TD&Co.
THOMPSON DAVIS & CO.

INITIATING COVERAGE

March 26, 2024

STERLING INFRASTRUCTURE, INC. | STRL

Specialty Contractor Generating Best-in-Class Margins; Launching at Buy

PRICE $111.54

PRICE TARGET $130.00

Engineering & Construction

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KEY TAKEAWAY

We are initiating coverage of Sterling Infrastructure with a Buy rating and a $130 12-month price target. Whereas historically Sterling was a heavy civil contractor focusing on low-bid heavy highway work, the company is now a diversified specialty contractor generating best-in-class margins and strong returns. Last year, Sterling generated an EBITDA margin of 13%, operating margin of 10%, and ROIC of 15%. By comparison, its peer group delivered an average EBITDA margin of 9%, operating margin of 6%, and ROIC of 11%. Sterling's multiple has re-rated higher in recent quarters; however, we see the potential for further expansion. Our $130 price target is based on 12.6x our 2025 EV/EBITDA forecast.

KEY POINTS

Initiating at Buy. We are initiating coverage of Sterling Infrastructure with a Buy rating. Our bullish thesis is based on three key points: (1) Sterling is exposed to favorable end markets, (2) the company is generating best-in-class margins, and (3) we forecast double-digit EBITDA growth in 2024–2025.

Favorable end markets. Historically, Sterling was a heavy civil contractor generating low margins and low returns. Since they joined the company in 2015, the current CEO and CFO have transitioned the company into a diversified specialty contractor generating best-in-class margins. Sterling is now primarily exposed to the boom in heavy nonresidential construction, including data centers and manufacturing plants. It is also poised to benefit from the IIJA infrastructure bill, as well as stronger single-family residential construction this year, we believe.

Best-in-class margins. Last year, Sterling generated an EBITDA margin of 13% and an operating margin of 10%. We have compared Sterling to seven top specialty contractors in our coverage universe. This group of specialty contractors delivered EBITDA margins of 7%–12% last year and operating margins of 1%–8%. Additionally, Sterling generated a 15% return on invested capital last year, which compares to its peer group average of 11% (see **Figure 7** on page 6).

We forecast double-digit growth. After Sterling's 24% EBITDA growth last year (to $260M), we forecast 12% growth in both 2024 (to $291M) and 2025 (to $327M). Our 2024 forecast is in line with consensus; 2025 is 2% above. We note that our estimates do not include acquisitions; however, we see plenty of dry powder for additional deals (a core competency for the company). Sterling ended 2023 with $130M of net cash; we forecast $423M of free cash flow in 2024–2025.

Strong EBITDA track record. Sterling has exceeded EBITDA consensus in 14 of the past 15 quarters. Additionally, in both 2022 and 2023, the company exceeded the high end of its initial EBITDA guidance range. In 2022, EBITDA came in 5% above the high end of its initial guidance range; in 2023, it came in 11% above.

Initiating at Buy with $130 12-month price target. In recent quarters, STRL's multiple has appropriately re-rated higher; we see the potential for further improvement. Sterling is currently trading at 11.6x our 2024 EV/EBITDA forecast. Our $130 target is based on 12.6x our 2025 EV/EBITDA forecast.

COMPANY STATISTICS

52-Week Range	$34.23-$116.36
Market Capitalization (M)	$3,495
Average Daily Volume (000s)	411
Debt/Total Cap	35%
Dividend	NA
Shares Outstanding (M) fd	31.3
Estimated 3-yr EPS Growth	22%
Enterprise Value (M)	$3,370
Float (M)	30.0

FINANCIALS

FYE Oct		2022A	2023A	2024E	2025E
P/E Ratio		35.1x	25.1x	22.3x	19.4x
EV/EBITDA		16.1x	13.0x	11.6x	10.3x
Revenue (M)		$1,769	$1,972	$2,135	$2,330
Op Inc (M)		$160	$206	$234	$265
EBITDA (M)		$210	$260	$291	$327
EPS	Q1	$0.59	$0.64	$0.67	$0.74
	Q2	$0.93	$1.27	$1.41	$1.62
	Q3	$1.01	$1.26	$1.62	$1.88
	Q4	$0.66	$1.28	$1.28	$1.51
Total		**$3.18**	**$4.44**	**$5.00**	**$5.75**
Consensus		---	---	**$4.98**	**$5.64**

Consensus estimates from Bloomberg

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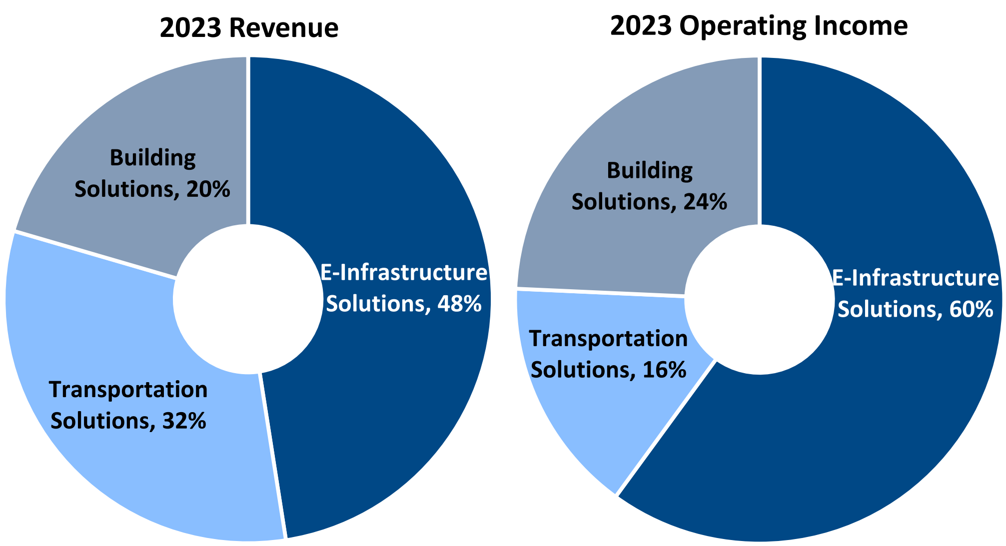
INITIATION OF COVERAGE

We are initiating coverage of Sterling Infrastructure with a Buy rating and a $130 12-month price target. Sterling is a specialty construction company that performs work in a variety of end markets, including heavy nonresidential, transportation, light commercial, and residential. *The company's CEO and CFO joined Sterling in 2015; since then, they have transformed it from a low-margin heavy civil contractor into a diversified specialty contractor generating best-in-class margins.*

Exposed to the super cycle. Sterling is exposed to the current super cycle in U.S. heavy nonresidential construction. The company's E-Infrastructure segment performs site preparation for large data centers, manufacturing plants, distribution centers, and warehouses. Last year, E-Infrastructure accounted for 48% of total sales and 60% of consolidated operating income. In 2023, the E-infrastructure segment generated a 15% operating margin, which is remarkable for a contractor, in our view.

Figure 1. 2023 Segment-Level Contributions



Source: Company reports

Our bullish thesis on Sterling is based on three key points:

1. *Favorable end markets.* In our view, Sterling is well positioned to benefit from the current boom in heavy nonresidential construction, primarily through its E-Infrastructure segment. At Transportation Solutions, Sterling is beginning to benefit from the IIJA infrastructure bill, we believe. Finally, at Building Solutions, Sterling should benefit from a reacceleration in new residential construction this year.

2. *Best-in-class margins*. We cover seven specialty contractors that we consider good comparisons to Sterling: DY, EME, FIX, MTZ, PRIM, PWR, and ROAD. Last year, Sterling generated the highest EBITDA margin in the group (at 13%) and the highest operating margin (at 10%). It was the only specialty contractor in the group to generate a double-digit EBIT margin. Sterling generated a return on invested capital of 15% last year, which compares favorably to the peer group average of 11%.

3. *We forecast double-digit EBITDA growth*. Last year, Sterling generated 24% adjusted EBITDA growth (to $260M). We forecast double-digit growth in 2024 and 2025 (+12% yr/yr for both years), not including acquisitions. Sterling generated free cash flow of $428M last year (nearly $14/sh) and finished the year with $130M of net cash. Over the past seven years, the company has made six acquisitions. While not factored into our model, future acquisitions could be additive to growth. Note that we forecast $423M of free cash flow in 2024–2025 (i.e., we see plenty of dry powder for deals).

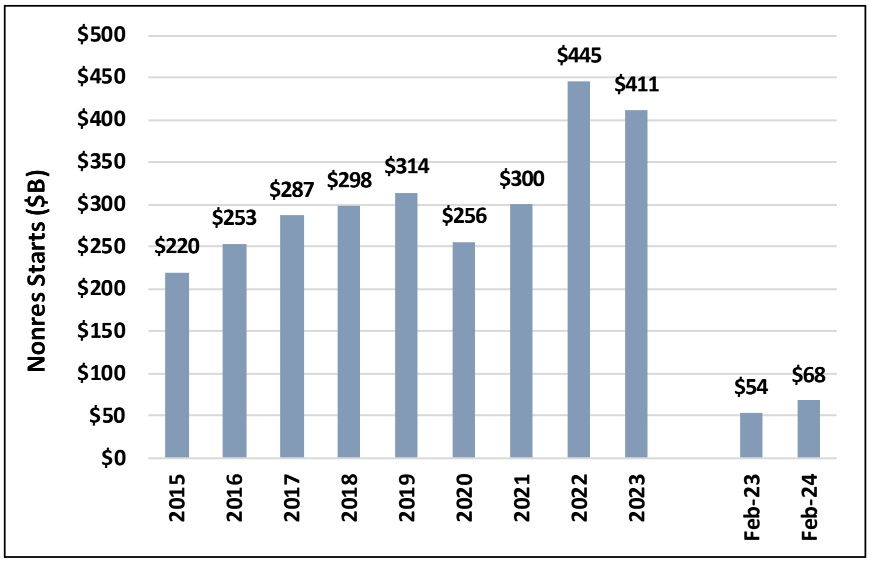
Favorable End Markets

Sterling is well positioned to benefit from strong U.S. construction demand over the forecast period. We are most bullish about heavy nonresidential and public construction, which are Sterling's largest end markets (80% of revenue last year). At Building Solutions (20% of 2023 sales), strong new residential construction demand should offset anticipated weakness in light commercial and multifamily sales this year.

Robust heavy nonresidential demand. Within its E-Infrastructure segment, Sterling has benefited from strong demand for data centers, manufacturing plants, distribution centers, and warehouses. Management sees potential future demand from new facilities for semiconductors, pharmaceuticals, food, and beverages.

In 2022–2023, U.S. nonresidential construction starts averaged $428B, as shown in **Figure 2**. *This was 56% above the average level of starts during 2015–2021 (of $275B).* On a YTD basis through February, nonresidential starts are up 26% yr/yr.

Figure 2. Nonresidential Construction Starts (2015–Present)

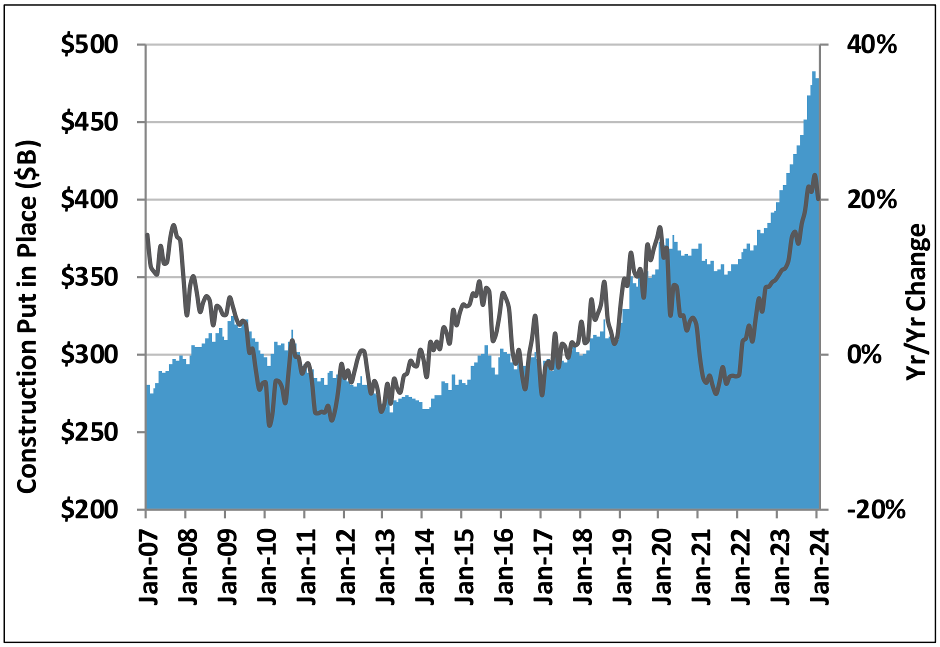


Source: Dodge Data

Sterling benefits from strong heavy nonresidential demand, primarily from its E-Infrastructure segment. However, in certain geographies, including the Mountain West, the company utilizes assets from its Transportation segment to support E-Infrastructure projects. E-Infrastructure ended 2023 with remaining performance obligations of $814M (+35% yr/yr). Last week, the company announced a $100M E-Infrastructure data center award, which is expected to begin construction in Q2'24.

Public works construction is surging. Following passage of the Infrastructure Investment and Jobs Act (IIJA) in late 2021, public works construction spending has experienced unprecedented growth. Over the past year, the seasonally adjusted annual rate of public works spending has averaged $443B, up 17% yr/yr.

Figure 3. U.S. Public Works Construction Spending (2007–2024)



Source: U.S. Census Bureau

We believe that the benefit of IIJA to companies such as Sterling remains in the early stages. Last week, **CEMEX** (CX–$8.59–Buy) management noted that the U.S. government has yet to deploy two-thirds of the $1.2T worth of IIJA funds.

Steady residential geographies. Sterling's residential construction business is concentrated in three metros: Dallas, Houston, and Phoenix. Last year, single-family building permits were –2% yr/yr in Dallas/Fort Worth, +5% in Houston, and –8% in Phoenix. The PPG acquisition should benefit Sterling's Dallas business, while the company believes that it can continue to gain share in Houston and Phoenix.

Figure 4. Metro Permits (2023)

Metro Permits (2023)		
Dallas	**Permits (000s)**	**YOY**
Single Family	42.5	(2%)
Multifamily	24.0	(29%)
Total	66.6	(14%)
Houston		
Single Family	50.0	5%
Multifamily	18.3	(35%)
Total	68.3	(10%)
Phoenix		
Single Family	24.8	(8%)
Multifamily	20.8	1%
Total	45.6	(4%)

Source: U.S. Census Bureau

Strong 2024 data. While it only represents two months, we note that metro permits were favorable during January–February. During the first two months of 2024, single-family permits increased 56% yr/yr in Dallas, 40% in Houston, and 124% in Phoenix.

Figure 5. Metro Permits (January–February 2024)

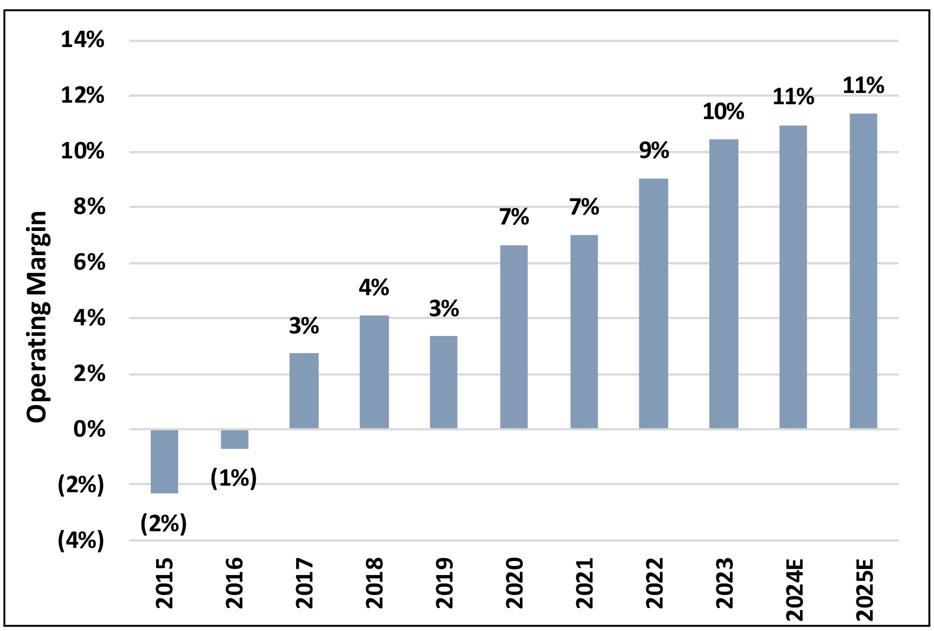
2024 Metro Permits (YTD)		
Dallas	**Permits (000s)**	**YOY**
Single Family	7.6	56%
Multifamily	3.9	(27%)
Total	11.5	12%
Houston		
Single Family	8.8	40%
Multifamily	1.9	(61%)
Total	10.7	(4%)
Phoenix		
Single Family	5.5	124%
Multifamily	3.0	10%
Total	8.5	65%

Source: U.S. Census Bureau

Best-in-Class Margins

Sterling's current management team has transitioned it from a low-margin heavy civil contractor to a high-margin specialty construction company. Over the past seven years, the company has completed six acquisitions (Tealstone, Plateau, Petillo, Kimes & Stone, Concrete Construction Services, and Professional Plumbers Group) and one disposition (Myers). Within its Transportation Solutions business, Sterling has transitioned away from low-bid heavy highway work to alternative delivery highway jobs and higher-margin aviation and commercial work.

Figure 6. Operating Margin Has Steadily Improved Under New Management



Source: Company reports, Thompson Davis & Co.

Peer group comparison. We cover seven specialty construction companies that we believe are comparable to Sterling. Last year, Sterling generated an EBITDA margin of 13%, versus the peer group range of 7%–12% and average of 9%. Similarly, Sterling's 2023 operating margin of 10% was the best in its peer group. Operating margins for the other specialty contractors we cover ranged from 1% to 8% and averaged 6%.

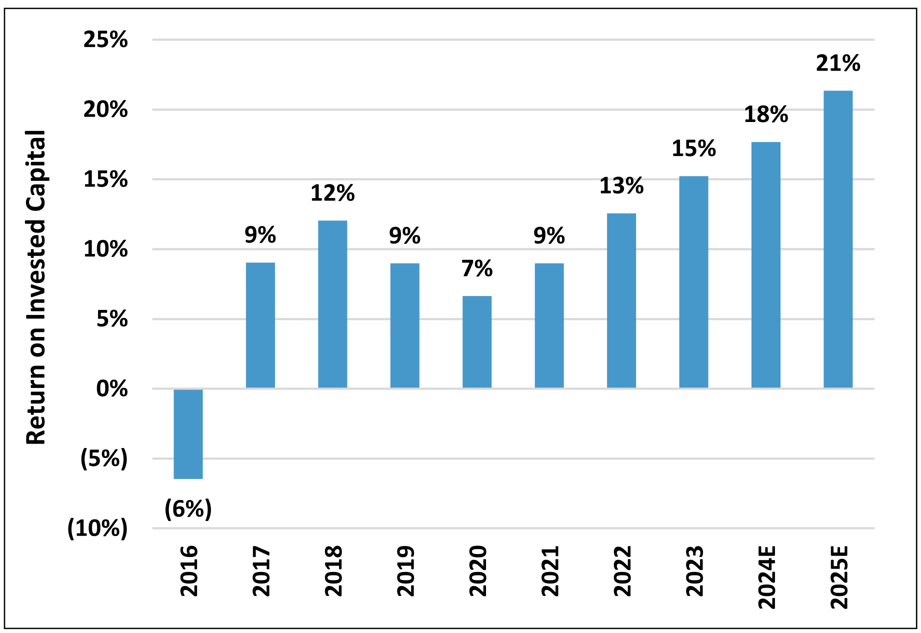
Figure 7. 2023 Margin Comparison, Sterling vs. Top Specialty Contractors

		EBITDA Margin	Operating Margin	ROIC
Sterling Infrastructure	**STRL**	**13%**	**10%**	**15%**
Comfort Systems	FIX	10%	8%	23%
Construction Partners	ROAD	11%	5%	6%
Dycom Industries	DY	12%	8%	12%
EMCOR Group	EME	8%	7%	26%
MasTec	MTZ	7%	1%	(1%)
Primoris Services	PRIM	7%	4%	5%
Quanta Services	PWR	9%	5%	8%
Average (ex. STRL)		**9%**	**6%**	**11%**

Source: Company reports, Thompson Davis & Co.

Strong ROIC. Last year, Sterling generated an ROIC of 15% (up from 13% in 2022). While this was below Comfort Systems (at 23%) and EMCOR (at 26%), it was above the peer group average of 11%. We note that Sterling's model is more capital intensive than that of Comfort and EMCOR. Still, we forecast significant ROIC improvement for Sterling in 2024 (to 18%) and 2025 (to 21%). This partially reflects the potential for strong cash flow generation and further balance sheet improvement.

Figure 8. Strong ROIC Improvement (2016–2025E)

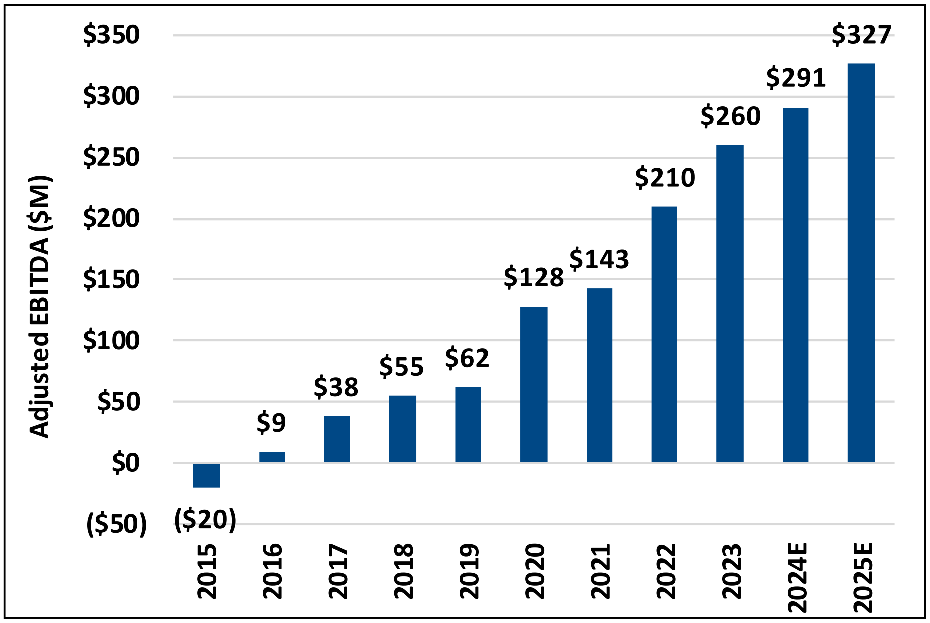


Source: Company reports, Thompson Davis & Co.

We Forecast Double-Digit EBITDA Growth

Sterling management initiated 2024 EBITDA guidance of \$285M–\$300M, implying the potential for 10%–15% growth this year. We believe that growth will be supported by robust end-market demand, including heavy nonresidential, public works, and single-family construction. Additionally, we note that remaining performance obligations finished 2023 at \$2.01B (+46% yr/yr).

Figure 9. Steady EBITDA Improvement (2015–2025E)



Source: Company reports, Thompson Davis & Co.

Sterling's management team has generated steady EBITDA improvement since joining the company and transitioning its mix away from low-bid heavy highway work. We see this continuing over the forecast period and project 12% EBITDA growth in 2024 (to $291M) and 12% in 2025 (to $327M), as shown in **Figure 9**.

Strong EBITDA record. While our current 2024 adjusted EBITDA forecast (of $291M) is towards the low end of guidance (of $285M–$300M), we note that in both 2022 and 2023, Sterling ended up exceeding the high end of its initial annual EBITDA guidance range. For 2022, EBITDA came in at $210M versus initial guidance of $185M–$200M. For 2023, Sterling delivered EBITDA of $260M versus initial guidance of $220M–$235M.

Potential acquisitions. While acquisitions are not included in our EBITDA forecasts, we do expect the company to continue to make platform and bolt-on deals. After generating strong cash flow in 2023, the company ended the year with $130M in net cash. Additionally, we forecast free cash flow of $423M during 2024–2025. The bottom line, in our view: Sterling management has a strong acquisition record and dry powder for deals.

COMPANY OVERVIEW

Sterling Infrastructure was originally founded as Oakhurst Company in Sterling Heights, MI, in 1955. The company relocated to Texas in 1978 and changed its name to Sterling Construction Company in 1991. In June 2022, Sterling Construction Company changed its name to Sterling Infrastructure, to reflect the diversification of its business model.

Sterling went public in 2001 and issued equity in 2007 to fund the acquisition of Road and Highway Builders and again in 2009 to acquire Ralph L. Wadsworth. The company's current CEO and CFO both joined in 2015 and have successfully transitioned Sterling away from low-bid heavy highway work to several niche end markets with significantly higher margin and growth profiles. Sterling is headquartered in The Woodlands, TX, and has approximately 3,000 employees (~20% are union members).

The company's subsidiaries are arranged into three segments:

1. **E-Infrastructure Solutions:** Provides large-scale site development services for manufacturing, data centers, e-commerce distribution centers, warehousing, and power generation. We believe that Sterling's high margins in this segment are

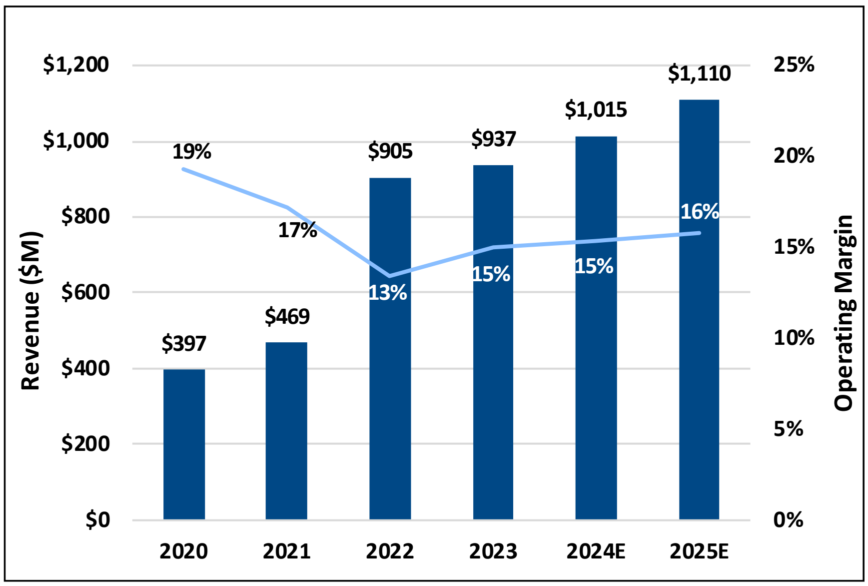
supported by its ability to deliver large-scale services, on time, to sophisticated customers such as Amazon and Meta.

2. **Transportation Solutions:** Provides infrastructure solutions in Arizona, Colorado, Hawaii, Nevada, Texas, and Utah. Projects include highways, roads, bridges, airports, ports, rail, and storm drainage systems. Margin improvement has been driven by a shift away from low-bid heavy highway work. We look for the mix in this segment to continue to evolve towards higher-margin services.
3. **Building Solutions:** Serves large homebuilders in Dallas, Houston, and Phoenix. Sterling constructs residential and light commercial concrete foundations for single- and multi-family homes, parking structures, and other concrete work. Recently acquired PPG specializes in plumbing services for new residential construction in Dallas.

E-Infrastructure Solutions

E-Infrastructure has been Sterling's fastest-growing, highest-margin segment since 2020. Quite frankly, we are amazed by the company's ability to generate mid- to high-teens *operating* margins in this segment over the past four years.

Figure 10. E-Infrastructure Revenue, Operating Margin (2020–2025E)



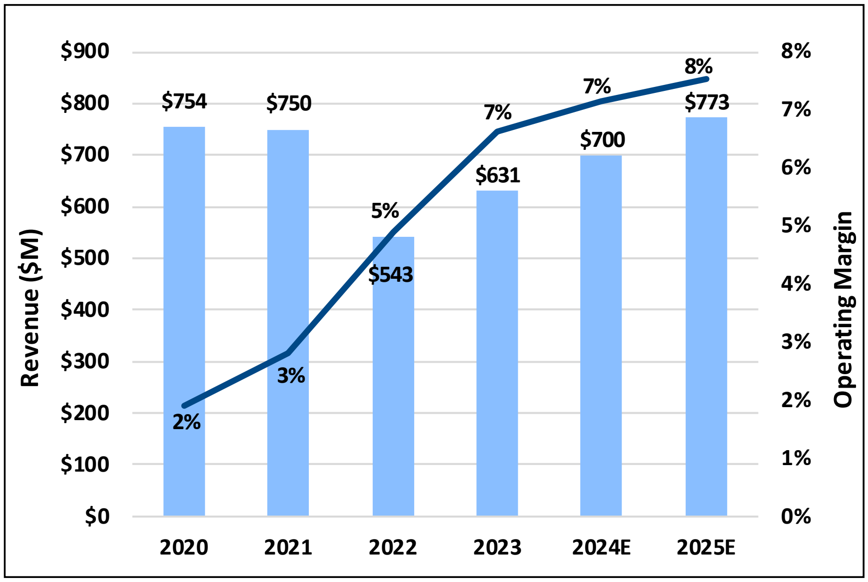
Source: Company reports, Thompson Davis & Co.

For 2024, management forecasts high-single to low-double-digit revenue growth and operating margin improvement. We forecast revenue growth of 8% in 2024 (to $1.02B) and 9% in 2025 (to $1.11B). Management expects e-commerce demand from Amazon to rebound in 2025, potentially supporting growth in this segment, we believe. We see operating margin expanding 30 bps in 2024 (to 15.3%) and 50 bps in 2025 (to 15.8%).

Transportation Solutions

This segment incorporates legacy Sterling. Given the mix-shift away from low-bid road construction, revenue declined at a 4% CAGR from 2020 to 2024. The company has refocused on alternative delivery highway work (not low-bid), aviation projects, and other end markets, including ports, light rail, storm drainage, and commercial.

Figure 11. Transportation Revenue, Operating Margin (2020–2025E)



Source: Company reports, Thompson Davis & Co.

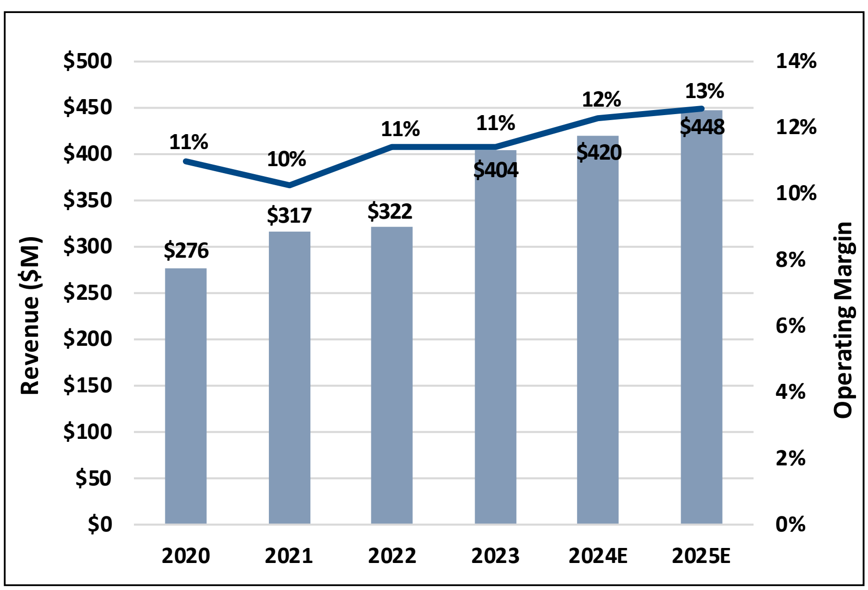
Remaining performance obligations in this segment increased 66% last year (to $1.18B), and management forecasts 2024 revenue growth of 10%–15%. On February 26, Sterling announced a $155M aviation award in Hawaii that will be included in Q1'24 backlog (and was contemplated in guidance, we believe).

We forecast 11% revenue growth this year (to $700M) and 10% in 2025 (to $773M). We see operating margin expanding 50 bps in 2024 (to 7.1%) and 40 bps in 2025 (to 7.5%).

Building Solutions

Sterling constructs concrete pads for residential and light commercial construction, primarily in Dallas, Houston, and Phoenix. The company's Q4'23 acquisition of PPG brings with it plumbing services for new residential construction in the Dallas/Fort Worth market. Sterling works primarily for large homebuilders; top customers include Pulte, D.R. Horton, and Lennar.

Figure 12. Building Solutions Revenue, Operating Margin (2020–2025E)



Source: Company reports, Thompson Davis & Co.

In addition to the PPG acquisition, growth drivers include share gains in Houston and Phoenix. While this is not reflected in our model, we would also not be surprised to see Sterling enter new markets. We forecast 4% revenue growth in 2024 (to $420M), as the PPG acquisition and robust single-family demand will be partially offset by weaker light commercial and multi-family sales. For 2025, we forecast 7% sales growth (to $448M).

Sterling forecasts margin improvement within Building Solutions this year, partially due to a more favorable mix. We project operating margin expansion of 90 bps this year (to 12.3%) and 30 bps next year (to 12.6%).

MANAGEMENT

Sterling's CEO, Joe Cutillo, joined the company in 2015 and ascended to the CEO role in 2017. Prior to joining Sterling, he was the President and CEO at Inland Pipe Rehabilitation, a $200M trenchless pipe rehabilitation company.

Sterling's current CFO, Ron Ballschmiede, joined Sterling in 2015 as CFO. Prior to joining Sterling, he was the CFO of Chicago Bridge & Iron.

In mid-February, Sterling announced that Ballschmiede plans to retire in 2024. While a formal replacement has yet to be identified, the company announced the appointment of Sharon Villaverde to the role of VP of Finance in early March. She joined Sterling from Dycom Industries.

Sterling's executive compensation is heavily weighted towards its adjusted EBITDA and EPS performance. Short-term incentive compensation is largely driven by its adjusted EBITDA performance, while long-term incentives are driven by EPS.

Figure 13. Executive Compensation

Short-Term Incentive Plan	
Financial - Adjusted EBITDA	75%
Acquisition-Related Integration	15%
Safety Performance	10%
Long-Term Incentive Plan	
3-Yr Annual Performance - Adjusted EPS	

Source: Company reports

MODEL

Sterling's management team has developed a strong record of EBITDA beats. Over the past 15 quarters, the company has exceeded adjusted EBITDA consensus in 14 out of 15 quarters. The lone miss came in Q3'23, when revenue was negatively impacted by the timing of large projects.

Figure 14. Strong Record of EBITDA Beats

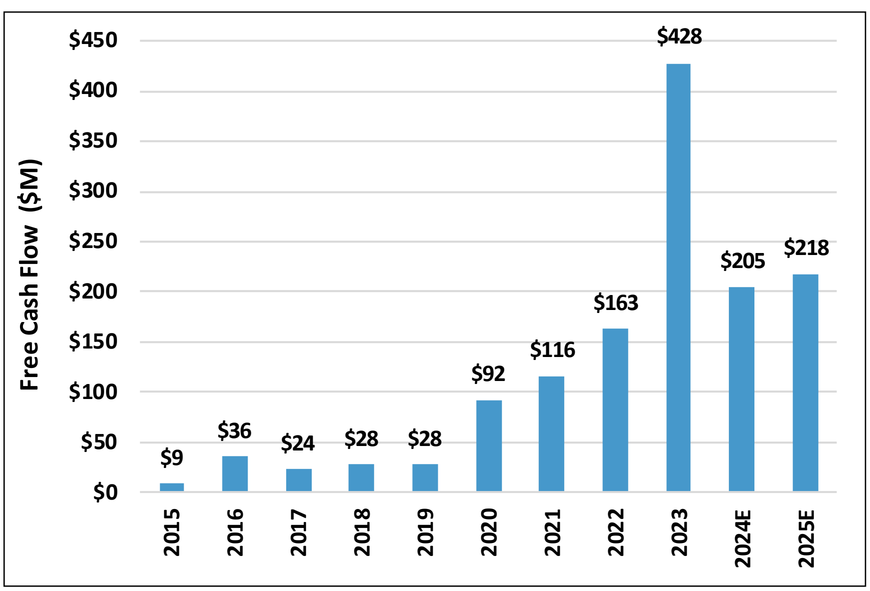
	Adjusted EBITDA		
($M)	Actual	Consensus	% Surprise
Q4'23	$68.9	$62.8	10%
Q3'23	*71.3*	*74.8*	*-5%*
Q2'23	73.5	61.0	20%
Q1'23	46.3	45.0	3%
Q4'22	50.1	47.1	6%
Q3'22	60.2	56.0	8%
Q2'22	54.3	51.6	5%
Q1'22	40.0	36.6	10%
Q4'21	32.0	27.9	15%
Q3'21	40.0	38.3	5%
Q2'21	41.0	37.5	9%
Q1'21	30.3	24.0	26%
Q4'20	28.9	26.3	10%
Q3'20	37.1	33.1	12%
Q2'20	41.4	28.1	47%
Average			**12%**

Source: Bloomberg

Our 2024 outlook. We are initiating a Q1'24 adjusted EBITDA forecast of $46M. Sterling does not provide quarterly guidance, but we have taken a conservative approach to Q1 given challenging weather. The other two Q1 estimates are $47M and $61M. It would not surprise us to see the company beat $46M–$47M for Q1; however, it *would* surprise us to see EBITDA approach the high estimate of $61M. For 2024, our adjusted EBITDA forecast of $291M is in line with the other two estimates (at $289M and $292M).

Free cash flow. Sterling generated sizable free cash flow last year (of $428M). However, it is also worth noting that the company has generated consistent positive free cash flow since 2015. Looking out over the next two years, we forecast free cash flow of $205M in 2024 ($6/sh) and $218M in 2025 ($7/sh). Upfront payments on large contract awards could drive better free cash flow than we currently anticipate, we believe.

Figure 15. History of Consistent Free Cash Flow



Source: Company reports, Thompson Davis & Co.

VALUATION

STRL is currently trading at 11.6x our 2024 EV/EBITDA forecast and 10.3x 2025. This represents a major re-rate versus the company's historical valuation. Over the past two years, STRL has traded at 6.8x forward EV/EBITDA, on average. And over the past five years, it has traded at an average forward valuation of 6.1x.

Why did shares re-rate higher? Historically, Sterling's multiple has been more in line with heavy civil contractors that specialize in low-bid public work. The recent improvement in Sterling's multiple can be justified by the significant change in its business mix in recent years, which has led to structurally higher margins and returns on capital, in our view.

Figure 16. Specialty Construction Comp Table

			TD&Co.		Current Year Estimates		Next Year Estimates	
Company	Symbol	Price	Rating	Target	EV/EBITDA	P/E	EV/EBITDA	P/E
Sterling Infrastructure	**STRL**	**$111.54**	**Buy**	**$130**	**11.6x**	**22.3x**	**10.3x**	**19.4x**
Comfort Systems	FIX	$318.92	Buy	$325	18.9x	29.9x	16.7x	25.0x
Construction Partners	ROAD	$55.50	Buy	$55	15.9x	44.6x	14.0x	36.8x
Dycom Industries	DY	$141.28	Buy	$165	8.8x	18.8x	8.0x	16.3x
EMCOR Group	EME	$347.12	Buy	$350	14.8x	24.0x	14.0x	22.5x
MasTec	MTZ	$92.05	Buy	$100	10.3x	36.4x	9.3x	24.4x
Primoris Services	PRIM	$40.90	Buy	$45	7.3x	13.0x	6.8x	11.5x
Quanta Services	PWR	$255.54	Buy	$250	18.7x	31.0x	17.0x	27.1x
Average (ex. Sterling)					**13.5x**	**28.3x**	**12.2x**	**23.4x**

Source: Company reports, Thompson Davis & Co.

Remains less expensive than peers. While Sterling's multiple has re-rated higher over the past year, the stock remains less expensive than our view of its peer group, as shown above in **Figure 16**. STRL is currently trading at 11.6x our 2024 EV/EBITDA forecast, which represents a 14% discount to its specialty construction peers.

Given the company's best-in-class margins and nearly best-in-class ROIC, we see the potential for further multiple expansion for Sterling.

Initiating a $130 12-month price target. Our price target of $130 represents a 13.8x multiple on 2024 EV/EBITDA and a 12.6x multiple on 2025 EV/EBITDA. This would represent a slight premium to the peer group average shown in **Figure 16**. Sterling's specialty construction peers are currently trading at an average of 13.5x our current-year EV/EBITDA forecasts and 12.2x next year.

RISKS

Primary risks to our investment thesis and to the achievement of our price target include:

1. **Macroeconomic conditions.** A decline in the general economy could reduce demand for construction services in the residential, nonresidential, and public sectors. Sterling has generated considerable operating income from the boom in heavy nonresidential construction starts during 2022–2023. While we believe that demand will remain elevated for large U.S. private construction projects, a primary risk to Sterling is that demand wanes for these types of projects.

2. **Uneven Building Solutions demand.** Sterling projects modest growth in Building Solutions revenue this year, driven by the PPG acquisition and new single-family construction. However, we could see a scenario where declining demand for multifamily construction as well as light commercial projects could cause results in this segment to disappoint.

3. **M&A activity.** We believe that Sterling is focused on finding acquisition candidates to continue to diversify its business away from legacy low-bid highway construction. While the company believes that it can continue to find reasonably priced acquisition candidates, this may not be the case.

4. **Elevated valuation multiples.** While Sterling trades at a discount to our view of its peer group, the company's current valuation multiple is elevated versus its historical average. Furthermore, there is a risk that all specialty construction multiples will re-rate lower over the coming years as the current construction boom recedes.

5. **Stock sensitivity to earnings disappointments.** While Sterling has only missed EBITDA consensus once over the past 15 quarters, we would note that the stock reacted very negatively to the Q3'23 EBITDA miss. According to Bloomberg, STRL lost 15.9% of its value around the Q3'23 miss. Should shifting project schedules, or weather, cause the company to miss again, shares could be negatively impacted.

CONCLUSION

We are initiating coverage of Sterling Infrastructure with a Buy rating and $130 12-month price target. Sterling's current management team has successfully transitioned the company away from being a heavy civil contractor focusing on low-bid highway work to a diversified specialty contractor generating best-in-class margins and high returns on invested capital. Looking forward, we expect that strong end-market demand, particularly for heavy nonresidential and public-sector work, will drive double-digit EBITDA growth in 2024 and 2025. Acquisitions could be additive to our forecasts. While Sterling's multiple has improved, we see the potential for further multiple expansion.

Sterling Infrastructure, Inc.
Earnings Model

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	2023A					2024E					2025E				
	Mar	June	Sept	Dec	Dec	Mar	June	Sept	Dec	Dec	Mar	June	Sept	Dec	Dec
($ millions)	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Revenue	$403.6	$522.3	$560.3	$486.0	$1,972.2	$395.0	$560.0	$630.0	$550.0	$2,135.0	$410.0	$615.0	$700.0	$605.0	$2,330.0
Cost of revenue	(341.8)	(430.1)	(468.5)	(394.2)	(1,634.6)	(331.8)	(459.2)	(516.6)	(451.0)	(1,758.6)	(344.4)	(502.8)	(570.5)	(494.6)	(1,912.3)
Gross Profit	61.7	92.3	91.9	91.8	337.6	63.2	100.8	113.4	99.0	376.4	65.6	112.2	129.5	110.4	417.8
Intangible asset amortization	(3.7)	(3.7)	(3.7)	(4.0)	(15.2)	(4.3)	(4.3)	(4.3)	(4.3)	(17.0)	(4.2)	(4.2)	(4.2)	(4.2)	(16.8)
SG&A	(23.3)	(24.0)	(25.2)	(26.1)	(98.7)	(24.5)	(26.3)	(28.6)	(27.7)	(107.2)	(25.2)	(28.9)	(32.1)	(29.8)	(115.9)
Acquisition related costs	(0.2)	(0.1)	(0.1)	(0.5)	(0.9)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other operating expense, net	(1.9)	(4.2)	(5.7)	(5.3)	(17.0)	(2.5)	(5.0)	(5.5)	(5.0)	(18.0)	(2.5)	(5.5)	(6.0)	(6.0)	(20.0)
Operating income	32.6	60.3	57.1	55.8	205.8	31.9	65.3	75.1	62.0	234.2	33.7	73.7	87.2	70.5	265.0
Interest income	2.0	2.2	4.2	5.8	14.1	5.0	5.0	5.0	5.0	20.0	5.5	5.5	6.0	6.0	23.0
Interest expense	(7.5)	(7.7)	(7.3)	(6.8)	(29.3)	(6.5)	(6.5)	(6.0)	(6.0)	(25.0)	(5.0)	(5.0)	(5.0)	(5.0)	(20.0)
Other income, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax income	27.1	54.7	54.0	54.8	190.6	30.4	63.8	74.1	61.0	229.2	34.2	74.2	88.2	71.5	268.0
Income taxes	(7.0)	(14.5)	(13.9)	(12.3)	(47.8)	(8.2)	(17.2)	(20.0)	(16.5)	(61.9)	(9.2)	(20.0)	(23.8)	(19.3)	(72.4)
Net income (cont. ops.)	20.0	40.2	40.1	42.4	142.8	22.2	46.5	54.1	44.5	167.3	25.0	54.1	64.4	52.2	195.6
Noncontrolling interests	(0.4)	(0.8)	(0.8)	(2.3)	(4.2)	(1.0)	(1.5)	(2.0)	(3.0)	(7.5)	(1.0)	(2.0)	(2.5)	(3.0)	(8.5)
Net income	19.6	39.5	39.4	40.2	138.7	21.2	45.0	52.1	41.5	159.8	24.0	52.1	61.9	49.2	187.1
EPS (cont. ops.)	**$0.64**	**$1.27**	**$1.26**	**$1.28**	**$4.44**	**$0.67**	**$1.41**	**$1.62**	**$1.28**	**$5.00**	**$0.74**	**$1.62**	**$1.88**	**$1.51**	**$5.75**
Shares outstanding (diluted)	30.8	31.0	31.2	31.3	31.2	31.6	31.8	32.1	32.3	32.0	32.6	32.2	32.8	32.5	32.5
EBIT (cont. ops.)	32.2	59.5	56.4	53.5	201.6	30.9	63.8	73.1	59.0	226.7	32.7	71.7	84.7	67.5	256.5
Depreciation & amortization	13.7	14.0	14.9	14.9	57.4	15.4	15.9	16.4	16.9	64.5	17.1	17.4	17.6	17.9	70.0
Acquisition related costs	0.2	0.1	0.1	0.5	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other adjustments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjusted EBITDA	**$46.1**	**$73.6**	**$71.3**	**$68.9**	**$259.9**	**$46.3**	**$79.6**	**$89.4**	**$75.9**	**$291.2**	**$49.8**	**$89.0**	**$102.3**	**$85.3**	**$326.5**
Percent of Sales:															
Gross margin	15.3%	17.7%	16.4%	18.9%	17.1%	16.0%	18.0%	18.0%	18.0%	17.6%	16.0%	18.3%	18.5%	18.3%	17.9%
Adjusted EBITDA margin	11.4%	14.1%	12.7%	14.2%	13.2%	11.7%	14.2%	14.2%	13.8%	13.6%	12.2%	14.5%	14.6%	14.1%	14.0%
Operating margin	8.1%	11.5%	10.2%	11.5%	10.4%	8.1%	11.7%	11.9%	11.3%	11.0%	8.2%	12.0%	12.5%	11.6%	11.4%
Pre-tax margin	6.7%	10.5%	9.6%	11.3%	9.7%	7.7%	11.4%	11.8%	11.1%	10.7%	8.3%	12.1%	12.6%	11.8%	11.5%
Net margin (cont. ops.)	4.9%	7.6%	7.0%	8.3%	7.0%	5.4%	8.0%	8.3%	7.6%	7.5%	5.8%	8.5%	8.8%	8.1%	8.0%
SG&A as a % of sales	5.8%	4.6%	4.5%	5.4%	5.0%	6.2%	4.7%	4.5%	5.0%	5.0%	6.1%	4.7%	4.6%	4.9%	5.0%
D&A as a % of sales	3.4%	2.7%	2.7%	3.1%	2.9%	3.9%	2.8%	2.6%	3.1%	3.0%	4.2%	2.8%	2.5%	3.0%	3.0%
Tax rate	26.0%	26.5%	25.7%	22.5%	25.1%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%
Yr/Yr Change:															
Revenues	10.3%	13.1%	13.7%	8.3%	11.5%	(2.1%)	7.2%	12.4%	13.2%	8.3%	3.8%	9.8%	11.1%	10.0%	9.1%
Gross profit	12.0%	29.9%	15.6%	33.0%	23.0%	2.4%	9.2%	23.4%	7.9%	11.5%	3.8%	11.3%	14.2%	11.5%	11.0%
SG&A	14.9%	15.3%	13.5%	13.0%	14.1%	5.2%	9.4%	13.3%	6.3%	8.6%	2.7%	9.7%	12.3%	7.3%	8.2%
Adjusted EBITDA	13.3%	29.0%	15.7%	37.4%	24.0%	0.4%	8.3%	25.4%	10.1%	12.1%	7.6%	11.8%	14.4%	12.5%	12.1%
Operating income	11.1%	37.0%	15.5%	50.5%	28.7%	(2.2%)	8.3%	31.4%	11.2%	13.8%	5.6%	12.9%	16.2%	13.6%	13.1%
Net income	11.2%	40.4%	28.2%	98.6%	43.4%	7.9%	14.1%	32.3%	3.4%	15.3%	13.0%	15.8%	18.8%	18.4%	17.1%
Diluted EPS	8.7%	37.5%	25.4%	94.8%	39.8%	5.2%	11.1%	28.7%	0.2%	12.6%	9.5%	14.4%	16.1%	17.9%	15.1%

Source: Company reports and Thompson Davis & Co. estimates

Sterling Infrastructure, Inc.
Cash Flow Model

	2022A	2023A					2024E					2025E				
	Dec	**Mar**	**June**	**Sept**	**Dec**	**Dec**	**Mar**	**June**	**Sept**	**Dec**	**Dec**	**Mar**	**June**	**Sept**	**Dec**	**Dec**
($ millions)	**Year**	**Q1**	**Q2**	**Q3**	**Q4**	**Year**	**Q1**	**Q2**	**Q3**	**Q4**	**Year**	**Q1**	**Q2**	**Q3**	**Q4**	**Year**
Operating activities:																
Net income (loss)	$108.2	$20.0	$40.2	$40.1	$42.4	$142.8	$22.2	$46.5	$54.1	$44.5	$167.3	$25.0	$54.1	$64.4	$52.2	$195.6
Depreciation & amortization	52.1	13.7	14.0	14.9	14.9	57.4	15.4	15.9	16.4	16.9	64.5	17.1	17.4	17.6	17.9	70.0
Change in working capital	29.5	10.6	70.5	88.8	82.6	252.5	(10.0)	(10.0)	10.0	20.0	10.0	(15.0)	(15.0)	15.0	30.0	15.0
Other	29.4	4.7	1.2	12.5	7.4	25.8	5.0	5.0	5.0	5.0	20.0	0.0	0.0	0.0	0.0	0.0
Cash flow from operating activities	$219.1	$49.1	$125.9	$156.2	$147.4	$478.6	$32.6	$57.4	$85.4	$86.4	$261.8	$27.1	$56.5	$97.0	$100.0	$280.6
Investing activities:																
Capital expenditures, gross	($60.9)	($14.2)	($24.6)	($10.4)	($15.1)	($64.4)	($15.0)	($20.0)	($20.0)	($10.0)	($65.0)	($15.0)	($22.5)	($22.5)	($12.5)	($72.5)
Proceeds from the sale of assets	4.9	6.7	1.8	1.1	4.2	13.8	2.0	2.0	2.0	2.0	8.0	2.5	2.5	2.5	2.5	10.0
Cash paid for acquisitions	(18.0)	0.0	0.0	0.0	(51.2)	(51.2)										
Disposition proceeds	(15.8)	14.0	0.0	0.0	0.0	14.0										
Other	0.0	0.0	0.0	0.0	0.0	0.0										
Cash flow from investing activities	($89.8)	$6.5	($22.8)	($9.3)	($62.1)	($87.8)										
Financing activities:																
Proceeds from debt	$0.0	$0.0	$0.0	$0.0	$2.6	$2.6										
Payment on debt	(23.4)	(30.8)	(36.7)	(9.3)	(16.6)	(93.5)										
Repurchases of common stock	0.0	0.0	0.0	0.0	0.0	0.0										
Proceeds from common stock issuance	0.0	0.0	0.0	0.0	0.0	0.0										
Exercise of stock options and other	(9.4)	(4.3)	(0.0)	(0.3)	(9.0)	(13.6)										
Cash flow from financing activities	($32.8)	($35.1)	($36.8)	($9.5)	($23.1)	($104.5)										
Net change in cash:	96.6	20.4	66.3	137.4	62.2	286.3										
Free cash flow	**$163.2**	**$41.6**	**$103.1**	**$146.9**	**$136.4**	**$428.0**	**$19.6**	**$39.4**	**$67.4**	**$78.4**	**$204.8**	**$14.6**	**$36.5**	**$77.0**	**$90.0**	**$218.1**
Free cash flow per share	$5.36	$1.35	$3.33	$4.71	$4.35	$13.71	$0.62	$1.24	$2.10	$2.42	$6.41	$0.45	$1.13	$2.34	$2.77	$6.71

Source: Company reports and Thompson Davis & Co. estimates

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	#	%
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