog	$ 125,850	$ 35,113
Sterling's noncontrolling interest in backlog	$ 60,947	$ 11,748
Sterling's receivables from and equity in construction joint ventures	$ 9,469	$ 12,930

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Total combined:				
Revenues	$ 15,520	$ 9,458	$ 44,074	$ 50,450
Income before tax	1,925	808	3,838	5,866
Sterling's portion of noncontrolling interest:				
Revenues	$ 6,103	$ 3,437	$ 17,567	$ 19,986
Income before tax	519	357	1,370	2,021

Approximately $61 million of the Company's backlog at September 30, 2016 was attributable to projects being performed by joint ventures. The majority of this amount is attributable to the Company's joint venture with Granite Construction Corporation, where the Company has a 49% interest.

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

14

8. Variable Interest Entities

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

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

	September 30, 2016	December 31, 2015
Assets:		
Current assets:		
Cash and cash equivalents	$ 2,074	$ 3,226
Contracts receivable, including retainage	25,107	19,941
Other current assets	10,052	15,887
Total current assets	37,233	39,054
Property and equipment, net	10,279	10,080
Goodwill	1,501	1,501
Total assets	$ 49,013	$ 50,635
Liabilities:		
Current liabilities:		
Accounts payable	$ 25,907	$ 20,596
Other current liabilities	11,541	10,986
Total current liabilities	37,448	31,582
Long-term liabilities:		
Other long-term liabilities	425	3,370
Total liabilities	$ 37,873	$ 34,952

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues	$ 50,739	$ 43,444	$ 121,649	$ 134,035
Operating income	2,720	2,216	4,894	5,885
Net income attributable to Sterling common stockholders	1,357	1,108	2,440	2,941

9. Stockholders' Equity

Stock Offering

On May 9, 2016, the Company completed an underwritten public offering of 5,175,000 shares of the Company's common stock, which included the full exercise of the sole underwriter's over-allotment option, at a price to the public of $4.00 per share ($3.77 per share net of underwriting discounts). The net proceeds from the offering of $19.1 million, after deducting underwriting discounts and other offering expenses, were used for working capital, repayment of our indebtedness under the revolving loan portion of our Equipment-based Facility and for general corporate purposes.

Stock-Based Compensation

The Company has a stock-based incentive plan which is administered by the Compensation Committee of the Board of Directors. Refer to Note 14 of the Notes to Consolidated Financial Statements included in the 2015 Form 10-K for further information.

During the three and nine months ended September 30, 2016, the Company awarded a total of zero and 79,240 shares of common stock, respectively, at a weighted-average grant date value of zero and $4.36 per share, respectively, based on the closing price of the Company's common stock on the date of award. The Company recorded stock-based compensation expense of $0.4 million and $1.2 million for the three months and nine months ended September 30, 2016, respectively, and $0.8 million and $1.3 million for the three and nine months ended September 30, 2015, respectively.

At September 30, 2016, total unrecognized compensation cost related to unvested common stock awards was $2.3 million. This cost is expected to be recognized over a weighted average period of 1.5 years. At September 30, 2016, there were 0.8 million shares of common stock covered by outstanding unvested common stock.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Numerator:				
Net income (loss) attributable to Sterling common stockholders	$2,415	$256	$(2,890)	$(19,278)
Denominator:				
Weighted average common shares outstanding — basic	25,003	19,628	23,915	19,269
Shares for dilutive unvested stock	362	-	-	-
Weighted average common shares outstanding and incremental shares assumed repurchased— diluted	25,365	19,628	23,915	19,269

Basic and diluted income (loss) per share attributable to Sterling common stockholders	$0.10	$0.01	$(0.12)	$(1.00)

In accordance with the treasury stock method, zero and approximately 0.3 million shares of unvested common stock were excluded from the calculation of the diluted weighted average common shares outstanding for the three and nine months ended September 30, 2016, as the Company incurred a loss during the nine month period and the impact of such shares would have been antidilutive. In accordance with the treasury stock method, 0.2 million and 0.4 million shares of unvested common stock were excluded from the diluted weighted average common shares outstanding for the three and nine months ended September 30, 2015, as the assumed proceeds related to these shares would purchase more shares than the unvested shares outstanding resulting in anti-dilution.

11. Debt

Debt consists of the following (in thousands):

	September 30, 2016	December 31, 2015
Equipment-based Facility	$ 9,553	$ 17,957
Less deferred loan costs	(891)	(1,119)
Equipment-based Facility, net	8,662	16,838
Notes payable for transportation and construction equipment and other	2,943	3,342
	11,605	20,180
Current maturities of long-term debt	5,009	5,192
Less current deferred loan costs	(356)	(336)
Less current maturities of long-term debt, net	(4,653)	(4,856)
Total long-term debt	$ 6,952	$ 15,324

Equipment-based Facility

At September 30, 2016, the Company had a borrowing base of $27.0 million, which was the result of calculating 65% of the appraised value (where appraised value equals net operating liquidated value) of the Company’s collateral.

During the three months ended September 30, 2016 the Company prepaid $5 million of the principal balance of our Term Loan and paid approximately $0.2 million as a prepayment fee which was recorded as “interest expense” in our condensed consolidated statement of operations.

Fair Value

The Company’s debt is recorded at its carrying amount in the condensed consolidated balance sheets. The Company uses an income approach to determine the fair value of its 12% Term Loan due May 29, 2019 using estimated cash flows, which is a Level 3 fair value measurement. As of September 30, 2016, the carrying values and fair values are as follows (amounts in thousands):

	September 30, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Revolving Loan	$-	$-	$-	$-
Term Loan	9,553	9,527	17,957	17,957
Total Equipment-based Facility debt	$9,553	$9,527	$17,957	$17,957

Notes Payable for Transportation and Construction Equipment

The Company has purchased and financed various transportation and construction equipment to enhance the Company's fleet of equipment. The total long-term notes payable related to the purchase of financed equipment was $2.9 million at September 30, 2016 and $3.3 million at December 31, 2015. The purchases have payment terms ranging from 3 to 5 years and the associated interest rates range from 3.12% to 7.13%. The fair value of these notes payable approximates their book value.

Interest Expense

Interest expense related to our Equipment-based Facility and other debt for the three and nine months ended September 30, 2016 was $0.5 million and $2.2 million, respectively, and $1.1 million and $2.1 million for the three and nine months ended September 30, 2015, respectively. The decrease in interest expense for the three months ended September 30, 2016 was due to the decreased debt outstanding during the period. The slight increase in interest expense for the nine months ended September 30, 2016, was due to the prepayment fee discussed above and the higher interest rate on the Equipment-based Facility compared to the interest rate on our prior credit facility.

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

Cautionary Comment Regarding Forward-Looking Statements

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

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

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

- changes in general economic conditions, including recessions, reductions in federal, state and local government funding for infrastructure services and changes in those governments' budgets, practices, laws and regulations;
- delays or difficulties related to the completion of our projects, including additional costs, reductions in revenues or the payment of liquidated damages, or delays or difficulties related to obtaining required governmental permits and approvals;
- actions of suppliers, subcontractors, design engineers, joint venture partners, customers, competitors, banks, surety companies and others which are beyond our control, including suppliers', subcontractors' and joint venture partners' failure to perform;
- factors that affect the accuracy of estimates inherent in our bidding for contracts, estimates of backlog, percentage-of-completion accounting policies, including onsite conditions that differ materially from those assumed in our original bid, contract modifications, mechanical problems with our machinery or equipment and effects of other risks discussed in this document;
- design/build contracts which subject us to the risk of design errors and omissions;
- cost escalations associated with our contracts, including changes in availability, proximity and cost of materials such as steel, cement, concrete, aggregates, oil, fuel and other construction materials and cost escalations associated with subcontractors and labor;
- our dependence on a limited number of significant customers;
- adverse weather conditions; although we prepare our budgets and bid contracts based on historical rain and snowfall patterns, the incidence of rain, snow, hurricanes, etc., may differ materially from these expectations;

- the presence of competitors with greater financial resources or lower margin requirements than ours and the impact of competitive bidders on our ability to obtain new backlog at reasonable margins acceptable to us;
- our ability to successfully identify, finance, complete and integrate acquisitions;
- citations issued by any governmental authority, including the Occupational Safety and Health Administration;
- federal, state and local environmental laws and regulations where non-compliance can result in penalties and/or termination of contracts as well as civil and criminal liability;
- adverse economic conditions in our markets; and
- the other factors discussed in more detail in our Annual Report on Form 10-K for the year ended December 31, 2015 ("2015 Form 10-K") under "Part I, Item 1A. Risk Factors."

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

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

Overview

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

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

Market Outlook and Trends

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

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

Backlog, backlog gross margin and gross margin trends:

	Backlog	**Gross Margin in Backlog**
	(Dollar amounts in thousands)	
Third quarter of 2016	$820,000	8.0%
Second quarter of 2016	$810,000	7.8%
First quarter of 2016	$854,000	7.7%
Fourth quarter of 2015	$761,000	7.0%
Third quarter of 2015	$718,000	6.5%

Our total margin in backlog has increased approximately 150 basis points, from 6.5% at September 30, 2015 to 8.0% at September 30, 2016. During the nine months ended September 30, 2016, we have won approximately $455 million worth of new projects at an average margin of more than 8.5%. In addition, once we complete approximately $21 million worth of legacy projects with small or zero margins, we expect that our overall backlog margins to continue to increase and will be in the 8.0% to 8.5% range by December 31, 2016. The increases noted above are primarily the result of the improving market conditions and actions that we have taken to improve bid discipline.

Our gross margin has increased 1.2%, 66.7% and 8.8% from the third quarter of 2015 to the third quarter of 2016, from the second quarter of 2015 to the second quarter of 2016 and from the first quarter of 2015 to the first quarter of 2016, respectively. These increases are a result of the improving market conditions, our bid discipline and our improving project execution.

For purposes of the discussions which follow, “Current Quarter” refers to the three-month period ended September 30, 2016, “Prior Quarter” refers to the three-month period ended September 30, 2015, Current Period” refers to the nine-month period ended September 30, 2016 and “Prior Period” refers to the nine-month period ended September 30, 2015.

Summary of Financial Results for the Current Quarter and Current Period

In the Current Quarter and Current Period, we had operating income of $3.7 million and $0.6 million, respectively, income before income taxes and earnings attributable to noncontrolling interest owners of $3.2 million and a loss of $1.6 million, respectively, net income attributable to Sterling common stockholders of $2.4 million and a loss attributable to Sterling common stockholders of $2.9 million, respectively, and net income per diluted share attributable to Sterling common stockholders of $0.10 and a net loss per diluted share attributable to Sterling common stockholders of $0.12, respectively.

Results of Operations

Backlog

At September 30, 2016, our backlog of construction projects was $820 million, as compared to $761 million at December 31, 2015. Our contracts are typically completed in 12 to 36 months. At September 30, 2016 and December 31, 2015, approximately $94 million and $197 million, respectively, was excluded from our consolidated backlog for projects in which we were the apparent low bidder, but had not yet been formally awarded the contract or the contract price had not been finalized (“Unsigned Low-bid Awards”). Total backlog, including Unsigned Low-bid Awards, at September 30, 2016 and December 31, 2015, was $914 million and $958 million, respectively. Backlog at September 30, 2016 includes $61 million attributable to our share of estimated revenues related to joint ventures where we are a noncontrolling joint venture partner.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2016	2015	% Change	2016	2015	% Change
	(Dollar amounts in thousands)					
Revenues	$205,629	$176,000	16.8 %	$521,778	$471,107	10.8 %
Gross profit	$17,032	$14,458	17.8	$36,951	$16,733	NM
General and administrative expenses	(9,575)	(11,119)	(13.9)	(29,221)	(32,320)	(9.6)
Other operating income (expense), net	(3,785)	(958)	NM	(7,143)	1,128	NM
Operating income (loss)	3,672	2,381	54.2	587	(14,459)	NM
Interest income	15	32	(53.1)	19	464	(95.9)
Interest expense	(491)	(1,087)	(54.8)	(2,176)	(2,103)	3.5
Loss on extinguishment of debt	-	-	NM	-	(240)	NM
Income (loss) before taxes and earnings attributable to noncontrolling interests a	3,196	1,326	NM	(1,570)	(16,338)	(90.4)
Income tax (expense) benefit	(41)	39	NM	(68)	8	NM
Net income (loss)	3,155	1,365	NM	(1,638)	(16,330)	(90.0)
Noncontrolling owners’ interests in earnings of subsidiaries and joint ventures	(740)	(1,109)	(33.3)	(1,252)	(2,948)	(57.5)
Net income (loss) attributable to Sterling common stockholders	$2,415	$256	NM	$(2,890)	$(19,278)	(85.0)
Gross margin	8.3 %	8.2 %	1.2	7.1 %	3.6 %	97.2
Operating margin (deficit)	1.8 %	1.4 %	28.6	0.1 %	(3.1)%	NM

NM – Not meaningful.

Revenues

Revenues increased $29.6 million, or 16.8%, in the Current Quarter compared with the Prior Quarter and increased $50.7 million, or 10.8%, in the Current Period compared with the Prior Period. As our markets continue to improve, so has the trend of increasing backlog which increased $102 million from September 30, 2015 to September 30, 2016. This trend has contributed to the increased execution of projects and has favorably affected revenues in both the Current Quarter and Current Period. Specifically, the increase in revenues during the Current Quarter as compared to the Prior Quarter is primarily the result of increased project activity in nearly all of our markets which resulted in a $35.0 million increase, offset by a $5.4 million decrease in Texas. The Texas decrease is primarily due to the slower ramp up of new work driven by owner delays. The majority of the increase was due to the ramp up of two large Utah projects constructed by our majority-owned construction joint venture that were not ongoing in the Prior Quarter or the Prior Period. The increase in the Current Period as compared to the Prior Period is primarily the result of the ramp up of these two large projects along with the lower revenue projects constructed in the Prior Period and the downward percent-complete revisions made to certain projects in the Prior Period. Current Period revenues increased largely in Utah, Nevada and Hawaii by $75.4 million which was offset by $24.7 million due to lower project activity in Texas as a result of heavy rainfall which caused flooding in the Houston and surrounding areas, slower ramp up of new work driven by owner delays and the winding down of a large project in California which was ongoing in the Prior Period.

Gross profit

Gross profit increased $2.6 million for the Current Quarter compared with the Prior Quarter and $20.2 million for the Current Period compared with the Prior Period. Our gross margins increased to 8.3% and 7.1% in the Current Quarter and Current Period, respectively, as compared to 8.2% and 3.6% in the Prior Quarter and Prior Period, respectively. The increase in gross margin during the Current Quarter as compared to the Prior Quarter was primarily related to the overall increasing margin in backlog driven by the Company’s improving markets and the change in the project margin mix as we have less revenue in the current quarter from zero or near zero margin projects. Favorable project mix has improved gross margin in backlog by 1.5% to 8.0% at September 30, 2016, from 6.5% at September 30, 2015. The increase in the gross margin during the Current Period as compared to the Prior Period is primarily a result of downward revision of gross profits related to construction projects in Texas in the Prior Period as well as improved project margin mix as noted above. Current Period gross margin was adversely affected by a completed California project which recorded an additional loss of approximately $1.6 million. This loss was primarily attributable to unfavorable developments relating to a subcontractor claim.

At September 30, 2016 and 2015, we had 121 and 133 contracts-in-progress, respectively, which were less than 90% complete. These contracts are of various sizes, of different expected profitability and in various stages of completion. The nearer a contract progresses toward completion, the more we are able to refine our estimate of total revenues (including incentives, delay penalties, change orders and claims), costs and gross profit. Thus, gross profit as a percent of revenues can increase or decrease from comparable and subsequent quarters due to variations among contracts and depending upon the stage of completion of contracts.

The Company has projects where we are in the process of negotiating, or awaiting final approval of, unapproved change orders and claims with our customers. The Company is proceeding with its contractual rights to recoup additional costs incurred from its customers based on completing work associated with change orders with pending change order pricing or claims related to significant changes in scope which resulted in substantial delays and additional costs in completing the work. Unapproved change order and claim information has been provided to our customers and negotiations with the customers are ongoing. If additional progress with an acceptable resolution is not reached, legal action will be taken.

Based upon our review of the provisions of our contracts, specific costs incurred and other related evidence supporting the unapproved change orders, claims and our entitled unpaid project price, together with the views of the Company's outside claim consultants, we concluded that including the unapproved change order, claim and entitled unpaid project price amounts of $2.4 million, $9.1 million and $3.9 million, respectively, at September 30, 2016, and $1.6 million, $5.2 million and $3.9 million, respectively, at December 31, 2015, in "Costs and estimated earnings in excess of billings on uncompleted contracts" on our condensed consolidated balance sheets was in accordance with GAAP. We expect these matters will be resolved without a material adverse effect on our financial statements. However, unapproved change order and claim amounts are subject to negotiations which may cause actual results to differ materially from estimated and recorded amounts.

General and administrative expenses

General and administrative expenses decreased $1.5 million to $9.6 million during the Current Quarter from $11.1 million in the Prior Quarter and decreased $3.1 million to $29.2 million during the Current Period from $32.3 million in the Prior Period. The decrease in the Current Quarter compared to the Prior Quarter is primarily the result of certain non-recurring costs related to consulting and employee severance payments of $1.1 million and $0.5 million, respectively, in the Prior Quarter. The decrease in the Current Period as compared to the Prior Period is primarily the result of certain non-recurring costs related to consulting and employee severance payments of $1.2 million and $2.9 million, respectively, in the Prior Period offset by an increase in certain employee and employee benefit costs in the Current Period.

As a percent of revenues, general and administrative expenses decreased 1.6% to 4.7% and 1.3% to 5.6% in the Current Quarter and Current Period, respectively, compared with 6.3% and 6.9% in the Prior Quarter and Prior Period, respectively. The decrease in general and administrative expenses, as a percentage of revenue, for the Current Quarter and Current Period is primarily the result of the decrease in the non-recurring employee severance costs and consulting costs paid in the Prior Period as mentioned above, along with the leverage generated from generally fixed costs and increases in revenue in both current periods.

Other operating income (expense), net

Other operating income (expense), net, includes 50% of earnings and losses related to members' interests, gains and losses from sales of property, plant and equipment and other miscellaneous operating income or expense. Members' interest earnings are treated as an expense and result in an increase to our liability account "Members' interest subject to mandatory redemption and undistributed earnings." The change in other operating income (expense), net was primarily due to increased Members' interest earnings and an earn-out expense of $3.4 million and $0.4 million, respectively, for the Current Quarter and Members' interest earnings of $7.3 million for the Current Period.

Income taxes

Our effective income tax rates for the Current and Prior Quarters were minimal. The Company is not expecting a current federal tax liability. We may incur current state tax liabilities in states in which we do not have sufficient net operating loss carry forwards. A minimal tax expense was recorded for the Current and Prior Quarters. The effective income tax rate varied from the statutory rate primarily as a result of the change in the valuation allowance, net income attributable to noncontrolling interest owners which is taxable to those owners rather than to the Company, state income taxes and other permanent differences.

Liquidity and Sources of Capital

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

	Nine Months Ended September 30,	
	2016	2015
Net cash (used in) provided by:		
Operating activities	$35,710	$3,492
Investing activities	(6,665)	(6,172)
Financing activities	9,550	(8,675)
Total increase (decrease) in cash and cash equivalents	$38,595	$(11,355)

	September 30,	December 31,
	2016	2015
Cash and cash equivalents	$43,021	$4,426
Working capital	$40,634	$30,610

Operating Activities.

During the Current Period, net cash provided by operating activities was $35.7 million compared to $3.5 million in the Prior Period. The drivers of operating activities cash flows were primarily the result of our lower net loss discussed above, non-cash items, the change in our accounts receivable, inventory, net contracts in progress and accounts payable balances (collectively, "Contract Capital") and the change in other assets as discussed below.

The significant non-cash items included in operating activities include depreciation and amortization expense, which were $12.1 million in the Current Period and $12.5 million in the Prior Period. Depreciation expense has decreased from the Prior Period to the Current Period as a result of our efforts to maintain our current fleet of equipment and supplement it as necessary with more economical project specific leased equipment.

The need for working capital for our business varies due to fluctuations in operating activities and investments in our Contract Capital. The components of Contract Capital at September 30, 2016 and December 31, 2015 and changes during the Current Period were as follows (amounts in thousands):

	September 30, 2016	December 31, 2015	Change
Costs and estimated earnings in excess of billings on uncompleted contracts	$31,989	$26,905	$(5,084)
Billings in excess of costs and estimated earnings on uncompleted contracts	(61,896)	(30,556)	31,340
Contracts in progress, net	(29,907)	(3,651)	26,256
Contracts receivable, including retainage	105,415	82,112	(23,303)
Receivables from and equity in construction joint ventures	9,469	12,930	3,461
Inventories	4,000	2,535	(1,465)
Accounts payable	(76,861)	(58,959)	17,902
Contract Capital, net	$12,116	$34,967	$22,851

The Current Period change in Contract Capital increased liquidity by $22.9 million. Fluctuations in our Contract Capital balance and its components are not unusual in our business and are impacted by the size of our projects and changing type and mix of projects in our backlog. Our Contract Capital is particularly impacted by the timing of new awards and related payments of performing work and the contract billings to the customer as we complete our projects. Contract Capital is also impacted at period-end by the timing of accounts receivable collections and accounts payable payments for our projects.

Other assets increased by $1.3 million in the Current Period compared to a decrease of $9.3 million in the Prior Period which was primarily due to the sale of our long-term contract receivable in the Prior Period.

Cash from operating activities continues to improve with the quality of our backlog margin. We expect this improvement in backlog margin, along with our focus on project cost containment and working capital management, to continue into 2017.

Investing Activities.

During the Current Period, net cash used in investing activities was $6.7 million compared to $6.2 million in the Prior Period. The primary driver of investing activities cash flows was cash used as collateral for our letter of credit requirements and for use in an escrow account where both amounts were designated as restricted cash and also investments in capital equipment as discussed below.

Capital equipment is acquired as needed to support changing levels of production activities and to replace retiring equipment. Expenditures for the replacement of certain equipment and to expand our construction fleet totaled $8.9 million for the Current Period. Proceeds from the sale of property and equipment totaled $2.2 million for the Current Period with an associated net gain of $0.3 million. For the Prior Period, expenditures totaled $7.1 million, while proceeds from the sale of property and equipment totaled $5.9 million with an associated net gain of $1.2 million. The decrease in proceeds in the Current Period was due to the completion of our Company wide initiative that focused on selling underutilized and non-core assets that was ongoing in the Prior Period. The level of expenditures in the Current Period increased by $1.8 million compared to the Prior Period. This increase was the result of the need to replace and expand our construction fleet in strategic areas of our markets in order to satisfy specific project needs.

Financing Activities.

During the Current Period, net cash provided by financing activities was $9.6 million compared to cash used of $8.7 million in the Prior Period. The increase in cash provided by financing activities was primarily a result of net proceeds of $19.1 million received from the issuance of common stock which was offset by the Revolving Loan payoff and Term Loan monthly payments along with a $5 million prepayment made in the Current Period. Financing activities in the Prior Period consisted of the net repayments on our Prior Credit Facility of $34.6 million and cumulative drawdowns on our equipment-based revolver of $13.1 million and cash received from our equipment-based term loan of $19.0 million, both of which were used to fund our operating activities and replace our Prior Credit Facility. In addition, during the Prior Period, distributions of $3.4 million were made to a noncontrolling interest member.

Cash and Working Capital.

Cash at September 30, 2016, was $43.0 million, which increased based on the items mentioned above. Cash includes $2.1 million that was held by our VIE, $14.1 million belonging to our majority owned joint venture and a $22.9 million increase in contract capital in the Current Period offset by our net loss attributable to Sterling common stockholders of $2.9 million in the Current Period.

Credit Facility and Other Sources of Capital

In addition to our available cash, cash equivalents and cash provided by operations, from time to time, we use borrowings under our Equipment-based Facility to finance our capital expenditures and working capital needs.

In May 2015, the Company and its wholly-owned subsidiaries entered into a $40.0 million loan and security agreement with Nations Fund I, LLC and Nations Equipment Finance, LLC, as the administrative agent and collateral agent for the lender (“Nations”), consisting of a $20.0 million term loan (the “Term Loan”) and a $20.0 million revolving loan (the “Revolving Loan” and combined with the Term Loan, the “Equipment-based Facility”), which replaced its prior credit facility. The amount of the Revolving Loan that may be borrowed from time to time is determined quarterly and may not exceed $20.0 million. In addition, the sum of the outstanding balance of the Equipment-based Facility may not exceed the lesser of $40.0 million or 65% of the appraised value of the collateral pledged for the loans. At September 30, 2016, the Company had a borrowing base of approximately $27.0 million, which was the result of calculating 65% of the appraised value (where appraised value equals net operating liquidated value) of the Company’s collateral. At September 30, 2016, we had $9.6 million outstanding on the Term Loan and no outstanding balance on the Revolving Loan.

The Equipment-based Facility bears interest at an initial fixed annual rate of 12%, which is subject to (i) a decrease of up to two percentage points based on the Company's fixed charge coverage ratio for each of the most recently ended four quarters beginning with the four quarters ended June 30, 2016; and (ii) an increase of two percentage points beginning December 31, 2015 based on the fixed charge coverage ratio at the end of the following two quarters. There have been no interest rate changes during the three and nine months ended September 30, 2016. Principal on the Term Loan is payable in 47 monthly installments (with accrued interest) with a final payment of the then outstanding principal amount on May 29, 2019. Up to $5.0 million of the Term Loan may be prepaid in any year, but subject to a pre-payment fee that declines as the Term Loan nears maturity. During the three and nine months ended September 30, 2016, we prepaid $5 million of the Term Loan and paid $0.2 million in pre-payment fees. The outstanding Revolving Loan is payable in full on May 29, 2019.

The Equipment-based Facility is secured by all of the Company's personal property, including all of its construction equipment, which forms the basis of availability under the Revolving Loan. The Equipment-based Facility is also secured by specified equipment of the Company's 50%-owned affiliates, Road and Highway Builders, LLC and Myers & Sons Construction, L.P. pursuant to a separate security agreement with those entities. If a default occurs, Nations may exercise the Company's rights in the collateral, with all of the rights of a secured party under the Uniform Commercial Code, including, among other things, the right to sell the collateral at public or private sale.

The Company’s Equipment-based Facility has no financial covenants; however, it contains restrictions on the Company’s ability to incur liens and encumbrances or dispose of a material portion of assets or merge with a third party.

Average borrowings under our Equipment-based Facility for the Current Quarter and Current Period were $11.0 million and $21.1 million, respectively, and the largest amount of borrowings was $31.6 million from January 5, 2016 to January 31, 2016. Average combined borrowings under the prior credit facility and the Equipment-based Facility during the year ended December 31, 2015, were $25.9 million and the largest amount of borrowings was under the Equipment-based Facility of $34.6 million from June 5, 2015 to June 30, 2015.

Based on our average borrowings for 2015 and our 2016 forecasted cash needs, we continue to believe that the Company has sufficient liquid financial resources to fund our requirements for the next twelve months of operations, including our bonding requirements. Furthermore, the Company is continually assessing ways to increase revenues and reduce costs to improve liquidity. However, in the event of a substantial cash constraint and if we were unable to secure adequate debt financing, or we continue to incur losses, our working capital could be materially and adversely affected. Refer to “Part I, Item 1A. Risk Factors” in the 2015 Form 10-K for further discussion of liquidity related risks.

On May 9, 2016, the Company completed an underwritten public offering of 5,175,000 shares of the Company’s common stock, which included the full exercise of the sole underwriter’s over-allotment option, at a price to the public of $4.00 per share ($3.77 per share net of underwriting discounts). The net proceeds from the offering of $19.1 million, after deducting underwriting discounts and other offering expenses, were used for working capital, repayment of our indebtedness under the revolving loan portion of our Equipment-based Facility and for general corporate purposes.

Due to the continuing improvement in our markets along with several large project wins during the Current Period, we will be exploring additional capital alternatives to further strengthen our financial position in order to take advantage of this improving transportation infrastructure market. This would include the potential sale of assets, businesses or equity, the favorable resolution of outstanding contract claims, refinancing our Equipment-based Facility, or a combination thereof. We expect to use proceeds from these initiatives to reduce a portion of our debt and for other working capital needs.

Inflation

Inflation generally has not had a material impact on our financial results; however, from time to time, increases in oil, fuel and steel prices have affected our cost of operations. Anticipated cost increases and reductions are considered in our bids to customers on proposed new construction projects.

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

Off-Balance Sheet Arrangements and Joint Ventures

We participate in various construction joint ventures in order to share expertise, risk and resources for certain highly complex projects. The venture’s contract with the project owner typically requires joint and several liability among the joint venture partners. Although our agreements with our joint venture partners provide that each party will assume and fund its share of any losses resulting from a project, if one of our partners is unable to pay its share, we would be fully liable for such share under our contract with the project owner. Circumstances that could lead to a loss under these guarantee arrangements include a partner’s inability to contribute additional funds to the venture in the event that the project incurs a loss or additional costs that we could incur should the partner fail to provide the services and resources toward project completion that had been committed to in the joint venture agreement.

At September 30, 2016, there was approximately $126 million of construction work to be completed on unconsolidated construction joint venture contracts, of which $61 million represented our proportionate share. Due to the joint and several liability under our joint venture arrangements, if one of our joint venture partners fails to perform, we and the remaining joint venture partners would be responsible for completion of the outstanding work. As of September 30, 2016, we are not aware of any situation that would require us to fulfill responsibilities of our joint venture partners pursuant to the joint and several liability provisions under our contracts.

Off-balance sheet arrangements related to operating leases are discussed in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations –Liquidity and Sources of Capital– Contractual Obligations” in our 2015 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Changes in interest rates are one of our sources of market risks. Outstanding indebtedness under our Equipment-based Facility does not bear interest at floating rates, so our results from operations are not impacted from a change in interest rates. However, our interest rate could increase by 2% based on our fixed charge coverage ratio as noted above in “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Sources of Capital.”

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures include, but are not limited to, 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, as amended (the “Exchange Act”), 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 allow 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 Exchange Act). 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 September 30, 2016 to ensure that the information required to be disclosed by the Company in this Report 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.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

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

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

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

Item 1A. Risk Factors

There have not been any material changes from the risk factors previously disclosed in "Part I, Item 1A. Risk Factors" of our 2015 Form 10-K. You should carefully consider such risk factors, which could materially affect our business, financial condition or future results.

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

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

The information concerning mine safety violations and other regulatory matters required by section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of Regulation S-K is included in Exhibit

95.1 of this Quarterly Report on Form 10-Q, which is incorporated by reference.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit No.	Description
31.1*	Certification of Paul J. Varello, Chief Executive Officer of Sterling Construction Company, Inc.
31.2*	Certification of Ronald A. Ballschmiede, Chief Financial Officer of Sterling Construction Company, Inc.
32*	Certification pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350) of Paul J. Varello, Chief Executive Officer, and Ronald A. Ballschmiede, Chief Financial Officer
95.1*	Mine Safety Disclosure
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

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* Filed herewith.

SIGNATURES

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

STERLING CONSTRUCTION COMPANY, INC.

Date: October 31, 2016	By: /s/ Paul J. Varello Paul J. Varello Chief Executive Officer
Date: October 31, 2016	By: /s/ Ronald A. Ballschmiede Ronald A. Ballschmiede Chief Financial Officer

STERLING CONSTRUCTION COMPANY, INC.

Quarterly Report on Form 10-Q for Period Ended September 30, 2016

Exhibit Index

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