STERLING CONSTRUCTION CO INC
Form 424B4
January 20, 2006

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Filed Pursuant to Rule 424(b)(4)
Registration No. 333-129780

PROSPECTUS

2,021,758 Shares
Sterling Construction Company, Inc.
Common Stock

We are offering to sell 1,700,000 shares of our common stock, and three of our stockholders are offering to sell an aggregate of 321,758 shares of our common stock. We will not receive any of the proceeds from the sale of shares of our common stock by the selling stockholders. The last reported sale price of our common stock on the American Stock Exchange, or AMEX, on January 19, 2006 (the last day on which we anticipate our common stock will trade on AMEX) was $15.65 per share. Our common stock will commence trading on The Nasdaq National Market, or Nasdaq, under the symbol STRL on January 20, 2006.

We have granted the underwriters the right to purchase up to 303,263 additional shares of common stock to cover any over-allotments. The underwriters can exercise this right at any time within 30 days after the offering.

Investing in our common stock involves risks. See Risk Factors beginning on page 8.

	Per Share	Total
Offering price	$15.00	$30,326,370
Discounts and commissions to underwriters	$ 1.05	$ 2,122,846
Offering proceeds to us, before expenses	$13.95	$23,715,000
Offering proceeds to the selling stockholders, before expenses	$13.95	$ 4,488,524

The underwriters expect to deliver the shares of common stock to investors on or about January 25, 2006.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

D.A. Davidson & Co. **Morgan Joseph**

The date of this prospectus is January 19, 2006

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SUMMARY

This summary highlights information contained elsewhere in this prospectus. This summary does not contain all of the information that may be important to you. You should read this entire prospectus carefully, including the risks discussed under Risk Factors and the consolidated financial statements and notes thereto included elsewhere in this prospectus. In this prospectus, all references to Sterling Construction, we, us and our refer to Sterling Construction Company, Inc. and its subsidiaries, unless the context otherwise requires or indicates.

Our Company

We are a leading heavy civil construction company that specializes in the building and reconstruction of transportation and water infrastructure in large and growing markets in Texas. Our transportation infrastructure projects include highways, roads, bridges and light rail, and our water infrastructure projects include water, wastewater and storm drainage systems. We provide general contracting services primarily to public sector clients utilizing our own employees and equipment for activities including excavating, paving, pipe installation and concrete placement. We purchase the necessary materials for our contracts and generally engage subcontractors only for ancillary services.

Since the founding of our construction business in 1955, we have expanded our service profile and market areas. We currently operate in several major Texas markets, including Houston, San Antonio, Dallas/ Fort Worth and Austin, and believe that we have the capability to expand into other Gulf Coast and Southwestern markets. We also have broadened our range of services, from our original focus on water and wastewater projects, to include concrete and asphalt paving, concrete slip forming, installation of large-diameter water and wastewater distribution systems, construction of bridges and similar large structures, light rail infrastructure, concrete crushing and concrete batch plant operations.

For the nine months ended September 30, 2005, our construction business revenues of $157.8 million and net income from continuing operations of $5.5 million were 66% and 142% higher, respectively, than for the same period in 2004. At September 30, 2005, our contract backlog of $288 million was 24% higher than the $232 million of contract backlog at January 1, 2005. As of December 31, 2005, we estimate that our contract backlog was approximately $300 million, reflecting new contracts of approximately $80 million added during our fourth quarter and our preliminary estimate of billings that will be recorded for that quarter.

Our Competitive Strengths

We believe that our competitive strengths in the construction business include the following:

Long and Successful Track Record of Infrastructure Construction. Through our 50 years of experience, we have developed efficient processes and controls that allow us to provide high-quality contracting services for building roads, highways, bridges, light rail facilities and water, wastewater and storm drainage systems. Our expertise, coupled with strong underlying market dynamics, has produced compound annual revenue growth in our construction business that has averaged approximately 18% since 1985, and was 66% for the first nine months of 2005 compared to the comparable period in 2004.

Leadership in Our Markets. We are an established leader in our markets based on our longevity, our management expertise and our reputation, as well as our in-depth knowledge of soil and other construction conditions in our market areas. Our scale of operations allows us to deploy and redeploy work crews, materials and equipment across multiple contracts and provides us with advantages in competitive bidding environments. We are prequalified with all of our significant public sector customers that require qualification, including the Texas Department of Transportation, or TXDOT, a requirement that has the effect of limiting competition from some other bidders for highway contracts and, in some cases, for municipal contracts.

Comprehensive Infrastructure Construction Capabilities. Over time, we have added construction services that provide us with competitive advantages. For example, from our base of water and wastewater work, we have added concrete and asphalt paving, concrete slip forming, installation of large-diameter water and wastewater distribution systems, construction of bridges and similar large structures, light rail infrastructure, concrete crushing and concrete batch plant operations. We currently perform approximately 75% of our work utilizing our own workforce and equipment. Our emphasis on providing comprehensive construction services allows us to capture additional profit margin that otherwise would be gained by subcontractors and to more aggressively bid contracts without sacrificing our profitability targets.

Consistent History of Managing Construction Projects and Contract Risk. Our significant experience and longevity in our markets provides us with an understanding of the many risks of infrastructure construction. We provide services predominantly pursuant to fixed unit price contracts, which, if properly managed, generally allow for better profit margin opportunities than cost-plus contracts. We monitor and manage risk throughout a contract s duration, including the bid process, the pre-construction planning activities and the construction process. Our project managers lead our estimating process, and our senior management reviews all bid proposals prior to submission, thereby increasing project managers accountability and understanding of the financial and operating risks and opportunities of our contracts. In addition, a significant portion of our project managers compensation is based on the profitability of contracts that they bid and manage, a policy which reinforces our goal of carefully and accurately bidding contracts.

Financial Strength. Our long-term debt-to-equity ratio as of September 30, 2005, giving effect to this offering and the anticipated repayment of certain related party notes described in Certain Transactions Contemplated Transactions as of that date, would have been approximately 25%, and we believe that we will have sufficient cash balances to meet our anticipated near-term liquidity needs. In addition, we have a substantial base of assets, including a fleet of over 500 pieces of heavy construction equipment, which allows for flexibility in meeting contract requirements and can provide an advantage over our competitors who lease their equipment. After this offering, we will have greater flexibility under our commercial bank line of credit to take advantage of appropriate expansion and acquisition opportunities in our markets. We believe that these financial strengths provide tangible benefits in the surety and credit markets, as well as intangible benefits in our relationships with customers, employees, suppliers and subcontractors.

Experienced Management Team and Skilled Workforce. Our management team and employees are critical to our success. Our chief executive officer and our president each has over 30 years of industry experience, and our 12 senior project managers have over 20 years of experience on average, in the infrastructure construction market. We benefit from their expertise, relationships with customers, suppliers and subcontractors, and the cohesive corporate culture that they have promoted and developed. We expend significant resources to attract, retain and train our employees, which is a key to the successful execution of our contracts. We conduct our construction business using full-time employees organized into more than 80 fully-equipped crews. We conduct extensive safety training programs, which have allowed us to maintain a high safety level at our worksites.

Our Business Strategy

We pursue the following strategies in order to improve our business and prospects, increase our revenue and profitability and, ultimately, enhance stockholder value:

Continue to Grow in Texas Markets. The Texas markets in which we operate, including Houston, San Antonio, Dallas/Fort Worth and Austin, generally are experiencing strong growth in infrastructure spending caused by factors such as an increasing population, increased federally-funded highway construction, a robust oil and gas economy, the need for new water sources, flood and subsidence control activities, and the installation of light rail public transit systems. We will continue our efforts to increase our market share in our core markets. Our strategy is to accomplish this by relying on our knowledge of local construction conditions coupled with our continued focus on infrastructure construction, by expanding

and upgrading our equipment fleet, by adding construction crews, and by extending our range of construction capabilities.

Position Our Business for Future Infrastructure Spending. There is a growing awareness of the need to build, reconstruct and repair our country s infrastructure, including water, wastewater and flood control systems and transportation systems. Significant funds have recently been authorized for investments in these areas, including the new U.S. federal highway funding bill, or SAFETEA-LU bill, which authorized $286 billion toward transportation infrastructure (with approximately $14.5 billion allocated to Texas for federal fiscal years 2005 through 2009). In addition, the Harris-Galveston Subsidence District has mandated that substantially all well water systems in Houston be replaced with surface water systems, and we anticipate that there will be efforts in Texas and other Gulf Coast areas affected by recent hurricanes to enhance storm drainage systems. We will continue to build on our expertise in the civil construction market for transportation and water infrastructure, to develop new capabilities to service these markets and to maintain our human and capital resources to effectively meet required demand.

Continue Adding Construction Capabilities. By adding capabilities that are complementary to 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. We continue to investigate opportunities to integrate additional services (such as drill shaft installation) and precast concrete products (such as beams and wall panels) into our business.

Expand into Attractive New Markets. We have demonstrated an ability to identify and expand into new markets where we have been able to operate profitably and grow. Our first expansion beyond Houston was in the Dallas/ Fort Worth market in 1995. In 2001, after obtaining an asphalt paving contract in San Antonio, we decided to establish a permanent presence in that market. Having recently been awarded a significant contract in the Austin area, we are now examining the potential for establishing a permanent office in Austin. We actively consider opportunities, and evaluate whether to establish a permanent presence, in new geographic areas based on factors such as market size and growth dynamics, competition, the availability of qualified employees and compatibility of unique local requirements with our own expertise. We currently believe that there are a number of attractive markets throughout Texas and in the Gulf Coast and Southwestern regions of the United States that present expansion opportunities for us.

Selectively Pursue Strategic Acquisitions. Our growth has been achieved both organically and through our acquisition of the Kinsel Heavy Highway construction business, or Kinsel, in 2002. We have been, and expect to continue, exploring acquisition opportunities that appear consistent with our return-on-investment goals and strategic objectives. In particular, we seek companies operated by talented management teams in growth markets and with a focus on infrastructure construction services. Ideal candidates would provide us with the ability to add construction services to our existing capabilities, as well as opportunities to provide an expanded service profile to the target s existing customer base. With our strong financial position and publicly traded common stock, we believe that we are an attractive acquiror for heavy civil construction firms whose owners desire to achieve liquidity.

Development of Employees. We believe that our employees are a key to the successful implementation of our business strategies. We plan to continue allocating significant resources in order to attract and retain talented managers and supervisory and field personnel.

Risks Related to Our Business and Strategy

You should carefully read and consider the information set forth below under Risk Factors, together with all of the other information set forth in this prospectus, before deciding to invest in shares of our common stock.

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Recent Developments

On December 22, 2005, we announced the following updated guidance for 2005, and initial guidance for 2006:

	Year Ending December 31, 2005	Year Ending December 31, 2006
	(In thousands)	
		Range
Revenues from continuing operations	$ 210,000	$ 230,000 - $250,000
Income from continuing operations before income taxes	$ 10,500	$ 11,500 - $ 13,000
Net income from continuing operations	$ 6,800	$ 7,500 - $ 8,500

This guidance is forward-looking information that is subject to risks and uncertainties as described in this prospectus. See Guidance for certain assumptions, risks and uncertainties that should be considered in connection with our guidance about expected results of operations.

Our common stock has been approved to be listed on the Nasdaq National Market, or Nasdaq, under the symbol STRL on January 20, 2006. We anticipate that trading of our common stock on AMEX has been suspended effective at the close of market on January 19, 2006.

In December 2005, we announced that we had been awarded a $46 million construction contract by St. Paul Travelers, or Travelers, to complete a TXDOT project for the building of highways, bridges and related infrastructure at NASA Road 1 in the Clear Lake area south of Houston, Texas. Work is expected to commence in the first quarter of 2006 and is scheduled for completion in early 2008.

On December 23, 2005, our board of directors elected Milton L. Scott to fill the vacancy created by the simultaneous resignation of Robert M. Davies, who had earlier indicated his intention to resign upon the election of his successor. Mr. Scott was also appointed to our audit committee.

Recognizing the strong growth of our construction business, where management s efforts and our resources are likely to be best employed in the future, and following expressions of interest from potential buyers of our distribution business, in August 2005 our board of directors authorized management to sell that business, which is operated by our wholly-owned subsidiary, Steel City Products, LLC, or Steel City Products. Accordingly, we have reclassified our financial statements for all periods presented to reflect that business as discontinued operations. Unless otherwise noted, the discussion in this prospectus pertains only to our construction business.

Having recently outgrown the bonding limits of our prior bonding company, in October 2005 we were approved by a new bonding company, Travelers, for our future construction contracts.

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The Offering

Nasdaq symbol	STRL
Common stock offered by us	1,700,000 shares
Common stock offered by selling stockholders	321,758 shares
Common stock to be outstanding after the offering	10,186,881 shares
Use of proceeds	The net proceeds to us from this offering will be approximately $22.9 million, or approximately $27.2 million if the underwriters exercise their over-allotment option in full. We plan to use these net proceeds for: capital expenditures to acquire property, plant and equipment to more efficiently complete a number of projects in our contract backlog as well as position us to capitalize on future project opportunities; repayments of certain related party promissory notes as described in Certain Transactions Contemplated Transactions ; and other general corporate purposes, including working capital to increase our bonding capacity, to finance ongoing business operations and to fund future growth of our construction business and additions to our construction services capabilities. We will not receive any of the proceeds from the sale of shares of our common stock by the selling stockholders.

The number of shares of common stock outstanding after this offering is based on the number of shares outstanding as of December 30, 2005 and excludes:

1,045,575 shares of common stock reserved for issuance upon the exercise of outstanding stock options at a weighted average exercise price per share of $2.558, which does not include 180,492 shares that will be issued pursuant to the exercise of options held by a selling stockholder and sold by him in this offering;

75,880 shares of common stock reserved for future awards under our stock option plans; and

386,073 shares of common stock reserved for issuance upon the exercise of outstanding warrants at an exercise price per share of $1.50, which does not include 141,266 shares that will be issued pursuant to the exercise of warrants held by two selling stockholders and sold by them in this offering.

Unless we indicate otherwise, the number of shares of common stock shown to be outstanding after the offering assumes no exercise by the underwriters of their option to purchase up to 303,263 additional shares of our common stock to cover over-allotments of shares.

Our Executive Offices

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 website is www.sterlingconstructionco.com. Information on, or accessible through, this website is not a part of, and is not incorporated into, this prospectus.

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Summary Historical Financial and Operating Data

The following table sets forth our summary historical consolidated financial and operating data for the periods indicated. The summary consolidated statement of operations data for the years ended December 31, 2002, 2003 and 2004, and the summary consolidated balance sheet data as of December 31, 2003 and 2004, have been derived from our audited consolidated financial statements, which are included elsewhere in this prospectus. The summary consolidated balance sheet data as of December 31, 2002, have been derived from our audited consolidated balance sheet as of December 31, 2002, which is not included in this prospectus. The summary consolidated financial data as of and for the nine months ended September 30, 2004 and 2005, are derived from our unaudited consolidated financial statements, which are included elsewhere in this prospectus. The unaudited consolidated financial statements have been prepared on the same basis as our audited consolidated financial statements and include all adjustments, consisting of normal and recurring adjustments, that we consider necessary for a fair presentation of our financial position and operating results for the unaudited periods. The summary historical financial and operating data as of and for the nine months ended September 30, 2005, are not necessarily indicative of the results that may be obtained for a full year. Contract backlog is not a measure defined in generally accepted accounting principles, or GAAP, and has not been derived from our consolidated financial statements.

In August 2005, our board of directors authorized management to sell the Steel City Products distribution business. Accordingly, we have reclassified our financial statements for all periods presented to reflect the business as discontinued operations.

The information presented below should be read in conjunction with Selected Historical Financial and Operating Data, Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and the notes thereto included elsewhere in this prospectus.

	Year Ended December 31,			Nine Months Ended September 30,	
	2002	2003	2004	2004	2005
				(Unaudited)	
	(Amounts in thousands, except share and per share data)				
Statement of Operations Data:					
Revenues	$ 111,747	$ 149,006	$ 132,478	$ 95,161	$ 157,805
Cost of revenues	98,935	131,181	119,217	83,970	141,541
Gross profit	12,812	17,825	13,261	11,191	16,264
General and administrative expenses, net	6,862	7,400	7,696	5,844	6,771
Operating income	5,950	10,425	5,565	5,347	9,493
Interest expense, net of interest income	2,427	1,842	1,456	1,053	1,198
Income from continuing operations before minority interest and income taxes	3,523	8,583	4,109	4,294	8,295
Minority interest(1)	873	1,627	962	862	
Income from continuing operations before income taxes	2,650	6,956	3,147	3,432	8,295
Income tax (benefit) expense	(174)	1,752	(2,134)	1,167	2,820

Net income from continuing operations		2,824		5,204		5,281		2,265		5,475
Net income from discontinued operations		528		215		372		342		532
Net income	$	3,352	$	5,419	$	5,653	$	2,607	$	6,007

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	Year Ended December 31,			Nine Months Ended September 30,	
	2002	2003	2004	2004	2005
				(Unaudited)	
	(Amounts in thousands, except share and per share data)				
Basic income per share:					
Continuing operations	$ 0.56	$ 1.02	$ 0.99	$ 0.43	$ 0.72
Discontinued operations	0.10	0.04	0.07	0.06	0.07
	$ 0.66	$ 1.06	$ 1.06	$ 0.49	$ 0.79
Diluted income per share:					
Continuing operations	$ 0.46	$ 0.80	$ 0.75	$ 0.32	$ 0.58
Discontinued operations	0.09	0.03	0.05	0.05	0.06
	$ 0.55	$ 0.83	$ 0.80	$ 0.37	$ 0.64
Weighted average number of shares outstanding used in computing per share amounts:					
Basic	5,061,598	5,089,849	5,342,847	5,274,730	7,638,261
Diluted	6,101,515	6,488,376	7,027,682	7,158,697	9,467,306
Balance sheet data (end of period):					
Cash and cash equivalents	$ 2,111	$ 2,651	$ 3,449	$ 2,851	$ 20,138
Working capital	9,556	6,834	16,052	18,167	22,599
Total assets	72,757	75,578	89,544	84,902	122,789
Total debt	32,784	20,058	29,379	24,347	30,011
Stockholders equity	10,825	16,636	35,208	19,900	43,202
Other operating data:					
Depreciation and amortization	$ 3,755	$ 4,690	$ 4,545	$ 3,487	$ 3,826
Capital expenditures	4,245	4,340	3,555	2,527	9,948
Contract backlog at end of period (unaudited)(2)	138,000	141,000	232,000	227,000	288,000

(1) Minority interest represents the 19.9% of Texas Sterling Construction, L.P., which along with its predecessors we refer to as TSC, not owned by us until December 2004. See Note 16 of Notes to Consolidated Financial Statements for the fiscal year ended December 31, 2004, included in this prospectus.

(2) 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, 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 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.

RISK FACTORS

An investment in our common stock involves various risks. Before making an investment in our common stock, you should carefully consider the following risks, as well as the other information contained in this prospectus, including our consolidated financial statements and the notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations. The risks described below are those which we believe are the material risks that we face. Any of the risk factors described below could significantly and adversely affect our business, prospects, financial condition and results of operations. As a result, the trading price of our common stock could decline, and you could lose a part or all of your investment.

Risks Relating to Our Business

If we are unable to accurately estimate the overall risks or costs when we bid on a contract which 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 contract 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, aggregate and other construction materials (such as stone, gravel and sand), as well as fuel and lubricants for our equipment;
- 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 practice in many instances has been to supersede these terms with an agreement to obtain insurance covering both the customer and ourselves. In cases where insurance is not obtained, 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 we are unable to

obtain insurance, and 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, or the cancellation of significant contracts, 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 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. 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.

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.

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

Our operations are concentrated in Texas, and primarily in the Houston area. Because of this concentration in a specific geographic location, we are susceptible to fluctuations in our business caused by adverse economic or other conditions in this region, including natural or other disasters. A stagnant or depressed economy in Texas generally or in Houston specifically, or in any of the other markets that we serve, could adversely affect our business, results of operations and financial condition.

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 us that, if they so desired, could establish a presence in our markets and compete with us for 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 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. 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 all of the materials (including aggregates, concrete, steel and pipe) for our contracts. We do not own any quarries, and there are no naturally occurring sources of aggregate in the Houston metropolitan area. We 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. 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 equipment used in our construction contracts. Decreased supplies of such products relative to demand and other factors can cause an increase in their cost. 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 be able to fully realize the revenue anticipated by our reported contract backlog.

As of September 30, 2005, our contract backlog was approximately $288 million. Almost all of our contracts 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 contract 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 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.

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 contract backlog. Cancellation of one or more contracts that constitute a large percentage of our contract 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, 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 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 attract and retain 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 new highly-skilled employees, our reputation may be harmed and our future earnings may be negatively impacted.

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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.

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

At any point in time, a substantial portion of our revenues may be derived from a limited number of large construction contracts. 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 work crews with contract needs. In some cases, we may maintain and bear the cost of a ready work crew that is larger than currently required, in anticipation of future employee 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, 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 an adverse effect on our operating results for a particular period.

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 fiscal 2004, approximately 58% of our revenues was generated from three customers. Similarly, our contract backlog frequently reflects multiple

contracts for individual customers; therefore, one customer may comprise a significant percentage of contract backlog at a certain point in time. An example of this is TXDOT, with which we had 20 contracts representing an aggregate of approximately 70% of our contract backlog at September 30, 2005. The loss of business from any one of such customers could have a material adverse effect on our business or results of operations. 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.

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

We have traditionally owned most of the construction equipment used to build our projects, and we do not bid on contracts for which we do not have, or cannot quickly procure (whether through acquisition or lease), the necessary equipment. 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 building contracts. In addition, our equipment 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.

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 construction business credit facility, thereby reducing the amount of credit available to us and impeding our ability to expand our business consistent with historical levels.

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

Because all of our construction projects are built outdoors, work on our contracts is subject to unpredictable weather conditions. For example, evacuations 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. While revenues can be recovered following a period of bad weather, it is generally impossible to recover the efficiencies, and hence, we may suffer reductions in the expected profit on contracts.

An inability to obtain bonding could limit the number 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 contract backlog and their underwriting standards, which may change from time to time. For instance, we recently outgrew the bonding limits of our prior surety bonding company and arranged a new source of bonding. 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 services on construction sites. 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.

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. 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. 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 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 acquisition strategy involves a number of risks.

In addition to organic growth of our construction business, we intend to pursue 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 agreement on 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;
- 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) 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 the cost savings or other financial benefits we anticipated.

Future acquisitions may require us to obtain additional equity or debt financing, which may not be available on terms acceptable to us. Moreover, to the extent that any acquisition results in additional

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goodwill, it will reduce our tangible net worth, which might have an adverse effect on our credit and bonding capacity.

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

Our revenue has grown rapidly in recent years. Our revenue increased by 66% from $95.2 million in the first nine months of 2004 to $157.8 million in the first nine months of 2005. However, we may be unable to sustain our recent revenue growth rate 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, the inability to hire and retain essential personnel and to acquire equipment to support growth, and the inability to identify acquisition candidates and successfully 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.

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.

Our discontinued operations subject us to continuing liabilities and other risks.

We will remain subject to the liabilities of Steel City Products distribution business until it is sold. Because we have reclassified the business as being held for sale, customers may become concerned about the continued viability of the business and may purchase their products elsewhere, and suppliers may become concerned about the continued viability of the business and limit shipments to us, thereby decreasing the revenues and income earned by the business. For similar reasons, we may have difficulty attracting and retaining qualified personnel, the business s reputation may be harmed, and future earnings may be negatively impacted. We may also have difficulty finding a purchaser for the business, and we will incur costs in connection with the disposition of the business and could continue to remain responsible for certain liabilities after a sale. As a result, we may record a loss from discontinued operations, and we may also incur a loss upon the sale of the business. In addition, we may have contractual or other further liabilities with respect to the discontinued operations after a sale of the distribution business is completed.

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;

accruals for estimated liabilities, including litigation and insurance reserves; and the value of our deferred tax assets. Our actual results could differ from those estimates.

In particular, as is more fully discussed in 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 cost 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.

We have historically relied upon financing from management to support a portion of our growth, but we do not expect to utilize such source for financing in the future. In addition, 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 2007. To the extent that cash flow from operations is insufficient to make 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 affect our efforts to arrange additional financing on terms satisfactory to us. We have pledged substantially all of our fixed assets as collateral in connection with our credit facilities, and our bonding capacity is dependent on maintaining an acceptable level of unencumbered working capital. As a result, we may have difficulty in obtaining additional financing in the future if such financing requires us to pledge our assets as collateral. In addition, under our credit facilities, 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.

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

Our construction business and our discontinued operations each has a revolving credit facility that restricts the respective borrowers 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;
- pledge accounts receivable, in the case of the Steel City Products revolving credit facility; and

incur negative income for two consecutive quarters, in the case of the construction business revolving credit facility.

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Our credit facilities contain financial covenants that require us to maintain, in the case of the construction business revolving credit facility, a specified debt ratio and cash flow coverage ratio, and in the case of the Steel City Products revolving credit facility, a specified fixed charge coverage ratio. 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 agreements, 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. Because our construction business credit facility is secured by substantially all of the construction business fixed assets and the Steel City Products revolving credit facility is secured by substantially all of the Steel City Products assets, acceleration of this debt could result in foreclosure of those assets. In addition, our Steel City Products revolving credit facility includes a subjective acceleration clause. In the event of a foreclosure, we would be unable to conduct our business and may be forced to discontinue operations.

We may not be able to utilize all of our NOLs if we experience an ownership change, and, even absent an ownership change, we expect that our NOLs will be fully utilized in 2007.

As of September 30, 2005, we had NOLs of approximately $38.9 million. These NOLs will expire in the years 2005 through 2020, although the amount available in any year to offset our net taxable income will be reduced if we experience an ownership change as defined in the Internal Revenue Code of 1986, as amended, or the Code. The tax laws pertaining to NOLs may be changed from time to time such that the NOLs may not be available to shield our future income from federal taxation. In addition, our attempts to minimize the likelihood that an ownership change will occur may not be successful. Finally, we expect that most of our federally-taxable income will be offset by NOLs through 2007, which is when we expect to have used up all of our NOLs. After the NOLs become unavailable to us or are fully utilized, our future income will not be shielded from federal income taxation, thereby reducing funds otherwise available for general corporate purposes.

Changes to the current tax laws could result in the imposition of entity level taxation on our construction operating subsidiary, which would result in a reduction in our anticipated cash flow.

Our construction operating subsidiary is organized as a partnership, which generally is not subject to entity level federal income or state franchise tax in the jurisdiction in which it is organized and operates. Current laws may change, subjecting our construction operating subsidiary to entity level taxation. For example, because of state budget deficits, the Texas legislature has been considering and evaluating ways to subject partnerships to entity level taxation through the imposition of state income, franchise or other forms of taxation. If Texas were to impose an entity-level tax upon our construction operating subsidiary, there would be a reduction in our net income and after-tax cash flow.

We will be exposed to risks relating to the evaluations of internal controls over financial reporting required by Section 404 of the Sarbanes-Oxley Act of 2002.

We are currently in the process of evaluating our internal control systems to allow management to report on, and our independent auditors to attest as to the effectiveness of, our internal controls over financial reporting. We will be performing the systems and process evaluations and testing (and making any necessary remediation) required to comply with the management certification and auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002. These systems are designed to produce accurate financial reports and to prevent fraudulent financial activity. We expect to be required to comply with Section 404 beginning with our Annual Report on Form 10-K for the year ending December 31, 2006. However, we cannot be certain as to the timing of completion of our evaluation, testing and remediation actions or the impact of the same on our operations. Furthermore, upon completion of this process, we may identify control deficiencies of varying degrees of severity under applicable Securities and Exchange Commission, or SEC, and Public Company Accounting Oversight Board rules and regulations,

which may remain unremediated. As a public company, we will be required to report, among other things, control deficiencies that constitute a material weakness or changes in internal controls that, or that are reasonably likely to, materially affect internal controls over financial reporting. A material weakness is a significant control weakness, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. If we fail to implement the requirements of Section 404 in a timely manner, we may be subject to sanctions or investigation by regulatory authorities such as the SEC or Nasdaq. In addition, if any material weakness or deficiency is identified or is not remedied, investors may lose confidence in the accuracy of our reported financial information, and our stock price could be significantly adversely affected as a result.

Risks Related to Our Common Stock and This Offering

Market prices of our equity securities have changed significantly and could change further.

The market price of our common stock has substantially increased since June 2005, at a rate exceeding our growth in earnings generally. The price may decline from its current levels in response to various factors and events beyond our control, including the following:

- a shortfall in operating revenue or net income from that expected by securities analysts and investors;
- changes in securities analysts estimates of our financial performance or the financial performance of our competitors or companies in our industry generally;
- general conditions in our industry;
- announcements of significant contracts by us or our competitors;
- the passage of legislation or other regulatory developments that affect us adversely;
- general conditions in the securities markets;
- the limited trading volume of our common stock;
- investor expectations resulting from the filing of the registration statement, of which this prospectus is a part;
- our issuance of a significant number of shares of our common stock upon exercise of employee stock options or warrants; and
- the other risk factors described herein.

Limited trading volume of our common stock may contribute to its price volatility.

The average daily trading volume during 2005 for our common stock as reported by AMEX was approximately 83,000 shares, and for the quarter ended December 31, 2005, the average daily trading volume was approximately 89,000 shares. Even if we achieve a wider dissemination by means of the shares offered pursuant to this prospectus, or as a result of our move to Nasdaq, we are uncertain as to whether a more active trading market in our common stock will develop. As a result, relatively small trades may have a significant impact on the price of our common stock.

Fluctuations in our quarterly revenues, operating results and contract backlog may lead to reduced prices for our common stock.

Because our operating results are primarily generated from a limited number of significant construction contracts, operating results in any given fiscal quarter can vary depending on the timing of progress achieved and changes in the estimated profitability of the contracts being reported. Progress on contracts may also be delayed by unanticipated adverse weather conditions. Such delays, if they occur,

may result in fluctuating quarterly operating results, which may in turn lead to reduced prices for our common stock.

We currently do not intend to pay dividends on our common stock and, consequently, your only opportunity to achieve a return on your investment is if the market price of our common stock appreciates above the price that you pay for it.

We currently do not plan to declare dividends on shares of our common stock for the foreseeable future. Furthermore, the payment of dividends by us is restricted by our credit facilities. See Dividend Policy for more information. Consequently, your only opportunity to achieve a return on your investment in our company will be if the market price of our common stock appreciates and you sell your shares at a profit.

Future sales of our common stock in the public market could lower our stock price.

Our principal stockholders, directors and executive officers will beneficially own approximately 2.7 million shares of our common stock after completion of this offering. These stockholders will be free to sell those shares, subject to the limitations of Rule 144 or Rule 144(k) under the Securities Act of 1933, as amended, or the Securities Act (which are discussed under Shares Eligible for Future Sale), and, subject to certain exceptions, the 120-day lock-up agreements that certain of these stockholders have entered into with the underwriters. In addition, the holders of warrants to purchase 527,339 shares of our common stock (143,730 of which are not subject to lock-up agreements) have registration rights that allow them to participate in any public offering of our shares (with certain exceptions). Registration of these restricted shares of common stock would permit their sale into the public market immediately. We cannot predict when these stockholders may sell their shares or in what volumes. However, the market price of our common stock could decline significantly if these stockholders sell a large number of shares into the public market after this offering or if the market believes that these sales may occur.

We may also issue our common stock from time to time as consideration for future acquisitions and investments. In the event that any such acquisition or investment is significant, the number of shares of our common stock that we may issue could in turn be significant. In addition, we may also grant registration rights covering those shares in connection with any such acquisition and investment.

Delaware law, our charter documents and our rights agreement may impede or discourage a takeover or change of control.

Our rights agreement, certain provisions of our restated and amended certificate of incorporation, as amended, our bylaws and the provisions of Delaware law described below under Description of Capital Stock, individually or collectively, may impede a merger, takeover or other business combination involving us or discourage a potential acquirer from making a tender offer for our common stock, which could affect the market price of our common stock.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus includes certain statements that are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of 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 prospectus, including in the sections entitled Summary, Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and Business 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, intend, may, plan, potential, pred and similar terms and phrases to identify forward-looking statements in this prospectus.

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, could result in our expectations not being realized or otherwise 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 or reductions in government funding for infrastructure services;
- adverse economic conditions in our markets in Texas;
- delays or difficulties related to the completion of our 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 escalations associated with our fixed-price contracts;
- our dependence on a few significant customers;
- adverse weather conditions;
- the presence of competitors with greater financial resources 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 under Risk Factors.

Potential investors are urged to consider these factors carefully in evaluating any forward-looking statements and are cautioned not to place undue reliance on these 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 prospectus are reasonable, we can provide no assurance that such plans, intentions or expectations will be achieved.

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

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USE OF PROCEEDS

Our net proceeds from the sale of 1,700,000 shares of our common stock in this offering will be approximately $22.9 million ($27.2 million if the underwriters option to purchase additional shares is exercised in full), after deducting underwriting discounts and commissions and estimated offering expenses. We will not receive any proceeds from the sale of shares of common stock by the selling stockholders. Net proceeds does not reflect cash of approximately $484,000 anticipated to be received by us from the exercise of stock options and warrants underlying shares offered by the selling stockholders.

We intend to use the net proceeds from this offering for:

- capital expenditures to acquire property, plant and equipment to more efficiently complete a number of projects in our contract backlog as well as position us to capitalize on future project opportunities;

- repayments of certain related party promissory notes as described in Certain Transactions Contemplated Transactions ; and

- other general corporate purposes, including working capital to increase our bonding capacity, to finance ongoing business operations and to fund future growth of our construction business and additions to our construction services capabilities.

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MARKET PRICE OF COMMON STOCK

Our common stock traded on AMEX under the symbol STV through January 19, 2006 and will begin trading on Nasdaq under the symbol STRL on January 20, 2006. The quarterly market high and low sales prices for our common stock for 2003, 2004 and 2005 are summarized below:

	High	Low
Year Ended December 31, 2003		
First Quarter	$ 1.95	$ 1.16
Second Quarter	$ 2.80	$ 1.55
Third Quarter	$ 4.45	$ 2.20
Fourth Quarter	$ 5.35	$ 2.75
Year Ended December 31, 2004		
First Quarter	$ 8.94	$ 3.60
Second Quarter	$ 4.60	$ 2.99
Third Quarter	$ 6.33	$ 3.02
Fourth Quarter	$ 6.40	$ 4.32
Year Ended December 31, 2005		
First Quarter	$ 7.97	$ 5.16
Second Quarter	$ 9.00	$ 6.70
Third Quarter	$ 28.35	$ 7.25
Fourth Quarter	$ 26.30	$ 16.71
Year Ended December 31, 2006		
First Quarter (through January 19, 2006)	$ 17.24	$ 15.05

On January 19, 2006, the closing sale price of our common stock as reported on the AMEX was $15.65 per share. At January 19, 2006, there were approximately 9,700 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 our board of directors, considering then-existing conditions, including our financial condition and results of operations, capital requirements, bonding prospects, contractual restrictions (including those under our revolving credit agreements), business prospects and other factors that our board of directors considers relevant.

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CAPITALIZATION

The following table sets forth our cash, cash equivalents and capitalization as of September 30, 2005:

on an actual basis; and

on an as adjusted basis, reflecting the completion of the anticipated repayment of certain related party promissory notes described in Certain Transactions Contemplated Transactions and the application of the net proceeds from this offering, after deducting $1.8 million for the underwriting discounts and commissions payable by us and estimated offering expenses of approximately $767,000, as set forth under Use of Proceeds.

You should read this table in conjunction with Use of Proceeds, Selected Historical Financial and Operating Data, Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the notes thereto included elsewhere in this prospectus. Cash and cash equivalents do not reflect cash of approximately $484,000 anticipated to be received by us from the exercise of stock options and warrants underlying shares offered by the selling stockholders.

	At September 30, 2005	
	Actual	**As adjusted**
	(Amounts in thousands, except share data)	
Cash and cash equivalents	$ 20,138	$ 34,637
Debt:		
Current maturities of long-term debt(1)(4)	$ 2,235	$ 651
Steel City Products revolving credit facility(2)	4,302	4,302
Long-term debt:		
Construction business revolving credit facility(3)	15,742	15,742
Related party notes(1)(4)	6,865	
Mortgages	809	809
Other indebtedness	58	58
Total debt	$ 30,011	$ 21,562
Stockholders equity:		
Common stock, $0.01 par value, 14,000,000 shares authorized; 8,147,483 shares issued and outstanding, actual; 10,169,241 shares issued and outstanding, as adjusted(5)	$ 81	$ 98
Preferred stock, $0.01 par value, 1,000,000 shares authorized; no shares issued and outstanding		
Accumulated deficit	(39,385)	(39,385)
Additional paid-in capital	82,506	105,437
Total stockholders equity	$ 43,202	$ 66,150
Total capitalization	$ 53,075	$ 53,075

(1) Current maturities of long-term debt include $528,000 of principal on related party notes, which was due and paid in December 2005.

(2) Steel City Products revolving credit facility provides for revolving loans up to a maximum of $5.0 million with a maturity date of May 31, 2007. The interest rate at September 30, 2005 was 6.75%. Steel City Products has been classified as discontinued operations in our financial statements.

(3) The construction business revolving credit facility provides for revolving loans up to a maximum of $17.0 million with a maturity date of May 1, 2007. The interest rate at September 30, 2005 was 6.75%.

(4) See Management s Discussion and Analysis of Financial Condition and Results of Operations Other Debt and Certain Transactions for a discussion of the existing related party notes and the planned prepayment with cash in connection with this offering.

(5) As of September 30, 2005, we had 8,147,483 shares of common stock outstanding; 1,252,873 shares of common stock reserved for issuance upon the exercise of outstanding stock options at a weighted average exercise price per share of $2.558; 75,880 shares of common stock reserved for future awards under our stock option plans; and 527,339 shares of common stock reserved for issuance upon the exercise of outstanding warrants at an exercise price per share of $1.50.

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SELECTED HISTORICAL CONSOLIDATED FINANCIAL AND OPERATING DATA

The following tables set forth our summary historical consolidated financial and operating data for the periods indicated. The summary consolidated statement of operations data for the years ended December 31, 2002, 2003 and 2004, and the summary consolidated balance sheet data as of December 31, 2003 and 2004, have been derived from our audited consolidated financial statements, which are included elsewhere in this prospectus. The summary consolidated statement of operations data for 2000 and 2001, and balance sheet data as of February 28, 2001 and December 31, 2001 and 2002, have been derived from our audited consolidated financial statements, which are not included in this prospectus. The summary consolidated financial data as of and for the nine months ended September 30, 2004 and 2005, are derived from our unaudited consolidated financial statements, which are included elsewhere in this prospectus. The unaudited consolidated financial statements have been prepared on the same basis as our audited consolidated financial statements and include all adjustments, consisting of normal and recurring adjustments, that we consider necessary for a fair presentation of our financial position and operating results for the unaudited periods. The summary historical financial and operating data as of and for the nine months ended September 30, 2005, are not necessarily indicative of the results that may be obtained for a full year. Contract backlog is not a measure defined in GAAP and has not been derived from our consolidated financial statements.

In August 2005, our board of directors authorized management to sell the Steel City Products distribution business. Accordingly, we have reclassified our financial statements for all periods presented to reflect the business as discontinued operations.

The information presented below should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and the notes thereto included elsewhere in this prospectus.

	Year Ended February 28,	Year Ended December 31,				Nine Months Ended September 30,	
	2001(1)	2001(1)(2)	2002	2003	2004	2004	2005
						(Unaudited)	
	(Amounts in thousands, except share and per share data)						
Statement of Operations Data:							
Revenues	$	$ 48,654	$ 111,747	$ 149,006	$ 132,478	$ 95,161	$ 157,805
Cost of revenues		44,694	98,935	131,181	119,217	83,970	141,541
Gross profit		3,960	12,812	17,825	13,261	11,191	16,264
General and administrative expenses, net	1,283	2,741	6,862	7,400	7,696	5,844	6,771
Operating (loss) income	(1,283)	1,219	5,950	10,425	5,565	5,347	9,493
Interest expense, net of interest income	1,675	1,919	2,427	1,842	1,456	1,053	1,198
(Loss) income from continuing operations before loss from equity	(2,958)	(700)	3,523	8,583	4,109	4,294	8,295

investments, minority interest and income taxes							
Loss from equity investments	(4,557)	(1,217)					
Minority interest(3)		647	873	1,627	962	862	
(Loss) income from continuing operations before income taxes	(7,515)	(2,564)	2,650	6,956	3,147	3,432	8,295
Income tax (benefit) expense	(160)		(174)	1,752	(2,134)	1,167	2,820
Net (loss) income from continuing operations	(7,355)	(2,564)	2,824	5,204	5,281	2,265	5,475
Net income (loss) from discontinued operations	683	(62)	528	215	372	342	532
Net (loss) income	$ (6,672)	$ (2,626)	$ 3,352	$ 5,419	$ 5,653	$ 2,607	$ 6,007

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	Year Ended February 28, 2001(1)	Year Ended December 31, 2001(1)(2)	2002	2003	2004	Nine Months Ended September 30, 2004	2005
						(Unaudited)	
	(Amounts in thousands, except share and per share data)						
Basic (loss) income per share:							
Continuing operations	$ (1.49)	$ (0.51)	$ 0.56	$ 1.02	$ 0.99	$ 0.43	$ 0.72
Discontinued operations	0.14	(0.01)	0.10	0.04	0.07	0.06	0.07
	$ (1.35)	$ (0.52)	$ 0.66	$ 1.06	$ 1.06	$ 0.49	$ 0.79
Diluted (loss) income per share:							
Continuing operations	$ (1.49)	$ (0.51)	$ 0.46	$ 0.80	$ 0.75	$ 0.32	$ 0.58
Discontinued operations	0.14	(0.01)	0.09	0.03	0.05	0.05	0.06
	$ (1.35)	$ (0.52)	$ 0.55	$ 0.83	$ 0.80	$ 0.37	$ 0.64
Weighted average number of shares outstanding used in computing per share amounts:							
Basic	4,943,018	5,055,516	5,061,598	5,089,849	5,342,847	5,274,730	7,638,261
Diluted	4,943,018	5,055,516	6,101,515	6,488,376	7,027,682	7,158,697	9,467,306
Balance sheet data (end of period):							
Cash and cash equivalents	$ 3	$ 2,620	$ 2,111	$ 2,651	$ 3,449	$ 2,851	$ 20,138
Working capital	(17,918)	6,102	9,556	6,834	16,052	18,167	22,599
Total assets	16,507	59,141	72,757	75,578	89,544	84,902	122,789
Total debt	18,329	28,944	32,784	20,058	29,379	24,347	30,011
Stockholders equity	(9,938)	6,135	10,825	16,636	35,208	19,900	43,202

Other operating data:							
Depreciation and amortization	$	$ 1,706	$ 3,755	$ 4,690	$ 4,545	$ 3,487	$ 3,826
Capital expenditures		1,204	4,245	4,340	3,555	2,527	9,948
Contract backlog at end of period (unaudited)(4)	110,000	103,000	138,000	141,000	232,000	227,000	288,000

(1) In November 2001, our board of directors voted to change our fiscal year-end from the last day of February to December 31. Accordingly, results for fiscal 2001 are for the ten-month period from March 1 through December 31, 2001.

(2) In July 2001, we increased our percentage equity ownership in Texas Sterling Construction, L.P., or TSC, from 12% to 80.1%. The original investments were recorded using the cost method. The acquisition in July 2001 resulted in step-acquisition treatment of the original investments.

(3) Minority interest represents the 19.9% of TSC not owned by us until December 2004. See Note 16 of the Notes to the Consolidated Financial Statements for the fiscal year ended December 31, 2004, included in this prospectus.

(4) 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, 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 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.

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GUIDANCE

On December 22, 2005, we announced the following updated guidance for 2005, and initial guidance for 2006:

		Year Ending December 31, 2005	Year Ending December 31, 2006
		(In thousands)	
			Range
Revenues from continuing operations	$	210,000	$230,000 - $250,000
Income from continuing operations before income taxes	$	10,500	$ 11,500 - $ 13,000
Net income from continuing operations	$	6,800	$ 7,500 - $ 8,500

Notes:

Guidance for 2006 does not reflect any effects from this offering. Weighted average shares outstanding are approximately 9.9 million for 2005, and are expected to be about 10.0 million for 2006, excluding any shares that may be issued in the offering.

Pending verification by the respective customers, updated guidance for 2005 does not include certain potential fourth quarter performance incentives of up to $1.5 million, before taxes, that may be earned on the early completion of certain projects.

The above figures include results from continuing operations of the construction business, and do not include results of discontinued operations of the distribution business operated by Steel City Products.

Net income from continuing operations for both guidance periods reflects a full tax charge. We have available NOLs that should shelter from taxes most income for 2005 and 2006.

Guidance figures for 2005 were previously updated on November 7, 2005, and included forecast Earnings before Income Taxes, Depreciation and Amortization, or EBITDA; we have decided to discontinue use of the non-GAAP EBITDA measure.

Our current practice is to issue guidance about our expected results of continuing operations on an annual basis, and to update it, as appropriate, on a quarterly basis. Because of the seasonal variations in our business and its susceptibility to adverse weather conditions and other factors, it is not our practice to issue guidance as to quarterly results of operations.

As of December 31, 2005, we estimate that our contract backlog was approximately $300 million, reflecting new contracts of approximately $80 million added during our fourth quarter and our preliminary estimate of billings that will be recorded for that quarter.

The following discussion outlines certain factors applicable to the issuance of guidance by us. Such guidance is forward-looking information that is subject to risks and uncertainties as described in this prospectus.

The preparation of budgets for a civil construction business such as ours is inherently inaccurate due to the large number of variables, especially the need to win contracts in a competitive bidding process, and the effects that unusually good or bad weather can have on our project performance.

Guidance is based on our budgets and reforecasts as appropriate. Because our budget process reflects equipment and work crew requirements, production goals and incentive compensation benchmarks, and is subject to many assumptions, risks and uncertainties, when we publish guidance as to expected results of operations, we evaluate the likelihood of achieving those budgets.

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Our determination of budgeted revenues and operating profits reflects the following factors, *inter alia*:

The level and potential profitability of uncompleted contracts in backlog;

The size of our equipment fleet, its suitability for the contracts in backlog and expected to be added, and the capital expenditures that may be required, or equipment rental costs if such equipment is not required on a permanent basis;

Forecast depreciation, which is based on our existing fleet and expected additions and disposals;

Our existing work crews, their suitability for the contracts in backlog and expected to be added, and our ability to add further crews if necessary;

The bidding climate, which affects our ability to replace contracts built and also affects the gross margins that may be achieved on new contract wins;

The levels of activity in the various geographic markets in which we operate, and the opportunities available to enter new markets;

Our competitors and their expected impacts on our markets;

Our expectations about efficiency, which means the extent to which we can best match our equipment and work crews to the mix of contracts in backlog at any time;

Our expectations about the weather. We assume that we will suffer rain interruptions based on historical averages, and this is inherently inaccurate;

The expected availability and cost of bonding, which depends on levels of working capital and stockholders equity, among other factors;

Our expectations about changes in the availability and prices of materials, sub-contract services, fuel, and other third party expense items;

Expectations about changes in the number and compensation of our construction crews;

Expected additions to, and costs of, our supervisory and project management staff;

Expected changes in overhead expense levels to support the level of our business;

Employee incentive compensation, which is generally budgeted at the level expected to be paid if the budget is achieved;

Our expected insurance costs, which are significant and can fluctuate materially;

Other anticipated changes in our expense structure; and

Our expectations as to the likelihood of incurring or achieving any contract performance penalties or bonuses that depend on the timeliness of project completion.

The budgeting of corporate expenses reflects personnel requirements, expected legal and accounting needs (especially changes in the regulatory environment), public company costs, expenses relating to forecast stock option grants, and other expected changes in the overhead structure or costs thereof.

Interest costs are budgeted based on existing and anticipated levels of cash and debt, and the expected costs of borrowing to finance our equipment fleet and working capital needs. Taxation is budgeted based on prevailing and expected federal and state tax rates, and the expected impact of our NOLs.

Unless otherwise indicated, our guidance does not reflect any possible business acquisitions.

MANAGEMENT S DISCUSSION AND
ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion together with the consolidated financial statements and the notes thereto included elsewhere in this prospectus. This discussion contains forward-looking statements that are based on management s current expectations, estimates and projections about our business and operations. The cautionary statements made in this prospectus should be read as applying to all forward-looking statements wherever they appear in this prospectus. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements as a result of a number of factors, including those we discuss under Risk Factors and elsewhere in this prospectus.

Overview

We are a leading heavy civil construction company that specializes in the building and reconstruction of transportation and water infrastructure in large and growing markets in Texas. Our transportation infrastructure projects include highways, roads, bridges and light rail, and our water infrastructure projects include water, wastewater and storm drainage systems. We provide general contracting services primarily to public sector clients utilizing our own employees and equipment for activities including excavating, paving, pipe installation and concrete placement. We purchase the necessary materials for our contracts and generally engage subcontractors only for ancillary services.

Since the founding of our construction business in 1955, we have expanded our service profile and market areas. We currently operate in several major Texas markets, including Houston, San Antonio, Dallas/ Fort Worth and Austin, and believe that we have the capability to expand into other Gulf Coast and Southwestern markets. We also have broadened our range of services, from our original focus on water and wastewater projects, to include concrete and asphalt paving, concrete slip forming, installation of large-diameter water and wastewater distribution systems, construction of bridges and similar large structures, light rail infrastructure, concrete crushing and concrete batch plant operations.

We derive the majority of our revenue from performing under fixed unit price contracts. Under fixed unit price contracts, we generally are committed to provide all of the resources required to complete a contract at a fixed price per unit. Cost of contract revenues earned includes labor, equipment, materials, subcontractors and indirect costs such as insurance, shop costs, fuel and safety costs.

Recognizing the strong growth of our construction business, where management s efforts and our resources are likely to be best employed in the future, and following expressions of interest from potential buyers of our distribution business, in August 2005 our board of directors authorized management to sell that business, which is operated by Steel City Products. Accordingly, we have reclassified our financial statements for all periods presented to reflect the business as discontinued operations. Unless otherwise noted, the discussion in this prospectus pertains only to our construction business.

Critical Accounting Policies

Our significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements for the fiscal year ended December 31, 2004, included in this prospectus.

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 and cost include differing site conditions (to the extent that contract remedies are unavailable), the performance of major material suppliers to deliver on time, the performance of major subcontractors, unusual weather conditions and the accuracy of the original bid estimate. Because we have a 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. Revenues relating to change order claims are recognized only if it is probable that the revenues 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 provide 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 tendering bids, we obtain firm quotations from our suppliers and subcontractors. As a result, we have rarely been exposed to material price or availability risk on contracts in our contract backlog. 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. Most of our state and municipal contracts provide for termination of the contract for the convenience of the party contracting with us, with provisions to pay us only for work performed through the date of termination.

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 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 number of contracts of varying levels of complexity and size 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 added scope changes, extended overhead due to customer-related and weather 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 $13 million at December 31, 2004, 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 effective October 1, 2004, and it did not reveal impairment of goodwill. The annual impairment review for goodwill effective October 1, 2005 is currently in process, and we do not expect it to reveal an impairment of goodwill.

Deferred 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 establish a valuation allowance based upon projected future taxable income and the expected timing of the reversals of existing temporary differences. Because realization of deferred tax assets related to NOLs is not assured, our valuation allowance at the respective time represents the amount of the deferred tax assets that we determine are more likely than not to expire unutilized. Reflecting management s assessment of expected future operating profitability and NOLs expiring unutilized, in the second quarter of 2005 and fiscal 2004, 2003 and 2002, our valuation allowance was reduced by $0.8 million, $18.9 million, $4.9 million and $1.5 million, respectively.

Income Taxes

As of December 31, 2004, we had NOLs of approximately $38.9 million, which will expire from time to time during the years 2005 through 2020 as discussed below. We expect that most of our federally-taxable income will be offset by NOLs through 2007, which is when we expect to have used all of our NOLs.

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 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.

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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.

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 that the distribution business became a long-lived asset held for sale and a discontinued operation in the third quarter of fiscal 2005. Consequently, we have reclassified the operating results of the distribution business from continuing operations in our statement of operations for all periods presented. We do not expect to incur a loss on the disposal of our distribution business.

Results of Operations

The following compares our results of operations for the nine months ended September 30, 2005 and 2004, for the fiscal years 2004 and 2003 and for the fiscal years 2003 and 2002.

Nine Months Ended September 30, 2005 Compared to the Nine Months Ended September 30, 2004

	2004	2005	% Change
	(Dollar amounts in thousands)		
Revenues	$ 95,161	$ 157,805	65.8%
Gross profit	11,191	16,264	45.3%
Gross profit %	11.8%	10.3%	(12.7)%
General and administrative expenses	5,844	6,771	15.9%
Operating income	5,347	9,493	77.5%
Operating income %	5.6%	6.0%	7.1%
Interest expense, net	1,053	1,198	13.8%
Income from continuing operations, before minority interest	4,294	8,295	93.2%
Minority interest	862		(100.0)%
Income taxes	1,167	2,820	141.6%
Net income from continuing operations	2,265	5,475	141.7%
Net income from discontinued operations	342	532	55.6%
Net income	$ 2,607	$ 6,007	130.4%
Contract backlog, end of period	$ 227,000	$ 288,000	26.9%

Revenues. Our revenues increased $62.6 million, or 66%, to $157.8 million in the first nine months of 2005, compared to $95.2 million in the first nine months of 2004. Revenues from state highway work increased $23.0 million, or 75%, and municipal revenues increased $39.6 million, or 61%, compared with the prior year. These increases were due to several factors, including:

a growing contract backlog, which enabled us to expand our equipment fleet and to hire more field crews, especially in the San Antonio market;

the continuing expansion of our construction capabilities, which allowed us to bid for and take on more complex work; and

certain water main contracts in process in the third quarter of the current year included large diameter pipe, facilitating greater revenues to be generated by our crews; and

better weather in the first half of 2005 provided for continuous work on construction contracts, compared with one of the wettest periods on record in the first half of 2004.

Gross profit. Gross profit for the first nine months of 2005 increased $5.1 million, or 45%, to $16.3 million, compared with gross profit of $11.2 million in the first nine months of 2004. The improvement was due to the 66% revenue increase, offset by lower gross margins, which decreased to 10.3% of revenues from 11.8% in the prior year. Although we have seen a gradual improvement in gross margins in our contract backlog in 2005 compared with 2004, the second quarter of 2004 reported much higher gross margins than usual due to the successful completion of a number of contracts. Also, there were losses in the first half of 2005 on some smaller contracts in the Dallas/Fort Worth market.

Contract Backlog. At September 30, 2005, contract backlog was approximately $288 million, reflecting an increase of $56 million from the beginning of 2005. At September 30, 2004, contract backlog was approximately $227 million, reflecting an increase of $86 million from the beginning of 2004. In both periods, new contracts were added at a greater rate than contracts were completed. In July 2005, we were the low bidder on two TXDOT contracts with an aggregate value of $103 million, which contributed to the increase in contract backlog.

General and administrative expenses, net of other income and expense. General and administrative, or G&A, expenses increased by $927,000, or 16%, for the first nine months of 2005, due principally to the hiring of additional personnel to support our enlarged contract backlog, increases in variable compensation accruals reflecting our improved profit levels, and increased accounting and legal fees.

Operating income. Our operating income increased $4.1 million, or 78%, to $9.5 million in the first nine months of 2005 from $5.3 million in the same period of 2004. This increase is due primarily to our increased gross profit levels. Our operating margin increased to 6.0% for the first nine months of 2005 compared to 5.6% for the same period of 2004. This was also due to our increased gross profits and the efficiencies associated with scale in our operations.

Interest expense, net of interest income. Interest expense, net of interest income, increased by $0.1 million in the first nine months of 2005 from the first nine months of the prior year, due primarily to the issuance of debt in December 2004 in connection with the purchase of the minority interest in TSC.

Minority interest. In December 2004, we purchased the 19.9% of TSC that we did not previously own. Accordingly, there was no minority interest expense recorded in 2005.

Income taxes. Federal income tax expense is computed at the expected rate of 34%. Income tax expense increased by $1.7 million for the first nine months of 2005 compared to the first nine months of 2004 due to the higher earnings level. Our payment of federal income taxes is largely sheltered by NOLs.

Net income from continuing operations. Our net income from continuing operations increased by $3.2 million, or 142%, to $5.5 million for the first nine months of 2005 compared to $2.3 million in the first nine months of 2004. This increase was due to the higher operating income and the absence of minority interest expense in 2005.

Discontinued operations. For the first nine months of 2005, Steel City Products reported sales of $17.6 million, essentially unchanged from the prior year. Gross profit increased by approximately $200,000, reflecting an improvement in gross margins to 15.6% of sales compared with 14.5% in the first nine months of the prior year, due to changes in product mix and certain price increases. Operating income was $1.0 million in the first nine months of 2005 compared with $715,000 in the first nine months of the prior year. Net of interest expense of $202,000 and taxes at an expected rate of 34%, Steel City Products reported income of $532,000 in the first nine months of 2005, compared with $342,000 in the first nine months of 2004.

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Fiscal Year Ended December 31, 2004 (Fiscal 2004) Compared with Fiscal Year Ended December 31, 2003 (Fiscal 2003)

	2003	2004	% Change
	(Dollar amounts in thousands)		
Revenues	$ 149,006	$ 132,478	(11.1)%
Gross profit	17,825	13,261	(25.6)%
Gross profit %	12.0%	10.0%	(16.6)%
General and administrative expenses	7,400	7,696	(4.0)%
Operating income	10,425	5,565	(46.6)%
Operating income %	6.9%	4.2%	(39.1%)
Interest expense, net	1,842	1,456	(21.0)%
Income from continuing operations, before minority interest	8,583	4,109	(52.1)%
Minority interest	1,627	962	(40.9)%
Income taxes	1,752	(2,134)	N/A
Net income from continuing operations	5,204	5,281	1.5%
Net income from discontinued operations	215	372	73.0%
Net income	$ 5,419	$ 5,653	4.3%
Contract backlog, end of year	$ 141,000	$ 232,000	64.5%

Revenues. Revenues decreased $16.5 million, or 11%, to $132.5 million for fiscal 2004 compared to $149.0 million for fiscal 2003. This decrease was due to several factors, including a decrease in business with the City of Houston and Harris County, Texas due to the completion of several large contracts in fiscal 2003, although this was offset in part by an increase of $11.4 million, or 41%, in state highway business, due principally to the acquisition of the Kinsel construction business. We also encountered poor weather conditions in the second and fourth quarters of 2004, which significantly reduced the number of available workdays on several of our contracts.

Gross profit. Gross profit decreased $4.6 million, or 26%, to $13.3 million for fiscal 2004 compared to $17.8 million for fiscal 2003, reflecting the lower revenues and a contraction in gross margins to 10.0% compared with 12.0% in the prior year. The decrease in gross margins was due to higher fixed cost absorption rates because of the lower revenues and weather-related delays, combined with a lower average gross margin mix in the contracts completed during fiscal 2004 compared with fiscal 2003. We also experienced adverse performance on several construction contracts in the Dallas market. In contrast, gross margins in fiscal 2003 were unusually high due to a combination of contract mix and excellent weather conditions.

Contract backlog. We began fiscal 2004 with a contract backlog of $141 million. During the year, the bidding climate improved and that, coupled with our continuing broadening service platform, resulted in our successfully competing for a variety of larger, multi-year contracts. At the end of fiscal 2004, our contract backlog was $232 million, an increase of 65% compared with the end of the prior year. Approximately $160 million of the contract backlog at December 31, 2004 was scheduled to be completed during fiscal 2005 and the remainder thereafter.

General and administrative expenses, net of other income and expense. G&A expenses increased $0.3 million, or 4%, to $7.7 million for fiscal 2004 compared to $7.4 million for fiscal 2003. In fiscal 2003, we increased our liability related to the put right (which is described under Certain Transactions Sterling Acquisition) in the amount of

$1.0 million. This increase in fiscal 2003 was not repeated in fiscal 2004, but we encountered increases in fiscal 2004 related to the listing of our common stock on the AMEX, the hiring of a public relations firm and expenses related to the conversion of zero coupon notes upon the settlement of the put right.

Operating income. Operating income decreased $4.9 million in fiscal 2004 compared with fiscal 2003. As a result, our operating margin contracted to 4.2% in fiscal 2004, from 6.9% in fiscal 2003.

Interest expense, net of interest income. Interest expense decreased in fiscal 2004 by $0.4 million, or 21%, due to lower interest rates on our credit facility with Comerica Bank, which we refer to as the construction business revolver.

Minority interest. We recorded a minority interest expense attributable to the 19.9% of TSC that we did not acquire until December 2004. There was a reduction in the minority interest expense in fiscal 2004 because of the lower level of operating profits in fiscal 2004 compared with fiscal 2003.

Income taxes. The benefit from income taxes for fiscal 2004 was $2.1 million compared to a provision of $1.8 million for fiscal 2003. In fiscal 2004, 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 used in the future. The effective tax rate of 25.2% in fiscal 2003 was less than the expected rate because of the utilization of $1.8 million of NOLs against current taxable income.

Net income from continuing operations. As a result of the factors discussed above, we recorded net income from continuing operations of $5.3 million for fiscal 2004 compared to $5.2 million for fiscal 2003. Basic income per common share from continuing operations were $1.06 for fiscal 2004, which were unchanged from the prior year. Diluted income per common share from continuing operations were $0.80 for fiscal 2004 compared to $0.83 for fiscal 2003, because there was an increase in the number of common shares outstanding in fiscal 2004 due to the settlement of the put right, in part through the issuance of common stock.

Effect of income tax benefits. Although we have the benefit of significant NOLs, which shelter 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 revaluation of the deferred tax asset are recorded in the income statement; such adjustments resulted in a benefit of $1.9 million in fiscal 2004 and $1.8 million in the prior year. Assuming an income tax rate of 34%, and disregarding adjustments to our deferred tax asset, net income would have been $2.1 million for fiscal 2004 and $4.6 million for fiscal 2003, and on the same basis, basic and fully diluted earnings from continuing operations per common share would have been $0.39 and $0.30, respectively, for fiscal 2004, compared with $0.90 and $0.71, respectively, for fiscal 2003. A reconciliation of reported net income for fiscal 2004 and fiscal 2003 to net income, as if a 34% tax rate had been applied, is set forth in the table below.

	Fiscal 2003	Fiscal 2004
	(Amounts in thousands, except per share data)	
Income from continuing operations before income taxes, as reported	$ 6,956	$ 3,147
Provision for income taxes (assuming a 34% effective rate)	2,365	1,070
Net income from continuing operations, as if a 34% rate had been applied	$ 4,591	$ 2,077
Basic income from continuing operations per common share	$ 0.90	$ 0.39
Diluted income from continuing operations per common share	$ 0.71	$ 0.30

To supplement our unaudited consolidated financial statements presented on a GAAP basis, we sometimes use non-GAAP measures of net income, earnings per share and other measures that we believe are appropriate to enhance an overall understanding of our historical financial performance and future prospects. The non-GAAP results, which are adjusted to exclude certain costs, expenses, gains and losses from the comparable GAAP measures, are an indication of our baseline performance before gains, losses or other charges that are considered by management to be outside of our core operating results. These non-GAAP results are among the indicators management uses as a basis

for evaluating our financial performance as well as for forecasting future periods. For these reasons, management believes that these

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non-GAAP measures can be useful to investors, potential investors and others. The presentation of this additional information is not meant to be considered in isolation or as a substitute for net income or earnings per share prepared in accordance with GAAP.

Discontinued operations, net of tax. Discontinued operations for fiscal 2004 and fiscal 2003 represent the results of operations of Steel City Products. Income from discontinued operations increased $0.2 million, or 73%, to $0.4 million for fiscal 2004 compared to $0.2 million for fiscal 2003. This increase was due to an increase in sales of $1.1 million, or 6%, from fiscal 2003 related to increased automotive sales and promotional orders of pet supplies, offset by a modest decrease of lawn and garden products sales. Gross profit margins remained relatively flat.

Fiscal Year Ended December 31, 2003 (Fiscal 2003) Compared with Fiscal Year Ended December 31, 2002 (Fiscal 2002)

	2002	2003	% Change
	(Dollar amounts in thousands)		
Revenues	$ 111,747	$ 149,006	33.3%
Gross profit	12,812	17,825	39.1%
Gross profit %	11.5%	12.0%	4.3%
General and administrative expenses	6,862	7,400	7.8%
Operating income	5,950	10,425	75.2%
Operating income %	5.3%	6.9%	30.2%
Interest expense, net	2,427	1,842	(24.1)%
Income from continuing operations, before minority interest	3,523	8,583	143.6%
Minority interest	873	1,627	86.4%
Income taxes	(174)	1,752	N/A
Net income from continuing operations	2,824	5,204	84.3%
Net income from discontinued operations	528	215	(59.3)%
Net income	$ 3,352	$ 5,419	61.7%
Contract backlog, end of year	$ 138,000	$ 141,000	2.2%

Revenues. Revenues increased $37.3 million, or 33%, to $149.0 million for fiscal 2003 compared to $111.7 million for fiscal 2002. This increase was due to higher revenues on municipal customer contracts and the effect of the full year of revenues generated by the addition of contracts acquired with the Kinsel Construction business. The increase was further enhanced by generally favorable weather conditions, which permitted faster average completion of contracts.

Gross profit. Gross profit increased $5.0 million, or 39%, to $17.8 million for fiscal 2003 compared to $12.8 million for fiscal 2002, reflecting the increase in revenues and favorable market conditions, combined with an improvement in gross margins from 11.5% to 12.0%.

Contract backlog. We began fiscal 2003 with a contract backlog of $138.0 million. At the end of the year, our contract backlog was $141.0 million, an increase of 2%. Approximately $107.0 million of the contract backlog at December 31, 2003 was scheduled to be completed during fiscal 2004 and the remainder thereafter.

General and administrative expenses, net of other income and expense. G&A expenses increased $0.5 million, or 8%, to $7.4 million for fiscal 2003 compared to $6.9 million for fiscal 2002. This was due to an increase of $500,000 in the liability related to the put right and to option compensation expense of $300,000, offset by decreases in our audit fees and other administrative expenses.

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Operating income. Operating income increased $4.5 million in fiscal 2003 compared with fiscal 2002 due principally to the higher gross profits. As a result, our operating margin expanded to 6.9% in fiscal 2003, from 5.3% in fiscal 2002.

Interest expense, net of interest income. Interest expense decreased by $0.6 million to $1.8 million in fiscal 2003 compared with fiscal 2002 due to lower interest rates and borrowings on the construction business revolver.

Minority interest. Minority interest expense increased by $0.8 million to $1.6 million in fiscal 2003 compared with fiscal 2002 due to the higher profit levels of TSC.

Income taxes. The provision for income taxes for fiscal 2003 was $1.8 million compared to a benefit of $0.2 million for fiscal 2002. The effective tax rate of 25.2% in fiscal 2003 was less than the expected rate due to the utilization of NOLs against current taxable income.

Net income from continuing operations. As a result of the factors discussed above, we recorded net income from continuing operations of $5.2 million for fiscal 2003 compared to $2.8 million for fiscal 2002. Basic income per common share from continuing operations were $1.02 for fiscal 2003, an increase of $0.46 from fiscal 2002. Diluted income per common share from continuing operations were $0.80 for fiscal 2003 compared to $0.46 for fiscal 2002.

Effect of income tax benefits. Assuming an income tax rate of 34%, and disregarding adjustments to our deferred tax asset, net income would have been $4.6 million for fiscal 2003 and $1.7 million for fiscal 2002, and on the same basis, basic and fully diluted earnings from continuing operations per common share would have been $0.90 and $0.71, respectively, for fiscal 2003, compared with $0.35 and $0.29, respectively, for fiscal 2002. A reconciliation of reported net income for fiscal 2003 and fiscal 2002 to net income, as if a 34% tax rate had been applied, is set forth in the table below.

	Fiscal 2002	**Fiscal 2003**
	(Amounts in thousands, except per share data)	
Income from continuing operations before income taxes, as reported	$ 2,650	$ 6,956
Provision for income taxes (assuming a 34% effective rate)	901	2,365
Net income from continuing operations, as if a 34% rate had been applied	$ 1,749	$ 4,591
Basic income from continuing operations per common share	$ 0.35	$ 0.90
Diluted income from continuing operations per common share	$ 0.29	$ 0.71

Discontinued operations, net of tax. Discontinued operations for fiscal 2003 and fiscal 2002 represent the results of operations of Steel City Products. Income from discontinued operations decreased $0.3 million, or 59%, to $0.2 million for fiscal 2003, compared to $0.5 million for fiscal 2002. This decrease was due primarily to the loss of business in fiscal 2002 from Ames Department Stores, Inc., or Ames, following its bankruptcy filing. Sales to Ames were approximately $3.0 million in fiscal 2002. This decrease was partially offset by an increase of $1.2 million in the sales of lawn and garden products to a new customer and increased sales to existing customers. Gross profit margins decreased approximately 4.3% between fiscal 2002 and fiscal 2003.

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Historical Cash Flows

The following table sets forth information about our cash flows for the years ended December 31, 2002, 2003 and 2004, and for the nine months ended September 30, 2004 and 2005.

	Year Ended December 31,			Nine Months Ended September 30,	
	2002	2003	2004	2004	2005
				(Unaudited)	
	(Amounts in thousands)				
Cash and cash equivalents (at end of period)	$ 2,111	$ 2,651	$ 3,449	$ 2,851	$ 20,138
Net cash provided by (used in) continuing operations:					
Operating activities	5,004	18,185	4,171	(980)	25,368
Investing activities	(6,801)	(4,270)	(5,809)	(2,374)	(9,678)
Financing activities	1,288	(13,376)	2,436	3,553	999
Cash from discontinued operations	33	(181)	(47)	387	132
Capital expenditures	4,245	4,340	3,555	2,527	9,948
Working capital (at end of period)	9,556	6,834	16,052	18,167	22,599

Operating activities

Significant non-cash items included in operating activities for the first nine months of 2005 were:

depreciation and amortization, which for the first nine months of 2005 totaled $3.8 million, an increase of $0.3 million from the same period in 2004, as a result of the increase in the size of our construction fleet in 2005; and

tax expense, which increased by $1.6 million during the first nine months of 2005 due to the increase in operating income.

Despite the significant increase in revenues during the first nine months of 2005, there was a reduction in total working capital requirements of $13.1 million during the first nine months of 2005, whereas there was an increase in working capital requirements during the first nine months of 2004 of $9.5 million. The significant components of the changes in working capital are as follows:

there was a decrease of $2.6 million in costs in excess of billings on uncompleted contracts in 2005, compared with an increase of $3.9 million in 2004. These changes reflect the resolution of timing differences as contracts progress;

billings in excess of costs on uncompleted contracts increased by $7.5 million in 2005, whereas in 2004 there was a decrease of $5.0 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 $14.9 million in 2005, compared with an increase of $4.5 million in 2004, principally reflecting the increased level of revenues in 2005; and

contracts receivable increased $14.5 million in 2005, compared with an increase of $6.9 million in 2004, principally reflecting the revenue increase and related level of customer retentions.

Investing activities

Expenditures to expand our construction fleet were $9.9 million in the first nine months of 2005, compared with $2.5 million during the first nine months of 2004. The much enlarged contract backlog required a significant expansion in our fleet in 2005.

Financing activities

Cash provided by operations, combined with the reduced level of working capital, more than offset the high level of capital expenditures in the nine months ended September 30, 2005, funding long-term debt repayments of $2.2 million and resulting in a substantial increase in our cash position. For the first nine months of 2005, cash increased by $16.7 million, of which $2.4 million was derived from an increase in borrowings under our revolving lines of credit. During the first nine months of fiscal 2004, there was an increase in borrowings under the lines of credit of $5.3 million because capital expenditures, long-term debt repayments and working capital requirements exceeded cash provided by operations.

Funds received from the exercise of warrants by North Atlantic Smaller Companies Investment Trust, or NASCIT, and the exercise of options by employees and directors, increased by $400,000 during the first nine months of 2005 compared with the same period in 2004.

Liquidity

The level of working capital for our construction business varies due to fluctuations in the levels of cost and estimated earnings in excess of billings, and of billings in excess of cost and estimated earnings, based in part on revenue levels; the size and status of contract mobilization payments, of customer receivables and of contract retentions; and the level of amounts owed to suppliers and subcontractors. Some of these fluctuations can be significant.

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.

Construction Business Revolver

Our construction business has a revolving credit facility with Comerica Bank. The revolver has a maturity date of May 1, 2007, and is a collateral-based facility with total borrowing capacity, subject to a borrowing base, of up to $17.0 million. At September 30, 2005, $15.7 million in borrowings were outstanding under this revolver. As of September 30, 2005, we had unused borrowing base availability of $1.3 million, in addition to cash and cash equivalents of $20.1 million.

This revolver, secured by all of our construction business equipment, provides working capital financing for the operation of our construction business and to fund the acquisition of equipment. The revolver provides for a quarterly commitment fee of 0.25% per annum on the unused portion of the line of credit. Borrowing rates are based on the bank s prime rate or on a Eurodollar rate. The interest rate on funds borrowed under this revolver during the nine months ended September 30, 2005 ranged from 5.25% to 6.75%. The revolver is subject to compliance with financial covenants relating to working capital, tangible net worth, fixed charges and cash coverage, and debt leverage ratios. We were in compliance with these covenants at September 30, 2005.

Steel City Products Revolver

Steel City Products has a revolving credit facility with National City Bank of Pennsylvania. This revolver has a current maturity date of May 31, 2007, and is a collateral-based facility with total borrowing capacity, subject to a borrowing base, of $5.0 million. At September 30, 2005, $4.3 million in borrowings were outstanding under the revolver, and we had unused borrowing base availability of approximately $0.3 million, in addition to cash and cash equivalents of $0.2 million.

The Steel City Products revolver, secured by substantially all of the assets of Steel City Products, provides working capital financing for the operation of the distribution business. Borrowing rates are based on the bank s prime rate. The interest rate on funds borrowed under this revolver during the nine months ended September 30, 2005 ranged from 6.0% to 6.75%. The revolver is subject to compliance with a financial covenant relating to fixed charge coverage. We were in compliance with this covenant at September 30, 2005.

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Other Debt

Related Party Notes

For the last five years, certain members of our management, directors and affiliates have, from time to time and through various methods, provided financing to help fund our expansion and operations.

As of September 30, 2005, we were indebted to such persons under unsecured notes in an aggregate amount of approximately $9.0 million, which included $338,505, $2,802,262, $192,531, $481,215 and $1,971,308 owed, respectively, to Messrs. Patrick T. Manning (our Chief Executive Officer), Joseph P. Harper, Sr. (our President and Chief Operating Officer), Hemsley (our Chief Financial Officer), Davies (a former director) and James D. Manning (the brother of our Chief Executive Officer). Principal and interest at the rate of 12% per annum are payable quarterly on these unsecured notes until their maturity date in July 2009. See Certain Transactions. In December 2005, we made $528,000 of principal payments on these notes, thereby reducing the aggregate outstanding amount to approximately $8.4 million.

Mortgages

In June 2001, we completed the construction of a new headquarters building on land adjacent to our existing equipment repair facility in Houston. The building was financed principally through an additional mortgage of $1.1 million on the land and facilities, at an interest rate of 7.75% per annum, repayable over 15 years. The new 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.

Uses of Capital

Contractual Obligations

The following table sets forth our fixed, non-cancelable obligations at December 31, 2004, including those related to our discontinued operations.

	Payments due by Period				
	Total	Less Than One Year	1 3 Years	4 5 Years	More Than 5 Years
	(Amounts in thousands)				
Debt	$ 16,954	$ 3,625	$ 13,329	$	$
Capital leases	58	25	23	10	
Operating leases	1,604	555	1,049		
Related party notes(1)	11,349	3,593	3,878	3,878	
Other long-term liabilities	1,018	123	246	246	403
	$ 30,983	$ 7,921	$ 18,525	$ 4,134	$ 403

(1) See Other Debt and Certain Transactions for a discussion of the existing related party notes and the planned prepayment in cash in connection with this offering.

To manage risks of changes in the 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.

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 both of our revolving lines of credit is paid monthly and fluctuates with the balances outstanding during the year, as well as fluctuations in interest rates. In fiscal 2004, such interest was approximately $700,000. We also pay interest on a quarterly basis on our related party notes, as described above, which amounts are expected to be approximately $1.2 million in

2005 and, if the notes are not prepaid as anticipated, an aggregate of $1.6 million for the one to three year period, and an aggregate of $579,000 in the four to five year period. All other debt is expected to have interest of approximately $60,000, $120,000 and $120,000, respectively, during such periods.

Capital Expenditures

Our capital expenditures during fiscal 2004 and the first nine months of 2005 totaled $2.5 million and $9.9 million, respectively, consisting almost exclusively of expenditures to purchase heavy construction equipment.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

New Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board, or FASB, issued SFAS No. 151, Inventory Costs an amendment of ARB No. 43, or SFAS No. 151, which is the result of its efforts to conform United States accounting standards for inventories with international accounting standards. SFAS No. 151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not believe that the adoption of SFAS No. 151 will have an impact on our consolidated financial statements.

In December 2004, the FASB issued FASB Statement No. 123(R), Share-Based Payment, or SFAS No. 123(R), which is a revision of FASB Statement No. 123 Accounting for Stock-Based Compensation. SFAS No. 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, or APB 25, and amends FASB Statement No. 95, Statement of Cash Flows . We are required to adopt SFAS No. 123(R) beginning January 1, 2006. Pro forma disclosure, as was allowed under APB 25 and SFAS No. 123, will no longer be an alternative. In addition, SFAS No. 123(R) requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS No. 123(R) and for all stock options granted thereafter. Because we utilize a fair value based method of accounting for stock-based compensation costs for all employee stock compensation awards granted, modified or settled since January 1, 2003 and will not have significant unvested awards from periods prior to January 1, 2003 outstanding at January 1, 2006, the adoption of SFAS No. 123(R) is not expected to have a material impact on our financial statements.

In March 2005, the FASB issued FASB Interpretation No. 47 Accounting for Conditional Asset Retirement Obligations, or FIN 47. FIN 47 clarifies that an entity must record a liability for a conditional asset retirement obligation if the fair value of the obligation can be reasonably estimated. The provision must be adopted no later than the end of the fiscal year ending December 31, 2005. We do not expect the adoption of FIN 47 will have a material impact on our financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections. SFAS No. 154 is a replacement of APB 20 and FASB Statement No. 3. SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application as the required method for reporting a change in accounting principle. SFAS No. 154 provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. The reporting of a correction of an error by restating previously issued financial statements is also addressed by SFAS No. 154. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We will adopt this pronouncement beginning in fiscal year 2006.

Quantitative and Qualitative Disclosure About Market Risk

Changes in interest rates are our primary sources of market risk. As of September 30, 2005, $20.0 million of our outstanding indebtedness was at floating interest rates. An increase of 1.0% in the interest rate would result in an increase in our interest expense of approximately $200,000 per year.

BUSINESS

General

We are a leading heavy civil construction company that specializes in the building and reconstruction of transportation and water infrastructure in large and growing markets in Texas. Our transportation infrastructure projects include highways, roads, bridges and light rail, and our water infrastructure projects include water, wastewater and storm drainage systems. We provide general contracting services primarily to public sector clients utilizing our own employees and equipment for activities including excavating, paving, pipe installation and concrete placement. We purchase the necessary materials for our contracts and generally engage subcontractors only for ancillary services.

Since the founding of our construction business in 1955, we have expanded our service profile and market areas. We currently operate in several major Texas markets, including Houston, San Antonio, Dallas/ Fort Worth and Austin, and believe that we have the capability to expand into other Gulf Coast and Southwestern markets. We also have broadened our range of services, from our original focus on water and wastewater projects, to include concrete and asphalt paving, concrete slip forming, installation of large-diameter water and wastewater distribution systems, construction of bridges and similar large structures, light rail infrastructure, concrete crushing and concrete batch plant operations.

Our Markets

We operate in the heavy civil construction segment for infrastructure projects, specializing on transportation and water infrastructure. Demand for this infrastructure depends on a variety of factors, including overall population growth, economic expansion and 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 that have 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.

Our geographic markets have experienced steady and significant growth over the last 10 years. As ranked by population, Texas is the second largest state in the United States; its population has grown by an average of 1.7% per year over the past 10 years, exceeding the 1.0% growth rate for the United States as a whole over the same period. According to the 2004 census, Houston ranks as the fourth largest city in the country, San Antonio as the eighth largest, Dallas as the ninth largest and Austin as the sixteenth largest.

In addition to our core geographical markets, we operate in large and growing construction sectors that have experienced solid and sustained growth over the past few 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 and water/wastewater infrastructure has grown at a 2.0% compound annual growth rate since 2002 and was $113 billion in 2004, the last year for which data are available. This includes 1.2% growth in the $87 billion transportation market and 4.2% growth in the $27 billion water/wastewater market. The U.S. Department of Commerce projects that nationwide construction spending on public works transportation, water supply systems and wastewater systems is expected to grow by 12%, 5% and 5%, respectively, in 2006. Based on dollars spent for construction of highways and bridges, water supply systems and sewer systems in the first nine months of 2005, Texas is ranked by McGraw-Hill, an industry data source, as the number one, number three and number four market in the nation, respectively.

Our highway and bridge work is generally funded through federal and state authorizations. The federal government recently enacted the SAFETEA-LU bill, which authorized $286 billion for transportation spending over the next five years, a 38% increase from the prior spending bill. Of this total, Texas is expected to receive an allocation of approximately $14.5 billion, a 37% increase from the prior spending

bill. TXDOT s budget shows $23.7 billion in spending from 2006 through 2010, an increase of 28% over the prior five-year period, prior to the passage of the SAFETEA-LU bill.

Our water and wastewater, underground utility, light transit and 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 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.

Competitive Strengths

We believe that our competitive strengths in the construction business include the following:

Long and Successful Track Record of Infrastructure Construction. Through our 50 years of experience, we have developed efficient processes and controls that allow us to provide high-quality contracting services for building roads, highways, bridges, light rail facilities and water, wastewater and storm drainage systems. Our expertise, coupled with strong underlying market dynamics, has produced compound annual revenue growth in our construction business that has averaged approximately 18% since 1985, and was 66% for the first nine months of 2005 compared to the comparable period in 2004.

Leadership in Our Markets. We are an established leader in our markets based on our longevity, our management expertise and our reputation, as well as our in-depth knowledge of soil and other construction conditions in our market areas. Our scale of operations allows us to deploy and redeploy work crews, materials and equipment across multiple contracts and provides us with advantages in competitive bidding environments. We are prequalified with all of our significant public sector customers that require qualification, including TXDOT, a requirement that has the effect of limiting competition from some other bidders for highway contracts and, in some cases, for municipal contracts.

Comprehensive Infrastructure Construction Capabilities. Over time, we have added construction services that provide us with competitive advantages. For example, from our base of water and wastewater work, we have added concrete and asphalt paving, concrete slip forming, installation of large-diameter water and wastewater distribution systems, construction of bridges and similar large structures, light rail infrastructure, concrete crushing and concrete batch plant operations. We currently perform approximately 75% of our work utilizing our own workforce and equipment. Our emphasis on providing comprehensive construction services allows us to capture additional profit margin that otherwise would be gained by subcontractors and to more aggressively bid contracts without sacrificing our profitability targets.

Consistent History of Managing Construction Projects and Contract Risk. Our significant experience and longevity in our markets provides us with an understanding of the many risks of infrastructure construction. We provide services predominantly pursuant to fixed unit price contracts, which, if properly managed, generally allow for better profit margin opportunities than cost-plus contracts. We monitor and manage risk throughout a contract s duration, including the bid process, the pre-construction planning activities and the construction process. Our project managers lead our estimating process, and our senior management reviews all bid proposals prior to submission, thereby increasing project managers accountability and understanding of the financial and operating risks and opportunities of our contracts. In addition, a significant portion of our project managers compensation is based on the profitability of contracts that they bid and manage, a policy which reinforces our goal of carefully and accurately bidding contracts.

Financial Strength. Our long-term debt-to-equity ratio as of September 30, 2005, giving effect to this offering and the anticipated repayment of certain related party notes described in Certain Transactions Contemplated Transactions as of that date, would have been approximately 25%, and we believe that we will have sufficient cash balances to meet our anticipated near-term liquidity needs. In addition, we have a substantial base of assets, including a fleet of over 500 pieces of heavy construction equipment, which allows for flexibility in meeting contract requirements and can provide an advantage over our competitors who lease their equipment. After this offering, we will have greater flexibility under our

commercial bank line of credit to take advantage of appropriate expansion and acquisition opportunities in our markets. We believe that these financial strengths provide tangible benefits in the surety and credit markets, as well as intangible benefits in our relationships with customers, employees, suppliers and subcontractors.

Experienced Management Team and Skilled Workforce. Our management team and employees are critical to our success. Our chief executive officer and our president each has over 30 years of industry experience, and our 12 senior project managers have over 20 years of experience on average, in the infrastructure construction market. We benefit from their expertise, relationships with customers, suppliers and subcontractors, and the cohesive corporate culture that they have promoted and developed. We expend significant resources to attract, retain and train our employees, which is a key to the successful execution of our contracts. We conduct our construction business using full-time employees organized into more than 80 fully-equipped crews. We conduct extensive safety training programs, which have allowed us to maintain a high safety level at our worksites.

Business Strategy

We pursue the following strategies in order to improve our business and prospects, increase our revenue and profitability and, ultimately, enhance stockholder value:

Continue to Grow in Texas Markets. The Texas markets in which we operate, including Houston, San Antonio, Dallas/ Fort Worth and Austin, generally are experiencing strong growth in infrastructure spending caused by factors such as an increasing population, increased federally-funded highway construction, a robust oil and gas economy, the need for new water sources, flood and subsidence control activities, and the installation of light rail public transit systems. We will continue our efforts to increase our market share in our core markets. Our strategy is to accomplish this by relying on our knowledge of local construction conditions coupled with our continued focus on infrastructure construction, by expanding and upgrading our equipment fleet, by adding construction crews, and by extending our range of construction capabilities.

Position Our Business for Future Infrastructure Spending. There is a growing awareness of the need to build, reconstruct and repair our country s infrastructure, including water, wastewater and flood control systems and transportation systems. Significant funds have recently been authorized for investments in these areas, including the SAFETEA-LU bill, which authorized $286 billion toward transportation infrastructure (with approximately $14.5 billion allocated to Texas for federal fiscal years 2005 through 2009). In addition, the Harris-Galveston Subsidence District has mandated that substantially all well water systems in Houston be replaced with surface water systems, and we anticipate that there will be efforts in Texas and other Gulf Coast areas affected by recent hurricanes to enhance storm drainage systems. We will continue to build on our expertise in the civil construction market for transportation and water infrastructure, to develop new capabilities to service these markets and to maintain our human and capital resources to effectively meet required demand.

Continue Adding Construction Capabilities. By adding capabilities that are complementary to 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. We continue to investigate opportunities to integrate additional services (such as drill shaft installation) and precast concrete products (such as beams and wall panels) into our business.

Expand into Attractive New Markets. We have demonstrated an ability to identify and expand into new markets where we have been able to operate profitably and grow. Our first expansion beyond Houston was in the Dallas/ Fort Worth market in 1995. In 2001, after obtaining an asphalt paving contract in San Antonio, we decided to establish a permanent presence in that market. Having recently been awarded a significant contract in the Austin area, we are now examining the potential for establishing a permanent office in Austin. We actively consider opportunities, and evaluate whether to establish a permanent presence, in new geographic areas based on factors such as market size and growth dynamics, competition, the availability of qualified employees and compatibility of unique local requirements with our own

expertise. We currently believe that there are a number of attractive markets throughout Texas and in the Gulf Coast and Southwestern regions of the United States that present expansion opportunities for us.

Selectively Pursue Strategic Acquisitions. Our growth has been achieved both organically and through our acquisition of the Kinsel construction business in 2002. We have been, and expect to continue, exploring acquisition opportunities that appear consistent with our return-on-investment goals and strategic objectives. In particular, we seek companies operated by talented management teams in growth markets and with a focus on infrastructure construction services. Ideal candidates would provide us with the ability to add additional construction services to our existing capabilities, as well as opportunities to provide an expanded service profile to the target s existing customer base. With our strong financial position and publicly traded common stock, we believe that we are an attractive acquiror for heavy civil construction firms whose owners desire to achieve liquidity.

Development of Employees. We believe that our employees are a key to the successful implementation of our business strategies. We plan to continue allocating significant resources in order to attract and retain talented managers and supervisory and field personnel.

Markets and Customers

For decades, we have concentrated our operations in Texas. Our headquarters is in Houston, and we serve the top markets in Texas, including Houston, San Antonio, Dallas/ Fort Worth and Austin.

Although we occasionally undertake contracts for private customers, the vast majority of our contracts are for public sector customers, including TXDOT, county and municipal public works departments, the Metropolitan Transit Authority of Harris County, Texas, or Metro, regional transit authorities, port authorities, school districts and municipal utility districts.

Our largest revenue customer is TXDOT. In 2004, contracts with TXDOT represented 35% of our revenues, and other public sector revenue generated in Texas represented 61% of our revenues. As a result of the SAFETEA-LU bill, the total amount of our revenues (and the related percentage of consolidated revenues) obtained from state agencies may increase. We provide services to our state customers exclusively pursuant to contracts awarded through competitive bidding processes.

Our municipal customers in 2004 included the City of Houston (14% of 2004 revenues) and Harris County, Texas (10% of 2004 revenues). We recently 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 and annexation of surrounding 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 we have approximately 150 competitors in the 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 us 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 markets and one of the largest contractors in Houston engaged in municipal civil construction work. 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 contract 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 that 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 market, 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 much more vertically-integrated, or they specialize in certain types of projects such as construction over water. However, such competitors 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. For the nine months ended September 30, 2005, state highway work accounted for 35% of our consolidated revenues, compared with 33% in 2004 and 19% in 2003.

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, 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 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.

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 Contracts 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 revenues 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 a negotiated change order, frequently due to a difference in site conditions from those anticipated when the bid is placed. Typically, one change order is issued upon completion of a contract to account for all of the quantity deviations from the original contract that were made during the construction process. 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 contract 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, 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 a contract s original bid. 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 contract 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.

The estimating process typically involves three phases. Initially, we spend up to approximately 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. After this initial review, we decide whether or not to continue to pursue the contract; if so, we then move to the second phase, which may take up to two weeks and consists of estimating 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 300 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 and risk. After the final review of the cost estimate, management adds an amount for profit to arrive at the total bid amount. 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 contract backlog. Our project managers are intimately involved throughout the estimating and construction process so that contract issues, and risks relating thereto, can be understood and addressed on a timely basis.

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. In either case, bidders must post a bid bond for generally 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.

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 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 such 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.

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 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. We 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 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 claims subject to stop-loss insurance coverage.

As a normal part of the construction business, we generally are 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 contract backlog that we have currently bonded and their current underwriting standards, which may change from time to time. Having recently outgrown the bonding limits of our prior bonding company, we have been approved by a new bonding company, Travelers, for our future construction contracts. As is customary, we have agreed to indemnify Travelers for all losses incurred by it in connection with bonds that are issued, and we have granted Travelers a security interest in certain personal property as collateral for such obligation.

Employees

As of November 30, 2005, we had approximately 815 employees, including 12 project managers and 32 superintendents who manage over 80 fully-equipped crews in our construction business. Of such employees, 29 were located in our Houston headquarters, with most of the others being field personnel. None of our construction business employees is represented by a labor union.

Our business is dependent upon a readily available supply of management, supervisory and field personnel. Substantially all of our employees are a permanent part of our workforce, and we generally do not rely on temporary employees to complete our contracts. In the past, we have been able to attract sufficient numbers of personnel to support the growth of our operations. Although we do not anticipate any shortage of labor in the near term, we may not be able to continue to attract sufficient numbers of new employees at all levels to support our future growth.

We conduct extensive safety training programs, which has 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.

Properties

For our construction business, we own a 15,000 square-foot headquarters office building in Houston, Texas, which is located on a seven-acre parcel of land on which our equipment repair center is also located. We also lease small offices in Fort Worth and San Antonio. In order to complete most contracts, we lease small parcels of real estate near the site of a contract to store materials, locate equipment and provide offices for the contracting customer, their representatives and our employees.

Government and Environmental Regulations

Our operations are subject to compliance with numerous regulatory requirements of federal, state and local agencies and authorities, including regulations concerning safety, wage and hour, and other labor issues, immigration controls, vehicle and equipment operations and other aspects of our business. For example, our construction operations are subject to the requirements of the Occupational Safety and Health Act, or OSHA, and comparable state laws directed toward the protection of employees. In addition, most of our construction contracts are entered into with public authorities, and these contracts frequently impose additional governmental requirements, including requirements regarding labor relations and subcontracting with designated classes of disadvantaged businesses.

All of our operations are also subject to federal, state and local laws and regulations relating to the environment, including those relating to discharges into air, water and land, the handling and disposal of solid and hazardous waste, the handling of underground storage tanks and the cleanup of properties affected by hazardous substances. For example, we must apply water or chemicals to reduce dust on road construction projects and to contain contaminants in storm run-off water at construction sites. In certain circumstances, we may also be required to hire subcontractors to dispose of hazardous wastes encountered on a project in accordance with a plan approved in advance by the customer. Certain environmental laws impose substantial penalties for non-compliance and others, such as the federal Comprehensive Environmental Response, Compensation and Liability Act, or CERCLA, impose strict, retroactive, joint and several liability upon persons responsible for releases of hazardous substances.

CERCLA and comparable state laws impose liability, without regard to fault or the legality of the original conduct, on certain classes of persons that contributed to the release of a hazardous substance into the environment. These persons include the owner or operator of the site where the release occurred and companies that disposed or arranged for the disposal of the hazardous substances found at the site. Under CERCLA, these persons may be subject to joint and several liability for the costs of cleaning up the hazardous substances that have been released into the environment, for damages to natural resources and for the costs of certain health studies. CERCLA also authorizes the federal Environmental Protection Agency, or EPA, and, in some instances, third parties, to act in response to threats to the public health or the environment and to seek to recover from the responsible classes of persons the costs they incur.

Solid wastes, which may include hazardous wastes, are subject to the requirements of the Federal Solid Waste Disposal Act, the federal Resource Conservation and Recovery Act, referred to as RCRA, and comparable state statutes. Although we do not generate solid waste, we occasionally dispose of solid waste on behalf of customers, at their risk. From time to time, the EPA considers the adoption of stricter disposal standards for non-hazardous wastes. Moreover, it is possible that additional wastes will in the future be designated as hazardous wastes. Hazardous wastes are subject to more rigorous and costly disposal requirements than are non-hazardous wastes.

Legal Proceedings

We are, and may in the future be involved as, a party to various legal proceedings, which 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.

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MANAGEMENT

Directors and Executive Officers

The following table sets forth the names and ages of each of our current directors and executive officers and the positions they held as of January 19, 2006:

Name	Position	Age
Patrick T. Manning	Chairman of the Board of Directors & Chief Executive Officer	59
Joseph P. Harper, Sr.	President & Chief Operating Officer and a Director	60
Maarten D. Hemsley	Chief Financial Officer and a Director	56
Roger M. Barzun	Vice President, Secretary and General Counsel	64
David R. A. Steadman	Director	68
John D. Abernathy	Director	68
Robert W. Frickel	Director	62
Milton L. Scott	Director	49
Christopher H. B. Mills	Director	53

Patrick T. Manning. Mr. Manning joined 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 our Chairman of the Board of Directors and Chief Executive Officer 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. In addition to his financial responsibilities, Mr. Harper has performed both estimating and project management functions. Mr. Harper has been a director and our President and Chief Operating Officer since July 2001. Mr. Harper is a certified public accountant.

Maarten D. Hemsley. Mr. Hemsley has been our employee in various capacities and/or a director since 1988. Mr. Hemsley served as our President, Chief Operating Officer and Chief Financial Officer until July 2001, and currently serves as our Chief Financial Officer. Since January 2001, Mr. Hemsley has also been a consultant to (and since May 2002 an employee of) JO Hambro Capital Management Group Limited, an investment management company based in the United Kingdom serving as Fund Manager of Leisure & Media Venture Capital Trust, plc, and since February 2005, as a principal of its Trident Private Equity II investment fund. Mr. Hemsley is a director of Tech/Ops Sevcon, Inc., a public company that manufactures electronic controls for electric vehicles, and of a number of privately-held companies in the United Kingdom. Mr. Hemsley is a U.K. Chartered Accountant.

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

David R. A. Steadman. Mr. Steadman is President of Atlantic Management Associates, Inc., a management services and investment group. An engineer by profession, he 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 Chairman of VISaer, Inc., a provider of software used in the maintenance, repair and overhaul of aircraft; as Chairman of Brookwood

Companies Incorporated, a major textile converter, dyer and finisher; and as a director of Mathsoft Engineering and Education, Inc., a provider of calculation management software solutions, all privately held companies. Mr. Steadman also serves on the board of directors of two public companies, Aavid Thermal Technologies, Inc., a provider of thermal management solutions for the electronics industry, and as Chairman of Tech/ Ops Sevcon, Inc. Mr. Steadman is a Visiting Lecturer in Business Administration at the Darden School of the University of Virginia.

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. From March 1991 to February 1994, he was the Managing Director of Summit, Solomon & Feldesman, a New York City law firm, and from July 1983 until June 1990, Mr. Abernathy was Chairman and Chief Executive Partner of BDO Seidman, a public accounting firm. He is also a director of Par Pharmaceutical Companies, Inc., a generic drug manufacturer. Mr. Abernathy is a certified public accountant.

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 the construction industry. Prior to the founding of the R.W. Frickel Company in 1974, he was employed by Ernst & Ernst. Mr. Frickel is a certified public accountant.

Milton L. Scott. Mr. Scott is a co-founder and Managing Director of Complete Energy Holdings, LLC, a company formed 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, a NYSE listed company that is in the oilfield services industry.

Christopher H. B. Mills. Mr. Mills is a director of JO Hambro Capital Management Group Ltd., or 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 NASCIT, a 10.7% stockholder of our common stock, and of American Opportunity Trust plc. Mr. Mills also serves as a director of Nationwide Accident Repair Services, PLC, a U.K. public company that repairs motor vehicles, Izodia PLC, a U.K. public company that is an e-commerce software publisher, and Lesco, Inc., a U.S. public company that manufactures and sells fertilizer and lawn products.

In December 2005, the independent members of our board of directors appointed Mr. Abernathy as Lead Director. Our board of directors held twelve meetings during our fiscal year ended December 31, 2005. Mr. Mills did not attend four of the meetings of our board of directors and one of the meetings of the audit committee, on which he served until May 2005. Each of the other directors attended more than 75% of the meetings of the board of directors while he was a director, as well as all meetings of committees of the board of directors on which he served.

Committees of the Board of Directors

The standing committees of our board of directors consist of an audit committee, a compensation committee and a corporate governance and nominating committee.

Audit Committee

The audit committee consists of Messrs. Abernathy (Chairman), Scott and Steadman, each of whom is an independent director under the standards of the SEC, Nasdaq and AMEX. Prior to his resignation on December 23, 2005, Mr. Robert Davies was a member of the audit committee and was also independent. Our board of directors has determined that Mr. Abernathy is the audit committee financial expert.

The audit committee assists our board of directors in fulfilling its responsibility to oversee our accounting and financial reporting processes and the audits of our financial statements. In particular, the audit committee has the responsibility to:

- review our financial reports and other financial information, our internal accounting and financial controls, our controls and procedures relating to public disclosure of information, and the audit of our financial statements by our independent auditors;
- appoint our independent auditors, approve their compensation, supervise their work, oversee their independence and evaluate their qualifications and performance;
- review with management and the independent auditors our audited and interim financial statements that are included in filings with the SEC;
- review the quality of our accounting policies;
- review with management our major financial risk exposures;
- review all proposed related party transactions in which the amount involved exceeds $50,000, which are subject to the prior written approval of the committee; and
- provide for the confidential, anonymous submission by our employees of concerns regarding questionable accounting or auditing matters.

The audit committee, which meets at least quarterly, held five meetings during the fiscal year ended December 31, 2005. Our board of directors adopted an audit committee charter on February 12, 2004, which, as amended, is posted on our website at www.sterlingconstructionco.com.

Compensation Committee

Our compensation committee consists of Messrs. Frickel (Chairman) and Abernathy, each of whom is an independent director under the standards of the SEC, Nasdaq and AMEX. Prior to his resignation, Mr. Davies was a member of the compensation committee and was also independent. Our compensation committee oversees our senior level compensation arrangements. In particular, the compensation committee has the responsibility to:

- review and approve any corporate goals and objectives relating to the chief executive officer s compensation;
- evaluate the chief executive officer s performance in light of those corporate goals and objectives;
- either as a committee or together with the other independent directors (as directed by our board of directors), to determine and approve the compensation of our chief executive officer and our other senior officers, and together with the boards of directors of our subsidiaries, to determine and approve the compensation of their senior officers;
- either as a committee or together with the other independent directors (as directed by our board of directors), to review and approve any employment agreements, severance arrangements, change-in-control arrangements or special or supplemental employee benefits, and any material amendments to the foregoing, that are applicable to our senior officers and, together with the boards of directors of our subsidiaries, that are applicable to their senior officers;

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either as a committee or together with the other independent directors (as directed by our board of directors), to administer our stock plans and make grants of stock options and other awards as provided in those plans;

make recommendations to our board of directors regarding incentive compensation plans and equity-based plans for our other senior officers and those of our subsidiaries;

advise the corporate governance and nominating committee on the compensation of directors, including the chairman of the board and the chairpersons of the committees of our board of directors; and

provide the report of the compensation committee on executive compensation for inclusion in our annual proxy statement pursuant to the rules and regulations of the SEC.

The compensation committee held two meetings during the fiscal year ended December 31, 2005. Our board of directors adopted a compensation committee charter on November 2, 2005, which is posted on our website at www.sterlingconstructionco.com.

Corporate Governance and Nominating Committee

In August 2005, our board of directors formed a corporate governance and nominating committee, which consists of Messrs. Steadman (Chairman) and Abernathy, each of whom is an independent director under the standards of the SEC, Nasdaq and AMEX. Prior to his resignation, Mr. Davies was also a member of our corporate governance and nominating committee and was also independent. Our corporate governance and nominating committee assists our board of directors in fulfilling its responsibility with respect to corporate governance. In particular, the corporate governance and nominating committee has the responsibility to:

develop and recommend to our board of directors appropriate corporate governance principles and rules;

recommend appropriate policies and procedures to ensure the effective functioning of our board of directors;

identify and nominate qualified candidates for election to our board of directors and its committees;

recommend directors for membership on our committees;

develop and make recommendations to our board of directors regarding standards and processes for determining the independence of our board of directors under applicable laws, rules and regulations;

develop and oversee the operation of an orientation program for new directors and determine whether and what form and level of continuing education for directors is appropriate;

periodically review our code of ethics and insider trading policy to ensure that they remain responsive both to legal requirements and to the nature and size of our business; and

set the remuneration for non-employee directors, committee members and committee chairpersons.

The corporate governance and nominating committee held one meeting during the fiscal year ended December 31, 2005. Our board of directors adopted a corporate governance and nominating committee charter on November 2, 2005, which is posted on our website at www.sterlingconstructionco.com.

Compensation Committee Interlocks and Insider Participation

In July 2001, Messrs. Abernathy, Frickel and Mills were appointed as the members of our compensation committee. In August 2004, Mr. Mills stepped down as a member of the compensation committee, and Mr. Davies was elected to take his place. Prior to July 2001, Mr. Davies was one of our executive officers, but none of our executive officers served as a director or member of the compensation

committee (or any other committee serving an equivalent function) of any other entity, whose executive officers served as a director or member of our compensation committee.

Our board of directors intends that any transactions with officers, directors and affiliates will be entered into on terms no less favorable to us than could be obtained from unrelated third parties and that they will be approved by a majority of the board of directors who are independent and disinterested with respect to the proposed transaction. Our audit committee reviews in advance all related party transactions in excess of $50,000.

See relationship involving Mr. Frickel disclosed under Certain Transactions Other Transactions.

Director Compensation

For fiscal 2005, non-employee directors received meeting fees and the committee chairmen received an additional fee, as set forth below. In August 2005, our board of directors formed a corporate governance and nominating committee and approved the payment of the same fees to the members and chairman of that committee as are paid to the members and chairman of the compensation committee. Current board of directors and committee fee arrangements are summarized in the table below:

Annual Fees:	
All Directors	$7,500
All Directors (at each annual meeting of stockholders)	A ten-year option to purchase 5,000 shares of our common stock, granted at the market price on the date of grant and vesting in full on the date of grant.
Additional Annual Fees:	
Chairman of the Audit Committee	$7,500
Chairman of the Compensation Committee	$2,500
Chairman of the Corporate Governance and Nominating Committee	$2,500
Meeting Fees:	
Regularly scheduled in-person Board meeting	$1,250
Regularly scheduled telephonic Board meeting	$1,000
Other telephonic Board meeting	$500
Committee meetings (including the chairman)	$750

Our directors do not receive additional compensation for serving on the board of directors of any of our subsidiaries. In addition, all directors are reimbursed for their reasonable out-of-pocket expenses incurred in attending meetings of our board and board committees. Directors living outside North America (currently only Mr. Mills) have the option of attending regularly scheduled in-person meetings by telephone, and those who elect to do so are paid an attendance fee as if they had attended in person.

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Executive Compensation

The following table sets forth all compensation earned during the 2005, 2004 and 2003 fiscal years by the chief executive officer and other executive officers of Sterling Construction Company, Inc., or SCC, who were serving at the end of the 2005 fiscal year and whose total annual salary and bonus earned in fiscal 2005 exceeded $100,000.

		Annual Compensation			Long-Term Compensation	
Name and Principal Position	Fiscal Year	Salary	Bonus	Other Annual Compensation	Securities Underlying Options/SARs	All Other (5)
Patrick T. Manning(1)	2005	$ 240,000	$ 365,000(2)	$ 28,200	11,500	$ 2,215
Chairman of the Board & Chief Executive	2004	$ 225,496	$ 179,873	$ 12,850	13,500	
Officer	2003	$ 200,000	$ 300,000	$ 12,850	3,500	
Joseph P. Harper, Sr.(3)	2005	$ 215,000	$ 340,000(2)	$ 30,850	11,500	$ 6,450
President & Chief	2004	$ 196,718	$ 173,776	$ 12,850	13,500	$ 5,919
Operating Officer	2003	$ 187,308	$ 300,000	$ 12,850	3,500	$ 5,205
Maarten D. Hemsley(4)	2005	$ 108,067	$ 50,000(2)	$ 7,660	2,800	$ 3,242
Chief Financial Officer	2004	$ 88,269		$ 4,500	5,000	$ 2,550
	2003	$ 88,651		$ 4,500		

(1) We entered into a three-year employment agreement with Mr. Manning, effective July 18, 2004, as amended, under which he is paid an annual base salary of $240,000. Other annual compensation in 2005 consists of country club fees and monthly dues and a $700 per month car allowance.

(2) The actual bonus amounts awarded for 2005 will be based on the terms of the respective named executive officer s employment agreement with us and our financial performance, which has not yet been determined. The amount listed herein is an estimate based on our expected results of operations, as described in Guidance.

(3) We entered into a three-year employment agreement with Mr. Harper, effective July 18, 2004, as amended, under which he is paid an annual base salary of $215,000. Other annual compensation in 2005 consists of country club monthly dues, a $700 per month car allowance and $18,000 for unused vacation time in 2005.

(4) We entered into a two-year employment agreement with Mr. Hemsley, effective July 18, 2005, under which he is paid an annual base salary of $135,000. Other annual compensation in 2005 consists of the payment by SCC of Mr. Hemsley s annual long-term disability insurance premium and life insurance premium.

(5) All other compensation includes employer contributions under our 401(k) plan.

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Stock Option Grants in the Last Fiscal Year

During fiscal 2005, options to acquire our common stock were granted by our board of directors to the individuals named above in the summary compensation table pursuant to our 2001 Stock Incentive Plan, as follows:

	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
Name	Number of Securities Underlying Options Granted (#)	% of Total Options Granted to Employees in Fiscal 2004	Exercise Price ($/Share)	Expiration Date	5%	10%
Patrick T. Manning	10,000	8.5%	$ 9.69	July 18, 2010	$ 26,772	$ 59,158
	1,500	1.3%	$ 16.78	September 12, 2010	$ 7,087	$ 15,696
Joseph P. Harper, Sr.	10,000	8.5%	$ 9.69	July 18, 2010	$ 26,772	$ 59,158
	1,500	1.3%	$ 16.78	September 12, 2010	$ 7,087	$ 15,696
Maarten D. Hemsley	2,800	2.3%	$ 9.69	July 18, 2010	$ 7,496	$ 16,564

Options to acquire 117,600 shares of our common stock were granted to our employees during fiscal 2005. The options to acquire 10,000 shares of our common stock granted to Messrs. Manning and Harper, and the option to acquire 2,800 shares of our common stock granted to Mr. Hemsley, vest in full on July 18, 2007. The options to acquire 1,500 shares of our common stock granted to Messrs. Manning and Harper vest in five equal installments on the first five anniversaries of the date of grant. Vesting of all of the options granted to Messrs. Manning, Harper and Hemsley is accelerated in the event of a change in control of our company, as defined in our 2001 Stock Incentive Plan.

Aggregate Option Exercises in the Last Fiscal Year and Fiscal Year-End Option Values

During fiscal 2005, there were no option exercises by any of the individuals named above in the executive compensation table.

The following table sets forth certain information based upon the fair market value per share of our common stock at December 30, 2005 ($16.83), with respect to stock options held on that date by each of the individuals named above in the summary compensation table. The value of unexercised in-the-money options is the difference between the market value of our common stock subject to the options at December 30, 2005 and the exercise price of the option shares.

	Number of Securities Underlying Unexercised	Value of Unexercised

Name	Options at December 30, 2005		In-the-Money Options at December 30, 2005	
	Exercisable	Unexercisable	Exercisable	Unexercisable
Patrick T. Manning	7,160	28,540	$ 106,000	$ 308,648
Joseph P. Harper, Sr.	10,701	24,999	$ 157,774	$ 256,875
Maarten D. Hemsley	438,924	5,300	$ 6,751,800	$ 54,317

Employment Contracts; Termination of Employment; and Change-in-Control Arrangements

Mr. Patrick T. Manning. Mr. Manning serves as our Chairman of the Board and Chief Executive Officer and President and Chief Executive Officer of Sterling General, Inc., or SGI, the general partner of TSC under an employment agreement dated July 18, 2004, as amended on November 2, 2005. The term of Mr. Manning s employment under the agreement continues until July 18, 2007, followed by additional one-year terms if we give at least 90 days notice to extend the agreement prior to the end of the term and if Mr. Manning has not already given 180 days notice of his intention to resign. Failure to extend the original three-year term of the agreement and any one-year extended term gives Mr. Manning good reason to terminate his employment agreement (as discussed below).

The agreement provides for the payment to Mr. Manning of a base annual salary of $240,000. Mr. Manning is also entitled to an annual bonus of $125,000 for any fiscal year during which TSC, on a consolidated basis, achieves 75% or more of its budgeted EBITDA. Annual budgets are subject to the approval of the boards of directors of both TSC and SCC. An additional incentive bonus of up to a maximum of 100% of his base annual salary is payable to Mr. Manning based on the extent by which (if at all) TSC s consolidated EBITDA for a given year exceeds budgeted EBITDA, provided that the excess is at least 10%. The additional incentive bonus, however, is subject to a cap that has the effect of limiting, on a pro rata basis, the additional incentive bonuses payable to certain executive officers of SGI (including Mr. Manning) to 30% of the amount of the excess EBITDA. As listed above in the summary compensation table, Mr. Manning earned total bonuses of $300,000 in 2003 and $179,873 in 2004, which were paid in 2004 and 2005, respectively. As of the effective date of the employment agreement and on its first two anniversaries, we are obligated to grant Mr. Manning an employee stock option to purchase 10,000 shares of our common stock at an exercise price equal to the fair market value of a share of common stock on the date of the grant. Each option expires five years from its date of grant and vests in full on July 18, 2007, the end of the three-year term of the employment agreement. Mr. Manning is also entitled to a car allowance, paid vacation time and participation in our health, bonus and other fringe benefit plans.

If Mr. Manning terminates his employment for good reason (as defined in the agreement), we must continue to pay his annual base salary for the balance of the term of the agreement, but in any event for 12 months. If we terminate Mr. Manning s employment without good cause (as defined in the agreement), we must continue to pay him his annual base salary until the earlier of the balance of the term of the agreement (including any extensions thereof) or until he ceases to be subject to the non-competition and non-solicitation obligation described below. If Mr. Manning terminates his employment without good reason, if we terminate his employment for good cause, or in the event of his death or permanent disability, we are only required to pay him his base annual salary and any vested benefits through the date of termination. The options granted to Mr. Manning under the employment agreement will continue in effect until they expire or are exercised notwithstanding his termination of employment, unless we terminate Mr. Manning s employment for good cause, in which case the options will terminate on the date that Mr. Manning s employment terminates.

Mr. Manning is also subject to non-competition and non-solicitation provisions for a period of one or two years after termination of employment depending on the reason for the termination, along with ongoing confidentiality requirements. If the termination of Mr. Manning s employment is by us without good cause or by Mr. Manning for good reason, our payment obligations described below and the non-competition and non-solicitation obligations continue for one year. If the termination of his employment is by us for good cause or by Mr. Manning without good reason, our payment obligations and the non-compete and non-solicitation obligations continue for two years. The agreement provides for a payment to Mr. Manning after his employment terminates of $1,000 per month in exchange for his obligation not to compete with SCC or TSC and not to solicit their customers, clients or employees during the applicable period. In the event Mr. Manning s employment is terminated by us without good cause, Mr. Manning may elect to forego the monthly payments and be free of any non-compete and non-solicitation obligations. In the event Mr. Manning terminates the agreement because of a change in control (as defined in the agreement), SCC is under no obligation to make the payments, and Mr. Manning is not subject to the non-competition or non-solicitation obligation. By their terms, the vesting of all of Mr. Manning s stock options is accelerated in the event of a change in control of our company.

Mr. Joseph P. Harper, Sr. Mr. Harper is our President and Chief Operating Officer and Treasurer of SGI under a three-year employment agreement identical to Mr. Manning s except that his base annual salary is $215,000 and he is entitled to take 18 weeks of vacation with the right to extend or reduce that vacation time by foregoing or receiving additional annual base salary at the rate of $4,000 per week. By their terms, the vesting of all of Mr. Harper s stock options is accelerated in the event of a change in control of our company.

Mr. Maarten D. Hemsley. Mr. Hemsley is our Chief Financial Officer under a two-year employment agreement that is substantially similar to Mr. Manning s, except that his base annual salary is $135,000, his maximum regular bonus is $50,000, any additional bonus is in the discretion of the compensation committee and is limited to a maximum of $75,000 and his annual stock option grant is 2,800 shares of our common stock. The agreement provides for long-term disability coverage and a minimum of $100,000 of term life insurance coverage. Unlike the employment agreements of Messrs. Manning and Harper, if Mr. Hemsley terminates his employment within 30 days after a change in control (as defined in the agreement), Mr. Hemsley is entitled to accelerated vesting of all his stock options and the payment of any bonus that is earned but has not been paid on the date of termination.

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PRINCIPAL AND SELLING STOCKHOLDERS

The following table sets forth information regarding the beneficial ownership of our common stock and the shares beneficially owned by the selling stockholders as of December 30, 2005, for:

- each person known by us to beneficially own more than 5% of our outstanding common stock;
- each executive officer named above in the summary compensation table;
- each of our directors;
- all of our executive officers and directors as a group; and
- the selling stockholders.

Beneficial ownership is determined in accordance with the rules of the SEC and includes voting and investment power with respect to securities. Except as indicated by footnote, and subject to applicable community property laws, the persons named in the table below have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them, and their address is 20810 Fernbush Lane, Houston, Texas 77073. The percentage of beneficial ownership before the offering is based on 8,165,123 shares of common stock outstanding as of December 30, 2005. The percentage of beneficial ownership after the offering is based on 10,490,144 shares of common stock outstanding, including the shares of common stock to be sold by us and the selling stockholders in this offering. Such number, and the post-offering ownership percentages in the table below, take into account the exercise of the underwriters overallotment option.

	Shares Beneficially Owned Prior to this Offering			Shares Beneficially Owned After this Offering	
Name of Beneficial Owner	**Number**	**Percent**	**Number of Shares Offered**	**Number**	**Percent**
John D. Abernathy	104,162(1)	1.3%		104,162	1.0%
Robert W. Frickel	79,000(2)	1.0%		79,000	*
Joseph P. Harper, Sr.	811,642(3)	9.8%		811,642	7.6%
Maarten D. Hemsley	519,812(4)	6.0%		519,812	4.8%
Patrick T. Manning	236,380(5)	2.9%		236,380	2.2%
Christopher H. B. Mills	887,000(6)	10.9%		887,000	8.4%
Milton L. Scott					
David R. A. Steadman	19,000(7)	*		19,000	*
North Atlantic Smaller Companies Investment Trust plc c/o North Atlantic Value LLP** Ryder Court 14 Ryder Street London SW1Y 6QB, England	870,000(8)	10.7%		870,000	8.3%
J O Hambro Capital Management Group, Limited	870,000(8)	10.7%		870,000	8.3%

Ryder Court 14 Ryder Street London SW1Y 6QB, England				
J O Hambro Capital Management Limited				
Ryder Court 14 Ryder Street London SW1Y 6QB, England	870,000(8)	10.7%	870,000	8.3%

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Name of Beneficial Owner	Shares Beneficially Owned Prior to this Offering		Number of Shares Offered	Shares Beneficially Owned After this Offering	
	Number	Percent		Number	Percent
Growth Financial Services Limited					
c/o North Atlantic Value LLP** Ryder Court 14 Ryder Street London SW1Y 6QB, England	870,000(8)	10.7%		870,000	8.3%
Robert M. Davies					
c/o Cahill Gordon & Reindel LLP					
80 Pine Street New York, New York 10005 Attention: John Schuster	180,492(9)	2.2%	180,492		
KTI, Inc.					
c/o Casella Waste Systems, Inc. 25 Greens Hill Lane Rutland, Vermont 05701	100,000(10)	1.2%	100,000		
Linda Manning					
14 Highland Green The Woodlands, Texas 77381	303,445(10)	3.7%	41,266	262,179	2.5%
All directors and executive officers as a group (9 persons)	2,700,156(11)	30.2%		2,700,156	24.0%

* Represents beneficial ownership of less than one percent (1%)

** Successor to J O Hambro Capital Management Limited

(1) This number includes 98,166 shares that are issuable under outstanding stock options within 60 days of December 30, 2005 at prices ranging from $0.75 to $6.87 per share.

(2) This number includes 17,000 shares issuable under outstanding stock options that are exercisable within 60 days of December 30, 2005 at prices ranging from $1.50 to $6.87 per share.

(3) This number includes 10,701 shares issuable under outstanding stock options that are exercisable within 60 days of December 30, 2005 at prices ranging from $1.50 to $16.78 per share and 127,574 shares issuable under a warrant that is presently exercisable at $1.50 per share.

(4) This number includes 438,924 shares issuable under outstanding stock options that are exercisable within 60 days of December 30, 2005 at prices ranging from $0.50 to $9.69 per share.

(5) This number includes 7,160 shares issuable under outstanding stock options that are exercisable within 60 days of December 30, 2005 at prices ranging from $1.50 to $16.78 per share and 22,220 shares issuable under a warrant that is presently exercisable at $1.50 per share.

(6) This number includes the 870,000 shares that are described in note 10 and 17,000 shares issuable under outstanding stock options that are exercisable within 60 days of December 30, 2005 at prices ranging from $1.50 to $6.87 per share.

(7) This number includes 5,000 shares issuable under outstanding stock options that are exercisable within 60 days of December 30, 2005 at $6.87 per share.

(8) J O Hambro Capital Management Group Limited, JOHCMG, Christopher H. B. Mills, Growth Financial Services Limited and NASCIT claim shared voting power of these shares pursuant to Amendment No. 1 to a Schedule 13G filed with the SEC on February 14, 2002.

(9) These shares are issuable under outstanding stock options that are exercisable within 60 days of December 30, 2005 at prices ranging from $0.875 to $6.87 per share.

(10) This number includes 41,266 shares issuable under an outstanding warrant that is exercisable within 60 days of December 30, 2005 at a price of $1.50 per share.

(11) This number includes 614,951 shares issuable under outstanding stock options that are exercisable within 60 days of December 30, 2005 at prices ranging from $0.50 to $16.78 per share and 149,794 shares issuable under warrants that are presently exercisable at $1.50 per share.

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CERTAIN TRANSACTIONS

The descriptions set forth below are qualified in their entirety by reference to the applicable agreements, copies of which are filed as exhibits to the registration statement, of which this prospectus forms a part.

Sterling Acquisition

Certain members of our management team have assisted us in expanding our capital base by providing different types of financing over the last seven years. In October 1999, we increased our consolidated equity ownership of TSC from 7% to 12% and subsequently increased our ownership to 80.1% in July 2001 and to 100% in December 2004. These acquisition transactions were financed in part through loans made by certain members of management to us.

In connection with the increase of our purchase of equity in TSC in 1999, Mr. James D. Manning (a founder of TSC and brother of Patrick T. Manning, our Chairman and Chief Executive Officer) and Mr. Hemsley (our Chief Financial Officer and a director) loaned $800,000 and $116,000, respectively, to us. These promissory notes accrued interest at the rate of 14% payable quarterly and had a maturity date of October 2000. In July 2001, we:

- refinanced the note issued to Mr. Hemsley by adding the amount of accrued and unpaid interest and reducing the interest rate to 12% per annum and extending the maturity date to July 2005;
- refinanced the note issued to James D. Manning by reducing the interest rate to 12% per annum and extending the maturity date to July 2005;
- issued a new $187,000 zero coupon promissory note to James D. Manning with an interest rate of 12% per annum, in consideration for his agreeing to amend the original note;
- issued an additional note to Mr. Hemsley ($136,421) with an interest rate of 12% per annum, in connection with a business combination; and
- issued warrants to purchase shares of our common stock, including warrants to Messrs. James D. Manning, Patrick T. Manning, Joseph P. Harper Sr. and Joseph Harper, Jr. (son of Joseph P. Harper, Sr.) for the acquisition of 111,407, 63,486, 127,574 and 13,119 shares of our common stock, respectively.

James D. Manning subsequently sold $370,000 of his notes to Mr. Harper (our President and Chief Operating Officer) and $123,000 of his notes to an officer of Sterling General, Inc., one of our subsidiaries. As a result of these transactions, Messrs. James D. Manning, Hemsley and Joseph P. Harper, Sr., held notes in the principal amounts of $493,500, $280,574 and $370,125, respectively. Thereafter, all of the notes were amended to provide for a maturity date coterminous with the date that we were required to purchase the remaining interest in TSC from the SHH stockholders who received a right during the 2001 equity purchase to sell (put) their remaining SHH shares to us starting in July 2004. In October 2005, Mr. Patrick T. Manning transferred a warrant to purchase 41,266 shares of common stock to Linda Manning.

In July 2004, the stockholders of SHH exercised their put right to require that we purchase their remaining shares of SHH for consideration consisting of a combination of cash, our common stock and our five-year notes bearing interest at an annual rate of 12%. The exercise of the put right also triggered the acceleration of the maturity of the other notes discussed above, which were satisfied in November and

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December 2004 through a payment of cash and the issuance of the same form of five-year notes. The cash paid and common stock and notes issued as a result of all these transactions were as follows:

Name	Cash	Shares	Five-Year Notes
Patrick T. Manning	$ 460,458	135,474	$ 364,831
James D. Manning	$ 660,649	218,357	$ 2,124,633
Joseph P. Harper, Sr.	$ 1,045,764	345,437	$ 3,020,201
Maarten D. Hemsley	$ 208,397		$ 207,504
Joseph P. Harper, Jr.	$ 102,023	142,339	$ 134,772

Contemplated Transactions

Concurrently with the consummation of this offering, we anticipate that we will prepay in full the approximately $8.4 million outstanding principal amount of, and accrued interest on, our five-year 12% promissory notes described in Management s Discussion and Analysis of Financial Condition and Results of Operations Other Debt. As a result, Messrs. Patrick T. Manning, James D. Manning, Joseph P. Harper, Sr., Hemsley and Joseph Harper, Jr. will receive cash principal payments of $318,592, $1,855,350, $2,637,422, $181,205 and $117,691, respectively.

Steel City Products Financing

In January 2003, certain members of management, including Mr. Harper ($70,000) and Mr. Hemsley ($25,000), loaned an aggregate of $250,000 to Steel City Products for working capital. Under the original terms of the loan, interest at an annual rate of 10% per annum was paid monthly, with a maturity date of July 2003. The maturity date was later extended to December 2003 with the addition of our guarantee of the notes and was extended again through June 2004 with an increase in the interest rate to 12% per annum. These notes were repaid in full in three installments in January and February 2005.

Other Transactions

Since January 2001, Mr. Hemsley has provided consulting services to (and since May 2002 has been an employee of) J O Hambro Capital Management Group Limited, or J O Hambro, as Fund Manager of Leisure & Media Venture Capital Trust plc, and recently of its Trident Private Equity II investment fund, neither of which funds were or are an investor in us or any of our affiliates. J O Hambro held 10.7% of our outstanding capital stock at December 30, 2005.

Mr. Frickel is President of R.W. Frickel Company, P.C., an accounting firm based in Michigan that performs certain accounting and tax services for us. Fees paid or accrued to R.W. Frickel Company for fiscal 2005 were approximately $113,000.

In July 2005, Patrick Manning married Amy Peterson, the sole beneficial owner of Paradigm Outdoor Supply, LLC and Paradigm Outsourcing, Inc., both of which are women-owned business enterprises. The Paradigm companies provide materials and services to us and to other contractors. From July 2005, when Ms. Peterson and Mr. Manning were married, through December 31, 2005, we paid approximately $6.0 million to the Paradigm companies for materials and services. Our audit committee approved all purchases from the Paradigm companies for the period July 2005 through December 31, 2005.

Joseph Harper, Jr., the son of our President and Chief Operating Officer, is employed as the Chief Financial Officer of Sterling General, Inc. and received a salary and bonus in fiscal 2005 of approximately $165,000.

Reference is made to information contained under the headings Management Director Compensation, Management Employment Contracts; Termination of Employment; and Change-in-Control Arrangements and Management Compensation Committee Interlocks and Insider Participation.

DESCRIPTION OF CAPITAL STOCK

Our authorized capital stock consists of 14,000,000 shares of common stock, par value $0.01 per share, and 1,000,000 shares of preferred stock, par value $0.01 per share, the rights and preferences of which may be established from time to time by our board of directors. Upon completion of this offering, there will be 10,186,881 outstanding shares of common stock, 1,121,455 shares reserved for issuance under our employee stock option plans (including outstanding options granted thereunder), 386,073 shares reserved for issuance under outstanding warrants, and no outstanding shares of preferred stock. The following description of our capital stock is only a summary, does not purport to be complete and is subject to and qualified by our restated and amended certificate of incorporation, as amended, and bylaws, which are included as exhibits to the registration statement of which this prospectus forms a part, and by the provisions of applicable Delaware law.

Common