GRANITE CONSTRUCTION INC
Form 10-Q
May 01, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ___________ to ___________

Commission File Number: 1-12911

GRANITE CONSTRUCTION INCORPORATED

| State of Incorporation: | I.R.S. Employer Identification Number: |
|---|---|
| Delaware | 77-0239383 |

Address of principal executive offices:

585 W. Beach Street

Watsonville, California 95076

(831) 724-1011

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

| | | | | |
|---|---|---|---|---|
| Large accelerated filer | Accelerated filer | Non-accelerated filer | Smaller reporting company | Emerging growth company |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of April 24, 2018.

| Class | Outstanding |
|---|---|
| Common Stock, $0.01 par value | 40,048,328 |

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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS
GRANITE CONSTRUCTION INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS

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

| | March 31, 2018 | December 31, 2017 | March 31, 2017 |
|---|---|---|---|
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents ($91,903, $94,359 and $60,406 related to consolidated construction joint ventures (“CCJVs”)) | $193,581 | $ 233,711 | $169,501 |
| Short-term marketable securities | 39,961 | 67,775 | 67,824 |
| Receivables, net ($17,598, $52,031 and $55,215 related to CCJVs) | 330,192 | 479,791 | 351,091 |
| Contract assets ($23,889, $0 and $0 related to CCJVs) | 178,663 | — | — |
| Costs and estimated earnings in excess of billings ($0, $1,437 and $2,965 related to CCJVs) | — | 103,965 | 90,112 |
| Inventories | 71,295 | 62,497 | 58,781 |
| Equity in construction joint ventures | 254,816 | 247,826 | 235,683 |
| Other current assets ($14,180, $10,384 and $7,047 related to CCJVs) | 43,125 | 36,513 | 54,542 |
| Total current assets | 1,111,633 | 1,232,078 | 1,027,534 |
| Property and equipment, net ($44,655, $38,361 and $26,161 related to CCJVs) | 409,708 | 407,418 | 412,490 |
| Long-term marketable securities | 67,305 | 65,015 | 59,989 |
| Investments in affiliates | 38,682 | 38,469 | 36,410 |
| Goodwill | 53,799 | 53,799 | 53,799 |
| Deferred income taxes, net | 3,718 | — | — |
| Other noncurrent assets | 74,382 | 75,199 | 87,997 |
| Total assets | $1,759,227 | $ 1,871,978 | $1,678,219 |
| | | | |
| LIABILITIES AND EQUITY | | | |
| Current liabilities | | | |
| Current maturities of long-term debt | $47,298 | $ 46,048 | $14,796 |
| Accounts payable ($31,854, $34,795 and $19,386 related to CCJVs) | 226,253 | 237,673 | 170,006 |
| Contract liabilities ($33,760, $0 and $0 related to CCJVs) | 71,030 | — | — |
| Billings in excess of costs and estimated earnings ($0, $37,701 and $34,467 related to CCJVs) | — | 135,146 | 91,527 |
| Accrued expenses and other current liabilities ($2,090, $2,126 and $1,426 | 233,637 | 236,407 | 224,850 |

| | | | |
|---|---|---|---|
| related to CCJVs) | | | |
| Total current liabilities | 578,218 | 655,274 | 501,179 |
| Long-term debt | 176,011 | 178,453 | 228,306 |
| Deferred income taxes, net | — | 1,361 | 5,609 |
| Other long-term liabilities | 40,104 | 44,085 | 47,066 |
| Commitments and contingencies | | | |
| Equity | | | |
| Preferred stock, $0.01 par value, authorized 3,000,000 shares, none outstanding | — | — | — |
| Common stock, $0.01 par value, authorized 150,000,000 shares; issued and outstanding: 40,047,187 shares as of March 31, 2018, 39,871,314 shares as of December 31, 2017 and 39,815,232 shares as of March 31, 2017 | 400 | 399 | 398 |
| Additional paid-in capital | 162,038 | 160,376 | 152,805 |
| Accumulated other comprehensive income (loss) | 1,197 | 634 | (257) |
| Retained earnings | 751,801 | 783,699 | 706,571 |
| Total Granite Construction Incorporated shareholders' equity | 915,436 | 945,108 | 859,517 |
| Non-controlling interests | 49,458 | 47,697 | 36,542 |
| Total equity | 964,894 | 992,805 | 896,059 |
| Total liabilities and equity | $1,759,227 | $ 1,871,978 | $1,678,219 |

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

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GRANITE CONSTRUCTION INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited - in thousands, except per share data)

| Three Months Ended March 31, | 2018 | 2017 |
|---|---|---|
| Revenue | | |
| Construction | $269,243 | $226,849 |
| Large Project Construction | 248,414 | 207,033 |
| Construction Materials | 45,722 | 34,518 |
| Total revenue | 563,379 | 468,400 |
| Cost of revenue | | |
| Construction | 230,847 | 199,520 |
| Large Project Construction | 228,048 | 204,478 |
| Construction Materials | 48,201 | 39,276 |
| Total cost of revenue | 507,096 | 443,274 |
| Gross profit | 56,283 | 25,126 |
| Selling, general and administrative expenses | 61,252 | 61,837 |
| Acquisition and integration expenses | 8,409 | — |
| Gain on sales of property and equipment | (543) | (270) |
| Operating loss | (12,835) | (36,441) |
| Other expense (income) | | |
| Interest income | (1,521) | (1,051) |
| Interest expense | 2,435 | 2,743 |
| Equity in income of affiliates | (224) | (916) |
| Other expense (income), net | 268 | (870) |
| Total other expense (income) | 958 | (94) |
| Loss before benefit from income taxes | (13,793) | (36,347) |
| Benefit from income taxes | (4,131) | (12,496) |
| Net loss | (9,662) | (23,851) |
| Amount attributable to non-controlling interests | (1,761) | 61 |
| Net loss attributable to Granite Construction Incorporated | $(11,423) | $(23,790) |
| | | |
| Net loss per share attributable to common shareholders (see Note 14) | | |
| Basic | $(0.29) | $(0.60) |
| Diluted | $(0.29) | $(0.60) |
| Weighted average shares of common stock | | |
| Basic | 39,908 | 39,649 |
| Diluted | 39,908 | 39,649 |
| Dividends per common share | $0.13 | $0.13 |

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

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GRANITE CONSTRUCTION INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited - in thousands)

| Three Months Ended March 31, | 2018 | 2017 |
|---|---|---|
| Net loss | $(9,662) | $(23,851) |
| Other comprehensive income (loss), net of tax: | | |
| Net unrealized gain on derivatives | $620 | $52 |
| Less: reclassification for net (gains) losses included in interest expense | (40) | 69 |
| Net change | $580 | $121 |
| Foreign currency translation adjustments, net | (17) | (7) |
| Other comprehensive income | $563 | $114 |
| Comprehensive loss | $(9,099) | $(23,737) |
| Non-controlling interests in comprehensive loss | (1,761) | 61 |
| Comprehensive loss attributable to Granite | $(10,860) | $(23,676) |

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

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GRANITE CONSTRUCTION INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited - in thousands)

| Three Months Ended March 31, | 2018 | 2017 |
|---|---|---|
| Operating activities | | |
| Net loss | $(9,662) | $(23,851) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Depreciation, depletion and amortization | 15,511 | 14,649 |
| Gain on sales of property and equipment, net | (543) | (270) |
| Stock-based compensation | 7,772 | 8,913 |
| Equity in net income from unconsolidated joint ventures | (2,637) | (1,456) |
| Changes in assets and liabilities: | | |
| Receivables | 58,527 | 68,272 |
| Costs and estimated earnings in excess of billings, net | — | (25,581) |
| Contract assets, net | (47,777) | — |
| Inventories | (8,798) | (3,536) |
| Contributions to unconsolidated construction joint ventures | (26,067) | (813) |
| Distributions from unconsolidated construction joint ventures | 4,036 | 16,179 |
| Other assets, net | (6,136) | (18,465) |
| Accounts payable | (12,838) | (28,161) |
| Accrued expenses and other current liabilities, net | (9,008) | 7,456 |
| Net cash (used in) provided by operating activities | (37,620) | 13,336 |
| Investing activities | | |
| Purchases of marketable securities | (9,952) | (29,910) |
| Maturities of marketable securities | 35,000 | 30,000 |
| Purchases of property and equipment ($0 and $6,207 related to CCJVs) | (15,967) | (21,372) |
| Proceeds from sales of property and equipment | 675 | 1,060 |
| Other investing activities, net | 345 | 67 |
| Net cash provided by (used in) investing activities | 10,101 | (20,155) |
| Financing activities | | |
| Long-term debt principal repayments | (1,250) | (1,250) |
| Cash dividends paid | (5,183) | (5,151) |
| Repurchases of common stock | (6,119) | (6,448) |
| Other financing activities, net | (59) | (157) |
| Net cash used in financing activities | (12,611) | (13,006) |
| Decrease in cash and cash equivalents | (40,130) | (19,825) |
| Cash and cash equivalents at beginning of period | 233,711 | 189,326 |
| Cash and cash equivalents at end of period | $193,581 | $169,501 |
| | | |
| Supplementary Information | | |

| | | |
|---|---|---|
| Cash paid during the period for: | | |
| Interest | $1,509 | $1,242 |
| Income taxes | 149 | 1,897 |
| Non-cash investing and financing activities: | | |
| Restricted stock units issued, net of forfeitures | $12,257 | $11,109 |
| Accrued cash dividends | 5,206 | 5,176 |
| Accrued equipment purchases | (1,418 ) | 749 |

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

GRANITE CONSTRUCTION INCORPORATED

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The condensed consolidated financial statements included herein have been prepared by Granite Construction Incorporated ("we," "us," "our," "the Company" or "Granite") pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"), are unaudited and should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") have been condensed or omitted. Further, the condensed consolidated financial statements reflect, in the opinion of management, all normal recurring adjustments necessary to state fairly our financial position at March 31, 2018 and 2017 and the results of our operations and cash flows for the periods presented. The December 31, 2017 condensed consolidated balance sheet data was derived from audited consolidated financial statements, but does not include all disclosures required by U.S. GAAP.

Our operations are typically affected more by weather conditions during the first and fourth quarters of our fiscal year which may alter our construction schedules and can create variability in our revenues and profitability. Therefore, the results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results to be expected for the full year.

We prepared the accompanying condensed consolidated financial statements on the same basis as our annual consolidated financial statements, except for the adoption of Accounting Standards Update ("ASU") No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business and ASU No. 2017-09, Compensation-Stock Compensation (Topic 718) Scope of Modification Accounting during the three months ended March 31, 2018, none of which had a material impact on our condensed consolidated financial statements. In addition, effective during the quarter ended March 31, 2018, we adopted ASU 2018-05, Income Taxes (Topic 740) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No.118, the impact of which is disclosed in Note 15 and effective January 1, 2018, we adopted Accounting Standards Codification ("ASC") Topic 606, Revenue from Contracts with Customers and subsequently issued additional related ASUs ("Topic 606"), the impact of which is described in detail below.

Reclassifications: Certain reclassifications of prior period amounts have been made to conform to the current period presentation.

Effect of adopting Topic 606

The core principle of Topic 606 is that revenue will be recognized when promised goods or services are transferred to customers in an amount that reflects consideration for which entitlement is expected in exchange for those goods or services. We adopted Topic 606 using a modified retrospective transition approach and elected to apply Topic 606 to contracts with customers that are not substantially complete, i.e. less than 90% complete, as of January 1, 2018.

While the adoption of Topic 606 did not have an impact on revenue of our Construction Materials segment, it did impact revenue of our Construction and Large Project Construction segments specifically in the following areas:

- Multiple performance obligations – In accordance with Topic 606, we have reviewed construction contracts with customers, including those related to contract modifications, to determine if there are multiple performance obligations. Based on this review, we have identified one unconsolidated joint venture contract in our Large Project Construction segment that has multiple performance obligations.
- Multiple contracts – We reviewed contracts containing task orders and identified one Construction segment master contract that consists of multiple individual contracts as defined by Topic 606. Previously, revenue for this contract was forecasted and recorded at the master contract level.
- Revenue recognition – We identified one contract in our Large Project Construction segment where performance obligations are satisfied and control of the promised goods and services are transferred to the customer upon delivery of goods rather than over time. Previously, revenue for this contract was recognized over time.
- Provisions for losses – We identified one unconsolidated joint venture contract in our Large Project Construction segment that has actual and provisions for losses at the performance obligation level related to completed and uncompleted performance obligations, respectively. Previously, provisions for losses were recorded at the contract level.

The impact to retained earnings as of January 1, 2018 from the adoption of Topic 606 related to the items noted above was a net cumulative decrease of $15.2 million.

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GRANITE CONSTRUCTION INCORPORATED

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

In addition, as of January 1, 2018, we began to separately present contract assets and liabilities in the condensed consolidated balance sheets. Contract assets include amounts due under contractual retainage provisions that were previously included in accounts receivable and costs, and estimated earnings in excess of billings that were previously separately presented. Contract liabilities include billings in excess of costs and estimated earnings that were previously separately presented as well as provisions for losses that were previously included in accrued and other current liabilities. See Note 6 for further information.

Disclosures included in Notes 4, 5 and 6 are related to the adoption of Topic 606 and are revenue disaggregated by operating group, information about unearned revenue and contract assets and liabilities, respectively.

The accounting policies that were affected by Topic 606 and the changes thereto are as follows:

Revenue Recognition: Our revenue is primarily derived from construction contracts that can span several quarters or years and from sales of construction materials. We recognize revenue in accordance with Topic 606. Topic 606 provides for a five-step model for recognizing revenue from contracts with customers as follows:

1. Identify the contract
2. Identify performance obligations
3. Determine the transaction price
4. Allocate the transaction price
5. Recognize revenue

Generally, our contracts contain one performance obligation.

Contracts with customers in our Construction Materials segment are typically defined by our customary business practices and are valued at the contractual selling price per unit. Our customary business practices are for the delivery of a separately identifiable good at a point in time which is typically when delivery to the customer occurs.

Contracts in our Construction and Large Project Construction segments may contain multiple distinct promises or multiple contracts within a master agreement (e.g. contracts that cross multiple locations/geographies and task orders), which we review at contract inception to determine if they represent multiple performance obligations or multiple separate contracts. This review consists of determining if promises or groups of promises are distinct within the context of the contract, including whether contracts are physically contiguous, contain task orders, purchase orders, or sales orders and/or contain elements not related to design and/or build.

The transaction price is the amount of consideration to which we expect to be entitled in exchange for transferring goods and services to the customer. The consideration promised in a contract with customers of our Construction and Large Project Construction segments may include both fixed amounts and variable amounts (e.g. bonuses/incentives or penalties/liquidated damages) to the extent that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved (“probable”) and estimable. When a contract has a single performance obligation, the entire transaction price is attributed to that performance obligation. When a contract has more than one performance obligation, the transaction price is allocated to each performance obligation based on estimated relative standalone selling prices of the goods or services at the inception of the contract, which typically is determined using cost plus an appropriate margin.

Subsequent to the inception of a contract in our Construction and Large Project Construction segments, the transaction price could change for various reasons, including the executed or estimated amount of change orders and unresolved contract modifications and claims to or from owners. Changes that are accounted for as an adjustment to existing performance obligations are allocated on the same basis at contract inception. Otherwise, changes are accounted for as separate performance obligation(s) and the separate transaction price is allocated as discussed above.

Changes are made to the transaction price from unapproved change orders to the extent the amount can be reliably estimated and recovery is probable.

On certain projects we have submitted and have pending unresolved contract modifications and affirmative claims (“affirmative claims”) to recover additional costs and the associated profit, if applicable, to which the Company believes it is entitled under the terms of contracts with customers, subcontractors, vendors or others. The owners or their authorized representatives and/or other third parties may be in partial or full agreement with the modifications or affirmative claims, or may have rejected or disagree entirely or partially as to such entitlement.

GRANITE CONSTRUCTION INCORPORATED

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

Changes are made to the transaction price from affirmative claims with customers to the extent it is probable that a claim settlement with a customer will result in additional revenue and the amount can be reasonably estimated. A reduction to costs related to affirmative claims with non-customers with whom we have a contractual arrangement ("back charges") is recognized when the estimated recovery is probable and the amount can be reasonably estimated. Except for contractual back charges, a reduction to cost related to affirmative claims against non-customers that are unrelated to jobs is recognized when the claims are settled. Recognizing affirmative claims and back charge recoveries requires significant judgments of certain factors including, but not limited to, dispute resolution developments and outcomes, anticipated negotiation results, and the cost of resolving such matters and estimates.

Certain construction contracts include retention provisions to provide assurance to our customers that we will perform in accordance with the contract terms and are therefore not considered a financing benefit. The balances billed but not paid by customers pursuant to these provisions generally become due upon completion and acceptance of the project work or products by the customer. We have determined there are no significant financing components in our contracts during the three months ended March 31, 2018.

Typically, performance obligations related to contracts in our Construction and Large Project Construction segments are satisfied over time because our performance typically creates or enhances an asset that the customer controls as the asset is created or enhanced. We recognize revenue as performance obligations are satisfied and control of the promised good and service is transferred to the customer. Revenue in our Construction and Large Project Construction segments is ordinarily recognized over time as control is transferred to the customers by measuring the progress toward complete satisfaction of the performance obligation(s) using an input (i.e., "cost to cost") method. Under the cost to cost method, costs incurred to-date are generally the best depiction of transfer of control.

All contract costs, including those associated with affirmative claims, change orders and back charges, are recorded as incurred and revisions to estimated total costs are reflected as soon as the obligation to perform is determined. Contract costs consist of direct costs on contracts, including labor and materials, amounts payable to subcontractors, direct overhead costs and equipment expense (primarily depreciation, fuel, maintenance and repairs).

The accuracy of our revenue and profit recognition in a given period depends on the accuracy of our estimates of the cost to complete each project. Cost estimates for all of our significant projects use a detailed "bottom up" approach, and we believe our experience allows us to create materially reliable estimates. There are a number of factors that can contribute to changes in estimates of contract cost and profitability. The most significant of these include:

- the completeness and accuracy of the original bid;
- costs associated with scope changes;
- changes in costs of labor and/or materials;
- extended overhead and other costs due to owner, weather and other delays;
- subcontractor performance issues;
- changes in productivity expectations;

- site conditions that differ from those assumed in the original bid;
- changes from original design on design-build projects;
- the availability and skill level of workers in the geographic location of the project;
- a change in the availability and proximity of equipment and materials;
- our ability to fully and promptly recover on affirmative claims and back charges for additional contract costs; and
- the customer's ability to properly administer the contract.

The foregoing factors, as well as the stage of completion of contracts in process and the mix of contracts at different margins may cause fluctuations in gross profit and gross profit margin from period to period. Significant changes in cost estimates, particularly in our larger, more complex projects have had, and can in future periods have, a significant effect on our profitability. All contract costs, including those associated with affirmative claims, change orders and back charges, are recorded as incurred and revisions to estimated total costs are reflected as soon as the obligation to perform is determined to be probable. Contract costs consist of direct costs on contracts, including labor and materials, amounts payable to subcontractors, direct overhead costs and equipment expense (primarily depreciation, fuel, maintenance and repairs).

All state and federal government contracts and many of our other contracts provide for termination of the contract at the convenience of the party contracting with us, with provisions to pay us for work performed through the date of termination including demobilization cost.

GRANITE CONSTRUCTION INCORPORATED

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

Generally, costs to obtain our contracts (“pre-bid costs”) that are not expected to be recovered from the customer are expensed as incurred and included in selling, general and administrative expenses on our consolidated statements of operations. Pre-bid costs that are explicitly chargeable to the customer even if the contract is not obtained are included in accounts receivable on our consolidated balance sheets with a corresponding reduction to selling, general and administrative expenses on our consolidated statements of operations.

Unearned Revenue: Unearned revenue represents the aggregate amount of the transaction price allocated to unsatisfied or partially unsatisfied performance obligations at the end of a reporting period. We generally include a project in our unearned revenue at the time a contract is awarded, the contract has been executed and to the extent we believe funding is probable. Certain contracts contain contract options that are exercisable at the option of our customers without requiring us to go through an additional competitive bidding process or contain task orders related to master contracts under which we perform work only when the customer awards specific task orders to us. Contract options and task orders are included in unearned revenue when exercised or issued, respectively.

Substantially all of the contracts in our unearned revenue may be canceled or modified at the election of the customer; however, we have not been materially adversely affected by contract cancellations or modifications in the past. Many projects in our Construction segment are added to unearned revenue and completed within the same fiscal quarter or year and, therefore, may not be reflected in our beginning or ending unearned revenue. Approximately $1.9 billion of the March 31, 2018 unearned revenue is expected to be recognized within the next twelve months and the remaining amount will be recognized thereafter. Unearned revenue is presented by segment and operating group in Note 5.

Contract Assets: Our contract assets include amounts due under contractual retainage provisions and costs, and estimated earnings in excess of billings. The balances billed but not paid by customers pursuant to retainage provisions generally become due upon completion and acceptance of the project work or products by the owners. Costs and estimated earnings in excess of billings also represent amounts earned and reimbursable under contracts, including claim recovery estimates, but have a conditional right for billing and payment such as achievement of milestones or completion of the project. With the exception of customer affirmative claims, generally, such unbilled amounts will become billable according to the contract terms and generally will be billed and collected over the next twelve months. Settlement with the customer of outstanding affirmative claims is dependent on the claims resolution process and could extend beyond one year or the project operating cycle. Based on our historical experience, we generally consider the collection risk related to billable amounts to be low. When events or conditions indicate that it is probable that the amounts outstanding become unbillable, the transaction price and associated contract asset is reduced.

Costs to mobilize equipment and labor to a job site, prior to substantive work beginning (“mobilization costs”) are capitalized as incurred and amortized over the expected duration of the contract. As of March 31, 2018 and January 1, 2018, we had no material capitalized mobilization costs.

Contract Liabilities: Our contract liabilities consist of provisions for losses and billings in excess of costs and estimated earnings. Provisions for losses are recognized in the consolidated statements of operations at the uncompleted performance obligation level for the amount of total estimated losses in the period that evidence indicates that the estimated total cost of a performance obligation exceeds its estimated total revenue. Billings in excess of costs and estimated earnings are billings to customers on contracts in advance of work performed, including advance payments negotiated as a contract condition. Generally, unearned project-related costs will be earned over the next twelve months.

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GRANITE CONSTRUCTION INCORPORATED

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

The amounts by which each condensed consolidated balance sheet line item as of March 31, 2018, and condensed consolidated statement of operations line item for the three months ended March 31, 2018 was affected by the adoption of Topic 606 relative to the previous revenue guidance are presented in the tables below. The changes are primarily related to reclassifications on the condensed consolidated balance sheet and the impact on the condensed consolidated statement of operations, both from new requirements under Topic 606. The change in retained earnings is net of the cumulative effect of initially applying Topic 606.

| Condensed Consolidated Balance Sheet | As Reported | Balances Without Adoption of Topic 606 | Effect of Change Higher/(Lower) |
|---|---|---|---|
| ASSETS | | | |
| Receivables, net | $330,192 | $426,123 | $ (95,931) |
| Contract assets | 178,663 | — | 178,663 |
| Costs and estimated earnings in excess of billings | — | 120,136 | (120,136) |
| Other current assets | 43,125 | 43,788 | (663) |
| Deferred income taxes, net | 3,718 | — | 3,718 |
| | | | |
| LIABILITIES AND EQUITY | | | |
| Contract liabilities | $71,030 | $— | $ 71,030 |
| Billings in excess of costs and estimated earnings | — | 104,306 | (104,306) |
| Accrued expenses and other current liabilities | 233,637 | 220,084 | 13,553 |
| Deferred income taxes, net | — | 1,554 | (1,554) |
| Retained earnings | 751,801 | 764,872 | (13,071) |

| Condensed Consolidated Statement of Operations | As Reported | Balances Without Adoption of Topic | Effect of Change Higher/(Lower) |
|---|---|---|---|

| | | 606 | |
|---|---|---|---|
| Revenue | | | |
| Construction | $269,243 | $269,481 | $ (238 ) |
| Large Project Construction | 248,414 | 246,621 | 1,793 |
| Cost of revenue | | | |
| Construction | 230,847 | 230,847 | — |
| Large Project Construction | 228,048 | 229,284 | (1,236 ) |
| Gross profit | 56,283 | 53,491 | 2,792 |
| Operating (loss) income | (12,835 ) | (15,627 ) | 2,792 |
| (Benefit from) provision for income taxes | (4,131 ) | (4,794 ) | 663 |
| Net (loss) income | (9,662 ) | (11,791 ) | 2,129 |
| Net (loss) income attributable to Granite | (11,423 ) | (13,552 ) | 2,129 |

2. Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-02, Leases (Topic 842) and subsequently issued a related ASU, which requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (a) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (b) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The ASU will be effective commencing with our quarter ending March 31, 2019. We expect the adoption of this ASU to have a material and equal increase to current assets and current liabilities on our consolidated balance sheets.

GRANITE CONSTRUCTION INCORPORATED

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

In February 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows companies to reclassify stranded tax affects resulting from the U.S. Tax Cuts and Jobs Act of 2017 ("Tax Reform"), from accumulated other comprehensive income to retained earnings. In addition, the ASU requires certain new disclosures regardless of the election. This ASU will be effective commencing with our quarter ending March 31, 2019. We do not expect the adoption of this ASU to have a material impact on our consolidated financial statements.

3. Revisions in Estimates

Our profit recognition related to construction contracts is based on estimates of costs to complete each project. These estimates can vary significantly in the normal course of business as projects progress, circumstances develop and evolve, and uncertainties are resolved. When we experience significant changes in our estimates of costs to complete, we undergo a process that includes reviewing the nature of the changes to ensure that there are no material amounts that should have been recorded in a prior period rather than as revisions in estimates for the current period. For revisions in estimates, generally we use the cumulative catch-up method for changes to the transaction price that are part of a single performance obligation. Under this method, revisions in estimates are accounted for in their entirety in the period of change. There can be no assurance that we will not experience further changes in circumstances or otherwise be required to revise our cost estimates in the future.

In our review of these changes for the three months ended March 31, 2018, we did not identify any material amounts that should have been recorded in a prior period. In our review of these changes for the three months ended March 31, 2017, we identified and corrected amounts that should have been recorded during the three months ended September 30, 2016. This correction resulted in a $4.9 million decrease to Large Project Construction revenue and gross profit and a $1.6 million increase in net loss attributable to Granite Construction Incorporated for the three months ended March 31, 2017. We have assessed the impact of this correction to the financial statements of prior periods' as well as to the financial statements for the three months ended March 31, 2017 and the year ended December 31, 2017 and have concluded that the amounts were not material.

In the normal course of business, we have revisions in estimated costs some of which are associated with unresolved affirmative claims and back charges. The estimated or actual recovery related to these estimated costs may be recorded in future periods or may be at values below the associated cost, which can cause fluctuations in the gross profit impact from revisions in estimates.

Affirmative Claims

Revisions in estimates for the three months ended March 31, 2018 included an increase in revenue of $2.6 million related to the estimated cost recovery of customer affirmative claims, which included increases of $2.1 million that were also affected by an increase in estimated contract costs in excess of the estimated recovery during the three months ended March 31, 2018. The remaining $0.5 million had estimated contract costs in excess of the estimated cost recovery that were recorded in prior periods.

Revisions in estimates for the three months ended March 31, 2017 included a net increase in revenue of $1.8 million related to the estimated cost recovery of customer affirmative claims, which included increases of $2.7 million that were also affected by an increase in estimated contract costs in excess of the estimated recovery during the three months ended March 31, 2017. Estimated contract costs in excess of estimated cost recovery were recorded in prior periods for the offsetting decrease of $0.9 million.

Back Charges

Revisions in estimates for the three months ended March 31, 2018 included a reduction of cost of revenue of $0.4 million related to the estimated recovery of back charges of which $0.2 million was also affected by an increase in estimated contract costs that were in excess of the estimated recovery during the three months ended March 31, 2018. The remaining $0.2 million had estimated contract costs in excess of estimated cost recovery that were recorded in prior periods.

Revisions in estimates for the three months ended March 31, 2017 included a reduction of cost of revenue of $0.3 million related to the estimated recovery of back charges all of which had estimated contract costs in excess of estimated cost recovery recorded in prior periods.

The tables below include the impact to gross profit from significant revisions in estimates related to estimated and actual recovery of customer affirmative claims and back charges as well as the associated estimated contract costs.

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GRANITE CONSTRUCTION INCORPORATED

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

(Unaudited)

Construction

There were no changes in project profitability from revisions in estimates, which individually had an impact of $1.0 million or more on gross profit during the three months ended March 31, 2018 and 2017.

Large Project Construction

The changes in project profitability from revisions in estimates, both increases and decreases, which individually had an impact of $1.0 million or more on gross profit, were decreases of $7.9 million and $13.0 million for the three months ended March 31, 2018 and 2017, respectively.

There were no amounts attributable to non-controlling interests for the three months ended March 31, 2018. The amounts attributable to non-controlling interests were $1.6 million of the net decrease for the three months ended March 31, 2017. The projects are summarized as follows:

Decreases

| | Three Months Ended March 31, |
|---|---|