

STERLING CONSTRUCTION CO INC
Form 10-Q
May 12, 2014

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

FORM 10-Q

(Mark one)

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

For the quarterly period ended: March 31, 2014

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___ to ___

Commission file number 1-31993

STERLING CONSTRUCTION COMPANY, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
State or other jurisdiction of incorporation
or organization

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

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

77073
(Zip Code)

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

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

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

Yes No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

At May 7, 2014, there were 18,773,098 shares outstanding of the issuer's common stock, par value \$0.01 per share.

STERLING CONSTRUCTION COMPANY, INC.
QUARTERLY REPORT ON FORM 10-Q
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PART I

Item 1. Financial Statements

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

	March 31, 2014	December 31, 2013
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,287	\$ 1,872
Contracts receivable, including retainage	78,345	77,245
Costs and estimated earnings in excess of billings on uncompleted contracts	18,751	11,684
Inventories	6,030	6,189
Receivables from and equity in construction joint ventures	11,196	6,118
Other current assets	11,485	11,377
Total current assets	127,094	114,485
Property and equipment, net	89,432	93,683
Goodwill	54,820	54,820
Other assets, net	9,475	10,030
Total assets	\$ 280,821	\$ 273,018
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	\$ 62,006	\$ 61,599
Billings in excess of costs and estimated earnings on uncompleted contracts	27,447	31,576
Current maturities of long-term debt	194	134
Income taxes payable	2,036	2,035
Accrued compensation	6,809	5,755
Current obligation for noncontrolling owners' interest in subsidiaries and joint ventures	196	196
Other current liabilities	3,330	4,504
Total current liabilities	102,018	105,799
Long-term liabilities:		
Long-term debt, net of current maturities	21,084	8,331
Member's interest subject to mandatory redemption and undistributed earnings	24,169	23,989
Other long-term liabilities	1,126	2,105
Total long-term liabilities	46,379	34,425
Commitments and contingencies (Note 8)		
Equity:		
Sterling stockholders' equity:		
Preferred stock, par value \$0.01 per share; 1,000,000 shares authorized, none issued	-	-
Common stock, par value \$0.01 per share; 19,000,000 shares authorized, 16,678,104 and 16,657,754 shares issued	167	167
Additional paid in capital	191,160	190,926
Retained deficit	(62,112)	(62,317)
Accumulated other comprehensive income	27	117
Total Sterling common stockholders' equity	129,242	128,893
Noncontrolling interests	3,182	3,901

Total equity	132,424	132,794
Total liabilities and equity	\$ 280,821	\$ 273,018

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

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

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

	Three Months Ended March 31,	
	2014	2013
Revenues	\$ 134,538	\$ 111,035
Cost of revenues	(126,669)	(109,650)
Gross profit	7,869	1,385
General and administrative expenses	(8,484)	(9,611)
Other operating income, net	1,056	343
Operating income (loss)	441	(7,883)
Gain on sale of securities	-	482
Interest income	358	281
Interest expense	(319)	(99)
Income (loss) before income taxes and earnings attributable to noncontrolling owners' interests	480	(7,219)
Income tax benefit	-	2,800
Net income (loss)	480	(4,419)
Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	(275)	(161)
Net income (loss) attributable to Sterling common stockholders	\$ 205	\$ (4,580)
Net earnings (loss) per share attributable to Sterling common stockholders:		
Basic	\$ 0.01	\$ (0.39)
Diluted	\$ 0.01	\$ (0.39)
Weighted average number of common shares outstanding used in computing per share amounts:		
Basic	16,667,939	16,598,255
Diluted	16,855,173	16,598,255

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

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

	Three Months Ended March 31,	
	2014	2013
Net income (loss) attributable to Sterling common stockholders	\$205	\$(4,580)
Net income attributable to noncontrolling owners' interests included in equity	275	186
Net loss attributable to noncontrolling owners' interests included in liabilities	-	(25)
Add /(deduct) other comprehensive income, net of tax:		
Realized gain from sale of available-for-sale securities	-	(307)
Realized gain from settlement of derivatives	(14)	(17)
Change in the effective portion of unrealized gain (loss) in fair market value of derivatives	(76)	45
Comprehensive income (loss)	\$390	\$(4,698)

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

STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2014
(Amounts in thousands)
(Unaudited)

STERLING CONSTRUCTION COMPANY, INC.
STOCKHOLDERS

	Common Stock		Treasury Stock		Addi- tional Paid in Capital	Retained Deficit	Accu- mulated Other Compre- hensive Income	Noncon- trolling Interests	Total
	Shares	Amount	Shares	Amount					
Balance at January 1, 2014	16,658	\$167	-	\$-	\$190,926	\$(62,317)	\$117	\$3,901	\$132,794
Net income	-	-	-	-	-	205	-	275	480
Other comprehensive loss	-	-	-	-	-	-	(90)	-	(90)
Issuance and amortization of restricted stock	20	-	-	-	234	-	-	-	234
Distribution to owners	-	-	-	-	-	-	-	(994)	(994)
Balance at March 31, 2014	16,678	\$167	-	\$-	\$191,160	\$(62,112)	\$27	\$3,182	\$132,424

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

STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

	Three Months Ended March	
	31, 2014	2013
Cash flows from operating activities:		
Net income (loss) attributable to Sterling common stockholders	\$ 205	\$ (4,580)
Plus: Noncontrolling owners' interests in earnings of subsidiaries and joint ventures	275	161
Net income (loss)	480	(4,419)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	4,633	4,622
Gain on disposal of property and equipment	(283)	(100)
Deferred tax benefit	-	(139)
Stock-based compensation expense	234	278
Gain on sale of securities	-	(471)
Tax impact from exercise of stock options	-	15
Changes in operating assets and liabilities:		
Contracts receivable	(1,100)	6,424
Costs and estimated earnings in excess of billings on uncompleted contracts	(7,067)	(13,739)
Receivables from and equity in construction joint ventures	(5,078)	1,555
Income tax receivable	(87)	(2,672)
Other current assets	727	(1,881)
Accounts payable	407	6,246
Billings in excess of costs and estimated earnings on uncompleted contracts	(4,129)	(6,048)
Accrued compensation and other liabilities	(919)	81
Net cash used in operating activities	(12,182)	(10,248)
Cash flows from investing activities:		
Additions to property and equipment	(2,283)	(4,898)
Proceeds from sales of property and equipment	2,260	813
Purchases of short-term securities, available for sale	-	(505)
Sales of short-term securities, available for sale	-	28,151
Net cash (used in) provided by investing activities	(23)	23,561
Cash flows from financing activities:		
Cumulative daily drawdowns – Credit Facility	66,278	35,888
Cumulative daily repayments – Credit Facility	(53,416)	(48,179)
Distributions to noncontrolling interest owners	(994)	-
Tax impact from exercise of stock options	-	(15)
Other	(248)	5
Net cash provided by (used in) financing activities	11,620	(12,301)
Net (decrease) increase in cash and cash equivalents	(585)	1,012
Cash and cash equivalents at beginning of period	1,872	3,142
Cash and cash equivalents at end of period	\$ 1,287	\$ 4,154
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	\$ 265	\$ 182
Cash paid during the period for income taxes	\$ -	\$ 21
Non-cash items:		
Revaluation of noncontrolling interest obligations, net of tax	\$ -	\$ (1,854)

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

STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Summary of Business and Significant Accounting Policies

Basis of Presentation

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

The accompanying condensed consolidated financial statements include the accounts of subsidiaries and construction joint ventures in which the Company has a greater than 50% ownership interest or otherwise controls such entities, and all significant intercompany accounts and transactions have been eliminated in consolidation. For all periods presented, the Company had no subsidiaries where its ownership interests were less than 50%.

Under accounting principles generally accepted in the United States (“GAAP”), the Company must determine whether each entity, including joint ventures in which it participates, is a variable interest entity. This determination focuses on identifying which owner or joint venture partner, if any, has the power to direct the activities of the entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity disproportionate to its interest in the entity, which could have the effect of requiring us to consolidate the entity in which we have a non-majority variable interest.

We determined that Myers and Sons Construction, L.P., a company in which we have a 50% limited partner interest (“Myers”), is a variable interest entity. As discussed further in Note 3 of the Notes to Consolidated Financial Statements included in the annual report on Form 10-K for the year ended December 31, 2013 (“2013 Form 10-K”), the Company determined that it exercises primary control over activities of the partnership and it is exposed to more than 50% of potential losses from the partnership. Therefore, the Company consolidates this partnership in the condensed consolidated financial statements and includes the other partners’ interests in the equity and net income of the partnership in the balance sheet line item “Noncontrolling interests” in “Equity” and the condensed statement of operations line item “Noncontrolling owners’ interests in earnings of subsidiaries and joint ventures,” respectively.

Where the Company is a noncontrolling joint venture partner, its share of the operations of such construction joint venture is accounted for on a pro rata basis in the consolidated statements of operations and as a single line item (“Receivables from and equity in construction joint ventures”) in the condensed consolidated balance sheets. Refer to Note 3 for further information regarding the Company’s construction joint ventures, including those where the Company does not have a controlling ownership interest.

The condensed consolidated financial statements included herein have been prepared by Sterling, without audit, in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) and should be read in conjunction with the 2013 Form 10-K. Certain information and note disclosures prepared in accordance with GAAP have been either condensed or omitted pursuant to SEC rules and regulations. The condensed consolidated financial statements reflect, in the opinion of management, all normal recurring adjustments necessary to present fairly the Company’s financial position at March 31, 2014 and the results of operations and cash flows for the periods presented. The December 31, 2013 condensed consolidated balance sheet data was derived from audited financial statements, but, as discussed above, does not include all disclosures required by GAAP. Interim results may be subject to significant seasonal variations, and the results of operations for the three months ended March 31, 2014 are

not necessarily indicative of the results to be expected for the full year or subsequent quarters.

Significant Accounting Policies

The Company's significant accounting policies are more fully described in Note 1 of the Notes to Consolidated Financial Statements in the 2013 Form 10-K. These accounting policies include, but are not limited to, those related to:

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

There have been no material changes to significant accounting policies since December 31, 2013.

Use of Estimates

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

Construction Revenue Recognition

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

Revenues are recognized on the percentage-of-completion method, measured by the ratio of costs incurred up to a given date to estimated total costs for each contract. Our contracts generally take 12 to 36 months to complete.

Contract costs include all direct material, labor, subcontract and other costs and those indirect costs related to contract performance, such as indirect salaries and wages, equipment repairs and depreciation, insurance and payroll taxes. Administrative and general expenses are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions and estimated profitability, including those changes arising from contract penalty provisions and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Changes in estimated gross margin during the three months ended March 31, 2014 resulted in a net gain of \$2.7 million included in operating income or \$0.16 per diluted share attributable to Sterling common stockholders.

Financial Instruments and Fair Value

The fair value of financial instruments is the amount at which the instrument could be exchanged in a current transaction between willing parties. The Company's financial instruments are cash and cash equivalents, short-term investments, short-term and long-term contract receivable, derivatives, accounts payable, mortgage and notes payable, a credit facility with Comerica Bank ("Credit Facility"), the buy/sell agreement related to certain noncontrolling owners'

interests in subsidiaries which was converted to a mandatorily redeemable long-term liability on December 30, 2013 and an earn-out liability related to the acquisition of J. Banicki Construction, Inc. ("JBC"). The recorded values of cash and cash equivalents, short-term investments, short-term contracts receivable and accounts payable approximate their fair values based on their short-term nature. We currently have one long-term contract receivable which is discounted at 4.25% and recorded at fair value. Interest earned related to the long-term contract receivable was \$0.1 million for the three months ended March 31, 2014. The recorded value of the Credit Facility debt approximates its fair value, as interest approximates market rates. Refer to Note 5 regarding the fair value of derivatives and Note 9 regarding the fair value of a certain earn-out liability and the change to the mandatorily redeemable long-term liability. The Company had one mortgage outstanding at March 31, 2014 and December 31, 2013 with a remaining balance of \$0.2 million in both periods. The mortgage was accruing interest at 3.50% at both March 31, 2014 and December 31, 2013 and contains pre-payment penalties. At March 31, 2014 and December 31, 2013, the fair value of the mortgage approximated book value. The Company also has long-term notes payable of \$0.4 million related to machinery and equipment purchased which have payment terms ranging from 3 to 5 years and associated interest rates ranging from 4.24% to 6.29%. The fair value of the notes payable approximates their book value. The Company does not have any off-balance sheet financial instruments other than operating leases (refer to Note 14 of the Notes to Consolidated Financial Statements in the 2013 Form 10-K).

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

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

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

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

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

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." This ASU clarifies the financial statement presentation of unrecognized tax benefits in certain circumstances. ASU 2013-11 is effective for interim and annual reporting periods beginning after December 15, 2013 and should be applied prospectively to all unrecognized tax benefits that exist at the effective date. The adoption of ASU 2013-11 did not have an impact on the Company's condensed consolidated financial statements as the Company did not have an unrecognized tax benefit at the reporting date.

In February 2013, the FASB issued ASU 2013-04, "Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date." This ASU provides guidance for the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, except for obligations addressed within existing GAAP guidance. ASU 2013-04 is effective for interim and annual reporting periods beginning after December 15, 2013 and is applied retrospectively to all prior periods presented. The adoption of ASU 2013-04 did not have an impact on the Company's condensed consolidated financial statements as no such liabilities existed at the reporting date.

2. Cash and Cash Equivalents and Short-term Investments

The Company considers all highly liquid investments with original or remaining maturities of three months or less at the time of purchase to be cash equivalents. At March 31, 2014, approximately \$1.1 million of cash and cash equivalents was fully insured by the FDIC under its standard maximum deposit insurance amount guidelines. At March 31, 2014, cash and cash equivalents included \$0.5 million belonging to majority-owned joint ventures that are consolidated in the accompanying condensed financial statements which generally cannot be used for purposes outside such joint ventures.

At March 31, 2014 and December 31, 2013, the Company had no short-term investments.

At March 31, 2013, gains and losses realized on short-term investment securities were included in “Gain on sale of securities” in the accompanying condensed consolidated statements of operations. Unrealized gains on short-term investments were included in accumulated other comprehensive income in stockholders’ equity, net of tax, as the gains and losses were considered temporary. For the three months ended March 31, 2013, total proceeds from sales of short-term investments were \$28.2 million with gross realized gains of \$0.5 million and immaterial gross realized losses. Accumulated other comprehensive income at March 31, 2013 included unrealized gains on short-term investments of \$0.6 million less the associated taxes of \$0.2 million. Upon the sale of short-term investments, the cost basis used to determine the gain or loss was based on the specific security sold. All items included in accumulated other comprehensive income are at the corporate level, and no portion is attributable to noncontrolling interests.

For the three months ended March 31, 2014 and 2013, the Company earned interest income of zero and \$0.2 million, respectively, on its cash, cash equivalents and short-term investments. These amounts were recorded in interest income in our condensed consolidated statement of operations.

3. Construction Joint Ventures

We participate in various construction joint venture partnerships. Generally, each construction joint venture is formed to accomplish a specific project and is jointly controlled by the joint venture partners. Refer to Note 6 of the Notes to Consolidated Financial Statements in the 2013 Form 10-K for further information. Condensed combined financial amounts of joint ventures in which the Company has a noncontrolling interest and the Company's share of such amounts which are included in the Company's condensed consolidated financial statements are shown below (amounts in thousands):

	March 31, 2014	December 31, 2013
Total combined:		
Current assets	\$ 45,036	\$ 51,329
Less current liabilities	(64,340)	(64,531)
Net assets	\$ (19,304)	\$ (13,202)
Backlog	\$ 84,905	\$ 101,014
Sterling's noncontrolling interest in backlog	\$ 26,946	\$ 30,652
Sterling's receivables from and equity in net assets of construction joint ventures	\$ 11,196	\$ 6,118
		Three Months Ended March 31,
		2014
		2013
Total combined:		
Revenues	\$19,237	\$24,874
Income (loss) before tax	560	(4,399)
Sterling's noncontrolling interest:		
Revenues	\$8,931	\$9,078
Income (loss) before tax	559	(2,216)

Approximately \$27 million of the Company's backlog at March 31, 2014 was attributable to projects performed by joint ventures. The majority of this amount is attributable to the Company's joint venture with Shimmick Construction Company, where the Company has a 30% interest.

4. Property and Equipment

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

	March 31, 2014	December 31, 2013
Construction equipment	\$ 126,183	\$ 127,199
Transportation equipment	18,602	19,132
Buildings	10,512	10,512
Office equipment	2,025	2,025
Leasehold Improvement	828	816
Construction in progress	280	-
Land	5,306	5,309
Water rights	200	200
	163,936	165,193
Less accumulated depreciation	(74,504)	(71,510)
	\$ 89,432	\$ 93,683

5. Derivative Financial Instruments

The Company enters into various fixed rate commodity swap contracts in an effort to manage its exposure to price volatility of diesel fuel. Historically, fuel prices have been volatile because of supply and demand factors, worldwide political factors and general economic conditions. The objective of the Company in executing the hedge is to mitigate the fuel price volatility that could adversely affect forecasted cash flows and earnings related to construction contracts. Swaps are designed so that the Company receives or makes payments based on a differential between fixed and variable prices for off-road ultra-low sulfur diesel ("ULSD"). The Company has designated its commodity derivative contracts as cash flow hedges designed to achieve more predictable cash flows, as well as to reduce its exposure to price volatility. While the use of derivative instruments limits the downside risk of adverse price movements, they also limit future benefits from reductions in costs as a result of favorable market price movements.

All of the Company's outstanding derivative financial instruments are recognized on the balance sheet at their fair values. The Company has a master netting arrangement with the counterparty; however, amounts are recorded gross on the balance sheet. All changes in the fair value of outstanding derivatives, except any ineffective portion, are recorded in accumulated other comprehensive income until earnings are impacted by the hedged transaction. Amounts in accumulated other comprehensive income are reclassified to earnings when the related hedged items affect earnings or the anticipated transactions are no longer probable. All items included in accumulated other comprehensive income are at the corporate level, and no portion is attributable to noncontrolling interests.

At March 31, 2014, accumulated other comprehensive income consisted of unrecognized gains of \$27,000, representing the unrealized change in fair value of the effective portion of the Company's commodity contracts, designated as cash flow hedges, as of the balance sheet date. For the three months ended March 31, 2014, the Company recognized a pre-tax net realized cash settlement gain on commodity contracts of \$14,000.

At March 31, 2014, the Company had hedged its exposure to the variability in future cash flows from forecasted diesel fuel purchases totaling 820,000 gallons. The monthly volumes hedged range from 10,000 gallons to 50,000 gallons over the period from April 2014 to August 2015 at fixed prices per gallon ranging from \$2.75 to \$2.89.

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

Balance Sheet Location	March 31, 2014	December 31, 2013
Derivative assets:		
Deposits and other current assets	\$ 23	\$ 109
Other assets, net	4	8
	\$ 27	\$ 117

The following table summarizes the effects of commodity derivative instruments on the condensed consolidated statements of operations and comprehensive income (loss) for the three months ended March 31, 2014 and 2013 (amounts in thousands):

	March 31, 2014	March 31, 2013
Increase (decrease) in fair value of derivatives included in other comprehensive income (loss) - effective portion	\$ (90)	\$ 43
Realized gain included in cost of revenues - effective portion	14	26
Increase (decrease) in fair value of derivatives included in cost of revenues - ineffective portion	-	-

The Company's derivative instruments contain certain credit-risk-related contingent features which apply both to the Company and to the counterparties. The counterparty to the Company's derivative contracts is a high credit quality financial institution.

Fair Value

The Company's swaps are valued based on a discounted future cash flow model. The primary input for the model is the forecasted prices for ULSD. The Company's model is validated by the counterparty's mark-to-market statements. The swaps are designated as Level 2 within the valuation hierarchy. Refer to Note 1 for a description of the inputs used to value the information shown above.

At March 31, 2014 and December 31, 2013, the Company did not have any derivative assets or liabilities measured at fair value on a recurring basis that meet the definition of Level 1 or Level 3.