

New Mountain Finance Corp  
Form 10-Q  
August 11, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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**x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the Quarter Ended June 30, 2011**

**o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**Commission File Number: 814-00832**

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**NEW MOUNTAIN FINANCE CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**27-2978010**  
(I.R.S. Employer  
Identification No.)

**787 Seventh Avenue**  
**48th Floor**  
**New York, N.Y.**  
(Address of principal executive offices)

**10019**  
(Zip Code)

**(212) 730-0300**

(Registrant's telephone number, including area code)

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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 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 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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The number of shares of the registrant's Common Stock, \$.01 par value outstanding as of August 11, 2011 was 10,697,691.

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**NEW MOUNTAIN FINANCE CORPORATION**

**FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2011**

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**New Mountain Finance Corporation**

**Statement of Assets and Liabilities**

**June 30, 2011**

**(unaudited)**

<b>Assets</b>	
<b>Total assets</b>	\$ 152,442,298
<b>Net Assets</b>	
Paid in capital in excess of par	144,289,098
<b>Total Net Assets</b>	\$ 152,442,298
<b>Net Asset Value Per Share</b>	\$ 14.25

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

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**New Mountain Finance Corporation**

**Statement of Operations**

**from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

<b>Net investment income allocated from New Mountain Finance Holdings, L.L.C.</b>	
Other income	105,921
<b>Net investment income allocated from New Mountain Finance Holdings, L.L.C.</b>	<b>1,584,129</b>
<b>Realized and unrealized gain (loss) allocated from New Mountain Finance Holdings, L.L.C.</b>	
Net change in unrealized appreciation (depreciation) of investments	380,661
<b>Realized and unrealized gain (loss) allocated from New Mountain Finance Holdings, L.L.C.</b>	<b>241,574</b>
<b>Total net increase in net assets resulting from operations allocated from New Mountain Finance Holdings, L.L.C.</b>	<b>1,825,703</b>
Unrealized appreciation in New Mountain Finance Holdings, L.L.C. resulting from public offering price	6,220,520
<b>Net increase in net assets resulting from operations</b>	<b>\$ 8,046,223</b>
Basic earnings per share	\$ 0.75
Diluted earnings per share	\$ 0.17

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

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**New Mountain Finance Corporation**

**Statement of Changes in Net Assets**

**from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

<b>Increase (Decrease) in net assets resulting from operations allocated from New Mountain Finance Holdings, L.L.C.:</b>	
Realized losses on investments	(139,087)
<b>Total net increase in net assets resulting from operations allocated from New Mountain Finance Holdings, L.L.C.</b>	<b>1,825,703</b>
<b>Unrealized appreciation in New Mountain Finance Holdings, L.L.C. resulting from public offering price</b>	<b>6,220,520</b>
Proceeds from shares sold	129,864,996
Contributions from Exchanged Shares	18,489,457
<b>Net assets at beginning of period</b>	

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

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**New Mountain Finance Corporation**

**Statement of Cash Flows**

**from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

<b>Cash flows from operating activities:</b>	
Net increase in net assets resulting from operations	\$ 8,046,223
Net investment income allocated from New Mountain Finance Holdings, L.L.C.	(1,584,129)
Unrealized appreciation in New Mountain Finance Holdings, L.L.C. resulting from public offering price	(6,220,520)
Purchase of investment	(129,864,996)
Proceeds from shares sold	129,864,996
<b>Net increase (decrease) in cash and cash equivalents</b>	
<b>Cash and cash equivalents at the end of the period</b>	<b>\$</b>
<b>Non-cash financing activities:</b>	
Deferred Offering Costs allocated from New Mountain Finance Holdings, L.L.C.	\$ (3,958,378)

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

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**New Mountain Finance Corporation**

**Notes to the Financial Statements**

**As of June 30, 2011 and for the period from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

**1. Formation and Business Purpose**

New Mountain Finance Corporation ( New Mountain Finance , the Company , we , us , or our ) is a Delaware corporation that was originally incorporated on June 29, 2010. New Mountain Finance is a closed-end, non-diversified management investment company that has elected to be treated as a business development company under the Investment Company Act of 1940, as amended (the 1940 Act ). As such, the Company is obligated to comply with certain regulatory requirements. New Mountain Finance intends to be treated, and intends to comply with the requirements to qualify annually, as a regulated investment company ( RIC ) under Subchapter M of the Internal Revenue Code of 1986, as amended, (the Code ) commencing with its taxable year ending December 31, 2011.

On May 19, 2011, New Mountain Finance priced its initial public offering (the IPO ) of 7,272,727 shares of common stock at a public offering price of \$13.75 per share. Concurrently with the closing of the offering and at the public offering price of \$13.75 per share, the Company sold an additional 2,172,000 shares of its common stock to certain executives and employees of, and other individuals affiliated with, New Mountain Capital Group, L.L.C. in a separate private placement.

New Mountain Finance is a holding company with no direct operations of its own, and its sole asset is its ownership in New Mountain Finance Holdings, L.L.C. (the Operating Company ). The Operating Company is externally managed and has elected to be treated as a business development company under the 1940 Act. As such, the Operating Company is obligated to comply with certain regulatory requirements. The Operating Company intends to be treated as a partnership for federal income tax purposes for so long as it has at least two members. The Operating Company, formerly known as New Mountain Guardian (Leveraged), L.L.C., was originally formed as a subsidiary of New Mountain Guardian AIV, L.P. ( Guardian AIV ) by New Mountain Capital (defined as New Mountain Capital Group, L.L.C. and its affiliates) in October 2008. Guardian AIV was formed through an allocation of approximately \$300 million of the \$5.1 billion of commitments supporting New Mountain Partners III, L.P., a private equity fund managed by New Mountain Capital. In February 2009, New Mountain Capital formed a co-investment vehicle, New Mountain Guardian Partners, L.P., comprising \$20.4 million of commitments. New Mountain Guardian (Leveraged), L.L.C. and New Mountain Guardian Partners, L.P., together with their respective direct and indirect wholly-owned subsidiaries, are defined as the Predecessor Entities.

New Mountain Finance entered into a joinder agreement with respect to the amended and restated limited liability company agreement of the Operating Company, pursuant to which New Mountain Finance was admitted as a member of the Operating Company and acquired from the Operating Company, with the gross proceeds of the IPO and the concurrent private placement, common membership units ( units ) of the Operating Company (the number of units are equal to the number of shares of New Mountain Finance s common stock sold in the IPO and the concurrent private placement). In connection with New Mountain Finance s IPO and through a series of transactions, the Operating Company owns all of the operations of the Predecessor Entities, including all of the assets and liabilities related to such operations.





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**As of June 30, 2011 and for the period from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

Guardian AIV was the parent of the Operating Company prior to the IPO and as a result of the offering obtained units in the Operating Company. Guardian AIV contributed its units in the Operating Company to its newly formed subsidiary, New Mountain Finance AIV Holdings Corporation ( AIV Holdings ), in exchange for common stock of AIV Holdings. AIV Holdings has the right to exchange all or any portion of its units in the Operating Company for shares of New Mountain Finance s common stock on a one-for-one basis. At June 30, 2011, New Mountain Finance and AIV Holdings own approximately 34.6% and 65.4%, respectively, of the units of the Operating Company.

The diagram below depicts our current organizational structure.

The Company's investment objective is to generate current income and capital appreciation through the Operating Company by the sourcing and originating of debt securities at all levels of the capital structure, including first and second lien debt, notes, bonds and mezzanine securities. In some cases, the Operating Company's investments may also include equity interests. The primary focus is in the debt of defensive growth companies, which are defined as generally exhibiting the following characteristics: (i) sustainable secular growth drivers, (ii) high

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**New Mountain Finance Corporation**

**Notes to the Financial Statements**

**As of June 30, 2011 and for the period from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

barriers to competitive entry, (iii) high free cash flow after capital expenditure and working capital needs, (iv) high returns on assets and (v) opportunities for niche market dominance.

**2. Summary of Significant Accounting Policies**

**Basis of accounting** The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ( GAAP ). The Company does not consolidate the Operating Company. New Mountain Finance applies investment company master-feeder financial statement preparation, as described in Accounting Standards Codification 946, *Financial Services Investment Companies*, ( ASC 946 ) to its interest in the Operating Company (or the Master Fund ). New Mountain Finance observes that it is industry practice to follow the presentation prescribed for a Master Fund-Feeder fund structure in ASC 946 in instances in which a Master Fund is owned by more than one Feeder Fund and that such presentation provides stockholders of New Mountain Finance with a clearer depiction of its investment in the Master Fund. The Operating Company's Form 10-Q for the quarter ended June 30, 2011 is attached to this report and should be read in conjunction with that of New Mountain Finance.

Interim financial statements are prepared in accordance with GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Articles 6 or 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements. In the opinion of management, all adjustments, consisting solely of normal recurring accruals considered necessary for the fair presentation of financial statements for the interim period, have been included. The current period's results of operations will not necessarily be indicative of results that ultimately may be achieved for the period ending December 31, 2011.

**Investments** New Mountain Finance is a holding company with no direct operations of its own, and its sole asset is its ownership in the Operating Company. New Mountain Finance's investment in the Operating Company is carried at fair value and represents the pro-rata interest in the net assets of the Operating Company as of the applicable reporting date. New Mountain Finance values its ownership interest on a quarterly basis, or more frequently if required under the 1940 Act. See the Operating Company's Form 10-Q for the quarter ended June 30, 2011 included in this filing for further details.

**Cash and cash equivalents** Cash and cash equivalents include cash and short-term, highly liquid investments with original maturities of three months or less.

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**Revenue, Expenses, and Capital Gains (Losses)** At each quarterly valuation date, the Operating Company's investment income, expenses, net realized gains (losses), and net increase (decrease) in unrealized appreciation (depreciation) are allocated to New Mountain Finance based on its pro-rata interest in the net assets of the Operating Company. This is recorded on New Mountain Finance's Statement of Operations. New Mountain Finance used the proceeds from its IPO and concurrent private placement to purchase units in the Operating Company at \$13.75 per unit (its IPO price per share). At the IPO date, \$13.75 per unit represented a discount to the actual net asset value per unit of the Operating

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**New Mountain Finance Corporation**

**Notes to the Financial Statements**

**As of June 30, 2011 and for the period from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

Company. As a result, New Mountain Finance experienced immediate unrealized appreciation on its investment in the Operating Company equal to the difference between the cost of \$13.75 per unit and the actual net asset value per unit. This unrealized appreciation is shown separately on the Statement of Operations of New Mountain Finance. See the Operating Company's Form 10-Q for the quarter ended June 30, 2011 included in this filing for further details.

All expenses, including those of New Mountain Finance, are paid and recorded by the Operating Company, and allocated to New Mountain Finance based on pro-rata ownership interest. In addition, the Operating Company paid all of the offering costs related to the IPO. New Mountain Finance has recorded its portion of the offering costs as a direct reduction to net assets and the cost of its investment in the Operating Company.

**Income taxes** New Mountain Finance intends to elect to be treated, and intends to comply with the requirements to qualify annually, as a RIC under subchapter M of the Code commencing with its taxable year ending on December 31, 2011. As a RIC, the Company will not be subject to federal income tax on the portion of taxable income and gains timely distributed to stockholders; therefore, no provision for income taxes has been recorded.

To qualify as a RIC, the Company is required to meet certain income and asset diversification tests in addition to distributing at least 90% of its investment company taxable income and net capital gains, as defined by the Code. Because federal income tax regulations differ from accounting principles generally accepted in the United States, distributions in accordance with tax regulations may differ from net investment income and realized gains recognized for financial reporting purposes.

The Company will be subject to a 4% nondeductible federal excise tax on certain undistributed income unless the Company distributes, in a timely manner as required by the Code, an amount at least equal to the sum of (1) 98% of its net ordinary income earned for the calendar year and (2) 98.2% of its capital gain net income for the one-year period ending October 31 in the calendar year.

The Company has adopted the Income Taxes topic of the Codification ( ASC 740 ). ASC 740 provides guidance for how uncertain income tax positions should be recognized, measured, and disclosed in the financial statements. Based on its analysis, the Company has determined that the adoption of ASC 740 did not have a material impact to the Company's financial statements.

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**Dividends** Dividends and distributions to common stockholders are recorded on the record date. Quarterly dividend payments are determined by the board of directors. New Mountain Finance intends to distribute approximately all of its portion of the Operating Company's adjusted net investment income on a quarterly basis and substantially all of its portion of the Operating Company's taxable income on an annual basis, except that it may retain certain net capital gains for reinvestment in units of the Operating Company. See the Operating Company's Form 10-Q for the quarter ended June 30, 2011 included in this filing for further details.

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**New Mountain Finance Corporation**

**Notes to the Financial Statements**

**As of June 30, 2011 and for the period from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

New Mountain Finance has adopted a dividend reinvestment plan that provides on behalf of its stockholders for reinvestment of any distributions declared, unless a stockholder elects to receive cash. Cash distributions reinvested in additional shares of New Mountain Finance's common stock will be automatically reinvested by New Mountain Finance in units of the Operating Company. New Mountain Finance will use only newly issued shares to implement the plan if the price at which newly-issued shares are to be credited is equal to or greater than 110% of the last determined net asset value of the shares. Under such circumstances, the number of shares to be issued to a stockholder is determined by dividing the total dollar amount of the distribution payable to such stockholder by the market price per share of New Mountain Finance's common stock at the close of regular trading on the New York Stock Exchange ( NYSE ) on the distribution payment date. Market price per share on that date will be the closing price for such shares on the NYSE or, if no sale is reported for such day, the average of their electronically reported bid and asked prices. If New Mountain Finance uses newly issued shares to implement the plan, New Mountain Finance will receive, on a one-for-one basis, additional units of the Operating Company in exchange for cash distributions that are reinvested in shares of New Mountain Finance's common stock under the dividend reinvestment plan. If New Mountain Finance's common stock price is less than 110% of the last determined net asset value of the shares, New Mountain Finance will either issue new shares or instruct the plan administrator to purchase shares in the open market to satisfy the additional shares required. Shares purchased in open market transactions by the plan administrator will be allocated to a stockholder based on the average purchase price, excluding any brokerage charges or other charges, of all shares of common stock purchased in the open market. The number of shares of New Mountain Finance's common stock to be outstanding after giving effect to payment of the distribution cannot be established until the value per share at which additional shares will be issued has been determined and elections of New Mountain Finance's stockholders have been tabulated.

*Use of estimates* The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Changes in the economic environment, financial markets, and other metrics used in determining these estimates could cause actual results to differ from the estimates used, and the differences could be material.

**3. Agreements**

On May 19, 2011, New Mountain Finance entered into a joinder agreement with respect to the amended and restated limited liability agreement of the Operating Company pursuant to which New Mountain Finance was admitted as a member of the Operating Company and agreed to acquire from the Operating Company a number of units of the Operating Company equal to the number of shares of common stock outstanding of New Mountain Finance.

The Operating Company entered into an Investment Management Agreement with New Mountain Finance Advisers BDC, L.L.C. (the Investment Advisor ). Under the





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**New Mountain Finance Corporation**

**Notes to the Financial Statements**

**As of June 30, 2011 and for the period from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

Investment Management Agreement, the Investment Adviser provides investment advisory services to the Operating Company. For providing these services, the Investment Adviser receives a fee from the Operating Company, consisting of two components – a base management fee and an incentive fee. See the Operating Company’s Form 10-Q for the quarter ended June 30, 2011 included in this filing for further details.

New Mountain Finance and the Operating Company have entered into an Administration Agreement with New Mountain Finance Administration, L.L.C. (the Administrator) under which the Administrator provides administrative services. The Administrator oversees our financial records, prepares reports filed with the SEC, generally monitors the payment of our expenses, and watches the performance of administrative and professional services rendered by others. The Operating Company will reimburse the Administrator for New Mountain Finance’s and the Operating Company’s allocable portion of overhead and other expenses incurred by the Administrator in performing its obligations to New Mountain Finance and the Operating Company under the Administration Agreement. During the first year of operations, the Operating Company has capped its direct and indirect expenses at \$3 million.

New Mountain Finance and the Operating Company have also entered into a license agreement with New Mountain Capital, pursuant to which New Mountain Capital has agreed to grant New Mountain Finance and the Operating Company a non-exclusive, royalty-free license to use the New Mountain name. Under this agreement, subject to certain conditions, New Mountain Finance and the Operating Company will have a right to use the New Mountain name, for so long as the Investment Adviser or one of its affiliates remains the investment adviser of the Operating Company. Other than with respect to this limited license, New Mountain Finance will have no legal right to the New Mountain name.

**4. Regulation**

The Company intends to elect to be treated, and intends to comply with the requirements to qualify annually, as a RIC under Subchapter M of the Code. In order to qualify as a RIC, among other things, the Company is required to timely distribute to its stockholders at least 90% of investment company taxable income, as defined by the Code, for each year. The Company, among other things, intends to make and continue to make the requisite distributions to its stockholders, which will generally relieve the Company from U.S. federal, state, and local income taxes (excluding excise taxes which may be imposed under the Code).

Additionally, as a business development company, both New Mountain Finance and the Operating Company must not acquire any assets other than qualifying assets specified in the 1940 Act unless, at the time the acquisition is made, at least 70% of its total assets are qualifying assets (with certain limited exceptions).



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**New Mountain Finance Corporation**

**Notes to the Financial Statements**

**As of June 30, 2011 and for the period from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

**5. Related Parties**

New Mountain Finance has entered into a number of business relationships with affiliated or related parties, including the following:

- New Mountain Finance and the Operating Company have entered into an Administration Agreement with the Administrator, a wholly-owned subsidiary of New Mountain Capital. The Administrator arranges office space for New Mountain Finance and the Operating Company and provides office equipment and administrative services necessary to conduct their respective day-to-day operations pursuant to the Administration Agreement. The Operating Company reimburses the Administrator for the allocable portion of overhead and other expenses incurred by it in performing its obligations to the Operating Company and New Mountain Finance under the Administration Agreement, including rent, the fees and expenses associated with performing administrative, finance, and compliance functions, and the compensation of the Operating Company's chief financial officer and chief compliance officer and their respective staffs. During the first year of operations, the Operating Company has capped its direct and indirect expenses at \$3 million.
- Together, New Mountain Finance and AIV Holdings own all the outstanding units of the Operating Company. As of June 30, 2011, New Mountain Finance and AIV Holdings own approximately 34.6% and 65.4%, respectively, of the units of the Operating Company.
- New Mountain Finance and the Operating Company have entered into a royalty-free license agreement with New Mountain Capital, pursuant to which New Mountain Capital has agreed to grant New Mountain Finance and the Operating Company a non-exclusive, royalty-free license to use the name "New Mountain".

Concurrently with the IPO, New Mountain Finance sold an additional 2,172,000 shares of its common stock to certain executives and employees of, and other individuals affiliated with, New Mountain Capital in a separate private placement.

**6. Commitments and Contingencies**

In the normal course of business, the Company may enter into contracts that contain a variety of representations and warranties and which may provide general indemnifications.



Table of Contents**New Mountain Finance Corporation****Notes to the Financial Statements****As of June 30, 2011 and for the period from May 19, 2011 (commencement of operations) to June 30, 2011****(unaudited)****7. Stockholders Equity**

The table below illustrates the effect of certain transactions on our capital accounts:

	Common Stock Shares	Common Stock Par Amount	Paid in Capital in Excess of Par	Net Unrealized Appreciation	Total Stockholders Equity
Balance at December 31, 2010		\$	\$	\$	\$
Issuances of common stock in the IPO(1)	7,272,727	72,727	99,927,269		99,999,996
Issuances of common stock in private placement(2)	2,172,000	21,720	29,843,280		29,865,000
Issuances of common stock to New Mountain Guardian Partners, L.P.(3)	1,252,964	12,530	18,476,927		18,489,457
Deferred Offering Costs allocated from New Mountain Finance Holdings, L.L.C.			(3,958,378)		(3,958,378)
Net increase in stockholders equity resulting from operations				8,046,223	8,046,223
Balance at June 30, 2011	10,697,691	\$ 106,977	\$ 144,289,098	\$ 8,046,223	\$ 152,442,298

(1) On May 19, 2011, New Mountain Finance priced its initial public offering of 7,272,727 shares of common stock at a public offering price of \$13.75 per share.

(2) Concurrently with the closing of the IPO and at the public offering price of \$13.75 per share, the Company sold an additional 2,172,000 shares of its common stock to certain executives and employees of, and other individuals affiliated with, New Mountain Capital in a separate private placement.

(3) On May 19, 2011, New Mountain Finance issued 1,252,964 shares of common stock to New Mountain Guardian Partners, L.P. for their respective ownership interest in the Predecessor Entities.



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**New Mountain Finance Corporation**

**Notes to the Financial Statements**

**As of June 30, 2011 and for the period from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

**8. Earnings Per Share**

The following information sets forth the computation of basic and diluted net increase in stockholders' equity per share resulting from operations for the period May 19, 2011 to June 30, 2011:

	<b>May 19, 2011 (commencement of operations) to June 30, 2011</b>
Numerator for basic earnings per share:	\$ 8,046,223
Denominator for basic weighted average share:	10,697,691
Basic net increase in net assets resulting from operations:	\$ 0.75
Numerator for diluted earnings per share (a):	\$ 5,276,851
Denominator for diluted weighted average share (b):	30,919,629
Diluted net increase in net assets resulting from operations:	\$ 0.17

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(a) Includes full income at the Operating Company for the period. Does not include unrealized appreciation in the Operating Company resulting from the initial public offering.

(b) Assumes AIV Holdings exchanges its units in the Operating Company for public shares of New Mountain Finance on May 19, 2011 (see Note 1, *Formation and Business Purpose*)



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**New Mountain Finance Corporation**

**Notes to the Financial Statements**

**As of June 30, 2011 and for the period from May 19, 2011 (commencement of operations) to June 30, 2011**

**(unaudited)**

**9. Financial Highlights**

The following information sets forth the financial highlights for the period May 19, 2011 to June 30, 2011. The ratios to average net assets have been annualized.

	<b>Period Ended June 30, 2011</b>
Per share data:	
Net asset value, beginning of period	\$ 13.50
Net increase in net assets resulting from operations allocated from New Mountain Finance Holdings, L.L.C.:	
Net investment income	0.15
Net realized and unrealized gain (loss)	0.02
Total net increase	0.17
Unrealized appreciation in New Mountain Finance Holdings, L.L.C. resulting from public offering price	0.58
Net asset value, end of period	\$ 14.25
Total Return (a)	(5.93)%
Average net assets for the period	\$ 151,529,446
Ratio to average net assets:	
Total expenses	5.42%
Net investment income	9.09%

tax expense, which increased by \$4.0 million in 2006 due principally to the increase in operating income. In 2005 we

recorded a reduction in the valuation allowance related to the deferred tax asset. Although we have the benefit of significant NOL s which offset most of our income from federal income taxes, we are required to reflect a full tax charge in our financial statements, through an adjustment to the deferred tax asset. In addition, we accelerate the depreciation of our fixed assets for tax purposes. The significant additions to fixed assets in 2006 increased our deferred tax liability and certain other timing differences are recorded in the income statement; and

stock based  
compensation  
expense,  
which  
increased by  
\$644,000  
from 2005,  
resulting from  
grants in 2006  
issued at  
significantly  
higher  
exercise  
prices due to  
an increase in  
our stock  
price over the  
year.

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

there was an increase of \$1.0 million in costs and estimated earnings in excess of billings on uncompleted contracts in 2006 compared with a decrease of \$3.7 million in 2005. These changes reflect timing differences as contracts progress;

billings in excess of costs and estimated earnings on uncompleted contracts increased by \$7.9 million in 2006, while in 2005 there was an increase of \$9.2 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 decreased by \$3.0 million in 2006 compared with an increase of \$6.0 million in 2005, reflecting the strength of our cash position; and

contracts receivable increased by \$7.9 million in 2006 and by \$8.7 million in 2005, principally reflecting the revenue increase and related level of customer retentions.

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### *Investing Activities.*

Expenditures to expand our construction fleet were \$24.6 million in 2006 compared with \$11.4 million in 2005. The much enlarged contract backlog required a significant expansion and upgrade of our fleet in 2005 and 2006. In January 2006, we purchased certain assets of Rathole Drilling, Inc. in order to expand our construction capabilities and in 2006, we invested funds raised in our public sale of common stock in auction-rate securities.

### *Financing Activities.*

The increase in cash provided by financing activities in 2006 was principally due to the sale of common stock to the public in January 2006, in which our net proceeds exceeded \$27.0 million. In addition, we received proceeds of \$0.9 million from the exercise of stock options and warrants. Funds received from the exercise of warrants by North Atlantic Smaller Companies Investment Trust plc, or NASCIT, and the exercise of options by employees and directors totaled \$0.8 million during 2005 compared with option exercise proceeds of \$0.4 million in 2004. In 2006 and 2005 we used approximately \$12.4 million and \$2.8 million, respectively, to pay long-term debt, which included payments on notes to related parties. During 2004, there was an increase in borrowings under the lines of credit of \$2.5 million because capital expenditures, long-term debt repayments and working capital requirements exceeded cash provided by operations.

### *Liquidity*

The level of working capital for our construction business varies due to fluctuations in the levels of costs and estimated earnings in excess of billings, and of billings in excess of cost and estimated earnings; 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. The significant increase in our working capital level in 2006 has been an important element in enabling us to expand our bonding facilities and therefore to continue to bid on larger and longer-lived projects. The Company believes that it has sufficient financial resources to fund its requirements for the next twelve months of operations.

### *Sources of Capital*

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

#### *Construction Business Revolver.*

Our construction business has a revolving credit facility with Comerica Bank, or the Construction Business Revolver. In April 2006, we renewed our existing line of credit to extend the maturity date and to increase our borrowing capacity. The Construction Business Revolver has a maturity date of May 31, 2009 and is a collateral-based facility with total borrowing capacity, subject to a borrowing base, of up to \$35.0 million. At December 31, 2006, \$30.0 million in borrowings were outstanding under the Construction Business Revolver and we had unused availability of \$5.0 million, in addition to cash and cash equivalents of \$28.5 million and short-term investment securities available for sale of \$26.0 million.

The Construction Business Revolver is secured by all of our construction business equipment and provides working capital financing for the operation of our construction business and to fund the acquisition of equipment. The Construction Business Revolver requires the payment of a quarterly commitment fee of 0.25% per annum of the unused portion of the line of credit. Borrowing interest rates are based on the bank's prime rate or on a Eurodollar rate at the option of the Company. The interest rate on funds borrowed under the Construction Business Revolver during the year ended December 31, 2006 ranged from 7.25% to 8.25%. The Construction Business Revolver is subject to our 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 all of these covenants at December 31, 2006. See Note 5 of *Notes to Consolidated Financial Statements*.



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*Capital Expenditures.*

Our capital expenditures during 2006 were \$24.8 million and during 2005 were \$11.4 million and consisted almost exclusively of expenditures to purchase heavy construction equipment. In 2007 we expect that our capital expenditure spending will be at similar levels to 2006.

***Off-Balance Sheet Arrangements***

We have no off-balance sheet arrangements.

***New Accounting Pronouncements***

In February 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments* an amendment of FASB Statements No. 133 and 140 which is effective for fiscal years beginning after September 15, 2006. The statement was issued to clarify the application of FASB Statement No. 133 to beneficial interests in securitized financial assets and to improve the consistency of accounting for similar financial instruments, regardless of the form of the instruments. The Company has evaluated the new statement and determined that the potential impact on its financial statements will not be material.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets* an amendment of FASB Statement No. 140 which is effective for fiscal years beginning after September 15, 2006. This statement was issued to simplify the accounting for servicing rights and to reduce the volatility that results from using different measurement attributes. The Company has evaluated the new statement and has determined that it will not have a significant impact on the determination or reporting of its financial results.

In July 2006, the FASB issued Interpretation 48, *Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109*. Interpretation 48, which clarifies Statement 109, *Accounting for Income Taxes*, establishes the criterion that an individual tax position has to meet for some or all of the benefits of that position to be recognized in the Company s financial statements. On initial application, Interpretation 48 will be applied to all tax positions for which the statute of limitations remains open. Only tax positions that meet the more-likely than-not recognition threshold at the adoption date will be recognized or continue to be recognized. The cumulative effect of applying Interpretation 48 will be reported as an adjustment to retained earnings at the beginning of the period in which it is adopted.

Interpretation 48 is effective for fiscal years beginning after December 15, 2006, and will be adopted by the Company on January 1, 2007. The Company s analysis indicates that adoption of Interpretation 48 will not have a significant effect on its financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS 157 is effective for financial statements for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, with early adoption permitted. The Company does not expect the implementation of SFAS 157 to have a material impact on its consolidated financial statements

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. Under this bulletin, registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered,

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is material. SAB 108 is effective for fiscal years ending on or after November 15, 2006. Adoption of SAB 108 in November 2006 did not have a material impact on the Company's consolidated financial statements. In September 2006, the FASB ratified a consensus opinion reached by the Emerging Issues Task Force (EITF) on EITF Issue 06-5, "Accounting for Purchases of Life Insurance - Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4." The guidance in EITF Issue 06-5 requires policyholders to consider other amounts included in the contractual terms of an insurance policy, in addition to cash surrender value, for purposes of determining the amount that could be realized under the terms of the insurance contract. If it is probable that contractual terms would limit the amount that could be realized under the insurance contract, those contractual limitations should be considered when determining the realizable amounts. The amount that could be realized under the insurance contract should be determined on an individual policy (or certificate) level and should include any amount realized on the assumed surrender of the last individual policy or certificate in a group policy. The consensus in EITF Issue 06-5 is effective for fiscal years beginning after December 15, 2006. The Company intends to adopt EITF Issue 06-5 effective January 1, 2007 and does not believe that the adoption will have a significant effect on its financial statements.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

Changes in interest rates are our primary sources of market risk. At December 31, 2006, \$30 million of our outstanding indebtedness was at floating interest rates. An increase of 1.0% in the interest rate would have resulted in an increase in our interest expense of approximately \$136,000 in 2006.

**Item 8. Financial Statements and Supplementary Data.**

Financial statements start on page F-1.

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

None

**Item 9A. Controls and Procedures.*****Evaluation of Disclosure Controls and Procedures***

The Company's principal executive officer and principal financial officer reviewed and evaluated the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based on that evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were effective at December 31, 2006 to ensure that the information required to be disclosed by the Company in this Annual Report on Form 10-K is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

***Management's Report on Internal Control over Financial Reporting***

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934). Under the supervision and with the participation of the Company's management, including the principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of internal control over financial reporting at December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. The Company's management has concluded that, at December 31, 2006, the Company's internal control over financial reporting is effective based on these criteria.

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Management's assessment of the effectiveness of the Company's internal control over financial reporting at December 31, 2006 has been audited by Grant Thornton LLP, an independent registered public accounting firm, as stated in their report which is included elsewhere herein.

**Changes in Internal Control over Financial Reporting**

There were no changes in the Company's internal control over financial reporting during the quarter ended December 31, 2006 that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

**Inherent Limitations on Effectiveness of Controls**

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

**Item 9B. Other Information.**

None

**PART III****Item 10. Directors and Executive Officers of the Registrant.****Directors and Executive Officers**

The following table sets forth the names and ages of each of the Company's current directors and the positions they held on March 1, 2007:

Name	Position	Age	Director Since	Year Term of Office Expires
Patrick T. Manning	Chairman of the Board of Directors & Chief Executive Officer	61	2001	2008
Joseph P. Harper, Sr.	President, Treasurer & Chief Operating Officer, Director	61	2001	2008
Maarten D. Hemsley	Chief Financial Officer, Director	57	1998	2007
John D. Abernathy	Director	69	1994	2009
Robert W. Frickel	Director	63	2001	2009
Donald P. Fusilli, Jr.	Director	55	2007	2007
Milton L. Scott	Director	50	2005	2009
Christopher H. B. Mills	Director	54	2001	2007
David R. A. Steadman	Director	69	2005	2008

*Patrick T. Manning.* Mr. Manning joined the predecessor of Texas Sterling Construction, L.P., our construction subsidiary, which along with its predecessors we refer to as TSC, in 1971 and led its move from Detroit, Michigan into the Houston market in 1978. He has been TSC's President and Chief Executive Officer since 1998 and the Company's 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 its Treasurer. In



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addition to his financial responsibilities, Mr. Harper has performed both estimating and project management functions. Mr. Harper has been a director and the Company's President and Chief Operating Officer since July 2001, and in May 2006 was elected Treasurer. Mr. Harper is a certified public accountant.

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

*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 Brookwood Companies Incorporated, a major textile converter, dyer and finisher and as a director of Aavid Thermal Technologies, Inc., a provider of thermal management solutions for the electronics industry, both privately-held companies. Mr. Steadman also serves as Chairman of Tech/Ops Sevcon, Inc., a public company that manufactures electronic controls for electric vehicles and other equipment. Mr. Steadman is a Visiting Lecturer in Business Administration at the Darden School of the University of Virginia.

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

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

*Donald P. Fusilli, Jr.* Mr. Fusilli was elected a director of the Company on March 14, 2007. Mr. Fusilli is an independent consultant. From May 1973 until September 2006, Mr. Fusilli served in a variety of capacities at Michael Baker Corporation, a public company listed on the American Stock Exchange that provides a variety of professional engineering services spanning the complete life cycle of infrastructure and managed asset projects. Mr. Fusilli joined Michael Baker Corporation as an engineer and over the course of his career rose to president and chief executive officer in April 2001. Since September 12, 2006 Mr. Fusilli has been an independent consultant providing strategic planning, marketing development and operations management services. Mr. Fusilli is a director of RTI International Metals, Inc., an NYSE-listed company that is a leading U.S. producer of titanium mill products and fabricated metal components. He holds a Civil Engineering degree from Villanova University, a Juris Doctor degree from Duquesne University School of Law and attended the Advanced Management Program at the Harvard Business School.

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*Milton L. Scott.* Mr. Scott is currently an independent consultant to the energy industry. He was previously a consultant to Complete Energy Holdings, LLC, a company of which he was Managing Director until January, 2006 and which he co-founded in January, 2004 to acquire, own and operate power generation assets in the United States. From March 2003 to January 2004, Mr. Scott was a Managing Director of The StoneCap Group, an entity formed to acquire, own and operate power generation assets. From October 1999 to November 2002, Mr. Scott served as Executive Vice President and Chief Administrative Officer at Dynegy Inc., a public company that was a market leader in power distribution, marketing and trading of gas, power and other commodities, midstream services and electric distribution. From July 1977 to October 1999, Mr. Scott was with the Houston office of Arthur Andersen LLP, a public accounting firm, where he served as partner in charge of the Southwest Region Technology and Communications practice. Mr. Scott is currently the lead director and chairman of the audit committee of W-H Energy Services, an 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 Limited, or JOHCMG, an investment management company based in the United Kingdom. Prior to founding JOHCMG in 1993, Mr. Mills was employed by Montagu Investment Management and its successor company, Invesco MIM, as an investment manager and director, from 1975 to 1993. He is the Chief Executive of North Atlantic Smaller Companies Investment Trust plc, which is a part of JOHCMG and a 6.23% holder of the Company's common stock. Mr. Mills is a director of three U.S. public companies: Lesco, Inc., which manufactures and sells fertilizer and lawn products; NetBank, Inc., a financial holding company that operates a family of businesses focused primarily on consumer and small business banking as well as conforming mortgage lending; and W-H Energy Services, Inc., which is in the oilfield services industry. Mr. Mills also serves as a director of a number of public and private companies outside of the U.S. in which JOHCMG funds have investments.

In addition to Messrs. Manning, Harper and Hemsley, the only other executive officer of the Company is Roger M. Barzun, 65, who has been Vice President, Secretary and General Counsel since August 1991, was elected a Senior Vice President from May 1994 until July 2001 and again in March 2006. Mr. Barzun has been a lawyer since 1968 and is a member of the bar of New York and Massachusetts. Mr. Barzun also serves as general counsel to other corporations from time to time on a part-time basis.

***Section 16(a) Beneficial Ownership Reporting Compliance***

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

Based solely upon a review of Forms 3 and 4 and amendments to them furnished to the Company during 2006, any Forms 5 and amendments to them furnished to the Company relating to 2006, and any written representations that no Form 5 is required, all Section 16(a) filing requirements applicable to the Company's insiders were satisfied except as follows:

In May 2006 Mr. Mills shared voting and investment power over 870,000 shares of the Company's common stock with North Atlantic Smaller Companies Investment Trust plc, or NASCIT, of which he is chief executive officer. Mr. Mills failed to timely file a Form 4 covering seven sales by NASCIT between May 26 and June 6, 2006 of 113,856 shares in total. A Form 4 reporting these sales was filed with the SEC on July 21, 2006.

In November 2006 Mr. Mills failed to timely file a Form 4 covering three sales by NASCIT of a total of 74,744 shares of the Company's common stock between November 20 and November 22, 2006. A Form 4 reporting these sales was filed with the SEC on November 27, 2006.

***Code of Ethics***

The Company has adopted a Code of Business Conduct & Ethics that complies with SEC rules. The

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Code applies to all the officers and in-house counsel of the Company and its subsidiaries and is posted on the Company's website at [www.sterlingconstructionco.com](http://www.sterlingconstructionco.com).

***The Audit Committee***

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

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

**Item 11. Executive Compensation**

***Compensation Discussion and Analysis***

*Introduction.* The Company has three executive officers whose compensation is required to be disclosed in the *Summary Compensation Table for 2006*, below. They are sometimes referred to in this Annual Report on Form 10-K as the named executive officers. They consist of the Chief Executive Officer, or CEO; the President and Chief Operating Officer, or COO; and the Chief Financial Officer, or CFO. From the early 1970's until 2001, the CEO and COO were senior managers of TSC and its predecessors, privately-held companies in which they and their family members were the principal stockholders. The CFO has been an employee of the Company and its predecessors since 1988. The compensation of these officers is not policy-driven because they are few in number and because of their long tenure. Since July 2001, when the Company acquired a majority interest in TSC, the CEO and the COO have continued their former positions at TSC and have also filled similar positions at the Company. As a result, their compensation has been based on their prior compensation, the Company's financial condition, and comparable compensation in the construction industry.

*Compensation Objectives.* The Company's compensation objectives for the named executive officers, as well as for other management employees, is to provide them with a fair rate of pay for the work they do, to give them an incentive to make the Company financially successful, and to give them an incentive to remain with the Company.

*Employment Agreements.* Since the July 2001 acquisition of TSC, the Company has entered into successive multi-year employment agreements with its named executive officers. Their current agreements expire in July 2007. The material terms of those agreements are described below in this Item 11 under the heading *Employment Agreements of Named Executive Officers*. The Company believes that an employment agreement has the benefit of assuring the executive of continuity both as to his continued employment and the amount and elements of his compensation. An employment agreement gives the Company some level of assurance that the executive will remain with the Company and enables the Company to budget salary costs over the term of the agreement. In the case of each named executive officer, his salary remains unchanged during the term of his agreement. All elements of the cash compensation of the named executive officers are paid according to the terms of their agreements.

*Elements of Compensation.* As shown in the *Summary Compensation Table for 2006*, below, executive compensation has three main parts: a salary paid in cash, an annual cash incentive bonus plan, in which payment is contingent on the financial performance of the Company, and a long-term equity incentive that the Company provides through the award of options to purchase the Company's common stock.

Salary is intended to reward executives for their current, day-to-day work. The cash incentive bonus is intended to be a reward for the executive's contribution to the financial success of the Company in a given year. Awards of equity are intended to create a longer-term incentive for the executive to

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remain with the Company because the benefit is realized, if at all, over a multi-year period.

*Levels of Compensation.*

Salary. Because an executive's salary is meant to reflect his value to the Company on a day-to-day basis, it is a fixed, predetermined element of his compensation. When the Compensation Committee reviews the level of an executive's salary for a possible increase at the end of the term of his employment agreement, that review is based on two main factors: his prior salary and the salary range of executives in comparable companies at a comparable level of responsibility.

Compensation Committee members take an executive's prior salary into account because they believe that it reflects the assessment of prior boards and/or compensation committees of the executive's value to the Company. Compensation levels of comparable companies are obtained from industry trade publications such as the Pas, Inc. Executive Compensation Survey for Contractors. In addition, the Chairman of the Compensation Committee provides his knowledge of construction industry compensation levels gained in the course of the work of his accounting firm, which represents several construction companies in the Detroit area. The executives' salaries are designed to fall within the range of comparable companies both as to salary and as to overall compensation. To date the Committee has not used compensation consultants.

Cash Incentive Bonus Plan. The level of compensation that an executive can earn under the cash incentive bonus plan is based on the Company's attainment of financial goals for a given year in relation to the annual budget, which the Board of Directors has approved in advance. Financial performance that exceeds expectations can enable the CEO and COO to earn an additional bonus equal to, but not more than, his salary, a limitation that Committee members in their personal judgement based on their business experience believe is reasonable. The cash incentive bonuses plan has both fixed and discretionary parts. The cash incentive bonus plan does not have any portion based on the executive's achievement of specific personal or individual goals or objectives because the Company has not believed that it is practical to try to distinguish on a year-to-year basis the relative contributions of the executive officers to the Company's overall financial results. In the case of the CFO, whose employment agreement permits him to work on non-Company matters, the Compensation Committee takes into account, among other things, the amount of time during a given year he has devoted to non-routine tasks for the Company in awarding any discretionary portion of his bonus.

The amount of the cash incentive bonus in a given year, if any, is derived from a formula based on TSC's, or in the case of Mr. Hemsley, the Company's, annual budgeted earnings before payment of interest charges, taxes, and charges for depreciation and amortization, referred to as EBITDA. The amount of budgeted EBITDA for each year must be approved by the Board of Directors, which has a majority of directors who are not employees of the Company. EBITDA is not a financial measure found in generally accepted accounting principles, or GAAP; it is calculated according to its definition in the named executive officers' employment agreements by taking net income determined in accordance with GAAP for a given fiscal year and

*adding back:*

- Interest expense for the period;
- Depreciation and amortization expense for the period;
- Federal and state income tax expense incurred for the period;
- Any extraordinary items to the extent a negative number;
- Any fees paid to non-employee directors;
- All charges for overhead or similar non-operating expenses of the Company as TSC's ultimate parent company; and

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Any extraordinary items to the extent a positive number; and  
Interest income for the period.

Because Mr. Hemsley's cash incentive bonus is based on the Company's consolidated EBITDA, bonuses paid to other members of management are also deducted in the computation of the Company's budgeted EBITDA, which is further adjusted for any material changes in the Company's business that occur during the year, such as the sale of a part of the business.

Footnote (1) to the table of *Grants of Plan-Based Awards for 2006*, below, describes the formulas for the calculation of cash incentive bonuses and additional cash incentive bonuses. The formula was made part of the executives' compensation agreements in 2001 when the Company acquired its majority interest in TSC. It was proposed by one of the major investors in the acquisition, among other things because the Company already had an operating subsidiary, Steel City Products. EBITDA was used as a measure of financial performance because it was the number over which the efforts of senior management had the most direct effect. Debt levels of the Company at the time of the acquisition were unrelated to the operations of TSC's business, and income tax expenses were being offset by tax loss carryforwards. In addition, the success or lack of success of operating management did not directly affect the overhead expenses of the Company as the ultimate parent of TSC.

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

The Compensation Committee authorizes the payment of incentive bonuses and, if applicable, makes any decisions on discretionary amounts, when the results for the year in question are known, typically in March of the following year. Bonuses for 2006 were approved in March, 2007. The 2006 EBITDA level achieved was sufficient to earn the executives their fixed cash incentive bonuses. However, because 2006 EBITDA fell between 110% of budgeted EBITDA, the level for earning the minimum additional cash incentive bonus, and 130% of budgeted EBITDA, the level for earning the maximum additional cash incentive bonus, the Committee was required under the executives' employment agreements to exercise its discretion in determining the amount of additional cash incentive bonuses to award between the minimum and the maximum. In exercising that discretion, members of the Committee considered the fact that 2006 EBITDA missed the target for the maximum bonus by only four percentage points; the overall management of the Company during 2006 by senior executives; and the Company's notable financial achievements during the year. The Committee approved additional cash incentive bonuses at 90% of the maximum that could have been awarded under the employment agreements. The *Summary Compensation Table for 2006*, below, shows the total 2006 cash incentive bonuses of each named executive officer.

When the executives' current employment agreements expire in July 2007, the Compensation Committee plans to use one or more GAAP financial measures for cash incentive bonuses that reflect the performance of the Company as a whole.

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

The Company calculates the value of a stock option award on the date of its grant under accounting requirements that involve the use of a complex formula consisting of estimates about the Company,

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its stock price and the likelihood of the option holder forfeiting the stock option. In 2003 the Company voluntarily started to record the value of stock option awards as an expense incurred by the Company like any other expense, such as salaries. As a result, in considering the size of a stock option award, the Compensation Committee takes into account both the value of the award to the recipient and the corresponding accounting cost to the Company. In 2006 recording stock option awards as an expense was required of all companies under Financial Accounting Standard No. 123 (revised 2004), or FAS 123R. The dollar amount shown in the *Summary Compensation Table for 2006*, below, for stock option awards is the value of the options computed under FAS 123R.

When the current employment agreements of Messrs. Manning and Harper were negotiated in July 2004, they each agreed to receive stock option awards in place of some of their salary to save the Company cash. To accomplish this, their employment agreements provide for annual stock option awards that are larger than would have otherwise been made and the Company has awarded smaller additional stock options to them when stock option awards were made to other management employees.

**Other Compensation.** The only other forms of compensation of the executive officers are health and other benefits made available to all salaried employees and the so-called perquisites shown in the *Summary Compensation Table for 2006*, below, in the column labeled *All Other Compensation*. A detailed description of the perquisites is shown in footnote 3 to the table. The car allowances and the payment of expenses of commuting to work for Messrs. Manning and Harper reflect the fact that they use their own automobiles for business purposes, such as visiting construction sites, attending meetings with customers and providing transportation to out-of-town business colleagues. The Company pays Messrs. Manning's and Harper's country club dues because the clubs are often used for business purposes and as accommodation for out-of-town business colleagues. The payment of Mr. Hemsley's term life insurance and long-term disability insurance premiums is a benefit that has been provided to him by the Company for many years and is continued because of that fact. Mr. Harper's 18 weeks of vacation is carried over from his prior employment agreement in which his vacation time increased over three years to eighteen weeks in contemplation of his possibly reducing his time commitment to the Company. In practice, however, with the rapid growth of the business, Mr. Harper has elected not to take all of that vacation time.

**Overall Compensation Levels.** As with salary, the Company attempts to provide its executives with a total compensation package that is comparable to their peers in the industry and that the members of the Compensation Committee believe in their personal judgement based on their business experience is fair and appropriate for the executive's level of responsibility and contribution to the Company. In the case of Mr. Hemsley, his compensation is also based on the fact that he is not a full-time employee.

The Company considers any payments made under the cash incentive bonus plan and any value realized from stock option awards to have been earned in the calendar year for which they were paid or realized. The Company takes prior compensation from these sources into account when considering whether future compensation should be increased or maintained at the then current level.

The Company does not have any policy on equity ownership by senior executives, primarily because in most cases they already have significant ownership positions.

**Stock Option Exercise Price and Fair Market Value.** The agreement covering the Company's acquisition of TSC required the Company to award stock options promptly after the closing of the purchase in July 2001 to certain management employees who were stockholders of TSC, including Messrs. Manning and Harper. Following those grants, the Compensation Committee has met annually on or about the anniversary of these awards to consider the further award of stock options. These meetings have been combined with the third regularly-scheduled quarterly Board meeting at which the Company's second quarter Form 10-Q is reviewed and approved for filing.

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Although it has not adopted a formal, written policy on the subject, the Company has always set the exercise price of stock options at the fair market value on the date of the award. Until recently, the Company's custom and practice was to treat the closing price of the common stock on the trading day immediately preceding the date of the meeting at which a stock option award was approved as the fair market value. These meetings were typically scheduled weeks in advance.

Beginning with the stock option awards made in August 2006, the Company has treated the closing price on the date of the meeting at which a stock option award is approved as the fair market value.

To the extent permissible under applicable tax laws and regulations, stock option awards to employees are intended to qualify as incentive stock options as defined in Section 422 of the Internal Revenue Code. The compensation paid to the named executive officers is not expected to exceed the limits on deductibility imposed by Section 162(m) of the Internal Revenue Code.

The Compensation Committee or the Board of Directors makes the final determination of the compensation of the named executive officers. However, the Committee discusses his compensation with each of the named executive officers in advance of making a decision.

**Summary Compensation Table for 2006**

The following table sets forth all compensation awarded to, earned by, or paid to, the Company's principal executive officer and its principal financial officer for 2006. The table also shows the compensation of the Company's President, who is the only other executive officer whose compensation for 2006 exceeded \$100,000. These executive officers are not compensated for their service on the Board of Directors. The Company pays compensation to these executive officers according to the terms of their employment agreements, which are described below in detail under the heading *Employment Agreements of Named Executive Officers*. The amounts include any compensation that was deferred by the executive through contributions to his defined contribution plan account under Section 401(k) of the Internal Revenue Code. All amounts are rounded to the nearest dollar.

Name and Principal Position	Year	Salary (\$)	Option Awards <sup>(1)</sup> (\$)	Non-Equity Incentive		Total (\$)
				Plan Compensation <sup>(2)</sup> (\$)	All Other Compensation (\$) <sup>(3)</sup>	
Patrick T. Manning <i>Chairman of the Board &amp; Chief Executive Officer (principal executive officer)</i>	2006	\$240,000	\$82,883	\$341,000	\$38,950	\$702,833
Joseph P. Harper, Sr. <i>President, Treasurer &amp; Chief Operating Officer</i>	2006	\$235,800*	\$82,883	\$318,500	\$21,150	\$658,333
Maarten D. Hemsley <i>Chief Financial Officer (principal financial officer)</i>	2006	\$129,808	\$22,862	\$117,500	\$12,350	\$282,520

\* This includes  
\$20,800 paid to  
Mr. Harper for  
foregoing

approximately five weeks of the vacation he is entitled to under his employment agreement.

- (1) The value of these stock option awards is the total dollar cost recognized by the Company of the award in 2006 for financial reporting purposes in accordance with FAS 123R. No amounts earned by the executive officers have been capitalized on the balance sheet for 2006. The cost does not reflect any estimates made for financial statement reporting purposes of forfeitures by the executive officer related to service-based vesting conditions.

The valuation of these options was made on the equity valuation assumptions described in Note 10 of *Notes to Consolidated Financial*



*Statements.*

None of the awards has been forfeited. For a description of the basis on

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which these stock options were awarded and their full grant date fair market value, see the table of *Grants of Plan-Based Awards for 2006*, below.

- (2) Cash incentive bonuses were calculated and approved by the Company's Compensation Committee in March 2007. The amounts are determined in part by the application of a formula found in the employment agreement of each executive officer and in part by the Compensation Committee exercising its discretion as to the amount of additional cash incentive bonus within the range provided for in the employment agreements. For a description of the formula and its application, see footnote (1) to the table of *Grants of Plan-Based*

*Awards for 2006, below, under the heading Non-Equity Incentive Plan Awards.*

- (3) A breakdown of the amounts in the *All Other Compensation* column is set forth in the following table. The dollar amounts indicated is the cost of the item to the Company.

<b>Type of Other Compensation</b>	<b>Mr. Manning</b>	<b>Mr. Harper</b>	<b>Mr. Hemsley</b>
Car allowance	\$ 8,400	\$8,400	
Expenses of commuting to work	\$ 2,500	\$1,800	
Country club dues	\$25,000	\$4,500	
Company contribution to 401(k) plan account	\$ 3,050	\$6,450	\$ 7,500
Long-term disability insurance premium			\$ 4,502
Term life insurance premium			\$ 348
			Page 46

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**Table of Contents****Grants of Plan-Based Awards for 2006**

The following table shows each grant under a Company plan of an award for 2006 to an executive officer named in the *Summary Compensation Table for 2006*, above. The Company did not award any SAR s, stock, restricted stock, restricted stock units, or similar instruments to any of the named executive officers in 2006.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive			All Other Option Awards: Number of Securities Underlying Options <sup>(3)</sup> (#)	Exercise or Base Price of Option Awards <sup>(4)</sup> (\$/sh)	Grant Date Fair Value of Option Awards <sup>(5)</sup> (\$)
		Threshold	Plan Awards <sup>(1)(2)</sup> (\$) Target	Maximum			
Patrick T. Manning	7/18/2006		\$24,000 to \$240,000				
	8/08/2006	\$ 125,000		\$ 240,000	10,000 1,000	\$24.96 \$25.21	\$ 163,300 \$ 16,440
Joseph P. Harper, Sr.	7/18/2006		\$21,500 to \$215,000				
	8/08/2006	\$ 125,000		\$ 215,000	10,000 1,000	\$24.96 \$25.21	\$ 163,300 \$ 16,440
Maarten D. Hemsley	7/18/2006	\$ 50,000	\$50,000	\$ 125,000	2,800	\$24.96	\$ 45,724

(1) *Messrs. Manning and Harper Non-Equity Incentive Plan Awards.*

Under his employment agreement, each of Messrs. Manning and Harper is entitled to an annual bonus of \$125,000 for any fiscal year during the term of the agreement in which TSC achieves 75% or

more of its budgeted EBITDA. This is the Threshold listed in the table since if the 75% is not achieved, no incentive payment is earned.

An additional cash incentive bonus is payable if TSC's EBITDA for a given year exceeds the amount budgeted by at least 10%. If TSC's EBITDA for a given year exceeds the amount budgeted by between 10% and 30%, the amount of the additional cash incentive bonus is in the discretion of the Compensation Committee of the Board of Directors, but may not be less than 10% of the executive's base salary or more than 100% of his base salary. This is the Target listed in the table.

If TSC's EBITDA for a given year exceeds the amount budgeted by more than 30%, the maximum additional cash

incentive bonus is required to be paid. This is the Maximum listed in the table.

Certain officers of TSC's general partner, Sterling General, Inc., or SGI, are entitled to cash incentive bonuses based on the same formulas described above. The employment agreements of Messrs. Manning and Harper provide that the additional cash incentive bonuses that can be paid them and to those SGI officers together cannot exceed 30% of the amount by which TSC's EBITDA exceeds the budgeted EBITDA.

- (2) *Mr. Hemsley's Non-Equity Incentive Plan Awards.* Under his employment agreement, Mr. Hemsley is entitled to a bonus of \$50,000 for any year during the term of his agreement in which the Company on a consolidated basis achieves 75% or more of

its budgeted EBITDA. The amount of any additional cash incentive bonus up to a maximum of \$75,000 is in the discretion of the Compensation Committee of the Board of Directors. In exercising their discretion, members of the Compensation Committee are to consider the Company's consolidated financial results for the year in question, the number of non-routine business transactions to which Mr. Hemsley devoted substantial time during the year and such other matters they consider relevant.

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

of the Company.

The July 18, 2006

Stock Option

Awards.

The employment agreements of the executive officers provided for the grant of these stock options on this date, which was the second anniversary of the date of the agreement.

Each option has a five-year term and vests, or becomes exercisable, in full on July 18, 2007, which is the date that each of the employment agreements expires if it is not extended by the Company.

The exercise or purchase price of the shares subject to these stock options was the fair market value of the common stock on the closing price of the common stock on the Nasdaq National Market on the trading day immediately preceding the date of grant, the custom and practice of the Company for many years. The

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executives employment agreements are described in detail under the heading *Employment Agreements of Named Executive Officers*, below.

If the executive officer's employment is terminated by the Company for cause, which is defined in the stock option agreement, or for good cause, which is defined in his employment agreement, all of his options immediately terminate.

If the executive officer's employment terminates for any other reason, the officer, his personal representative or a permitted transferee of the officer (depending on the circumstances of his termination) may exercise the option from the date it becomes exercisable through its expiration date.

**The August 8, 2006 Stock Option Awards.**

These stock options were awarded by the Compensation Committee in the exercise of its discretion on the date that stock options were awarded to other officers and employees of the Company.

Each option has a sixty-one-month term and vests, or becomes exercisable, in five substantially equal installments on each of the first five anniversaries of the date of the grant.

The exercise or purchase price of the shares subject to these stock options is the closing price of the Company's common stock on August 8, 2006, which was the date of the meeting of the Compensation Committee at which the stock options were approved.

If the officer's employment terminates by reason of his permanent disability or death, or if he dies within three months after he ceases to be an employee, then the officer, his legal representative, his estate, or his beneficiaries (depending on the circumstances of the termination) may exercise the option for a period of one year or until the option's expiration date, whichever comes first, but only for the number of shares that had become exercisable on the date his employment terminated.

If the officer's employment is terminated for cause, which is defined in the option agreement, or for good cause, which is defined in his employment agreement, all of his options immediately terminate.

If the officer's employment terminates for any other reason, he may exercise the option for a period of ninety days after his employment terminates or until the expiration date of the option, whichever comes first, but only for the number of shares that had become exercisable on the date his employment terminated.

- (4) *Establishing the Option Exercise Price.* Before August 2006, the Company as a matter of custom and practice used the closing price of its common stock on the trading day immediately preceding the date an option was approved as the grant date market value. Granting a stock option with an exercise price equal to the fair market value on the date of grant is required if the option holder is to receive the tax benefits of Section 422 of the Internal Revenue Code. Using the closing price immediately preceding the approval date of the grant satisfied this requirement.

Had the Company used the closing price of the common stock on July 18, 2006 as the fair market value rather than the closing price on the immediately preceding trading day, the exercise price would have been twenty-four cents per share more.

In view of the recently heightened sensitivity of the investing public to the establishment of the exercise price of employee stock options, since July 2006, the Company's policy has been to use the closing price of the common stock on the date of the meeting at which a stock option award is approved as the option's per-share exercise price.

- (5) The grant date fair value is the value computed for financial reporting purposes in accordance with FAS 123R. The valuation was made on the equity valuation assumptions described in Note 10 of *Notes to Consolidated*

*Financial Statements.*

***Employment Agreements of Named Executive Officers***

Each of Messrs. Manning and Harper is an executive officer of both the Company and its wholly-owned subsidiary, Sterling General, Inc., or SGI, which in turn is the general partner of the Company's construction business, TSC. Mr. Hemsley is an executive officer of the Company and a director of SGI.

Messrs. Manning, Harper and Hemsley are compensated under similar employment agreements that expire on July 18, 2007. Features of these agreements are included above under the headings *Compensation Discussion and Analysis*, *Summary Compensation Table for 2006*, and *Grants of Plan-Based Awards for 2006*. The following discussion describes material features of those agreements not discussed elsewhere in this Item 11.

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Under the agreements, the executive may resign his employment at any time by giving the Company 180 days' notice. After July 18, 2007, assuming the executive has not given the Company a notice of resignation, the Company may continue the executive's agreement for successive one-year terms by giving him 90 days' notice before the July 18, 2007 expiration date and after that, 90 days before the expiration of each following one-year extension. If at the end of the initial term or of any one-year extension the Company does not give a notice to extend the agreement, the executive may terminate his employment for good reason, a defined term in the agreement. For a description of the different circumstances in which the executive's employment may terminate and the consequences of termination, see the section below entitled *Potential Payments Upon Termination or Change-in-Control*.

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

	<b>Mr. Manning</b>	<b>Mr. Harper</b>	<b>Mr. Hemsley</b>
<b>Base Salary</b>	\$ 240,000	\$ 215,000	\$ 135,000
<b>Threshold Cash Incentive Bonus<sup>(1)</sup></b>	\$ 125,000	\$ 125,000	\$ 50,000
<b>Maximum Additional Cash Incentive Bonus<sup>(1)</sup></b>	240,000	215,000	75,000
<b>Annual Option Grant (Shares)<sup>(2)</sup></b>	\$ 10,000	\$ 10,000	\$ 2,800
<b>Vacation Time</b>	8 weeks	18 weeks*	Not specified
<b>Benefits Paid by the Company<sup>(3)</sup></b>			
<i>Car Allowance</i>	\$ 700/month	\$ 700/month	No
<i>Country Club Dues</i>	Yes	Yes	No
<i>Payment of Commuting Expenses</i>	Yes	Yes	No
<i>Company-Paid Long-Term Disability Insurance</i>	No	No	7,500/month benefit
<i>Company-Paid Term Life Insurance</i>	No	No	\$ 100,000 death benefit

\* Mr. Harper is entitled to take 18 weeks of vacation each year. He may take additional vacation by forfeiting salary at the rate of \$4,000 per week and he may forfeit his vacation time and be paid for it at the rate of \$4,000 per week. In 2006, Mr. Harper took approximately thirteen weeks of vacation and was paid \$20,800 for the

approximately five weeks not taken. That amount is included as part of his 2006 salary in the *Summary Compensation Table for 2006*, above.

- (1) This cash incentive bonus is based on the financial performance of the Company. The calculation of the cash incentive bonus and the additional cash incentive bonus is described in detail in footnote (1) to the table of *Grants of Plan-Based Awards for 2006*, above, in this Item 11. The cash incentive bonus plan is also discussed above in this Item 11, under the heading *Compensation Discussion and Analysis Cash Incentive Bonus Plan*.
- (2) The terms of these stock options, which each have a July 18 grant

date, are described above in this Item 11 in footnote (3) to the table of *Grants of Plan-Based Awards for 2006*. Option grants are also discussed above in this Item 11, under the heading *Compensation Discussion and Analysis Equity Incentive Plan*.

- (3) For the cost of these benefits in 2006, see footnote (3) of the *Summary Compensation Table for 2006*, above.

**Table of Contents****Outstanding Equity Awards at December 31, 2006**

The following table shows certain information concerning unexercised stock options and stock options that have not vested and that were outstanding on December 31, 2006 for each executive officer named in the *Summary Compensation Table for 2006*, above. No stock awards have been made to the named executive officers.

Name	Option Awards					
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price/Share (\$)	Option Grant Date	Option Expiration Date	Vesting Date Footnotes
Patrick T. Manning		1,000	\$25.21	8/08/2006	9/08/2011	(1)
		10,000	\$24.96	7/18/2006	7/18/2011	(2)
	300	1,200	\$16.78	8/12/2005	9/12/2010	(1)
		10,000	\$ 9.69	7/18/2005	7/18/2010	(2)
	1,400	2,100	\$ 3.10	8/12/2004	8/12/2014	(1)
		10,000	\$ 3.10	8/12/2004	8/12/2009	(2)
	2,100	1,400	\$ 3.05	8/20/2003	8/20/2013	(1)
	2,800	700	\$1.725	7/24/2002	7/24/2012	(1)
		\$ 1.50	7/23/2001	7/23/2011	(1)	
Joseph P. Harper, Sr.		1,000	\$25.21	8/08/2006	9/08/2011	(1)
		10,000	\$24.96	7/18/2006	7/18/2011	(2)
	300	1,200	\$16.78	8/12/2005	9/12/2010	(1)
		10,000	\$ 9.69	7/18/2005	7/18/2010	(2)
	2,334	1,166	\$ 3.10	8/12/2004	8/12/2014	(3)
		10,000	\$ 3.10	8/12/2004	8/12/2009	(2)
	3,500		\$ 3.05	8/20/2003	8/20/2013	(3)
	3,500		\$1.725	7/24/2002	7/24/2012	(3)
		\$ 1.50	7/23/2001	7/23/2011	(1)	
Maarten D. Hemsley		2,800	\$24.96	7/18/2006	7/18/2011	(2)
		2,800	\$ 9.69	7/18/2005	7/18/2010	(2)
	3,750	1,250	\$ 3.10	8/12/2004	8/12/2014	(4)
	75,000		\$0.875	1/13/1998	10/27/2013	(5)
	100,000		\$ 2.75	4/29/1994	2/11/2010	(6)
	28,424		\$ 2.75	6/29/1991	6/13/2007	(7)

*Vesting of Stock Options.* If there is a change-in-control of the Company, all the stock options then held by a named executive officer become exercisable in full. Absent a change in control of the Company, the options listed above vest as follows:

(1) This option vests in equal installments on the first five anniversaries of its grant date.

(2) This option vests in a single installment on July 18, 2007.

(3) This option vests in equal installments on the first three anniversaries of its grant date.

- (4) This option vests in equal installments on the grant date and the first three anniversaries of its grant date.
- (5) This option vested in a single installment on December 18, 1998.
- (6) This option vested in equal installments on the grant date and the first four anniversaries of its grant date.
- (7) This option vested in a single installment on its grant date.

**Table of Contents****Option Exercises and Stock Vested for 2006**

The following table contains information on an aggregated basis about each exercise of a stock option during 2006 by each of the executive officers named in the *Summary Compensation Table for 2006*, above. No stock awards have been granted to an executive officer named in the *Summary Compensation Table for 2006*, above.

Name	Option Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized Upon Exercise <sup>(1)</sup> (\$)
Patrick T. Manning		
Joseph P. Harper, Sr.		
Maarten D. Hemsley	233,000	\$ 5,246,480

(1) SEC regulations define the Value Realized Upon Exercise is the difference between the market price of the shares on the date of the purchase, and the exercise or purchase price of the option shares, whether or not the shares are sold, or if they are sold, whether or not the sale occurred on the date of the exercise.

**Potential Payments Upon Termination or Change-in-Control**

The following table describes the payment and other obligations of the Company and the named executive officer if there is a termination of his employment or a change in control of the Company. If the executive had been terminated on December 31, 2006, the payments to him (in monthly installments) would have been be \$12,000 or \$24,000 depending on whether the payments were required to be made for twelve months or twenty-four months.

Event	Payment and/or Other Obligations*
Termination by the Company <i>without good cause</i> <sup>(1)</sup>	The Company must  Give the executive 180 days notice of termination.



Continue to pay the executive his base salary<sup>(2)</sup> for the balance of the term of his employment agreement or for one year, whichever period is longer.

Pay the executive an additional \$1,000 per month for one year.

The executive may

accept the additional \$1,000/month payment, in which case he may not compete with the Company or solicit its customers or employees during the one-year period, or

decline any post employment payments by the Company, in which case he is not prohibited from competing with the Company or soliciting its customers or employees.

The executive's options continue to be exercisable for varying periods depending on the terms of the option agreement.

Termination by the Company *for good cause*<sup>(1)</sup>

The executive is prohibited from competing with the Company or soliciting its customers or employees for two years, during which period the Company must pay the executive \$1,000 a month.

All of the executive's stock options terminate.

Termination by the executive *for good reason*<sup>(1)</sup>

The Company must

Continue to pay the executive his base salary for the

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**Event**

**Payment and/or Other Obligations\***

remaining term of his agreement, but in no event for less than twelve additional months.

Pay the executive an additional \$1,000 per month for one year, during which time he is prohibited from competing with the Company or soliciting its customers or employees.

Termination by the executive *without good reason*<sup>(1)</sup>

The Company is only obligated to pay the executive \$1,000 a month for two years during which period he is prohibited from competing with the Company or soliciting its customers or employees.

A change in control of the Company or the execution by the Company of any agreement that will result in a change in control that is not consented to in writing by the executive before the change in control is completed.

All the executive's stock options become exercisable in full.

The executive may elect by written notice to the Company to terminate his employment agreement and his employment. If he does so, the executive is not thereafter prohibited from competing with the Company or soliciting its customers or employees and the Company is not required to make any monthly payment to him.

The Company is obligated to pay the executive any bonus earned but not yet paid.

\* In all events, the Company is required to pay the executive his accrued but unpaid salary through the date of termination, as required by law.

(1) The terms good reason and good cause are defined in the agreement and generally mean either a breach of the terms of the agreement or what is

commonly referred to as cause in employment matters, such as gross negligence, dishonesty, insubordination, inadequate performance of responsibilities after notice and the like.

- (2) Any obligation of the Company to continue to pay the executive his base salary after termination of his employment ceases if the executive breaches his obligation under the agreement not to disclose confidential information of the Company or any obligation he has under the terms of the termination not to compete with the Company or solicit its customers or employees. The executives' base salaries are set forth above under the heading *Employment Agreements of Named Executive Officers*.

**Director Compensation for 2006**

Directors who are employees of the Company, namely Messrs. Manning, Harper and Hemsley (the named executive officers) are not paid additional compensation for serving on the Board of Directors. The following table contains information concerning the compensation for 2006 of directors who are not officers or employees of the Company. All dollar numbers are rounded to the nearest dollar.

<b>Name</b>	<b>Fees Earned or Paid in Cash<sup>(1)</sup> (\$)</b>	<b>Stock Awards<sup>(1)(2)(3)</sup> (\$)</b>	<b>Total<sup>(1) 4)</sup> (\$)</b>
John D. Abernathy (Lead director) <i>Chairman of the Audit Committee</i> <i>Member of the Compensation Committee</i> <i>Member of the Corporate Governance &amp; Nominating Committee</i>	\$32,300	\$ 23,333	\$55,633
Robert W. Frickel <i>Chairman of the Compensation Committee</i>	\$18,800	\$ 23,333	\$42,133
Donald P. Fusilli, Jr.*			
Christopher H. B. Mills	\$11,750	\$ 23,333	\$35,083

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<b>Name</b>	<b>Fees Earned or Paid in Cash<sup>(1)</sup> (\$)</b>	<b>Stock Awards<sup>(1)(2)(3)</sup> (\$)</b>	<b>Total<sup>(1) 4)</sup> (\$)</b>
Milton L. Scott <i>Member of the Audit Committee</i> <i>Member of the Compensation Committee</i> <i>Member of the Corporate Governance &amp; Nominating Committee</i>	\$19,800	\$ 23,333	\$43,133
David R. A. Steadman <i>Chairman of the Corporate Governance &amp; Nominating Committee</i> <i>Member of the Audit Committee</i>	\$25,500	\$ 23,333	\$48,833

\* Mr. Fusilli was elected to the Board on March 14, 2007 as the third Class I director and therefore earned no fees in 2006.

(1) The fees and awards for 2006 are based on the standard compensation arrangements for directors adopted by the Corporate Governance & Nominating Committee on May 10, 2006 and are as follows:

**Annual Fees****Annual Fees**

**Each Non-Employee  
Director  
\$7,500**

An award (on the date of each Annual Meeting of Stockholders) of restricted stock that has an accounting income charge under FAS 123R limited to \$35,000 per grant.\*

#### **Additional Annual Fees for Committee Chairmen**

Chairman of the Audit Committee	\$ 7,500
Chairman of the Compensation Committee	\$ 2,500
Chairman of the Corporate Governance & Nominating Committee	\$ 2,500

#### ***Meeting Fees***

<b>In-Person Meetings</b>	<b>Per Director Per Meeting</b>
Board Meetings	\$ 1,500
Committee Meetings	
<i>Audit Committee Meetings</i>	
on the same day as a Board meeting	\$ 1,000
on a day other than a Board meeting day	\$ 1,500
<i>Other Committee Meetings</i>	
on the same day as a Board meeting	\$ 500
on a day other than a Board meeting day	\$ 750
<b>Telephonic Meetings</b> ( <i>Board &amp; committee meetings</i> )	
One hour or longer	\$ 1,000
Less than one hour	\$ 300

\* The shares awarded are restricted because they may not be sold, assigned, transferred, pledged or otherwise disposed of until the restrictions expire. The restrictions for the May 10, 2006 grant expire on the day before the 2007 Annual Meeting of Stockholders, but earlier if the

director dies or becomes disabled or if there is a change in control of the Company. The shares are forfeited if before the restrictions expire, the director ceases to be a director other than because of his death or disability.

- (2) The value of these stock awards is the total dollar cost recognized from the award in 2006 for financial reporting purposes in accordance with FAS 123R. No amounts earned by a director have been capitalized on the

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balance sheet for 2006. The cost does not reflect any estimates made for financial statement reporting purposes of future forfeitures by the executive officer related to service-based vesting conditions. The valuation of these options was made on the equity valuation assumptions described in Note 10 of *Notes to Consolidated Financial Statements*. None of the awards has been forfeited.

- (3) The following table shows for each non-employee director the grant date fair value of each stock award that has been expensed, the aggregate number of shares of stock awarded and the number of shares underlying stock options that



were  
outstanding on  
December 31,  
2006.

Name	Grant Date	Securities Underlying	Aggregate Stock Awards	Grant Date Fair Value of Stock
		Option Awards Outstanding at December 31, 2006 (#)	Outstanding at December 31, 2006 (#)	and Option Awards (\$)
John D. Abernathy	5/1/1997	3,000		
	1/13/1998	65,000		
	5/1/1998	3,000		
	5/1/1999	3,000		
	5/1/2000	3,000		
	5/1/2001	1,666		
	7/23/2001	12,000		57,600
	5/19/2005	5,000		27,950
	5/10/2006		1,207	34,991
<b>Total</b>		<b>95,166</b>	<b>1,207</b>	<b>N/A</b>
Robert W. Frickel	7/23/2001	12,000		57,600
	5/19/2005	5,000		27,950
	5/10/2006		1,207	34,991
<b>Total</b>		<b>17,000</b>	<b>1,207</b>	<b>120,541</b>
Donald P. Fusilli, Jr.				
Christopher H. B. Mills	5/19/2005	5,000		27,950
	5/10/2006		1,207	34,991
<b>Total</b>				<b>62,941</b>
Milton L. Scott	5/10/2006		1,207	34,991
David R. A. Steadman	5/19/2005	5,000		27,950
	5/10/2006		1,207	34,991

**Total****62,941**

These options were not expensed.

- (4) During 2006, none of the non-employee directors received any other compensation for any service provided to the Company. All directors are reimbursed for their reasonable out-of-pocket expenses incurred in attending meetings of the Board and Board committees. Directors living outside of North America, currently only Mr. Mills, have the option of attending regularly-scheduled in-person meetings by telephone, and if they choose to do so, they are paid an attendance fee as if they had attended in person.

***Compensation Committee Interlocks and Insider Participation***

During 2006, Robert W. Frickel (Chairman), John D. Abernathy and Milton L. Scott served on the Compensation Committee. None of the Compensation Committee members is or has been an officer or employee of the Company. Mr. Frickel is President of R.W. Frickel Company, P.C., an accounting firm that performs certain accounting and tax services for the Company. In 2006, the

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Company paid or accrued for payment to R.W. Frickel Company approximately \$57,500 in fees. The Company estimates that during 2007, the fees of R.W. Frickel Company will be approximately the same as in 2006. None of the Company's executive officers served as a director or member of the compensation committee, or any other committee serving an equivalent function, of any other entity that has an executive officer who is serving or during 2006 served as a director or member of the Compensation Committee.

**Compensation Committee Report**

The Compensation Committee of the Board of Directors has reviewed and discussed with management the *Compensation Discussion and Analysis* set forth above in this Item 11. Based on that review and those discussions, the Compensation Committee recommended to the Board of Directors that the *Compensation Discussion and Analysis* be included in this Annual Report on Form 10-K.

*Submitted by the members of the Compensation Committee on March 15, 2007*

Robert W. Frickel, *Chairman*

John D. Abernathy

Milton L. Scott

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.****Equity Compensation Plan Information**

The following table contains information at December 31, 2006 about compensation plans (including individual compensation arrangements) under which the Company has authorized the issuance of equity securities.

Plan Category	Number of Securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans, excluding securities reflected in column (a) (c)
Equity compensation plans <i>approved</i> by security holders:	752,454	\$ 5.87	442,545
Equity compensation plans <i>not approved</i> by security holders:	28,424 <sup>(1)</sup>	\$ 2.75	- 0 -
Total:	1,223,423	\$ 5.61	442,545

(1) These shares are subject to purchase under a currently outstanding individual stock

option grant that is one of a total of eight stock option grants made in August 1991 to certain persons who were then directors of the Company. The grants were not approved by stockholders.

This stock option is fully exercisable at \$2.75 per share and expires on June 13, 2007.

The holder of this stock option remains a director of the Company.

***Security Ownership of Certain Beneficial Owners and Management***

The following table sets forth certain information at March 1, 2007 about the beneficial ownership of shares of the Company's common stock by each person or entity known to the Company to own beneficially more than 5% of the outstanding shares of common stock and by each director; the executive officers named above in *Item 11. Executive Compensation*, under the heading *Summary Compensation Table for 2006*; and all directors and executive officers as a group. None of the shares are pledged as security. The Company has no other class of equity securities outstanding.

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Based on information furnished by the beneficial owners, the Company believes that they have sole investment and voting power over the shares of common stock shown as beneficially owned by them, except as stated otherwise in the footnotes.

Rule 13d-3(d)(1) of the Exchange Act requires that the percentages listed in the following table assume for each person or group the acquisition of all shares that the person or group could acquire within sixty days of March 1, 2007, for instance by the exercise of a stock option, but not the acquisition of the shares that could be acquired in that period by any other person or group listed.

Except for Mr. Mills and the entities listed below, the address of each person listed below is the address of the Company.

Name and Address of Beneficial Owner	Number of Outstanding Shares of Common Stock Owned	Shares Subject to Purchase*	Total Beneficial Ownership	Percent of Class
North Atlantic Smaller Companies Investment Trust plc (or NASCIT) c/o North Atlantic Value LLP, Ryder Court, 14 Ryder Street, London SW1Y 6QB, England	681,400 <sup>(1)</sup>		681,400	6.23%
North Atlantic Value LLP (or NAV) Court, 14 Ryder Street, London SW1Y 6QB, England	681,400 <sup>(1)</sup>		681,400	6.23%
Dreman Value Management, LLC Harborside Financial Center Plaza 10, Suite 800 Jersey City, New Jersey 07311	934,183 <sup>(2)</sup>		934,183	8.54%
Deutsche Bank AG Taunusanlage 12 D-60325 Frankfurt am Main Federal Republic of Germany	648,900 <sup>(3)</sup>		648,900	5.93%
John D. Abernathy	10,203 <sup>(4)</sup>	45,166	55,369	
Robert W. Frickel	63,207 <sup>(4)</sup>	17,000	80,207	
Donald P. Fusilli, Jr.				
Joseph P. Harper, Sr.	585,140 <sup>(5)</sup>	140,908	726,048	6.55%
Maarten D. Hemsley	114,888	207,174	322,062	2.89%
Patrick T. Manning	149,000	32,520	181,520	1.65%

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Christopher H. B. Mills c/o North Atlantic Value LLP, Ryder Court, 14 Ryder Street, London SW1Y 6QB, England	694,607 <sub>(1)(4)(6)</sub>	5,000	699,607	6.39%
Milton L. Scott	1,207 <sub>(4)</sub>		1,207	
David R. A. Steadman	15,207 <sub>(4)</sub>	5,000	20,207	
All directors and executive officers as a group (10 persons)	1,655,620 <sub>(7)</sub>	463,248 <sub>(7)</sub>	2,118,868 <sub>(7)</sub>	18.59%

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\* These are shares that the entity or person could acquire within sixty days of March 1, 2007.

Less than one percent.

(1) According to a Form 13G/A (Amendment No. 3) filed with the Securities and Exchange Commission on February 6, 2007, each of NASCIT, Mr. Mills and NAV claims shared voting and investment power over these shares.

(2) According to a Form 13G filed with the Securities and Exchange Commission on February 14, 2007, Dreman Value Management, LLC is an investment adviser with sole voting and dispositive power over these shares.

(3) According to a Form 13G filed with the

Securities and  
Exchange  
Commission on  
February 2,  
2007, Deutsche  
Bank AG has  
sole voting and  
dispositive  
power over  
these shares.  
Deutsche Bank  
AG further  
states in the  
filing: In  
accordance with  
Securities  
Exchange Act  
Release  
No. 39538  
(January 12,  
1998), this filing  
reflects the  
securities  
beneficially  
owned by the  
Corporate and  
Investment  
Banking  
business group  
and the  
Corporate  
Investments  
business group  
(collectively,  
CIB ) of  
Deutsche Bank  
AG and its  
subsidiaries and  
affiliates  
(collectively,  
DBAG ). This  
filing does not  
reflect  
securities, if  
any, beneficially  
owned by any  
other business  
group of  
DBAG.  
Consistent with  
Rule 13d-4



under the Securities Exchange Act of 1934 ( Act ), this filing shall not be construed as an admission that CIB is, for purposes of Section 13(d) under the Act, the beneficial owner of any securities covered by the filing.

Furthermore, CIB disclaims beneficial ownership of the securities beneficially owned by (i) any client accounts with respect to which CIB or its employees have voting or investment discretion, or both, and (ii) certain investment entities, of which CIB is the general partner, managing general partner, or other manager, to the extent interests in such entities are held by persons other than CIB.

- (4) This number includes, or in the case of

Mr. Scott, consists entirely of, 1,207 shares subject to restrictions that expire on the day preceding the 2007 Annual Meeting of Stockholders, but earlier if the director dies or becomes disabled or if there is a change in control of the Company. The shares are forfeited before the expiration of the restrictions if the director ceases to be a director other than because of his death or disability.

- (5) This number includes 8,000 shares held by Mr. Harper as custodian for his grandchildren.
- (6) This number consists of the 681,400 shares owned by NASCIT; 12,000 shares owned by Mr. Mills personally over which he claims sole voting and investment power; and 1,207 shares owned by Mr. Mills that

are subject to the same restrictions as are described in footnote (2), above.

- (7) See the footnotes above for a description of certain of the shares included in this total.

**Item 13. Certain Relationships and Related Transactions.**

***Transactions with Related Persons***

At December 31, 2006, NASCIT held 6.23% of the Company's outstanding common stock. NASCIT is a part of JO Hambro Capital Management Group Limited, or JOHCMG, an investment company and fund manager located in the United Kingdom. From January 2001 until May 2002, Mr. Hemsley was a consultant to JO Hambro Capital Management Limited, or JOHCM, which is part of JOHCMG and since May 2002 has been an employee of JOHCM. Mr. Hemsley has served since 2001 as Fund Manager of JOHCMG's Leisure & Media Venture Capital Trust, plc, and since February 2005, as Senior Fund Manager of its Trident Private Equity II LLP investment fund. Neither of those funds was or is an investor in the Company or any of the Company's affiliates.

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 the Company. In 2006, the Company paid or accrued for payment to R.W. Frickel Company approximately \$57,500 in fees. The Company estimates that during 2007, the fees of R.W. Frickel Company will be approximately the same as in 2006.

Joseph P. Harper, Jr., the son of Joseph P. Harper, Sr., President and Chief Operating Officer, is Chief Financial Officer of Sterling General, Inc., or SGI, the general partner of TSC. For 2006 Mr. Harper Jr. received a salary and an aggregate cash incentive bonus of approximately \$225,750.

Since July 2005, Patrick T. Manning has been the husband of Amy Peterson, the sole beneficial owner of Paradigm Outdoor Supply, LLC and Paradigm Outsourcing, Inc.. The Paradigm companies have provided materials and services to the Company and to other contractors for many years. In 2006, the Company paid a total of approximately \$3.3 million to the Paradigm companies. The

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Audit Committee reviews and approves these payments in the manner described below under the heading *Policies and Procedures for the Review, Approval or Ratification of Transactions with Related Persons*.

On January 27, 2006 the Company prepaid in full the approximately \$8.5 million of outstanding principal amount, (together with accrued interest) of the Company's five-year, 12% promissory notes described in *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations* under the heading *Related Party Notes* and in Note 14 of *Notes to Consolidated Financial Statements*. Among the payments were those made to the following note holders:

Name	Amount
Patrick T. Manning	\$ 321,459
James D. Manning	\$ 1,872,047
Joseph P. Harper, Sr.	\$ 2,661,159
Maarten D. Hemsley	\$ 182,836
Joseph P. Harper, Jr.	\$ 118,750

***Policies and Procedures for the Review, Approval or Ratification of Transactions with Related Persons***

**General.** The Board of Directors' policy on transactions between the Company and related parties is set forth in the written charter of the Audit Committee. The policy requires that the Audit Committee must review in advance the terms of any transaction by the Company with a director; executive officer; nominee for election as director; stockholder; or any affiliate or any of their immediate family members that involves more than \$50,000. If the Audit Committee approves the transaction, it must do so in compliance with Delaware law and report it to the full Board of Directors.

**Mr. Hemsley.** Mr. Hemsley's relationship with JOHCM has not been the subject of any approval process by the Board or the Audit Committee because, as noted above, neither of the funds he manages were or are an investor in the Company or any of its affiliates.

**Mr. Frickel.** The Company's Audit Committee reviews and approves the retention of Mr. Frickel's firm and the payment of its fees. A description of this written procedure is found in *Item 14. Principal Accounting Fees and Services*, below, under the heading *Audit and Non-Audit Service Approval Policy*.

**Joseph P. Harper, Jr.** The Compensation Committee reviews Mr. Harper, Jr.'s salary and bonus as well as the salary and bonus of other senior managers of TSC. Neither Mr. Harper, Sr. nor Mr. Harper, Jr. is a member of the Compensation Committee, which is made up entirely of independent directors.

**The Paradigm Companies.** TSC engages the Paradigm companies primarily for City of Houston projects to comply with requirements that a portion of contracts be subcontracted to minority and/ or women-owned businesses. Both Paradigm companies are woman-owned businesses. Paradigm Outdoor Supply arranges for the purchase of construction materials. The materials are delivered directly to the project site and are billed by Paradigm to the Company. Paradigm Outdoor Supply and similar companies charge a percentage commission ranging from 2% to 3% of the cost of the materials. Paradigm Outsourcing provides flagmen and other temporary construction personnel to contractors and charges competitive rates for such services.

During 2006, the Company paid Paradigm Outdoor Supply a total of approximately \$2.4 million for the materials it purchased for the Company. During 2006 the Company paid Paradigm Outsourcing \$896,101 for temporary personnel supplied to the Company.

The Audit Committee has a written policy regarding transactions with the Paradigm companies. Under the policy, project managers are required, as for all subcontracts, to request [competitive?] bids for goods and/or services they need on a project. The project manager then prepares a list of all bids received and presents them at a review meeting with at least one senior manager. At this meeting, the project manager and the senior manager or managers select the bidder they believe will

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provide the Company with the best combination of price and service. Mr. Manning or any other member of management with a connection to a bidder is not permitted to be present at the meeting or to be involved in the selection of the winning bid. Every quarter, the payments the Company has made to the Paradigm companies are subject to the review and approval of the Audit Committee.

**Note Prepayment.** The prepayment of the notes held by management was approved by the independent members of the Board of Directors and was described in the Use of Proceeds section of the Company's prospectus for its public offering of common stock in January 2006. A description of the source of the notes is contained in Note 5 of *Notes to Consolidated Financial Statements* under the heading *Related Party Notes*. The Company does not expect that notes will be issued in the future to members of management.

***Director Independence***

The following table shows the Company's independent directors in 2006 and the committees of the Board of Directors on which they served. Each of the directors has in the past and continues to satisfy the Nasdaq's definition of an independent director. Each member of the Audit, Compensation and Corporate Governance & Nominating Committees of the Board of Directors also satisfies Nasdaq's independence standards for service on those committees. In addition, the members of the Audit Committee satisfy the independence requirements of the SEC's Regulation §240.10A-3.

<b>Name</b>	<b>Committee Assignment</b>
John D. Abernathy	Audit Committee (Chairman) Compensation Committee Corporate Governance & Nominating Committee
Robert W. Frickel	Compensation Committee (Chairman)
Christopher H. B. Mills	
Milton L. Scott	Audit Committee Compensation Committee Corporate Governance & Nominating Committee
David R. A. Steadman	Corporate Governance & Nominating Committee (Chairman) Audit Committee

The relationship between Mr. Frickel's accounting firm and the Company is described above under the heading *Transactions with Related Persons*.

In determining that Mr. Mills is independent under Nasdaq rules, the Board of Directors considered the fact that Mr. Mills is the Chief Executive Officer of NASCIT, which is a stockholder holding less than 10% of the Company's common stock and therefore under applicable rules and regulations is not an affiliate of the Company. The Board also considered the payments of interest that the Company made on a promissory note it issued to NASCIT in 2001 in connection with the Company's acquisition of TSC and the fact that the note was paid in full on June 30, 2005. The Board has concluded that under Nasdaq's standards for independence, neither of Mr. Frickel's nor Mr. Mills' relationship to the Company adversely affects his independence. In reaching this conclusion, the Board also relied on the fact that both Messrs. Frickel and Mills were directors at the time that the Company applied for the listing of its common stock on Nasdaq and that they qualified as independent at the time.

In 2005, the Company retained Eugene Abernathy, brother of Audit Committee Chairman John Abernathy, to assist the Company on GAAP compliance issues. Eugene Abernathy is a certified public accountant and a consultant who has in the past worked at the predecessor of PricewaterhouseCoopers, a public accounting firm, and was a member of the Construction Contractor Guide Committee that issued the Audit and Accounting Guide for Construction Contractors under the sponsorship of the American Institute of Certified Public Accountants. In 2006 the Company paid fees of \$18,975 to Eugene Abernathy, of which \$8,875 had been accrued at December 31, 2005. In view of the

small amount of the fees the Company has paid to Eugene

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Abernathy, the Board does not consider that this relationship has any effect on John Abernathy's independence.

**Item 14. Principal Accountant Fees and Services.**

The following table sets forth the aggregate fees billed to the Company for the years ended December 31, 2006 and 2005 by the Company's independent registered public accounting firm, Grant Thornton LLP.

Fee Category	2006	Percentage Approved by the Audit Committee	2005	Percentage Approved by the Audit Committee
Audit Fees:	\$529,300	100%	\$208,000	100%
Audit-Related Fees:	\$110,300	100%	\$259,300	100%
Tax Fees:		NA		NA
All Other Fees:		NA		NA

The *Audit Fees* category includes the fees for the separate audit of Sterling Houston Holdings, Inc. in 2006 and 2005, the consolidated audit of the Company, and the resolution of issues that arose during the audit process.

The *Audit-Related Fees* category in 2005 includes work in connection with the Company's public offering of common stock made in January 2006. These fees in both 2005 and 2006 include audit work on potential acquisition candidates in connection with acquisitions (\$168,000 in 2005 and \$59,000 in 2006) that were not consummated as well as compliance with the Sarbanes-Oxley Act of 2002.

As indicated in the table, Grant Thornton does not perform any tax or other work for the Company.

The Audit Committee determined that services provided in 2006 in the *All Other Fees* category did not impair the independence of Grant Thornton LLP.

***Audit and Non-Audit Service Approval Policy***

In accordance with the requirements of the Sarbanes-Oxley Act of 2002 and the related rules and regulations, the Audit Committee has adopted a policy that it believes will result in an effective and efficient procedure to approve services of the Company's independent registered public accounting firm.

*Audit Services.* Audit services include the annual financial statement audit (including quarterly reviews) and other procedures required to be performed by the independent registered public accounting firm so that it is able to form an opinion on the Company's financial statements. The Audit Committee annually approves specified audit services engagement terms and fees and other specified audit fees. All other audit services must be specifically pre-approved by the Audit Committee. The Audit Committee monitors the audit services engagement and may approve, if necessary, any changes in terms, conditions and fees resulting from changes in audit scope or other items.

*Audit-Related Services.* Audit-related services are assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements, which historically have been provided by our independent registered public accounting firm, and are consistent with the SEC's rules on auditor independence. The Audit Committee annually approves specified audit-related services within established fee levels. All other audit-related services must be pre-approved by the Audit Committee.

*Tax Fees.* Our independent registered public accounting firm does not provide tax services to the Company.

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*All Other Services.* Other services, if any, are services provided by our independent registered public accounting firm that do not fall within the established audit, audit-related and tax services categories. The Audit Committee may pre-approve specified other services that do not fall within any of the specified prohibited categories of services.

***Procedures***

All requests for services that are to be provided by our independent registered public accounting firm, which must include a detailed description of the services to be rendered and the amount of corresponding fees, are submitted to both the President and the Chairman of the Audit Committee. The Chief Financial Officer authorizes services that have been approved by the Audit Committee within the pre-set limits. If there is any question as to whether a proposed service fits within an approved service, the Chairman of the Audit Committee is consulted for a determination. The Chief Financial Officer submits to the Audit Committee any requests for services that have not already been approved by the Audit Committee. The request must include an affirmation by the Chief Financial Officer and the independent registered public accounting firm that the request is consistent with the SEC's rules on auditor independence.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules.**

The following Financial Statements and Financial Statement Schedules are filed with this Report:

***Financial Statements***

Report of the Company's Independent Registered Public Accounting Firm

Consolidated Balance Sheets at December 31, 2006 and December 31, 2005

Consolidated Statements of Operations for the fiscal periods ended December 31, 2006, December 31, 2005 and December 31, 2004

Consolidated Statements of Stockholders' Equity for the fiscal periods ended December 31, 2006, December 31, 2005 and December 31, 2004

Consolidated Statements of Cash Flows for the fiscal periods ended December 31, 2006, December 31, 2005 and December 31, 2004

Notes to the Consolidated Financial Statements

***Financial Statement Schedules***

All other schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or the notes thereto.

The following exhibits are filed with this Report:

*Explanatory Note:* Prior to changing its name to Sterling Construction Company, Inc. in November 2001, the Company was known as Hallwood Holdings Incorporated from May 1991 to July 1993; Oakhurst Capital, Inc. from July 1993 to April 1995; and Oakhurst Company, Inc. from April 1995 to November 2001. References in the following exhibit list use the name of the Company in effect at the date of the exhibit.



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<b>Number</b>	<b>Exhibit Title</b>
1.1	Form of Underwriting Agreement dated as of January 19, 2006 between Sterling Construction Company, Inc. and the underwriters and other parties named therein (incorporated by reference to Exhibit 1.1 to Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 13, 2006 (SEC File number 333-129780)).
2.1	Asset Purchase Agreement, dated September 23, 2002, by and among Texas Sterling Construction, L.P., Kinsel Industries, Inc. and Tracks of Texas, Inc. (incorporated by reference to Exhibit 10.4 to Sterling Construction Company, Inc. s quarterly report on Form 10-Q for the fiscal quarter ended September 30, 2002, filed on November 14, 2002 (SEC File No. 000-19450)).
3.1	Restated and Amended Certificate of Incorporation of Oakhurst Company, Inc., dated as of September 25, 1995 (incorporated by reference to Exhibit 3.1 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
3.2	Certificate of Amendment of the Certificate of Incorporation of Oakhurst Company, Inc., dated as of November 12, 2001 (incorporated by reference to Exhibit 3.2 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
3.3	Bylaws of Oakhurst Company, Inc. (incorporated by reference to Exhibit 3.2 to its Annual Report on Form 10-K for the fiscal year ended February 28, 1998, filed on May 29, 1998 (SEC File No. 000-19450)).
4.1	Certificate of Designations of Oakhurst Company, Inc. s Series A Junior Participating Preferred Stock, dated as of February 10, 1998 (incorporated by reference to Exhibit 4.2 to its Annual Report on Form 10-K, filed on May 29, 1998 (SEC File No. 000-19450)).
4.3	Rights Agreement, dated as of December 29, 1998, by and between Oakhurst Company, Inc. and American Stock Transfer & Trust Company, including the form of Series A Certificate of Designation, the form of Rights Certificate and the Summary of Rights attached thereto as Exhibits A, B and C, respectively (incorporated by reference to Exhibit 99.1 to Oakhurst Company, Inc. s Registration Statement on Form 8-A, filed on January 5, 1999 (SEC File No. 000-19450)).
4.4	Form of Common Stock Certificate of Sterling Construction Company, Inc. (incorporated by reference to Exhibit 4.5 to its Form 8-A, filed on January 11, 2006 (SEC File No. 011-31993)).
10.1#	Oakhurst Capital, Inc. 1994 Omnibus Stock Plan, with form of option agreement (incorporated by reference to Exhibit 10.1 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
10.2#	Oakhurst Capital, Inc. 1994 Omnibus Stock Plan, as amended through December 18, 1998, (incorporated by reference to Exhibit 10.21 to Oakhurst Company, Inc. s Annual Report on Form 10-K, filed on June 1, 1999 (SEC File No. 000-19450)).
10.3#	Oakhurst Capital, Inc. 1994 Non-Employee Director Stock Option Plan, with form of option agreement (incorporated by reference to Exhibit 10.3 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
10.4#	

Oakhurst Company, Inc. 1998 Stock Incentive Plan (incorporated by reference to Exhibit 10.4 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).

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<b>Number</b>	<b>Exhibit Title</b>
10.5#	Form of Stock Incentive Agreements under Oakhurst Company, Inc. s 1998 Stock Incentive Plan (incorporated by reference to Exhibit 10.51 to Sterling Construction Company, Inc. s Annual Report on Form 10-K for the year ended December 31, 2004, filed on March 29, 2005 (SEC File No. 001-31993)).
10.6#	Oakhurst Company, Inc. 2001 Stock Incentive Plan (incorporated by reference to Exhibit 10.6 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
10.7#	Forms of Stock Option Agreement under the Oakhurst Company, Inc. 2001 Stock Incentive Plan (incorporated by reference to Exhibit 10.51 to Sterling Construction Company, Inc. s Annual Report on Form 10-K for the year ended December 31, 2004, filed on March 29, 2005 (SEC File No. 001-31993)).
10.8#	Form of Employee Stock Option Agreement, dated as of August 29, 1991, by and between Hallwood Holdings Incorporated and certain of its directors and officers (incorporated by reference to Exhibit 10.8 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
10.12#	Employment Agreement, dated as of July 18, 2004, by and between Patrick T. Manning, Sterling Construction Company, Inc. and Sterling Houston Holdings, Inc. (incorporated by reference to Exhibit 99.1 to Sterling Construction Company, Inc. s Current Report on Form 8-K, dated as of March 23, 2005, filed on March 28, 2005 (SEC File No. 001-31993)).
10.13#	Employment Agreement, dated as of July 18, 2004, by and between Joseph P. Harper, Sr., Sterling Construction Company, Inc. and Sterling Houston Holdings, Inc. (incorporated by reference to Exhibit 99.2 to Sterling Construction Company, Inc. s Current Report on Form 8-K, dated as of March 23, 2005, filed on March 28, 2005 (SEC File No. 001-31993)).
10.14#	Employment Agreement, dated as of July 13, 2005, by and between Maarten D. Hemsley and Sterling Construction Company, Inc. (incorporated by reference to Exhibit 10.1 to its Quarterly Report on Form 10-Q for the quarter ended September 30, 2005, filed on November 7, 2005 (SEC File No. 001-31993)).
10.15#	Summary of Compensation for Non Employee Directors of Sterling Construction Company, Inc. (incorporated by reference to Exhibit 10.15 to its Registration Statement on Form S
10.26	Oakhurst Group Tax Sharing Agreement, dated as of July 18, 2001, by and among Oakhurst Company, Inc., Sterling Construction Company, Steel City Products, Inc. and such other companies as are set forth on Schedule A thereto (incorporated by reference to Exhibit 10.28 to Sterling Construction Company, Inc. s Transition Report on Form 10-K for the ten months ended December 31, 2001, filed on April 8, 2002 (SEC File No. 000-19450)).
10.27	Fourth Amended and Restated Revolving Credit Loan Agreement, dated as of May 10, 2006, by and between Comerica Bank, Sterling Construction Company, Inc., Sterling General, Inc., Sterling Houston Holdings, Inc. Texas Sterling Construction, L.P. (incorporated by reference to Exhibit 10.1 (and referred to as Amended Revolving Line of Credit Agreement with Comerica Bank ) to Sterling Construction Company, Inc. s Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2006, filed on November 13, 2006 (SEC File No. 001-31993)).

- 10.28 Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.1 to Oakhurst Company, Inc. s Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2001, filed on August 16, 2001 (SEC File No. 000-19450)).

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<b>Number</b>	<b>Exhibit Title</b>
10.29	Amendment, dated as of September 12, 2001, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.3 to Oakhurst Company, Inc. s Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2001, filed on October 22, 2001 (SEC File No. 000-19450)).
10.30	Second Amendment, dated as of December 13, 2001, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.35 to Sterling Construction Company, Inc. s Transition Report on Form 10-K for the ten months ended December 31, 2002, filed on April 8, 2002 (SEC File No. 000-19450)).
10.31	Third Amendment, dated as of June 27, 2002, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.31 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
10.32	Fourth Amendment, dated as of September 25, 2002, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.32 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
10.33	Fifth Amendment, dated as of November 30, 2002, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.33 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
10.34	Sixth Amendment, dated as of January 15, 2003, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.34 to Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on November 17, 2005 (SEC File number 333-129780)).
10.35	Seventh Amendment to Credit Agreement and Waiver, dated as of November 6, 2003, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.35 to Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).
10.36	Eighth Amendment to Credit Agreement, dated as of September 17, 2004, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.36 to Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).
10.37	Ninth Amendment to Credit Agreement, dated as of December 21, 2004, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.37 Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).
10.38	Tenth Amendment to Credit Agreement, dated as of April 18, 2005, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.38 to Sterling

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Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).

- 10.39 Eleventh Amendment to Credit Agreement and Note, dated as of June 3, 2005, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.39 to Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).

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<b>Number</b>	<b>Exhibit Title</b>
10.40	Twelfth Amendment to Credit Agreement, dated as of September 14, 2005, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.40 to Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).
10.42#	Amendment No. 1 to Executive Employment Agreement, dated November 2, 2005, by and between Patrick T. Manning, Sterling Construction Company, Inc., Sterling General, Inc. and Sterling Houston Holdings, Inc. (incorporated by reference to Exhibit 10.36 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
10.43#	Amendment No. 1 to Executive Employment Agreement, dated November 2, 2005, by and between Joseph P. Harper, Sr., Sterling Construction Company, Inc., Sterling General, Inc. and Sterling Houston Holdings, Inc. (incorporated by reference to Exhibit 10.37 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
10.45#	Note Prepayment Agreement, dated as of December 27, 2005, by and between SCC and certain of its noteholders named therein (incorporated by reference to Exhibit 10.1 to SCC s Current Report on Form 8-K, dated as of December 27, 2005, filed on December 27, 2005 (SEC File No. 001-31993)).
10.46#	[Note Prepayment] Termination Agreement, dated as of December 30, 2005, by and between Sterling Construction Company, Inc. and certain of its noteholders named therein (incorporated by reference to Exhibit 10.1 to SCC s Current Report on Form 8-K, dated as of December 30, 2005, filed on January 3, 2006 (SEC File No. 001-31993)).
21	Subsidiaries of Sterling Construction Company, Inc. (incorporated by reference to Exhibit 21 to Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).
23.1*	Consent of Grant Thornton LLP.
31.1*	Certification of Patrick T. Manning, Chief Executive Officer of Sterling Construction Company, Inc.
31.2*	Certification of Maarten D. Hemsley, Chief Financial Officer of Sterling Construction Company, Inc.
32.0*	Certification pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350) of Patrick T. Manning, Chief Executive Officer, and Maarten D. Hemsley, Chief Financial Officer.
#	Management contract or compensatory plan or arrangement.
*	Filed herewith.

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**Signatures**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**Sterling Construction Company, Inc.**

Dated: March 14, 2007

By: /s/ Patrick T. Manning  
 Patrick T. Manning, Chief Executive  
 Officer  
 (duly authorized officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ Patrick T. Manning Patrick T. Manning	Chairman of the Board of Directors; Chief Executive Officer (principal executive officer)	March 14, 2007
/s/ Joseph P. Harper, Sr. Joseph P. Harper, Sr.	President, Treasurer & Chief Operating Officer; Director	March 14, 2007
/s/ Maarten D. Hemsley Maarten D. Hemsley	Chief Financial Officer; Director (principal financial officer)	March 14, 2007
/s/ Karen A. Stempinski Karen A. Stempinski	Vice President, Controller & Chief Accounting Officer (principal accounting officer)	March 14, 2007
/s/ John D. Abernathy John D. Abernathy	Director	March 14, 2007
Donald P. Fusilli, Jr.	Director	March 14, 2007
/s/ Robert W. Frickel Robert W. Frickel	Director	March 14, 2007
/s/ Christopher H. B. Mills Christopher H. B. Mills	Director	March 14, 2007
/s/ Milton L. Scott	Director	March 14, 2007



Milton L. Scott

/s/ David R. A. Steadman

Director

March 14, 2007

David R. A. Steadman

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
Sterling Construction Company, Inc.

We have audited management's assessment, included in the accompanying management's Report on Internal Control Over Financial Reporting, appearing under Item 9A, that Sterling Construction Company, Inc. (a Delaware corporation) and subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Sterling Construction Company, Inc. and subsidiaries management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Sterling Construction Company, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, Sterling Construction Company, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Sterling Construction Company, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006 and our report dated March 14, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ GRANT THORNTON LLP

Houston, Texas

March 14, 2007

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
Sterling Construction Company, Inc.

We have audited the accompanying consolidated balance sheets of Sterling Construction Company, Inc. (a Delaware corporation) and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sterling Construction Company, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment", on a modified prospective basis as of January 1, 2006. Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. Schedule II is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Sterling Construction Company, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 14, 2007, expressed an unqualified opinion on management's assessment of the effectiveness of internal control over financial reporting and an unqualified opinion on the effectiveness of internal control over financial reporting.

/s/ GRANT THORNTON LLP

Houston, Texas

March 14, 2007

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**STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

**December 31, 2006 and 2005**

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

	<b>2006</b>	<b>2005</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 28,466	\$ 22,267
Short-term investments	26,169	
Accounts receivable, other	276	
Contracts receivable	42,805	34,912
Costs and estimated earnings in excess of billings on uncompleted contracts	3,157	2,199
Inventories	965	
Deferred tax asset	4,297	4,224
Assets of discontinued operations held for sale		8,969
Note receivable, current	300	
Other	973	1,056
Total current assets	107,408	73,627
Property and equipment, net	46,617	27,271
Goodwill	12,735	12,735
Deferred tax asset, net		4,288
Note receivable, long term	325	
Other assets	687	534
	13,747	17,557
Total assets	\$ 167,772	\$ 118,455
 <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 17,373	\$ 20,416
Billings in excess of cost and estimated earnings on uncompleted contracts	21,536	13,635
Short-term debt, related parties		8,449
Current maturities of long term obligations	123	123
Liabilities of discontinued operations held for sale		8,385
Other accrued expenses	5,502	4,265
Total current liabilities	44,534	55,273
Long-term obligations:		
Long-term debt, net of current maturities	30,659	14,570
Deferred tax liability, net	1,588	
	32,247	14,570
Commitments and contingencies		
Stockholders' equity:		

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Preferred stock, par value \$0.01 per share; authorized 1,000,000 shares, none issued		
Common stock, par value \$0.01 per share; authorized 14,000,000 shares, 10,875,438 and 8,165,123 shares issued	109	82
Additional paid in capital	114,630	82,822
Accumulated deficit	(23,748)	(34,292)
Total stockholders' equity	90,991	48,612
Total liabilities and stockholders' equity	\$ 167,772	\$ 118,455

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

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**Table of Contents****STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS****December 31, 2006, 2005 and 2004****(Amounts in thousands, except share and per share data)**

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Revenues	\$ 249,348	\$ 219,439	\$ 132,478
Cost of revenues	220,801	195,683	119,217
Gross profit	28,547	23,756	13,261
General and administrative expenses	10,825	9,375	7,692
Other income (loss)	276	284	(4)
Operating income	17,998	14,665	5,565
Interest income	1,426	150	9
Interest expense	220	1,486	1,465
Income from continuing operations before minority interest and income taxes	19,204	13,329	4,109
Minority interest			962
Income from continuing operations before income taxes	19,204	13,329	3,147
Income tax expense (benefit):			
Current	310	257	169
Deferred	6,256	2,531	(2,303)
Total income tax expense (benefit)	6,566	2,788	(2,134)
Net income from continuing operations	12,638	10,541	5,281
Income from discontinued operations, including gain on disposal of \$121, net of income taxes of \$308, \$313 and \$216	682	559	372
Net income	\$ 13,320	\$ 11,100	\$ 5,653
Basic net income per share:			
Net income from continuing operations	\$ 1.19	\$ 1.36	\$ 0.99
Net income from discontinued operations	\$ 0.06	\$ 0.07	\$ 0.07
Net income	\$ 1.25	\$ 1.43	\$ 1.06
Weighted average number of shares outstanding used in computing basic per share amounts	10,582,730	7,775,476	5,342,847
Diluted net income per share:			
Net income from continuing operations	\$ 1.08	\$ 1.11	\$ 0.75
Net income from discontinued operations	\$ 0.06	\$ 0.05	\$ 0.05

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Net income	\$	1.14	\$	1.16	\$	0.80
Weighted average number of shares outstanding used in computing diluted per share amounts		11,714,310		9,537,923		7,027,682

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

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**STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**  
**For the years ended December 31, 2006, 2005 and 2004**  
**(Amounts in thousands)**

	Common stock		Additional		Treasury	
	Shares	Amount	paid in	Accumulated	stock	Total
			capital	deficit		
Balance at December 31, 2003	5,140	\$ 51	\$ 67,631	\$ (51,045)	\$ (1)	\$ 16,636
Stock issued upon option exercise	220	2	403			405
Stock based compensation expense			381			381
Conversion of debt to stock	450	5	1,714			1,719
Shares issued upon settlement of Put	1,569	16	8,051			8,067
Purchase of minority interest of SCPL			(49)			(49)
Reduction of valuation allowance deferred tax asset			2,396			2,396
Net income				5,653		5,653
Balance at December 31, 2004	7,379	74	80,527	(45,392)	(1)	35,208
Stock issued upon option exercise	786	8	819			827
Stock based compensation expense			463			463
Tax benefit of stock option exercise			1,013			1,013
Cancellation of treasury stock of SCPL					1	1
Net income				11,100		11,100
Balance at December 31, 2005	8,165	82	82,822	(34,292)		48,612
Stock issued upon option/warrant exercise	701	7	906			913
Stock based compensation expense			991			991
Stock issued in equity offering, net of expenses	2,003	20	27,019			27,039
Issuance of restricted stock	6		117			117
Available excess tax benefits from exercise of			2,775	(2,775)		



stock options							
Net income				13,320			13,320
Balance at December 31, 2006	10,875	\$ 109	\$ 114,630	\$ (23,748)	\$		\$ 90,991

The accompanying notes are an integral part of this consolidated financial statement  
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**STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the years ended December 31, 2006, 2005 and 2004**  
**(Amounts in thousands, except share data)**

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Net income	\$ 13,320	\$ 11,100	\$ 5,653
Net income from discontinued operations	682	559	372
Net income from continuing operations	12,638	10,541	5,281
Adjustments to reconcile income from continuing operations to net cash provided by continuing operating activities:			
Depreciation and amortization	7,011	5,064	4,545
(Gain) loss on sale of property and equipment	(276)	(279)	4
Deferred tax expense (benefit)	6,256	2,531	(2,303)
Stock based compensation expense	1,108	463	381
Minority interest in net earnings of subsidiary			962
Fair value of induced conversion of debt to equity			257
Other changes in operating assets and liabilities:			
(Increase) decrease in contracts receivable	(7,893)	(8,662)	254
(Increase) decrease in costs and estimated earnings in excess of billings on uncompleted contracts	(958)	3,685	(4,603)
Increase in inventories	(965)		
(Increase) decrease in prepaid expenses and other assets	(46)	730	370
(Decrease) increase in trade payables	(3,043)	6,034	4,487
Increase (decrease) in billings in excess of costs and estimated earnings on uncompleted contracts	7,901	9,158	(5,265)
Increase (decrease) in accrued compensation and other liabilities	1,356	2,001	(199)
Net cash provided by continuing operating activities	23,089	31,266	4,171
Cash flows from continuing operations investing activities:			
Purchase of certain assets of RDI	(2,206)		
Net cash paid upon acquisition of TSC minority interest			(2,446)
Additions to property and equipment	(24,849)	(11,392)	(3,555)
Proceeds from sale of property and equipment	866	420	192
Purchases of short-term securities, available for sale	(144,192)		
Sales of short-term securities, available for sale	118,023		
Net cash used in continuing operations investing activities	(52,358)	(10,972)	(5,809)
Cash flows from continuing operations financing activities:			
Cumulative daily drawdowns- revolver	106,025	139,593	102,531
Cumulative daily reductions revolver	(89,813)	(139,134)	(95,770)
Repayments under related party long term debt	(8,449)	(2,649)	(3,995)
Repayments under long-term obligations	(123)	(113)	(735)
Increase in deferred loan costs	(123)		

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Issuance of common stock pursuant to warrants and options	913	827	405
Net proceeds from sale of common stock	27,039		
Net cash provided by (used in) continuing operations financing activities	35,468	(1,476)	2,436
Net increase in cash and cash equivalents from continuing operations	6,199	18,818	798
Cash provided by (used in) discontinued operating activities	495	(294)	(977)
Cash used in discontinued operations investing activities	4,739		(34)
Cash (used in) provided by discontinued operations financing activities	(5,357)	349	964

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	<b>2006</b>	<b>2005</b>	<b>2004</b>
Net cash (used in) provided by discontinued operations	(123)	55	(47)
Cash and cash equivalents at beginning of period	22,267	3,449	2,651
Cash and cash equivalents at end of period	\$ 28,466	\$ 22,267	\$ 3,449
Supplemental disclosures of cash flow information:			
Cash paid during the period for interest	\$ 521	\$ 1,916	\$ 2,097
Cash paid during the period for taxes	\$ 300	\$ 355	\$ 14
Supplemental disclosure of non-cash financing activities:			
Capital lease obligations for new equipment		\$ 83	\$ 26

224,000 shares of common stock were issued upon the conversion of \$560 of convertible debt in 2004.

1,569,000 additional shares of common stock were issued upon the conversion of \$901 of zero coupon notes in 2004 upon settlement of the Put.

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

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**STERLING CONSTRUCTION COMPANY, INC. & SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Summary of Business and Significant Accounting Policies**

***Basis of Presentation:***

Sterling Construction Company, Inc. ( Sterling or the Company ) owns two subsidiaries; Sterling Houston Holdings, Inc and Steel City Products, LLC. Sterling Houston Holdings is a 99% limited partner of Texas Sterling Construction Company, LP a Texas limited partnership that operates the construction business and that was, in a different form, the predecessor of Sterling Houston Holdings. For ease of reference, Sterling Houston Holdings, Inc. and Texas Sterling Construction, L.P. are referred to collectively as Construction or TSC , and Steel City Products, LLC is referred to as Distribution or SCPL . The assets and liabilities of the business of SCPL were sold in October 2006.

The accompanying consolidated financial statements include the accounts of subsidiaries in which the Company has a greater than 50% ownership interest and all significant intercompany accounts and transactions have been eliminated in consolidation. For all years presented, the Company had no subsidiaries with ownership interests of less than 50%.

***Organization and business:***

The Company s primary business consists of the operations of TSC, a heavy civil construction company based in Houston, Texas. Until October 27, 2006, the Company also operated a smaller business, which consisted of the operations of SCPL, a wholesale distributor of automotive accessories, pet supplies and lawn and garden products, based in McKeesport, Pennsylvania. In August 2005 management identified SCPL as held for sale and accordingly reclassified its consolidated financial statements for all periods to separately present Distribution as discontinued operations. See Note 2 for a discussion on the sale of the business of SCPL.

***Use of Estimates:***

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which require 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 amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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, estimates for the use of the Company s net operating loss carryforwards and the allowance for doubtful accounts. Management evaluates all of its estimates and judgments on an on-going basis.

***Revenue Recognition:***

***Construction***

The Company s primary business since July 2001 has been as a general contractor in the State of Texas where it engages in various types of heavy civil construction projects principally for public owners. Credit risk is minimal with public (government) 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

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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.

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. An amount attributable to contract claims is included in revenues when realization is probable and the amount can be reliably estimated. The Company generally provides a one-year warranty for workmanship under its contracts. Warranty claims historically have been inconsequential.

The asset, Costs and estimated earnings in excess of billings on uncompleted contracts represents revenues recognized in excess of amounts billed. The liability Billings in excess of costs and estimated earnings on uncompleted contracts represents billings in excess of revenues recognized.

***Distribution***

Distribution s revenue was earned primarily from the sale of products to retail companies. Revenue was recognized when all of the following criteria were met:

Persuasive evidence of an arrangement existed

Delivery had occurred or service was rendered

Distribution s price to the buyer had been fixed or was determinable, and

Collectibility was reasonably assured.

***Cash and Cash Equivalents:***

The Company considers all highly liquid investments with maturities of three months or less to be cash equivalents. Included in cash and cash equivalents at December 31, 2006 and 2005 are uninsured temporary cash investments of \$40.1 million and \$26.2 million, respectively, in a money market fund stated at fair value. Additionally, the Company maintains cash in bank deposit accounts that at times may exceed federally insured limits. For the years ended December 31, 2006, 2005 and 2004, the Company recorded interest income of \$1.4 million, \$150,000 and \$9,000, respectively.

***Short-term Investments***

The Company classifies its short-term investments (including auction-rate securities) as securities available for sale in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*". At December 31, 2006, the Company had short-term securities available for sale of \$26.2 million.

***Contracts Receivable:***

Contracts receivable are based on contracted prices. Based upon a review of outstanding contracts receivable, historical collection information and existing economic conditions, management has determined that all contracts receivable at December 31, 2006 and 2005 are fully collectible, and accordingly, no allowance for doubtful accounts against contracts receivable is required. Contracts receivable are written

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off based on individual credit evaluation and specific circumstances of the customer, when such treatment is warranted.

**Accounts Receivable:**

The Company maintained an allowance for doubtful accounts for Distribution, which was reviewed periodically based on customer credit history reports and other factors including payment history and sales levels. Past due balances over 90 days and other higher risk accounts were reviewed individually for collectibility. Account balances were charged against the allowance after all collection efforts had been exhausted and the potential for recovery was considered remote. The allowance decreased in 2005 by \$163,000 due to the write-off of the debt owed by a bankrupt customer, which had been completely reserved. The allowance for doubtful accounts, included in the assets of discontinued operations held for sale was \$853,000 in 2005. Upon sale of the Distribution business, the Company retained an accounts receivable from Ames Department Stores (a bankrupt customer of SCPL) in the net carrying amount of \$18,000. Because of the nature of the receivable, the Company believes the collection is reasonably assured.

**Retainage:**

Many of the contracts under which Construction performs work contain retainage provisions. Retainage refers to that portion of billings made by the Company but held for payment by the customer pending satisfactory completion of the project. Unless reserved, the Company assumes that all amounts retained by customers under such provisions are fully collectible. Retainage on active contracts is classified as a current asset regardless of the term of the contract. Retainage is generally collected within one year of the completion of a contract. Retainage was approximately \$16.4 million and \$14.3 million at December 31, 2006 and December 31, 2005, respectively, of which \$7.1 million at December 31, 2006 is expected to be collected beyond 2007. At December 31, 2005, retainage expected to be collected beyond 2006 was \$1.4 million.

**Inventories:**

The Company's Construction inventories are stated at the lower of cost or market as determined by the average cost method. Inventories at December 31, 2006 consist primarily of raw materials, such as concrete and millings which are expected to be utilized in construction projects in the future. The cost of inventory includes labor, trucking and other equipment costs. At December 31, 2005, Construction did not have inventories. Distribution held inventories at the lower of cost or market as determined by the first-in first-out (FIFO) method. Inventories at Distribution were included in the assets of discontinued operations at December 31, 2005. Pursuant to the agreement for the sale of Distribution's business, the Company recorded a liability of \$50,000 representing the estimated cost of certain Distribution inventory not expected to be sold by the buyer following the sale of the business.

**Property and Equipment:**

Property and equipment are stated at cost. Depreciation and amortization are computed using the straight-line method. The estimated useful lives used for computing depreciation and amortization are as follows:

Building	39 years
Construction equipment	5-15 years
Land improvements	5-15 years
Office furniture and fixtures	3-10 years
Transportation equipment	5 years
Leasehold improvements*	3-10 years, depending on lease term
Warehouse equipment*	3-10 years

\* All leasehold improvements and warehouse equipment were owned by SCPL,

*which was sold  
on October 27,  
2006.*

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Depreciation expense was approximately \$6.9 million, \$5.1 million, and \$4.5 million in 2006, 2005 and 2004, respectively, for continuing operations, and approximately \$0.1 million for discontinued operations in each of 2006, 2005 and 2004.

***Deferred Loan Costs:***

Deferred loan costs represent loan origination fees paid to the lender and related professional fees. These fees are amortized over the term of the loan. In 2006, TSC renewed its line of credit and substantially increased its borrowing limit. The Company incurred loan costs in the amount of \$123,000 upon renewal of the line, which are being amortized over the three year term of the line of credit. Loan cost amortization expense for fiscal years 2006, 2005 and 2004 was \$99,000, \$56,000 and \$82,000, respectively.

***Financial instruments:***

The Company's financial instruments are cash and cash equivalents, contracts receivable, accounts payable, mortgages payable and long-term debt. The recorded values of cash and cash equivalents, contracts receivable and accounts payable approximate their fair values based on their short-term nature. The recorded values of mortgages payable and long-term debt approximate their fair values, and interest approximates market rates.

***Goodwill:***

Goodwill represents the excess of the cost of companies acquired over the fair value of their net assets at the dates of acquisition.

The Company accounts for goodwill in accordance with Statement of Financial Accounting Standards No. 142

*Goodwill and Other Intangible Assets* (SFAS 142). SFAS 142 requires that: (1) goodwill and indefinite lived intangible assets are no longer amortized, (2) goodwill is tested for impairment at least annually at the reporting unit level, (3) the amortization period of intangible assets with finite lives is no longer limited to forty years, and (4) intangible assets deemed to have an indefinite life are tested for impairment at least annually by comparing the fair value of these assets with their recorded amounts.

Goodwill impairment is tested on the first day of the last quarter of each calendar year. The first step compares the book value of the Company's stock to the fair market value of the shares as reported on a widely recognized internet web site. If the fair market value of the stock is greater than the calculated book value of the stock, the goodwill is deemed not to be impaired and no further testing is required. If the fair market value is less than the calculated book value, additional steps of determining fair value of additional assets can be taken to determine impairment. Step one indicated the fair market value of the Company's stock was in excess of the book value and no further testing was required. Based on the results of such tests for impairment, the Company concluded that no impairment of goodwill existed on October 1, 2006.

Intangible assets that have finite lives continue to be subject to amortization. In addition, the Company must evaluate the remaining useful life in each reporting period to determine whether events and circumstances warrant a revision of the remaining period of amortization. If the estimate of an intangible assets remaining life is changed, the remaining carrying amount of such asset is amortized prospectively over that revised remaining useful life. There have been no changes in goodwill in 2006 and 2005.

***Equipment Under Capital Leases:***

The Company's policy is to account for capital leases, which transfer substantially all the benefits and risks incident to the ownership of the property to the Company, as the acquisition of an asset and the

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incurrence of an obligation. Under this method of accounting, the recorded value of the leased asset is amortized principally using the straight-line method over its estimated useful life and the obligation, including interest thereon, is reduced through payments over the life of the lease. Depreciation expense on leased equipment and the related accumulated depreciation is included with that of owned equipment. Capital leases were included in the assets and liabilities of discontinued operations until the sale date of October 27, 2006.

***Shipping and Handling Costs:***

Shipping costs at Distribution were recorded in cost of goods sold. Expenses incurred for handling goods in preparation for shipment to customers totaled \$829,000 and \$772,000 during fiscal years 2005 and 2004, respectively and were \$679,000 through October 27, 2006, the date of the sale of the business. These expenses were primarily related to warehouse personnel. Shipping and handling revenues were not significant.

***Federal and State Income Taxes:***

Sterling accounts for income taxes using an asset and liability approach. Deferred tax liabilities and assets are recognized for the future tax consequences of events that have already been recognized in the financial statements or tax returns. Net deferred tax assets are recognized to the extent that management believes that realization of such benefits is considered more likely than not. Changes in enacted tax rates or laws may result in adjustments to the recorded deferred tax assets or liabilities in the period that the tax law is enacted (see Note 8).

***Stock-Based Compensation:***

The Company has five stock-based incentive plans which are administered by the Compensation Committee of the Board of Directors. Prior to August 2006, the Company used the closing price of its common stock on the trading day immediately preceding the date the option was approved as the grant date market value. Since July 2006, the Company's policy has been to use the closing price of the common stock on the date of the meeting at which a stock option award is approved as the option's per-share exercise price. The term of the grants do not exceed 10 years. Stock options generally vest over a three to five year period. Refer to Note 10 for further information regarding the stock-based incentive plans.

Effective January 1, 2006, the Company adopted the provisions of SFAS 123(R), using the modified prospective transition method and therefore has not restated financial results for prior periods. Since January 1, 2003, the Company has accounted for its stock-based compensation under the provisions of SFAS No. 148 *Accounting for Stock-Based Compensation - Transition and Disclosure* which amended SFAS Statement No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. Because the Company had utilized the fair value method for expensing stock options in the past several years, the impact on financial results of the transition to SFAS 123(R) at January 1, 2006 for unvested options was not material. The Company utilizes the Black-Scholes valuation model to estimate the fair value of its stock option grants. The fair value is recognized on a straight-line basis over the vesting period.

The Company recorded compensation expense of approximately \$84,000 and \$315,000 in 2005 and 2004, respectively, related to options granted between June 2000 and January 2003 under option plans that were subject to variable option accounting. The Board of Directors amended these plans in March 2004 with the result that the market price at which these options are measured as compensation expense throughout their vesting periods was fixed at the date of such amendment.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS Statement No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation (amounts in thousands, except per share data). Because the Company has net operating loss carryforwards to offset taxable income, it is unable to recognize excess tax benefits generated from the exercise of non-qualified stock options until the net

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operating loss carryforwards are exhausted. Therefore, there was no impact on cash flows from operating activities and financing activities upon adoption of SFAS 123(R).

	<b>Fiscal Year Ended December 31, 2005</b>	<b>Fiscal Year Ended December 31, 2004</b>
Net income from continuing operations, as reported	\$ 10,541	\$ 5,281
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	463	381
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(418)	(117)
Proforma net income from continuing operations	10,586	5,545
Net income from discontinued operations	559	372
Proforma net income	\$ 11,145	\$ 5,917
Basic and diluted net income per share:		
From continuing operations:		
Basic, as reported	\$ 1.36	\$ 0.99
Diluted, as reported	\$ 1.11	\$ 0.75
Proforma, basic	\$ 1.36	\$ 1.03
Proforma, diluted	\$ 1.11	\$ 0.79
From discontinued operations:		
Basic, as reported	\$ 0.07	\$ 0.07
Diluted, as reported	\$ 0.05	\$ 0.05
Proforma, basic	\$ 0.07	\$ 0.07
Proforma, diluted	\$ 0.05	\$ 0.05
Total:		
Basic, as reported	\$ 1.43	\$ 1.06
Diluted, as reported	\$ 1.16	\$ 0.80
Proforma, basic	\$ 1.43	\$ 1.10
Proforma, diluted	\$ 1.16	\$ 0.84

**Net Income Per Share:**

Basic net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share is the same as basic but assumes the exercise of convertible subordinated debt securities and includes dilutive stock options and warrants using the treasury stock method. The following table reconciles the numerators and denominators of the basic and diluted per common share computations for net income for 2006, 2005 and 2004 (in thousands, except per share data):

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Numerator:			
Net income from continuing operations, as reported	\$ 12,638	\$ 10,541	\$ 5,281
Interest on convertible debt, net of tax			44
	12,638	10,541	5,325

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Net income from continuing operations before interest on convertible debt

Income from discontinued operations, net of taxes	682	559	372
Net income before interest on convertible debt	\$ 13,320	\$ 11,100	\$ 5,697
Denominator:			
Weighted average common shares outstanding basic	10,583	7,775	5,343

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	<b>2006</b>	<b>2005</b>	<b>2004</b>
Shares for dilutive stock options and warrants	1,131	1,763	1,685
Weighted average common shares outstanding and assumed conversions diluted	11,714	9,538	7,028
Basic earnings per common share:			
Net income from continuing operations	\$ 1.19	\$ 1.36	\$ 0.99
Net income from discontinued operations	\$ 0.06	\$ 0.07	\$ 0.07
Net income	\$ 1.25	\$ 1.43	\$ 1.06
Diluted earnings per common share:			
Net income from continuing operations	\$ 1.08	\$ 1.11	\$ 0.75
Net income from discontinued operations	\$ 0.06	\$ 0.05	\$ 0.05
Net income	\$ 1.14	\$ 1.16	\$ 0.80

The 81,500 options granted in 2006 were considered antidilutive at December 31, 2006 as the option exercise price exceeded the average share price. No options or warrants were considered antidilutive at December 31, 2005 and 2004.

**Derivatives**

Financial derivatives, consisting of interest rate swap agreements, are used as part of the Company's overall risk management strategy to manage the risk related to changes in interest rates. Interest rate swap agreements are used to modify variable rate obligations to fixed rate obligations, thereby reducing the exposure to higher interest rates. Amounts paid or received under interest rate swap agreements are accrued as interest rates change with the offset recorded in interest expense.

The Company applies SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Under SFAS No. 133, the Company's interest rate swaps have not been designated as hedging instruments; therefore changes in fair value are recognized in current earnings.

**Interest Costs**

During 2006, TSC began expansion of its maintenance facilities and office building. Construction was in progress at December 31, 2006. Accordingly, approximately \$14,000 of interest related to the construction of qualifying assets is capitalized as part of construction costs in accordance with SFAS No. 34 *Capitalization of Interest Cost*.

**Self-Insurance**

The Company is primarily self-insured for workers' compensation insurance, up to \$250,000 per occurrence, with a maximum of \$2.7 million per year. Operations are charged with the cost of claims reported and an estimate of claims incurred but not reported. A liability for unpaid claims and associated expenses, including incurred but not reported claims, is reflected in the balance sheet as an accrued liability. At December 31, 2006 and 2005, the Company's accrued liability for such claims was \$575,000 and \$673,000, respectively.

The Company also has a self-insured health plan for its employees and has purchased stop-loss insurance to limit its exposure. See Note 16 for details of the health insurance plan.

**Recent Accounting Pronouncements:**

In February 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments* an amendment of FASB Statements No. 133 and 140 which is effective for fiscal years beginning after September 15, 2006. The statement was issued to clarify the application of FASB Statement No. 133 to beneficial interests in securitized financial assets and to improve the consistency of accounting for similar financial instruments, regardless of the form of the instruments. The Company

has evaluated the new statement and determined that the potential impact on its financial statements will not be material.

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In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets* an amendment of FASB Statement No. 140 which is effective for fiscal years beginning after September 15, 2006. This statement was issued to simplify the accounting for servicing rights and to reduce the volatility that results from using different measurement attributes. The Company has evaluated the new statement and has determined that it will not have a significant impact on the determination or reporting of its financial results.

In July 2006, the FASB issued Interpretation 48, *Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109*. Interpretation 48, which clarifies Statement 109, *Accounting for Income Taxes*, establishes the criterion that an individual tax position has to meet for some or all of the benefits of that position to be recognized in the Company's financial statements. On initial application, Interpretation 48 will be applied to all tax positions for which the statute of limitations remains open. Only tax positions that meet the more-likely-than-not recognition threshold at the adoption date will be recognized or continue to be recognized. The cumulative effect of applying Interpretation 48 will be reported as an adjustment to retained earnings at the beginning of the period in which it is adopted. Interpretation 48 is effective for fiscal years beginning after December 15, 2006, and was adopted by the Company on January 1, 2007. The Company does not believe that the adoption of Interpretation 48 will have a significant effect on its financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS 157 is effective for financial statements for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, with early adoption permitted. The Company does not expect the implementation of SFAS 157 to have a material impact on its consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. Under this bulletin, registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for fiscal years ending on or after November 15, 2006. Adoption of SAB 108 did not have a material impact on the Company's consolidated financial statements.

In September 2006, the FASB ratified a consensus opinion reached by the Emerging Issues Task Force (EITF) on EITF Issue 06-5, *Accounting for Purchases of Life Insurance - Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4*. The guidance in EITF Issue 06-5 requires policyholders to consider other amounts included in the contractual terms of an insurance policy, in addition to cash surrender value, for purposes of determining the amount that could be realized under the terms of the insurance contract. If it is probable that contractual terms would limit the amount that could be realized under the insurance contract, those contractual limitations should be considered when determining the realizable amounts. The amount that could be realized under the insurance contract should be determined on an individual policy (or certificate) level and should include any amount realized on the assumed surrender of the last individual policy or certificate in a group policy.

EITF Issue 06-5 is effective for fiscal years beginning after December 15, 2006. The Company intends to adopt EITF Issue 06-5 effective January 1, 2007, and does not believe that the adoption will have a significant effect on its financial statements.

**Table of Contents****Reclassifications:**

Certain prior years' balances (other income and interest income) have been reclassified to conform to current year presentation.

**2. Discontinued operations/Sale of the operations of SCPL**

In 2005 management identified SCPL as held for sale and accordingly, reclassified its consolidated financial statements for all periods to separately present Distribution as discontinued operations.

On October 27, 2006, the Company sold the operations of SCPL to an industry buyer based in Toledo, Ohio. The Company received proceeds from the sale of \$5.4 million, which included a two-year promissory note in the amount of \$650,000. From the proceeds, the Company paid SCPL's revolving line of credit in full and retained and settled certain liabilities primarily related to severance and bonus payments. The Company reported a pre-tax gain of \$249,000 on the sale, equal to \$121,000 after taxes. The Company retained an accounts receivable, which it believes is fully collectible and recorded liabilities related to the right of the purchaser to request payment for certain inventory not sold within a year and for legal claims which remained unresolved at the sale date.

Summarized financial information for discontinued operations is presented below (in thousands):

	<b>2006*</b>	<b>2005</b>	<b>2004</b>
Net sales	\$ 17,661	\$ 22,029	\$ 21,700
Income before income taxes	741	872	588
Income taxes	180	313	216
Gain on disposal, net of tax of \$128	121		
Net income from discontinued operations	\$ 682	\$ 559	\$ 372

\* through the date of sale, October 27, 2006

The following is a summary of the assets and liabilities of discontinued operations (in thousands):

	<b>December 31, 2005</b>
Assets	
Current assets	\$ 8,286
Deferred tax asset, current	312
Total current assets	8,598
Property, plant and equipment, net	210
Goodwill	128
Deferred tax asset, long-term	30
Other assets	3
	\$ 8,969
Liabilities	
Current liabilities*	\$ 8,326
Long-term obligations, net of current portion	59
	\$ 8,385



Net assets \$ 584

\* The SCPL  
revolver is  
included in  
current  
liabilities.

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**Table of Contents****3. Property and Equipment**

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

	December 31, 2006	December 31, 2005
Construction equipment	\$ 56,406	\$ 35,663
Transportation equipment	7,685	5,204
Buildings	1,488	1,488
Office equipment	435	490
Construction in progress	259	
Land	1,204	182
	67,477	43,027
Less accumulated depreciation	(20,860)	(15,756)
	\$ 46,617	\$ 27,271

Warehouse equipment financed under capital leases by SCPL amounted to \$124,000 at December 31, 2005, and accumulated depreciation related to such leased assets was \$39,000. These assets were included in the assets of discontinued operations and were sold as part of the sale of the business.

**4. Investment in Affiliated Company ( *Sterling Transaction* )**

In July 2001, the Company completed a transaction (the *Sterling Transaction* ) in which it increased its equity ownership in TSC from 12% to 80.1%.

Total consideration for the 80.1% ownership interest in TSC was \$24.6 million, including the Company's previous investment in TSC of \$3.5 million, and consisted of (a) cash payment of \$9.9 million, (b) conversion of a \$1.3 million TSC subordinated note receivable into Sterling equity, (c) issuance of subordinated notes and warrants, and (d) the sale and issuance of the Company's common stock. For accounting purposes, the value of the 1,124,536 shares of common stock sold was determined based on the average trading price of the Company's common shares over the 5-day period before and after the closing date.

As part of the *Sterling Transaction*, the Company granted the selling shareholders a Put option for the remaining 19.9% of TSC stock owned by them, pursuant to which they had the right to sell those TSC shares to the Company at a date of their choosing between July 2004 and July 2005 at a minimum price of \$105 per TSC share. The Company recorded the fair value of the Put as a \$4.1 million liability at July 18, 2001. The fair value of the Put was reviewed quarterly and changes were reflected as components of pre-tax earnings. Effective July 19, 2004, the Selling Shareholders exercised the Put.

The purchase price of the TSC shares was computed as a multiple of TSC's EBITDA for the twelve months preceding the exercise, with a minimum price of \$12 million. A compilation of the financial statements of TSC for the period from July 2003 through June 2004 was completed in November 2004 and the Put (purchase) price was fixed at \$15.1 million. Settlement of the Put transaction occurred in December 2004, following which the Company owned 100% of TSC.

The Put price was satisfied in cash of approximately \$2.4 million (derived from borrowings on available long-term bank facilities), five-year notes with an original principal amount of approximately \$6.4 million, and the balance through the issuance of approximately 1,569,000 shares of the Company's common stock at a negotiated value of \$4.00 per share, which represented a premium to the market price on the date of the Put exercise in July 2004. At the date the terms were settled and announced, November 13, 2004, the common stock was recorded at fair value of \$5.14 per share. The cash owed to the selling

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shareholders and the notes issued in connection with the Put accrued interest from November 13, 2004 until the date of closing.

The final settlement of the Put transaction resulted in an increase of approximately \$5.1 million to the Company's reported amount of goodwill related to TSC. The Company determined that there were no adjustments to the fair value of the underlying value of the assets and liabilities of TSC, as book value approximated market value in all material aspects.

The settlement of the Put triggered the repayment of approximately \$7.9 million of the Company's debt owed to management and others who funded the Sterling Transaction in 2001. The Company paid this amount with a combination of cash of approximately \$2.4 million (from borrowings on available long-term bank facilities), issuance of five-year notes with an original principal amount of approximately \$4.7 million and the balance through the issuance of approximately 225,000 shares of the Company's common stock, at a fair value of \$5.14 per share.

**5. Line of Credit and Long-Term Obligations**

Long-term obligations consist of the following (in thousands):

	December 31, 2006	December 31, 2005
TSC Revolving Credit Agreement, due May 2009	\$ 30,000	\$ 13,788
SCPL Revolving Credit Agreement, due May 2007		4,261
TSC mortgages due monthly through June 2016	782	905
Management/Director Notes		2,279
Management Notes		6,170
Other		83
	30,782	27,486
Less current maturities of long-term obligations	(123)	(123)
Less short-term debt, related parties		(8,449)
Amounts included in discontinued operations		(4,344)
	\$ 30,659	\$ 14,570

***TSC Revolver***

In conjunction with the Sterling Transaction in 2001, TSC entered into a three-year agreement providing for a bank revolving line of credit with a maximum line of \$13.0 million, subject to a borrowing base, computed on the value of capital equipment (the "TSC Revolver"). The line of credit carried interest at prime, subject to achievement of certain financial targets and is secured by the equipment of TSC and guarantees by the parent company. In December 2004, TSC entered into an amendment of the agreement providing for a maximum line of \$17 million with a maturity date of May 1, 2007, under substantially the same terms as the original line. In April 2006, the terms of the TSC Revolver were modified to renew the line for a term of three years, maturing on May 31, 2009 and to provide for an increase in the line from \$17.0 million to \$35.0 million. The facility was also modified to add the Company as a co-borrower. The interest rate may vary quarterly, based on the Company's ratio of debt to tangible net worth. The credit facility continues to be subject to restrictive covenants including the maintenance of certain financial ratios and a prescribed level of tangible net worth. In addition, the bank has made available a long-term facility of up to \$1.5 million repayable over 15 years to finance the expansion of the Company's office building and maintenance facilities in Houston, Texas. The TSC Revolver requires the payment of a quarterly commitment fee of 0.25% per annum of the unused portion of the line of credit. Borrowing interest rates are based on the bank's prime rate or on a Eurodollar rate at the option of the Company. The interest rate on funds borrowed under this revolver during the year ended December 31, 2006 ranged from 7.25% to 8.25%. Availability on the line at December 31, 2006 was \$5 million.

Management believes that the TSC Revolver will provide adequate funding for TSC's working capital, debt service and capital expenditure requirements, including seasonal fluctuations at least through March 31, 2008.



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The TSC Revolver contains restrictions on the ability to:

Make distributions and dividends;

Incur liens and encumbrances;

Incur further indebtedness;

Guarantee obligations;

Dispose of a material portion of assets or merge with a third party;

Incur negative income for two consecutive quarters.

***SCPL Revolver***

Distribution maintained a revolving line of credit with a maximum line of \$5.0 million, subject to a borrowing base, computed on levels of accounts receivable and inventory. At December 31, 2005, the outstanding balance on the line of credit was \$4.3 million and the effective rate of interest was 7.25% and the line was included in the liabilities of discontinued operations. The line of credit was paid in full from the proceeds of the sale of the distribution business.

***TSC Mortgages***

In 2001 TSC completed the construction of a headquarters building and financed it principally through an additional mortgage of \$1.1 million on the land and facilities, at an interest rate of 8.5% per annum, repayable over 15 years. This mortgage is cross-collateralized with a mortgage on the land and facilities which was obtained in 1998 in the amount of \$500,000, repayable over 15 years with an interest rate of 9.3% per annum.

***Related Party Notes***

***Management Notes/NASCIT note***

The Sterling Transaction in 2001 was funded in part through the sale of zero coupon notes combined with the issuance of zero coupon notes to certain selling shareholders of TSC. Warrants for Sterling common stock were issued in connection with the zero coupon notes and are exercisable for ten years from closing at \$1.50 per share. The zero coupon notes were discounted at a rate of 12%, matured four years from the date of closing of the Sterling Transaction, and were subject to earlier payment in the event the TSC Put was exercised before such date. Employee selling shareholders of TSC received an aggregate face value of \$3.8 million in zero coupon notes: James D. Manning and Joseph P. Harper, Sr., the Company's President, received zero coupon notes in the face amount of \$799,000 and \$1.0 million, respectively, and warrants to purchase 63,498 shares and 81,301 shares, respectively. North Atlantic Smaller Companies Investment Trust plc (NASCIT), an investor in TSC, received a note in the face value of \$4 million. In December 2003, a prepayment of \$1.3 million was made on the zero coupon note issued to NASCIT in consideration of the forgiveness of six months' interest on such note. Accretion on the zero coupon notes was \$617,000 and \$744,000 in fiscal 2004 and 2003, respectively.

The Put was exercised in July 2004, and this triggered repayment of all the zero coupon notes. Upon settlement of the Put in December 2004, the employee selling shareholders received a cash payment of \$783,000 utilizing funding from long-term borrowings under TSC's line of credit. Of the balance of the zero coupon notes, \$901,000 was converted into 225,326 shares of common stock, and the remaining \$1.9 million was converted into five-year notes bearing interest at 12%, with principal and interest payable quarterly beginning March 31, 2005. NASCIT received a cash payment of \$834,000, with the balance of \$1.4 million converted into a five-year note bearing interest at 12%, with principal and interest payable quarterly beginning March 31, 2005.

In February 2005, the Board approved a change in the date, from January 2006 to January 2005, on which all outstanding warrants would first become exercisable, and an agreement was reached between the Company, NASCIT and certain holders of debt issued to the Selling Shareholders, as well as Robert M.

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Davies, a former director, and Maarten D. Hemsley, the Company's Chief Financial Officer (the Noteholders), whereby NASCIT exercised all its warrants in March 2005, providing a payment to the Company of approximately \$484,000. That amount funded a partial principal prepayment to NASCIT of its five-year note on March 31, 2005. The other Noteholders agreed to defer certain principal payments otherwise due to them in March and June 2005, sufficient to facilitate the prepayment of the balance of NASCIT's note by June 2005.

The remaining related party notes were paid in full in January 2006, following the completion of the Company's equity offering as described in Note 14...

*Management/Director Notes*

Notes with an aggregate face amount of \$1.3 million issued in connection with the October 1999 purchase of the second tranche of shares of TSC were restructured as part of the Sterling Transaction in 2001. Of the total, notes for \$800,000 were issued to several members of Sterling's management, including Joseph P. Harper, who was appointed the Company's President in July 2001. Notes totaling approximately \$559,000 were due to Robert M. Davies, and, through a participation agreement, Maarten D. Hemsley. In consideration for the extension of the maturity dates of these notes, the principal amounts were increased in July 2001 by an aggregate of approximately \$342,000. Furthermore, certain amounts owed by the Company to Messrs. Davies and Hemsley aggregating approximately \$355,000 were converted into notes. All such notes matured over four years and bore interest at 12%.

Pursuant to a Restructuring Agreement entered into in September 2003, the exercise of the Put in July 2004 triggered payment of the Management/Director notes, with one half of the balance of the notes paid in cash utilizing funding from long-term borrowings under the TSC line of credit and the remainder converted into five-year notes bearing interest at 12%, payable quarterly beginning March 31, 2005. Upon settlement of the Put, Mr. Davies, Mr. Harper, Mr. Hemsley and Mr. James D. Manning received cash payments of \$166,876, \$1,045,764, \$208,397 and \$460,458, respectively.

Pursuant to the previously-described agreement reached in February 2005, among the Company, NASCIT and certain holders of debt issued to the Selling Shareholders, as well as Messrs. Davies and Hemsley (the Noteholders), NASCIT exercised all its warrants in March 2005, providing a payment to the Company of approximately \$484,000. That amount funded a principal repayment to NASCIT on March 31, 2005. The other Noteholders agreed to defer certain principal payments otherwise due to them in March and June 2005, sufficient to facilitate the repayment of all of NASCIT's note by June 2005.

The management/director notes were paid in full in January 2006, following the completion of the equity offering.

*Other Debt*

The Company acquired certain warehouse and computer equipment through capital leases, usually with five-year lease terms, with expiration dates through December 2009. These assets were leased by SCPL, were included in the assets of discontinued operations, and were acquired by the buyer of the operations of SCPL, which also assumed the related lease obligations in October 2006.

**Table of Contents****Maturity of Debt**

The Company's long-term obligations mature in future years as follows (in thousands):

<b>Fiscal Year</b>	
2007	\$ 123
2008	102
2009	30,073
2010	73
2011	73
Thereafter	338
	\$ 30,782

**6. Financial Instruments**

SFAS No. 107, *Disclosure About Fair Value of Financial Instruments* defines the fair value of financial instruments as the amount at which the instrument could be exchanged in a current transaction between willing parties.

Due to their near-term maturities, the carrying amounts of accounts receivable and accounts payable are considered equivalent to fair value. As the interest rates on the TSC Revolver and SCPL Revolver are variable, their fair value approximates their carrying value.

The Company's other debt (which was repaid in January 2006) was owed to management and directors, and book value was considered to be equal to fair value, as these notes were subordinated to the Company's lines of credit, and were subject to a greater degree of risk. Management believed that the 12% interest rate on these notes approximated market rates of interest for similar subordinated debt.

TSC has two mortgages, at 8.5% and 9.3%, which contain pre-payment penalties. To determine the fair value of the mortgages, the amount of future cash flows was discounted using TSC's borrowing rate on its Revolver. At December 31, 2006 and December 31, 2005, the carrying value of the mortgages was \$782,000 and \$905,000, respectively. At December 31, 2006 and December 31, 2005, the fair value of the mortgages was \$741,000 and \$890,000, respectively.

TSC has one interest rate swap agreement which matures in November 2007, which is adjusted quarterly to its fair value and is included as a component of current assets, other on the consolidated balance sheet.

The Company does not have any off-balance sheet financial instruments.

**7. Derivative Financial Instruments**

During fiscal 2002, in connection with certain long-term debt, TSC entered into two interest rate swap agreements to manage exposure to fluctuations in interest rates on a portion of the loan balances.

Under the interest rate swap agreements, the Company exchanged variable rate interest on a portion of the loan balances, equal to a notional amount of \$3,000,000 each, with fixed rates of 5.87% and 6.57%. The swap agreement with a rate of 5.87% matured in November 2005.

During the years ended December 31, 2006 and December 31, 2005, TSC recorded interest expense of \$12,000 and a credit to interest expense of \$78,300 to adjust the carrying amounts of the derivative to reflect its face value of \$42,546 and \$55,092, respectively.

**Table of Contents****8. Income Taxes and Deferred Tax Asset**

At December 31, 2006, Sterling had the benefit of net operating tax loss carryforwards (the Tax Benefits ) of approximately \$9.8 million, which expire in 2020 and which offset a portion of income of Sterling and its subsidiaries from federal income taxes through part of 2007. The availability of the net operating tax loss carryforwards may be adversely affected by future ownership changes of Sterling. At this time, such changes cannot be predicted. Under IRC Section 382, if a corporation undergoes an ownership change, generally defined as a change of control of greater than 50% in any three year period, the amount of net operating losses available to offset taxable income in a taxable period may be subject to limitation under these provisions. In order to reduce the likelihood of such a change of control occurring, Sterling's Certificate of Incorporation includes restrictions on the registration of transfers of stock resulting in, or increasing, individual holdings exceeding 4.5% of the Company's common stock.

The Company has available to it excess tax benefits resulting from the exercise of non-qualified stock options. Under the provisions of SFAS 123(R), the Company cannot recognize these benefits as deferred tax assets until its existing net operating losses are fully utilized, and therefore, the deferred tax asset related to net operating loss carryforwards differs from the amount available on its federal tax returns. The Company has approximately \$5.3 million of excess tax benefits from the exercise of stock options available to reduce future tax liabilities.

Deferred tax assets and liabilities of continuing operations consist of the following (in thousands):

	December 31, 2006		December 31, 2005	
	Current	Long Term	Current	Long Term
Assets related to:				
Net operating loss carryforwards	\$ 3,346	\$	\$ 3,311	\$ 5,738
Accrued compensation	974	162	913	129
AMT carryforward		1,289		
Other	64			14
	4,384	1,451	4,224	5,881
Liabilities related to:				
Contract accounting	(87)			
Depreciation of property and equipment		(3,039)		(1,593)
Net asset	\$ 4,297	\$ (1,588)	\$ 4,224	\$ 4,288

During fiscal 2005, the valuation allowance was reduced to zero following a reassessment based on future taxable income forecasts. Fluctuations in market conditions and trends and other changes in the Company's earnings base, such as subsidiary acquisitions and disposals, warrant periodic management reviews of the recorded tax asset to determine if an increase or decrease in the recorded valuation allowance is necessary to change the tax asset to an amount that management believes will more likely than not be realized.

In fiscal 1990, SCPL underwent a quasi-reorganization. As a result, any subsequent recognition of net operating loss carryforwards generated before the quasi-reorganization resulted in an adjustment to paid-in capital. At February 28, 2001, the Company had approximately \$147 million in net operating losses generated before the quasi-reorganization. Of this amount, approximately \$18 million had previously been recognized and then subsequently re-reserved, resulting in a charge to earnings of approximately \$6.1 million in prior years. During fiscal 2001, most of these net operating loss carryforwards were either utilized to offset current taxable income or the valuation allowance was reduced based on the evaluation of the deferred tax assets when accounting for the TSC acquisition. At December 31, 2006, the Company has utilized all net operating losses that relate to the period prior to the quasi-reorganization.



The deferred tax effects of temporary differences relate primarily to the difference between book and tax depreciation for additions to fixed assets in 2006. Current income tax expense represents federal alternative minimum tax. Until such time as the NOL s are fully utilized, the Company will recognize alternative minimum tax payments as a credit to its deferred tax liability.

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The income tax provision differs from the amount using the statutory federal income tax rate of 34% applied to income or loss from continuing operations, for the following reasons (in thousands):

	<b>December 31, 2006</b>	<b>Fiscal Year Ended December 31, 2005</b>	<b>December 31, 2004</b>
Tax expense at the U.S. federal statutory rate	\$ 6,787	\$ 4,829	\$ 1,270
State income tax expense, net of refunds and federal benefits			17
Decrease in deferred tax asset valuation allowance		(1,390)	(3,787)
Adjustment to value of net operating loss carryforward		(364)	
Non-deductible costs	86	98	558
Other		(70)	24
Income tax expense (benefit)	\$ 6,874	\$ 3,104	\$ (1,918)
Income tax on discontinued operations including taxes on the gain on sale in 2006	308	315	216
Income tax on continuing operations	\$ 6,566	\$ 2,788	\$ (2,134)

In the second quarter of 2006, the State of Texas revised its existing franchise tax to include most business entities ( the Texas Margins Tax ), which will become effective for franchise tax reports due after January 1, 2008. The Company has assessed the impact the Texas Margins Tax has on its existing deferred tax liabilities, which was immaterial for the year ended December 31, 2006.

**9. Costs and Estimated Earnings and Billings on Uncompleted Contracts**

Costs and estimated earnings and billings on uncompleted contracts at December 31, 2006 and 2005 are as follows (in thousands):

	<b>Fiscal Year Ended December 31, 2006</b>	<b>Fiscal Year Ended December 31, 2005</b>
Costs incurred and estimated earnings on uncompleted contracts	\$ 222,170	\$ 156,916
Billings on uncompleted contracts	(240,549)	(168,352)
	\$ (18,379)	\$ (11,436)

Included in accompanying balance sheets under the following captions:

	<b>Fiscal Year Ended December 31, 2006</b>	<b>Fiscal Year Ended December 31, 2005</b>
Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 3,157	\$ 2,199
Billings in excess of costs and estimated earnings on uncompleted contracts	(21,536)	(13,635)
	\$ (18,379)	\$ (11,436)

## **10. Stock Options and Warrants**

### ***Options***

In fiscal 1991, the Board of Directors granted options to purchase 194,388 shares of the Company's common stock to key employees and to certain members of the Board of Directors. The exercise price of the options, which was equal to the market value of the stock at the date of the grant, was \$2.75.

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In fiscal 1994, the Board of Directors adopted and shareholders approved two stock option plans, the 1994 Omnibus Stock Plan (the 1994 Omnibus Plan ) and the 1994 Non-Employee Director Stock Option Plan (the Director Plan ). Under both plans, the exercise price of options granted may not be less than the fair market value of the common stock on the date of the grant and the term of the grant may not exceed ten years.

The 1994 Omnibus Plan initially provided for the issuance of a maximum of 350,000 shares of the Company s common stock pursuant to the grant of incentive stock options to employees of Sterling and its subsidiaries and the grant of non-qualified stock options, stock or restricted stock to employees, consultants, directors and officers of Sterling and its subsidiaries. Subsequently, the number of shares available for issuance under the plan was increased to 950,000 shares. The options generally vest over a four-year period and expire ten years from the date of the grant.

The Director Plan (a formula plan ) provided for the issuance of up to 100,000 shares of common stock pursuant to options granted to directors who were not employees of the Company. The plan provided that on every May 1, each non-employee director holding office on such date would automatically receive a fully-exercisable, fully vested, ten-year option to purchase 3,000 shares at the market value on such date. Each director s options expire 180 days after he or she ceases to be a director. Options covering the final 7,000 shares that remained under the plan were issued in May 2001.

In December 1998, the Board of Directors adopted and in October 2001 shareholders approved the 1998 Stock Incentive Plan (the 1998 Plan ). Under the 1998 Plan, the exercise price of the options granted may not be less than the fair market value of the common stock on the date of grant and the term of the grant may not exceed ten years. The 1998 Plan provides for the issuance of 700,000 shares of the Company s common stock. Stock options granted under the plan generally vest over a three-year period.

In July 2001, the Board of Directors adopted and in October 2001 shareholders approved the 2001 Stock Incentive Plan (the 2001 Plan ). The 2001 Plan provides for the issuance of stock awards for up to 500,000 shares of the Company s common stock. Under the 2001 Plan, stock options may be granted at an exercise price not less than the fair market value of the common stock on the date of grant. The Company s and its subsidiaries directors, officers, employees, consultants and advisors are eligible to be granted awards under the plan. Stock options granted under the 2001 Plan generally vest over three to five years and can be exercised no more than 10 years after the date of the grant. The plan also provides for stock grants; in 2006 stock grants were made to independent directors totaling 6,035 shares.

Beginning in 1998 and as part of the Sterling Transaction in 2001, certain stock options granted to Robert M. Davies and Maarten D. Hemsley were extended beyond their normal expiration date under a standstill agreement, to help protect the Company s tax loss carryforwards. At the time of the standstill agreement, the fair value of the stock was lower than the option exercise price.

In May 2006 the independent directors of the Company were each granted 1,207 shares of restricted stock with one-year vesting at the market price on the day of grant of \$28.99. Total compensation cost for the stock grants was \$175,000, of which \$116,000 was recognized through December 2006.

Shareholders in May 2006 approved an amendment to the 2001 Stock Incentive Plan to increase the number of shares issuable under the Plan from 500,000 to 1,000,000. At December 31, 2006 there were 441,745 shares of common stock available under the 2001 Plan for issuance pursuant to future stock option and share grants. No shares are or will be available for grant under the Company s other option plans, all of which have been terminated except with respect to stock options outstanding under those plans.

Certain options granted in 2004 to employees of Steel City Products remained unvested at the date the business was sold. The Board of Directors approved the acceleration of vesting of these options with an expiration of 75 days past the date of sale of the business. The Company expensed an additional \$15,300 in connection with the accelerated vesting.

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The following tables summarize the activity under the five plans:

	<b>1991 Plan</b>		<b>Director Plan</b>		<b>1994 Omnibus Plan</b>	
	<b>Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Shares</b>	<b>Weighted Average Exercise Price</b>
Outstanding at December 31, 2003:	84,420	\$ 2.75	87,502	\$ 1.77	770,384	\$ 1.48
Granted						
Exercised		\$ 2.75	(37,170)	\$ 1.77	(162,192)	\$ 1.95
Expired/forfeited			(3,000)		(29,996)	\$ 2.42
Outstanding at December 31, 2004:	84,420	\$ 2.75	47,332	\$ 1.67	578,196	\$ 1.29
Granted						
Exercised		\$ 2.75	(3,000)	\$ 1.83	(154,000)	\$ 0.99
Expired/forfeited			(13,166)	\$ 2.75		\$ 2.42
Outstanding at December 31, 2005:	84,420	\$ 2.75	31,166	\$ 1.58	424,196	\$ 1.40
Granted						
Exercised	(55,996)	\$ 2.75	(18,000)	\$ 2.05	(166,016)	\$ 1.08
Expired/forfeited		\$ 2.75				
Outstanding at December 31, 2006:	28,424	\$ 2.75	13,166	\$ 0.94	258,180	\$ 1.60
			<b>1998 Plan</b>		<b>2001 Plan</b>	
			<b>Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Shares</b>	<b>Weighted Average Exercise Price</b>
Outstanding at December 31, 2003:			540,500	\$0.56	214,100	\$ 1.58
Granted					157,800	\$ 3.10
Exercised			(20,375)	\$1.05	(420)	\$ 2.04
Expired/forfeited			(1,500)	\$1.00	(7,180)	\$ 1.82
Outstanding at December 31, 2004:			518,625	\$0.54	364,300	\$ 2.48
Granted					117,600	\$10.88
Exercised			(289,500)	\$0.50	(17,540)	\$ 2.06
Expired/forfeited					(7,200)	\$ 2.43
Outstanding at December 31, 2005:			229,125	\$0.58	457,160	\$ 4.66
Granted					81,500	\$16.36
Exercised			(225,875)	\$0.57	(64,057)	\$ 2.46
Expired/forfeited					(4,400)	\$ 7.83

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Outstanding at December 31, 2006:	3,250	\$1.00	470,203	\$ 8.35
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The following table summarizes information about stock options outstanding and exercisable at December 31, 2006:

Range of Exercise Price Per Share	Number of Shares	Options Outstanding		Options Exercisable	
		Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price Per Share	Number of Shares	Weighted Average Exercise Price Per Share
\$0.50 \$0.88	165,346	3.40	\$ 0.88	165,346	\$ 0.88
\$1.00 \$1.50	62,050	4.06	\$ 1.43	62,050	\$ 1.43
\$1.73 \$2.00	40,100	5.57	\$ 1.73	30,900	\$ 1.73
\$2.75 \$3.38	313,087	4.32	\$ 2.95	188,208	\$ 2.85
\$6.87	20,000	8.39	\$ 6.87	20,000	\$ 6.87
\$9.69	62,800	3.55	\$ 9.69		\$ 0.00
\$16.87	28,540	3.70	\$ 16.87	5,660	\$ 16.87
\$24.96	62,800	4.55	\$ 24.96		\$ 0.00
\$25.21	18,500	4.69	\$ 25.21		\$ 0.00
	773,223		\$ 5.80	472,164	\$ 2.24

		Aggregate intrinsic value
Total outstanding in-the-money options at 12/31/06	691,923	\$ 12,605,000
Total vested in-the-money options at 12/31/06	472,164	\$ 9,217,000
Total options exercised during 2006	529,944	\$ 12,636,000

Aggregate intrinsic value represents the total pretax intrinsic value (the difference between the Company's closing stock price on December 31, 2006 (\$21.76) and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2006.

Compensation expense for options granted during 2006, 2005 and 2004 were calculated using the Black-Scholes option pricing model using the following assumptions in each year:

	Fiscal 2006	Fiscal 2005	Fiscal 2004
Risk free interest rate	4.9%	4.2%	4.0%
Expected volatility	76.3%	77.8%	78.0%
Expected life of option	5.0 years	6.0 years	10.0 years
Expected dividends	None	None	None

The risk-free interest rate is based upon interest rates that match the contractual terms of the stock option grants. The expected volatility is based on historical observation and recent price fluctuations. The expected life is based on evaluations of historical and expected future employee exercise behavior, which is not less than the vesting period of the options. The Company does not currently pay dividends. The weighted average fair value of stock options granted in 2006, 2005 and 2004 was \$16.36, \$7.32 and \$2.55, respectively.

Pre-tax compensation expense was \$991,000 (\$652,000 after tax effects of 34.2%), \$463,000 (\$306,000 after tax effects of 34.0%), and \$381,000 (\$251,000 after tax effects of 34.0%), in 2006, 2005 and 2004, respectively. Proceeds received by the Company from the exercise of options in 2006, 2005 and 2004 were \$657,000, \$827,000 and

\$405,000, respectively. At December 31, 2006, total unrecognized stock-based compensation expense related to unvested stock options was approximately \$1.4 million, which is expected to be recognized over a weighted average period of approximately 2.1 years.

Prior to the adoption of SFAS 123(R), all tax benefits resulting from the exercise of non-qualified stock options (or disqualifying dispositions of incentive stock options) were presented as operating cash flows in the Consolidated Statements of Cash Flows. SFAS 123(R) requires that cash flows from the exercise of such stock options resulting from tax benefits in excess of recognized cumulative compensation cost (excess tax benefits) be classified as financing cash flows. Because the Company has not fully utilized its net operating loss carryforwards, the tax benefit cannot be recorded until it can be realized. Upon adoption

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of SFAS 123(R), the Company recorded \$2.8 million of these benefits as a component of stockholders' equity. During 2006 approximately another \$2.6 million of excess tax benefits will become available to the Company when it fully utilizes its net operating loss carryforwards.

**Warrants**

As part of the Sterling Transaction in July 2001, warrants attached to zero coupon notes were issued to certain members of TSC management, to NASCIT and to KTI, Inc. These ten-year warrants to purchase shares of the Company's common stock at \$1.50 per share were exercisable 54 months from the issue date. Following settlement of the Put, the date the warrants first become exercisable was changed to January 2005. In April 2003, a loan made to the Company by KTI, Inc. was prepaid, and as part of the consideration for the prepayment, warrants to purchase 394,302 shares were cancelled. As part of an agreement to prepay its note, in March 2005 NASCIT exercised its warrant to purchase 322,661 shares. At December 31, 2005 and 2004 warrants to purchase 527,339 and 850,000 shares, respectively remained outstanding. In January 2006 KTI, Inc. and Linda Manning (former spouse of Patrick Manning, the Company's Chief Executive Officer) exercised warrants purchasing 141,266 shares and sold the shares in the Company's public equity offering. During 2006 an additional 29,807 warrants were exercised. The Company received proceeds in the amount of \$257,000 in connection with the exercise of warrants in 2006. At December 31, 2006, 356,266 warrants were outstanding.

**11. Employee Benefit Plan**

The Company and its subsidiaries maintain defined contribution profit-sharing plans covering substantially all persons employed by the Company and its subsidiaries, whereby employees may contribute a percentage of compensation, limited to maximum allowed amounts under the Internal Revenue Code. The Plans provides for discretionary employer contributions, the level of which, if any, may vary by subsidiary and is determined annually by each company's board of directors. The Company and TSC made aggregate matching contributions of \$325,000, \$276,000 and \$328,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

**12. Operating Leases**

Operations of TSC are conducted from an owned building in Houston, Texas. TSC also leases incidental office space in Fort Worth and San Antonio, Texas on month-to-month agreements.

In 2005 and 2006, TSC entered into several long-term operating leases for equipment with lease terms of approximately three to five years. Certain of these lease structures allows TSC to purchase the equipment on or before the end of the lease term in October 2011. If TSC does not purchase the equipment at the fair market value, the equipment is returned to the lender. One lease obligates TSC to pay a guaranteed residual not to exceed 20% of the original equipment cost. The Company is accruing this liability, which is not expected to exceed \$200,000. Lease expense for those equipment leases was approximately \$576,000 in 2006 and \$562,000 in 2005.

Minimum annual rentals for all operating leases having initial non-cancelable lease terms in excess of one year are as follows (in thousands):

	<b>Fiscal Year</b>	
2007		1,010
2008		776
2009		624
2010		624
2011		468
Thereafter		
Total future minimum rental payments		\$ 3,502

Total rent expense for all operating leases (including discontinued operations) amounted to approximately \$995,000, \$1,013,000 and \$614,000 in fiscal years 2006, 2005 and 2004, respectively.

**Table of Contents****13. Customers**

The following table shows contract revenues generated from TSC's largest customers which accounted for more than 10% of revenues (dollars in thousands):

	December 31, 2006		December 31, 2005		December 31, 2004	
	Contract Revenues	% of Revenues	Contract Revenues	% of Revenues	Contract Revenues	% of Revenues
Texas State Department of Transportation	\$ 166,333	67.1%	\$ 84,827	38.8%	\$ 44,461	33.6%
City of Houston	\$ 29,848	12.1%	\$ 49,437	22.6%	\$ 16,512	12.5%
Harris County	*	*	\$ 29,796	13.6%	*	*

\* represents less than 10% of revenues

**14. Equity Offering**

In January 2006, the Company completed a public offering of approximately 2.0 million shares of its common stock at \$15.00 per share. The Company received proceeds, net of underwriting commissions, of approximately \$28.0 million (\$13.95 per share) and paid approximately \$907,000 in related offering expenses. In addition, the Company received approximately \$484,000 from the exercise of warrants and options to purchase 321,758 shares, such shares were sold by the option and warrant holders in the offering. From the proceeds of the offering, the Company repaid all its outstanding related party promissory notes in January 2006. Executive management, directors and former directors received proceeds as follows:

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

During the first quarter of 2006, the Company utilized a portion of the offering proceeds to purchase additional capital equipment for the construction business and to replenish funds used for the acquisition of RDI (see note below). In the second through fourth quarters, a portion of the offering proceeds was also used to purchase additional capital equipment for the construction business.

**15. Purchase of certain assets of Rathole Drilling, Inc. ( RDI )**

In January, 2006, TSC acquired certain assets of the crane division of RDI. The acquisition included the purchase of construction equipment at its appraised value of approximately \$2.0 million, the trade name RDI and the assumption by TSC of certain RDI contracts. TSC paid cash for the acquired assets of \$2.2 million. The size of the acquisition and the amount of assets acquired were not material in relation to the Company's historical business.

**16. Commitments and Contingencies****Employment Agreements**

Joseph P. Harper, Sr. and Patrick T. Manning and certain other officers of TSC have employment agreements with the general partner of TSC which provide for payments of annual salary, bonuses and certain benefits if their employment is terminated without cause.

In July 2005, Mr. Hemsley entered into a new employment agreement with the Company. The employment agreement provides for payments of annual salary, bonuses and certain benefits if his employment is terminated without cause.



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SCPL had an employment agreement with its President, Terrance W. Allan that provided for payments of annual salary, a bonus and certain benefits if his employment was terminated without cause. As part of the sale of the Distribution business, a termination agreement was reached with Mr. Allan.

***Self-Insurance***

TSC is self-insured for employee health claims. Its policy is to accrue the estimated liability for known claims and for estimated claims that have been incurred but not reported as of each reporting date. The Company has obtained reinsurance coverage for the policy period from June 1, 2006 through May 31, 2007 as follows:

Specific excess reinsurance coverage for medical and prescription drug claims in excess of \$60,000 for each insured person with a maximum lifetime reimbursable of \$2,000,000.

Aggregate reinsurance coverage for medical and prescription drug claims with a plan year maximum of approximately \$1.1 million which is the estimated maximum claims and fixed cost based on the number of employees.

For the twelve months ended December 31, 2006, TSC incurred \$1.2 million in expenses related to this plan, compared with \$1.0 million in 2005 and \$803,000 in 2004.

TSC is also self-insured for workers' compensation claims up to \$250,000 per occurrence, with a maximum aggregate liability of \$2.7 million per year. Its policy is to accrue the estimated liability for known claims and for estimated claims that have been incurred but not reported as of each reporting date. At December 31, 2006 and 2005, TSC had recorded an estimated liability of \$575,000 and \$673,000, respectively, which it believes is adequate based on its claims history. TSC has a safety and training program in place to help prevent accidents and injuries and works closely with its employees and the insurance company to monitor all claims.

In 2006, TSC had outgrown the bonding limits of its bonding company, but was successful in obtaining increased bonding capacity through Travelers Casualty and Surety Company of America, for future construction contracts. As is customary, the Company indemnifies Travelers for all losses incurred by it in connection with bonds that are issued. The Company has granted Travelers a security interest in certain personal property for that obligation.

***Guarantees***

The Company typically indemnifies contract owners for claims arising during the construction process and carries insurance coverage for such claims, which in the past have not been material.

The Company's Certificate of Incorporation provides for indemnification of its officers and directors. The Company has a Director and Officer insurance policy that limits its exposure. At December 31, 2006 the Company had not accrued a liability for this guarantee, as the likelihood of incurring a payment obligation in connection with this guarantee is remote.

***Litigation***

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

***Purchase Commitments***

To manage the risk 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

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bid. These quotations do not include any quantity guarantees. As soon as we are advised that our bid is the lowest, we enter into firm contracts with our materials suppliers and most sub-contractors, thereby mitigating the risk of future price variations affecting the contract costs.

**17. Minority Interests**

During fiscal 1993, the cumulative dividends on SCPL's Series A Preferred Stock exceeded SCPL's net income for that year, thus creating a loss attributable to SCPL's common stockholders in excess of the minority interest, and accordingly, the Company reduced to zero the minority interest related to SCPL. In October 2003, the Board of Directors of SCPL approved a 1 for 300,000 share reverse stock split of SCPL's common stock. The transaction was approved by the Company, SCPL's majority shareholder. In March 2004 the reverse stock split of SCPL's common stock was completed with the result that the Company became SCPL's sole shareholder.

From July 2001 to December 2004, the Company had an 80.1% investment in TSC. A minority interest liability of \$5.3 million was reflected in the consolidated balance sheet for fiscal year 2003. In December 2004, the Company purchased the remaining 19.9% of TSC. Minority interest expense of \$962,000 is reflected in the consolidated results of operations for fiscal 2004.

**18. Related Party Transactions**

In October 1999, certain shareholders of TSC exercised their right to sell a second tranche of equity securities to Oakhurst Technology, Inc. (a wholly owned subsidiary of the Company) (OTI) thereby increasing the Company's consolidated equity ownership of TSC from 7% to 12%. The equity purchase was financed through the issuance of two notes. One of these notes reflecting loans in the amount of \$559,000, was issued to Robert M. Davies (the First Note) in which Maarten D. Hemsley had a participation of \$116,000. The second of the notes in the amount of \$800,000 (the Manning Note) was issued to James D. Manning, the brother of Patrick T. Manning and one of the TSC shareholders who sold TSC equity securities to OTI. The First Note provided for interest at 14% payable quarterly and was due in October 2000; however, no interest payments were made and the First Note was not repaid in October 2000. In connection with the transaction in July 2001 in which the Company increased its ownership of TSC to 80.1%, (the Sterling Transaction), accrued unpaid interest in the amount of \$134,000 on the First Note was added to the principal, the maturity date of the First Note was extended to July 2005, and the interest rate was reduced to 12%. In connection with the Sterling Transaction, the Company also issued an additional four-year 12% promissory note to each of Messrs. Hemsley (\$136,421) and Davies (\$250,623) (the Second Notes) to repay certain amounts due to them from the Company or OTI, including deferred compensation, the fee (and related interest) owed to them in connection with the acquisition of the second tranche of TSC equity in October 1999, the fee due in July 2001 to them in connection with the Sterling Transaction and a fee for the extension of the First Note.

In connection with the Sterling Transaction, the maturity date of the Manning Note also was extended to July 2005 and the interest rate was reduced from 14% to 12%. In consideration for the extension of the maturity date and interest rate reduction, James D. Manning received a zero coupon promissory note due in July 2005 with principal and interest payable at maturity in the aggregate amount of \$187,000. Interest and principal on the First Note, the Second Notes and the Manning Note were payable prior to maturity only to the extent of cash available to Sterling for these payments and as permitted by institutional lenders to Sterling or its subsidiaries.

After the Sterling Transaction, Joseph P. Harper, Sr. and another officer of TSC purchased \$370,000 and \$123,000, respectively, of James D. Manning's notes. As a result, Mr. Harper held a separate note in the principal amount of \$370,000, an officer of TSC held a separate note in the principal amount of \$123,000, and James D. Manning held a note in the principal amount of \$493,500, in each case, on the same terms and conditions as the Manning Note.

In September 2003, the First Note, the Manning Note and the Second Notes were amended to provide for a maturity date that was the date the Company was required to purchase the remaining shares of TSC if

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the holders of those shares exercised their rights to sell such shares to the Company, and to provide for payment of those notes with a combination of cash and five-year notes of the Company.

In December 2003 prepayments of accrued interest and principal were made to certain of these noteholders. Mr. Harper received a prepayment totaling \$86,000 and Mr. Davies received a prepayment totaling \$411,000. Mr. Hemsley waived any prepayment of his notes at that time.

In July 2004, the remaining shareholders of TSC exercised their right to sell their shares of TSC to the Company (the Put ) for consideration (paid in December 2004) consisting of a combination of cash (funded through long-term borrowings), stock and five-year notes of the Company bearing interest at an annual rate of 12%. The exercise of the Put triggered the acceleration of the maturity of the other debt issued in July 2001. Those obligations were satisfied in December 2004 through a payment of cash, the issuance of shares and the issuance of the same form of five-year notes. The cash paid and shares and notes issued were as follows:

Name	Cash	Shares	Five-year Notes
Patrick T. Manning	\$ 460,458	135,474	\$ 365,831
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
Robert M. Davies	\$ 166,876		\$ 518,641

James D. Manning is employed by an operating subsidiary of TSC under a three-year employment agreement that commenced January 1999 and that was extended for an additional three-year term in July 2001 and again in July 2004 pursuant to which he was entitled to receive an annual salary of \$75,000 plus \$75.00 per hour for each hour worked in excess of 1,000 hours during any calendar year. In addition, he was entitled to receive incentive compensation of up to 100% of his base pay if certain financial goals were met. In fiscal 2004 and 2005, he earned his maximum bonus of \$50,000. In late 2005, Mr. Manning's employment agreement was changed to a consulting agreement for which he receives a monthly retainer of \$2,000 plus \$800 per day worked. The agreement limits the ability of Mr. Manning to compete for a period of two years after he ceases to be an employee if he terminates his employment without good reason or TSC terminates his employment for good cause, and for a period of one year after he ceases to be an employee if he terminates his employment for good reason or TSC terminates his employment without good cause; provided that these non-competition obligations may be avoided by Mr. Manning if TSC terminates the employment agreement other than for good cause.

From March 2001 until May 2002, Mr. Hemsley provided consulting services to, and since May 2002 he has been an employee of JO Hambro Capital Management Limited as Fund Manager of Leisure & Media Venture Capital Trust plc, and since February 2005 as Senior Fund Manager of its Trident Private Equity II LLP investment fund, neither of which funds were or are an investor in the Company or any of its affiliates.

In December 2001, in order to strengthen SCPL's working capital position, Sterling obtained funding in the amount of \$500,000 from members of management and directors, including Robert W. Frickel, Joseph P. Harper, Sr. and Maarten D. Hemsley, who loaned \$155,000, \$100,000 and \$25,000, respectively. The notes, which ranked senior to debt incurred in the Sterling Transaction, bore interest at 12%, payable monthly. The notes were convertible into shares of common stock of the Company at a conversion price of \$2.50 per share at any time prior to the maturity date in December 2004. All holders of these notes converted their debt into common stock on December 31, 2004.

In January 2003 certain members of management, including Joseph P. Harper, Sr. (\$70,000) and Maarten D. Hemsley (\$25,000), loaned an aggregate of \$250,000 to SCPL for working capital. Under the original terms of the loan, interest at an annual rate of 10% was paid monthly, with a maturity date of July 2003. The maturity date was later extended to December 2003 with the addition of a guarantee by the

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Company and was extended again to July 2004 with an increase in the interest rate to 12%. These notes were repaid in three installments in January and February 2005.

In July 2001, Mr. Frickel was elected to the Board of Directors. He is President of R.W. Frickel Company, P.C., an accounting firm based in Michigan that performs certain accounting and tax services for TSC. Fees paid or accrued to R.W. Frickel Company for 2006, 2005 and 2004 and were approximately \$57,500, \$113,000 and \$82,000, respectively.

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 the Company and to other contractors. From July 2005, when Ms. Peterson and Mr. Manning were married, through December 31, 2005, the Company paid approximately \$6.0 million to the Paradigm companies for materials and services. In 2006, the Company paid approximately \$3.3 million to Paradigm for materials and services.

**19. Capital Structure**

At December 31, 2006 the authorized capital stock of the Company consisted 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.

Holder of common stock are entitled to one vote for each share on all matters voted upon by the stockholders, including the election of directors, and do not have cumulative voting rights. Subject to the rights of holders of any then outstanding shares of preferred stock, common stockholders are entitled to receive ratably any dividends that may be declared by the Board of Directors out of funds legally available for that purpose. Holders of common stock are entitled to share ratably in net assets upon any dissolution or liquidation after payment of provision for all liabilities and any preferential liquidation rights of our preferred stock then outstanding. Common stock shares are not subject to any redemption provisions and are not convertible into any other shares of capital stock. The rights, preferences and privileges of holders of common stock are subject to those of the holders of any shares of preferred stock that may be issued in the future.

The Board of Directors may authorize the issuance of one or more classes or series of preferred stock without stockholder approval and may establish the voting powers, designations, preferences and rights and restrictions of such shares. No preferred shares have been issued.

In December 1998, the Company entered into a rights agreement with American Stock Transfer & Trust, as rights agent, providing for a dividend of one purchase right for each outstanding share of common stock for stockholders of record on December 29, 1998. Holders of shares of common stock issued since that date are issued rights with their shares. The rights trade automatically with the shares of common stock and become exercisable only if a takeover attempt of the Company occurs. The rights will expire on December 29, 2008, unless redeemed or exchanged before that time.

**Table of Contents****20. Quarterly Financial Information  
(Unaudited)****Fiscal 2006 Quarter Ended**

	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>	<b>Total</b>
	<b>(Dollar amounts in thousands, except per share data)</b>				
Revenues	\$ 56,480	\$ 60,010	\$ 68,743	\$ 64,115	\$ 249,348
Gross profit	6,686	7,310	7,878	6,673	28,547
Pre-tax income from continuing operations	4,563	4,832	5,354	4,455	19,204
Net income from continuing operations	3,022	3,156	3,545	2,915	12,638
Net income from discontinued operations, including gain on sale of \$121 in 2006	171	208	65	238	682
Net income	\$ 3,193	\$ 3,364	\$ 3,610	\$ 3,153	\$ 13,320
Basic income per share:					
From continuing operations:	\$ 0.30	\$ 0.30	\$ 0.33	\$ 0.26	\$ 1.19
From discontinued operations:	\$ 0.02	\$ 0.02	\$ 0.01	\$ 0.01	\$ 0.06
Net income per share, basic:	\$ 0.32	\$ 0.32	\$ 0.34	\$ 0.27	\$ 1.25
Diluted income per share:					
From continuing operations	\$ 0.27	\$ 0.27	\$ 0.30	\$ 0.24	\$ 1.08
From discontinued operations	\$ 0.01	\$ 0.02	\$ 0.01	\$ 0.01	\$ 0.06
Net income per share, diluted:	\$ 0.28	\$ 0.29	\$ 0.31	\$ 0.25	\$ 1.14

**Fiscal 2005 Quarter Ended**

	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>	<b>Total</b>
	<b>(Dollar amounts in thousands, except per share data)</b>				
Revenues	\$ 39,413	\$ 57,228	\$ 61,163	\$ 61,635	\$ 219,439
Gross profit	3,358	6,005	6,902	7,491	23,756
Pre-tax income from continuing operations	903	3,266	4,126	5,034	13,329
Net income from continuing operations	596	2,156	2,723	5,066	10,541
Net income from discontinued operations	231	245	57	26	559
Net income	\$ 827	\$ 2,401	\$ 2,780	\$ 5,092	\$ 11,100
Basic income per share:					
From continuing operations:	\$ 0.08	\$ 0.28	\$ 0.35	\$ 0.65	\$ 1.36
From discontinued operations:	\$ 0.03	\$ 0.03	\$ 0.01	\$ 0.00	\$ 0.07
Net income per share, basic:	\$ 0.11	\$ 0.31	\$ 0.36	\$ 0.65	\$ 1.43



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Diluted income per share:						
From continuing operations	\$ 0.06	\$ 0.23	\$ 0.29	\$ 0.53	\$ 1.11	
From discontinued operations	\$ 0.02	\$ 0.03	\$ 0.00	\$ 0.00	\$ 0.05	
Net income per share, diluted:	\$ 0.08	\$ 0.26	\$ 0.29	\$ 0.53	\$ 1.16	

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**Exhibit Index**

**Number Exhibit Title**

- 1.1 Form of Underwriting Agreement dated as of January 19, 2006 between Sterling Construction Company, Inc. and the underwriters and other parties named therein (incorporated by reference to Exhibit 1.1 to Sterling Construction Company, Inc.'s Registration Statement on Form S-1A, filed on January 13, 2006 (SEC File number 333-129780)).
- 2.1 Asset Purchase Agreement, dated September 23, 2002, by and among Texas Sterling Construction, L.P., Kinsel Industries, Inc. and Tracks of Texas, Inc. (incorporated by reference to Exhibit 10.4 to Sterling Construction Company, Inc.'s quarterly report on Form 10-Q for the fiscal quarter ended September 30, 2002, filed on November 14, 2002 (SEC File No. 000-19450)).
- 3.1 Restated and Amended Certificate of Incorporation of Oakhurst Company, Inc., dated as of September 25, 1995 (incorporated by reference to Exhibit 3.1 to Sterling Construction Company, Inc.'s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
- 3.2 Certificate of Amendment of the Certificate of Incorporation of Oakhurst Company, Inc., dated as of November 12, 2001 (incorporated by reference to Exhibit 3.2 to Sterling Construction Company, Inc.'s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
- 3.3 Bylaws of Oakhurst Company, Inc. (incorporated by reference to Exhibit 3.2 to its Annual Report on Form 10-K for the fiscal year ended February 28, 1998, filed on May 29, 1998 (SEC File No. 000-19450)).
- 4.1 Certificate of Designations of Oakhurst Company, Inc.'s Series A Junior Participating Preferred Stock, dated as of February 10, 1998 (incorporated by reference to Exhibit 4.2 to its Annual Report on Form 10-K, filed on May 29, 1998 (SEC File No. 000-19450)).
- 4.3 Rights Agreement, dated as of December 29, 1998, by and between Oakhurst Company, Inc. and American Stock Transfer & Trust Company, including the form of Series A Certificate of Designation, the form of Rights Certificate and the Summary of Rights attached thereto as Exhibits A, B and C, respectively (incorporated by reference to Exhibit 99.1 to Oakhurst Company, Inc.'s Registration Statement on Form 8-A, filed on January 5, 1999 (SEC File No. 000-19450)).
- 4.4 Form of Common Stock Certificate of Sterling Construction Company, Inc. (incorporated by reference to Exhibit 4.5 to its Form 8-A, filed on January 11, 2006 (SEC File No. 011-31993)).
- 10.1# Oakhurst Capital, Inc. 1994 Omnibus Stock Plan, with form of option agreement (incorporated by reference to Exhibit 10.1 to Sterling Construction Company, Inc.'s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
- 10.2# Oakhurst Capital, Inc. 1994 Omnibus Stock Plan, as amended through December 18, 1998, (incorporated by reference to Exhibit 10.21 to Oakhurst Company, Inc.'s Annual Report on Form 10-K, filed on June 1, 1999 (SEC File No. 000-19450)).
- 10.3# Oakhurst Capital, Inc. 1994 Non-Employee Director Stock Option Plan, with form of option agreement (incorporated by reference to Exhibit 10.3 to Sterling Construction Company, Inc.'s Registration Statement

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on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).

- 10.4# Oakhurst Company, Inc. 1998 Stock Incentive Plan (incorporated by reference to Exhibit 10.4 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).

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**Number Exhibit Title**

- 10.5# Form of Stock Incentive Agreements under Oakhurst Company, Inc. s 1998 Stock Incentive Plan (incorporated by reference to Exhibit 10.51 to Sterling Construction Company, Inc. s Annual Report on Form 10-K for the year ended December 31, 2004, filed on March 29, 2005 (SEC File No. 001-31993)).
- 10.6# Oakhurst Company, Inc. 2001 Stock Incentive Plan (incorporated by reference to Exhibit 10.6 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
- 10.7# Forms of Stock Option Agreement under the Oakhurst Company, Inc. 2001 Stock Incentive Plan (incorporated by reference to Exhibit 10.51 to Sterling Construction Company, Inc. s Annual Report on Form 10-K for the year ended December 31, 2004, filed on March 29, 2005 (SEC File No. 001-31993)).
- 10.8# Form of Employee Stock Option Agreement, dated as of August 29, 1991, by and between Hallwood Holdings Incorporated and certain of its directors and officers (incorporated by reference to Exhibit 10.8 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
- 10.12# Employment Agreement, dated as of July 18, 2004, by and between Patrick T. Manning, Sterling Construction Company, Inc. and Sterling Houston Holdings, Inc. (incorporated by reference to Exhibit 99.1 to Sterling Construction Company, Inc. s Current Report on Form 8-K, dated as of March 23, 2005, filed on March 28, 2005 (SEC File No. 001-31993)).
- 10.13# Employment Agreement, dated as of July 18, 2004, by and between Joseph P. Harper, Sr., Sterling Construction Company, Inc. and Sterling Houston Holdings, Inc. (incorporated by reference to Exhibit 99.2 to Sterling Construction Company, Inc. s Current Report on Form 8-K, dated as of March 23, 2005, filed on March 28, 2005 (SEC File No. 001-31993)).
- 10.14# Employment Agreement, dated as of July 13, 2005, by and between Maarten D. Hemsley and Sterling Construction Company, Inc. (incorporated by reference to Exhibit 10.1 to its Quarterly Report on Form 10-Q for the quarter ended September 30, 2005, filed on November 7, 2005 (SEC File No. 001-31993)).
- 10.15# Summary of Compensation for Non Employee Directors of Sterling Construction Company, Inc. (incorporated by reference to Exhibit 10.15 to its Registration Statement on Form S
- 10.26 Oakhurst Group Tax Sharing Agreement, dated as of July 18, 2001, by and among Oakhurst Company, Inc., Sterling Construction Company, Steel City Products, Inc. and such other companies as are set forth on Schedule A thereto (incorporated by reference to Exhibit 10.28 to Sterling Construction Company, Inc. s Transition Report on Form 10-K for the ten months ended December 31, 2001, filed on April 8, 2002 (SEC File No. 000-19450)).
- 10.27 Fourth Amended and Restated Revolving Credit Loan Agreement, dated as of May 10, 2006, by and between Comerica Bank, Sterling Construction Company, Inc., Sterling General, Inc., Sterling Houston Holdings, Inc. Texas Sterling Construction, L.P. (incorporated by reference to Exhibit 10.1 (and referred to as Amended Revolving Line of Credit Agreement with Comerica Bank ) to Sterling Construction Company, Inc. s Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2006, filed on November 13, 2006 (SEC File No. 001-31993)).

- 10.28 Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.1 to Oakhurst Company, Inc. s Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2001, filed on August 16, 2001 (SEC File No. 000-19450)).

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**Number Exhibit Title**

- 10.29 Amendment, dated as of September 12, 2001, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.3 to Oakhurst Company, Inc. s Quarterly Report on Form 10-Q for the fiscal quarter ended May 31, 2001, filed on October 22, 2001 (SEC File No. 000-19450)).
- 10.30 Second Amendment, dated as of December 13, 2001, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.35 to Sterling Construction Company, Inc. s Transition Report on Form 10-K for the ten months ended December 31, 2002, filed on April 8, 2002 (SEC File No. 000-19450)).
- 10.31 Third Amendment, dated as of June 27, 2002, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.31 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
- 10.32 Fourth Amendment, dated as of September 25, 2002, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.32 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
- 10.33 Fifth Amendment, dated as of November 30, 2002, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.33 to Sterling Construction Company, Inc. s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
- 10.34 Sixth Amendment, dated as of January 15, 2003, to Credit Agreement, dated as of July 13, 2001, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.34 to Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on November 17, 2005 (SEC File number 333-129780)).
- 10.35 Seventh Amendment to Credit Agreement and Waiver, dated as of November 6, 2003, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.35 to Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).
- 10.36 Eighth Amendment to Credit Agreement, dated as of September 17, 2004, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.36 to Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).
- 10.37 Ninth Amendment to Credit Agreement, dated as of December 21, 2004, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.37 Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).
- 10.38 Tenth Amendment to Credit Agreement, dated as of April 18, 2005, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.38 to Sterling

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Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).

- 10.39 Eleventh Amendment to Credit Agreement and Note, dated as of June 3, 2005, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.39 to Sterling Construction Company, Inc. s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).

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**Number Exhibit Title**

- 10.40 Twelfth Amendment to Credit Agreement, dated as of September 14, 2005, by and between National City Bank of Pennsylvania and Steel City Products, Inc. (incorporated by reference to Exhibit 10.40 to Sterling Construction Company, Inc.'s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).
  
- 10.42# Amendment No. 1 to Executive Employment Agreement, dated November 2, 2005, by and between Patrick T. Manning, Sterling Construction Company, Inc., Sterling General, Inc. and Sterling Houston Holdings, Inc. (incorporated by reference to Exhibit 10.36 to Sterling Construction Company, Inc.'s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
  
- 10.43# Amendment No. 1 to Executive Employment Agreement, dated November 2, 2005, by and between Joseph P. Harper, Sr., Sterling Construction Company, Inc., Sterling General, Inc. and Sterling Houston Holdings, Inc. (incorporated by reference to Exhibit 10.37 to Sterling Construction Company, Inc.'s Registration Statement on Form S-1, filed on November 17, 2005 (SEC File number 333-129780)).
  
- 10.45# Note Prepayment Agreement, dated as of December 27, 2005, by and between SCC and certain of its noteholders named therein (incorporated by reference to Exhibit 10.1 to SCC's Current Report on Form 8-K, dated as of December 27, 2005, filed on December 27, 2005 (SEC File No. 001-31993)).
  
- 10.46# [Note Prepayment] Termination Agreement, dated as of December 30, 2005, by and between Sterling Construction Company, Inc. and certain of its noteholders named therein (incorporated by reference to Exhibit 10.1 to SCC's Current Report on Form 8-K, dated as of December 30, 2005, filed on January 3, 2006 (SEC File No. 001-31993)).
  
- 21 Subsidiaries of Sterling Construction Company, Inc. (incorporated by reference to Exhibit 21 to Sterling Construction Company, Inc.'s Registration Statement on Form S-1A, filed on January 3, 2006 (SEC File number 333-129780)).
  
- 23.1\* Consent of Grant Thornton LLP.
  
- 31.1\* Certification of Patrick T. Manning, Chief Executive Officer of Sterling Construction Company, Inc.
  
- 31.2\* Certification of Maarten D. Hemsley, Chief Financial Officer of Sterling Construction Company, Inc.
  
- 32.0\* Certification pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350) of Patrick T. Manning, Chief Executive Officer, and Maarten D. Hemsley, Chief Financial Officer.