HALLADOR ENERGY CO
Form 10-K
March 02, 2012

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-K

[x] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2011 OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 0-14731

"COAL KEEPS YOUR LIGHTS ON" "COAL KEEPS YOUR LIGHTS ON"

HALLADOR ENERGY COMPANY
(www.halladorenergy.com)

COLORADO	84-1014610
(State of incorporation)	(IRS Employer Identification No.)
1660 Lincoln Street, Suite 2700, Denver, Colorado	80264-2701
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number: 303.839.5504

Securities registered pursuant to Section 12(b) of the Exchange Act: NONE

Securities registered pursuant to Section 12(g) of the Exchange Act: Common Stock, $.01 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15 (d) of the Act. Yes o No þ

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 and 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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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 þ No o

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

o Large accelerated filer	o Accelerated filer
o Non-accelerated filer (do not check if a small reporting company)	þ 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 o No þ

The aggregate market value of the common stock held by non-affiliates on June 30, 2011 was about $50 million based on the closing price reported that date by the NASDAQ of $9.59 per share.

As of February 29, 2012 we had 28,309,000 shares outstanding.

Portions of our information statement to be filed with the SEC in connection with our annual stockholders' meeting to be held on April 19, 2012 are incorporated by reference into Part III of this Form 10-K.

PART 1

ITEM 1. BUSINESS.

General Development of Business

In December 2009 we changed our name from Hallador Petroleum Company to Hallador Energy Company. We are a Colorado corporation and were organized by our predecessor in 1949. About 77% of our stock is held by officers, directors and their affiliates. Our stock is thinly traded (average daily volume is about 16,000 shares) on the NASDAQ Capital Market listing under the symbol HNRG.

The largest portion of our business is devoted to underground coal mining in the state of Indiana through Sunrise Coal LLC (a wholly-owned subsidiary) serving the electric power generation industry. We also own a 45% equity interest in Savoy Energy, L.P., a private oil and gas company with operations in Michigan. In late December 2010 we invested $2.4 million for a 50% interest in Sunrise Energy, LLC which then purchased existing gas reserves and gathering equipment from an unrelated third party with plans to develop and operate such reserves. Sunrise Energy also plans to develop and explore for coal-bed methane gas reserves on or near our underground coal reserves. Development is pending an increase in nat-gas prices. The primary reason we consummated this purchase was to protect our coal reserves from unwanted fracking by unrelated parties. We account for our investments in Savoy and Sunrise Energy using the equity method. Through our Denver operations we also lease oil and gas mineral rights with the intent to sell the prospects to third parties and retain an overriding royalty interest (ORRI) or carried interest. Occasionally, we participate in the drilling of oil and gas wells. See Item 7- MD&A on page 18 for a discussion of Savoy, our successful lease play in North Dakota and our ORRIs in Wyoming.

Our largest contributor to revenue and earnings is the Carlisle underground coal mine located in western Indiana. The Carlisle mine was in the development stage through January 31, 2007. Coal shipments began February 5, 2007.

Active Reserve (assigned) - Carlisle

Our coal reserves at December 31, 2011 assigned to the Carlisle mine were 46 million tons compared to beginning of year reserves of 46.7 million tons. Primarily through the execution of new leases, our reserve additions of 2.6 million tons replaced about 80% of our 2011 production of about 3.3 million tons.

In addition to the Allerton reserve discussed below, we are currently evaluating multiple mining projects which could add to our coal reserves by the end of 2012. Some of these projects are near the Carlisle mine and if they come to fruition we expect to utilize our existing wash plant and load-out facility.

New Reserve (unassigned) - Allerton

We have leased roughly 19,500 acres in Vermillion County, Illinois near the village of Allerton. Based on our reserve estimates we currently control 32.3 million tons of recoverable coal reserves; 15.8 million which are proven and 16 million which are probable. A considerable amount of our 19,500 acres of leases has yet to receive any exploratory drilling, thus we anticipate our controlled reserves to grow as we continue drilling in 2012. The permitting process was started in the summer of 2011 and we anticipate filing the formal permit with the state of Illinois and the appropriate Federal regulators during the second quarter of 2012. If the process proceeds smoothly, we anticipate receiving a mining permit in the first half of 2013. Unassigned reserves represent coal reserves that would require new mineshafts, mining equipment and plant facilities before operations could begin on the property. The primary reason for this distinction is to inform investors which coal reserves will require substantial capital expenditures before production can begin. Sunrise personnel have opened coal mines in this area in the past.

Full-scale mine development will not commence until there is proven market demand and we have a sales commitment.

Our Coal Contracts

Over the past three years we sold over 90% of our coal to three investment-grade customers. We have close relationships with these customers: Duke Energy Corporation (NYSE:DUK), Hoosier Energy, an electric cooperative, and Indianapolis Power & Light Company, a wholly-owned subsidiary of The AES Corporation (NYSE:AES). During 2011 we sold 300,000 tons of coal to Jacksonville Electric Authority (JEA). The addition of JEA is noteworthy as this is the first time we have sold coal to a customer as far as Jacksonville, Florida. We have no more contracts with JEA but are in discussion with other Florida utilities regarding such. We believe these discussions are the continuation of the trend of Illinois Basin (ILB) coal replacing Central Appalachia coal that traditionally supplied the southeast markets.

Only about 37% of our 2014 expected coal production is contracted for and we have no contracts extending past 2014. Of our 46 million tons of coal reserves assigned to the Carlisle mine, only 6.9 million tons are under contract; in other words about 85% of our reserves are uncommitted.

The table below illustrates the status of our current coal contracts:

Year	Contracted Tons	Average Price
2012	2,900,000	$42.35
2013*	2,900,000	40.14
2014*	1,100,000	46.34

*For 2013 and 2014 we have a contract for 900,000 tons each year with one of our customers and we have agreed to reopen the contracted price during 2013. Each side has agreed to negotiate in good faith; however, if we can't reach an agreed upon price, then our customer has the right to call the tons at the higher contracted price or if they don't call the tons then we have the right to put the tons to them at the lower contracted price. For purposes of the table we used the lowest price option considering the current state of the coal markets.

In the short-run, the market for thermal coal in the United States faces a number of challenges. Unusually mild winter weather has reduced electricity generation and thus both coal burn and gas burn, resulting in a rapid build in coal inventories that now stand at greater than 180 million tons nationwide, an increase of more than 30 million tons from just three months ago. The mild weather, burgeoning inventories and prolific production of natural gas has recently driven the price of natural gas to decade lows, which has increased fuel switching in favor of gas and forced the price of thermal coals lower across all production basins. Regulatory uncertainties, particularly surrounding the recently delayed Cross-state Air Pollution Rule (CSAPR), and Maximum Achievable Control Technology (MACT), are causing utilities to defer coal purchasing decisions, and in some cases to retire coal-fired generating facilities.

That being said, two of our customers have advised us that their coal stockpiles are increasing. We have orally agreed with one of the two customers to store 300,000 tons of coal on our property from the summer of 2012 to the summer of 2013. We will continue to sell the coal as contracted to this customer. The risks and rewards of ownership will pass from us to them. We will be paid an additional storage fee on the stored tons. We continue to work with the other customer and their inventory issues; a possible solution may also include storing their contracted tons. At this time we are unsure as to the ultimate outcome of these discussions.

If our future cash mining costs remain in our historical range of $24-25/ton over the next two years and if our expected maintenance capital expenditures (cap ex) each year are in the $10-12 million range, we expect to generate ample amounts of cash flow.

We have two sister wash plants engineered to work together with an annual capacity of 3.5-3.9 million clean tons at current recoveries. We have the capability of expanding underground production to meet this capacity. If prices are favorable we will expand underground production.

We expect to continue selling a significant portion of our coal under supply agreements with terms of one year or longer. Our approach is to selectively renew, blend and extend existing contracts, or enter into new, coal supply contracts when we can do so at prices we believe are favorable.

Typically, customers enter into coal supply agreements to secure reliable sources of coal at predictable prices while we seek stable sources of revenue to support the investments required to open, expand and maintain or improve productivity at the mines needed to supply these contracts. The terms of coal supply agreements result from competitive bidding and extensive negotiations with customers.

Quality and volumes for the coal are stipulated in coal supply agreements and in some limited instances buyers have the option to vary annual or monthly volumes if necessary. Variations to the quality and volumes of coal may lead to adjustments in the contract price. Our coal supply agreements contain provisions requiring us to deliver coal within certain ranges for specific coal characteristics such as heat content (British Thermal Units-Btus), moisture, sulfur and ash content.

Suppliers

The main types of goods we purchase are mining equipment and replacement parts, steel-related (including roof control) products, belting products, lubricants, electricity, fuel and tires. Although we have many long, well-established relationships with our key suppliers, we do not believe that we are dependent on any of our individual suppliers other than for purchases of certain underground mining equipment and electricity. The supplier base providing mining materials has been relatively consistent in recent years, although there has been some consolidation. Purchases of certain underground mining equipment are concentrated with one principle supplier; however, supplier competition continues to develop.

Carlisle Mine

The Carlisle mine is located in the ILB and has about 46 million tons of high-sulfur bituminous coal reserves. Our historical coal specifications for this mine are: 13.15 % moisture; 11,483 Btu; 8.63% ash; 3.02% SO2 and 5.27 lb SO2. Compared to other ILB mines, our reserves have lower chlorine (<0.10%) than the average ILB of 0.22%. The relatively low chlorine content makes it highly attractive to buyers given their desire to limit the corrosive effects in their power plants.

The ILB boasts several long-term trends that are expected to benefit coal producers in the region. Historically, ILB coal demand has outpaced supply for several years. This supply/demand dynamic is driven by an increase in scrubber retrofits, new coal-fired capacity coming on line and coal depletion in the Eastern Basins. The local Indiana supply/demand market dynamics, coupled with new pockets of demand from nearby domestic markets, should provide a strong long-term demand foundation for our coal. Over 95% of the electricity generated in Indiana comes from coal-fired plants. Only West Virginia is higher. The majority of Indiana coal is consumed in Indiana.

Outside of the local market, demand for ILB coal has been on the rise and is expected to continue for the foreseeable future. ILB coal is well positioned to supply other domestic markets, as Eastern U.S. coal providers with depleting reserves continue to seek higher prices in international markets.

Transportation Advantage

The Carlisle mine has a double 100 rail car loop facility and a four-hour certified batch load out facility connected to the CSX railroad. The Indiana Rail Road (INRD) also has limited running rights on the CSX to our mine. Dual rail access gives us a freight advantage to our Indiana customers. Long term, the CSX anticipates our coal being shipped to southeast markets via their railroad.

We sell our coal FOB the mine. Substantially all of our coal is transported by rail. Our mine is accessible by truck and is within 90 miles of nine coal-fired plants that have been retrofitted to burn our high-sulfur coal.

Coal Preparation

Coal extracted from Carlisle contains impurities such as rock and sulfur. We utilize a wash plant located at the mine to remove impurities from the coal and to insure our product meets contract specifications. Our wash plant allows us to treat the coal we extract from Carlisle to ensure a consistent quality.

Illinois Basin (ILB)

The coal industry underwent a significant transformation in the early 1990s, as greater environmental accountability was established in the electric utility industry. Through the U.S. Clean Air Act, acceptable baseline levels were established for the release of sulfur dioxide in power plant emissions. In order to comply with the new law, most utilities switched fuel consumption to low-sulfur coal, thereby stripping the ILB of over 50 million tons of annual coal demand. This strategy continued until mid 2000 when a shortage of low-sulfur coal drove up prices. This price increase combined with the assurance from the U.S. government that the utility industry would be able to recoup their costs to install scrubbers caused utilities to begin investing in scrubbers on a large scale. With scrubbers, the ILB has reopened as a significant fuel source for utilities and has enabled them to burn lower cost, high sulfur coal.

The ILB consists of coal mining operations covering more than 50,000 square miles in Illinois, Indiana and western Kentucky. The ILB is centrally located between four of the largest regions that consume coal as fuel for electricity generation (East North Central, West South Central, West North Central and East South Central). These regions consumed about 63% of coal used in electric generation in 2008. The region also has access to sufficient rail and water transportation routes that service coal-fired power plants in these regions as well as other significant coal consuming regions of the South Atlantic and Middle Atlantic.

U. S. Coal Industry

The U.S. has over 200 billion tons of recoverable coal reserves, representing about 94% of the domestic fossil fuel energy, according to the U.S. Geological Survey (USGS). This is about 27% of the world's total proven reserves. The energy potential of American coal exceeds that of all the oil in the Middle East. The EIA (Energy Information Administration) estimates that current domestic recoverable coal reserves could supply enough electricity to satisfy domestic demand for 200 years. The U.S. is also the second largest coal producer in the world, exceeded only by China. Annual coal production in the U.S. has increased from 434 million tons in 1960 to about 1 billion tons in 2010, based on information provided by the EIA. Coal is the fastest growing fuel in the world. The majority of coal consumed in the United States is used to generate electricity, with the balance used by a variety of industrial users to heat and power foundries, cement plants, paper mills, chemical plants and other manufacturing and processing facilities. Metallurgical coal is predominately consumed in the production of metallurgical coke used in steelmaking blast furnaces. In 2010, coal-fired power plants produced approximately 45% of all electric power generation, more than natural gas and nuclear, the two next largest domestic fuel sources, combined. In 2010, 95% of US thermal coal consumption was by the electric power sector with the balance used in industrial and commercial applications.

According to the EIA, coal is expected to remain the largest energy source of electric power generation in the United States for the foreseeable future.

The major coal production basins in the U.S. include Central Appalachia (App), Northern App, Illinois Basin, Powder River Basin and the Western Bituminous region. The Central App Basin includes eastern Kentucky, Tennessee, Virginia and southern West Virginia. The Northern App Basin includes Maryland, Ohio, Pennsylvania and northern West Virginia. The Illinois Basin includes Illinois, Indiana and western Kentucky. The Powder River Basin is located in northeastern Wyoming and southeastern Montana. The Western Bituminous Basin includes western Colorado, eastern Utah and southern Wyoming.

Coal type varies by basin. Heat value and sulfur content are important quality characteristics and determine the end use for each coal type.

Coal in the U.S. is mined through surface and underground mining methods. According to the National Mining Association (NMA), of the coal produced during 2010, came from surface mines and from underground mines.

The primary underground mining techniques are longwall mining and continuous (room-and-pillar) mining. The geological conditions dictate which technique to use. The Carlisle mine uses the continuous technique.

In continuous mining, rooms are cut into the coal bed leaving a series of pillars, or columns of coal, to help support the mine roof and control the flow of air. Continuous mining equipment cuts the coal from the mining face. Generally, openings are driven 20' wide and the pillars are rectangular in shape measuring 40'x 40'. As mining advances, a grid-like pattern of entries and pillars is formed. Roof bolts are used to secure the roof of the mine. Battery cars move the coal to the conveyor belt for transport to the surface. The pillars can constitute up to 50% of the total coal in a seam.

Competitive Pressures

The United States coal industry is highly competitive, with numerous producers selling into all markets that use coal. We compete against large producers and hundreds of small producers in the United States. The five largest producers are estimated by the 2009 NMA Survey to have produced approximately 53% (based on tonnage produced) of the total United States production in 2009. The U.S. Department of Energy reported about 1,300 active coal mines in the United States in 2010, the latest year for which government statistics are available. Peabody Energy Corporation (NYSE:BTU) and Foresight Energy, a private company controlled by Chris Cline are probably the two largest operators in the ILB. While we sold about three million tons from our Carlisle mine, Peabody sold about 28 million tons from 12 mines (surface and underground) in the ILB during 2011. Demand for our coal by our principal customers is affected by many factors including:

- the price of competing coal and alternative fuel supplies, including nuclear, natural gas, oil and renewable energy sources, such as hydroelectric power or wind;
- coal quality;
- transportation costs from the mine to the customer; and
- the reliability of fuel supply.

Continued demand for our coal and the prices that we receive are affected by demand for electricity, environmental and government regulation, technological developments and the availability and price of competing coal and alternative fuel supplies.

Coal is the primary fuel source (about 45%) for electrical generation in the U.S. Despite capacity growth for other fuel sources of electricity, coal is still expected to provide the largest share of energy for U.S. electricity generation.

Natural Gas

One of the trends that cause us concern is the burning of natural gas to generate electricity in the U.S. Affordability plays a significant role in coal's position as the most used fuel source in energy generation. In the U.S., coal has historically had a relatively lower delivered cost per million Btu (MMBtu) compared to other energy sources. The EIA projects coal prices to be $2.40 on a dollars per MMbtu basis.

Although coal has been and remains the major fuel for electricity generation in the U.S., natural gas has increased its share as a fuel in electrical generation in recent years. High natural gas prices in 2003 and 2004 made it economical for power generators to retrofit existing coal-burning units with scrubbers and low nitrogen oxide burner technology or switch to lower-sulfur coals in order to reduce emissions. Recently, however, natural gas substitution in electricity generation has increased. Natural gas spot prices declined sharply from about $13 per MMBtu in the summer of 2008 to current prices in the $2.50 per MMBtu range prompting some utilities to substitute natural gas for coal as fuel in electricity generation.

Gas producers have been arguing for some time that new sources of fuel, especially shale gas, have made it both plentiful and reliable. Furthermore, carbon dioxide emission from burning natural gas compared to coal is about 50% less. But residential and industrial consumers, from homeowners to power utilities, have been reluctant to increase their dependence on natural gas because of concerns about price volatility. This appears to be changing, due to a combination of factors. Huge new discoveries in the U.S. and Canada have greatly increased supplies, lowering prices. Big infrastructure build-outs in recent years have made it easier to move gas around to where it is needed, helping ease regional price spikes. Recent multi-billion deals by large domestic and foreign entities are the latest signs that these entities see U.S. natural gas, especially gas found in shale rock, as a giant resource. Gas producers hope these deals will help them convince federal officials and power executives that prices are entering a period of relative calm.

There are some that believe natural gas will overtake coal as the most economic way to produce electricity in the U.S. In the event the government places a price tag on carbon emissions, natural gas would gain another advantage over coal since electricity from coal produces more carbon. Some natural gas producers believe that there is certainly the potential for natural gas producers and utilities to develop a new relationship that has not been possible historically.

Employees

Our coal operations currently employ 333 people. We use a consulting geologist when evaluating new coal mine projects. We also use a consultant to sell our coal, find new buyers and help in contract negotiations. The mine currently operates two production shifts and one maintenance shift while coal is produced 270 days of the year. The Carlisle mine is non-union.

Safety and Environmental Regulations

Our operations, like operations of other coal companies, are subject to extensive regulation, primarily by federal and state authorities, on matters such as: air quality standards; reclamation and restoration activities involving our mining properties; mine permits and other licensing requirements; water pollution; employee health and safety; management of materials generated by mining operations; storage of petroleum products; protection of wetlands and endangered plant and wildlife protection. Many of these regulations require registration, permitting, compliance, monitoring and self-reporting and may impose civil and criminal penalties for non-compliance.

Additionally, the electric generation industry is subject to extensive regulation regarding the environmental impact of its power generation activities, which could affect demand for our coal over time. The possibility exists that new legislation or regulations may be adopted or that the enforcement of existing laws could become more stringent, causing coal to become a less attractive fuel source and reducing the percentage of electricity generated from coal. Future legislation or regulation or more stringent enforcement of existing laws may have a significant impact on our mining operations or our customers' ability to use coal.

While it is not possible to accurately quantify the expenditures we incur to maintain compliance with all applicable federal and state laws, those costs have been and are expected to continue to be significant. Federal and state mining laws and regulations require us to obtain surety bonds or post letters of credit from our banks to guarantee performance or payment of certain long-term obligations, including mine closure and reclamation costs.

We don't think it is necessary to discuss all the different laws and regulations that we are subject to. Suffice it to say, the coal industry in under attack by the current administration. If there is a change in administration resulting from the November 2012 elections that will be positive for the coal industry, if not, that would be negative.

Reclamation

The Carlisle mine began commercial production in February 2007 and is operating in compliance with all local, state, and federal regulations. We have no old mine properties to reclaim, other than the Howesville mine, which was operated for only eight months before it was closed in June 2006 due to safety concerns. During 2007, we finished Phase I of the reclamation of the Howesville mine. To reach final reclamation we must raise commercial crops for a period of five years.

Currently we do not operate any surface mines.

Mining Permits and Approvals

Numerous governmental permits or approvals are required for mining operations. When we apply for these permits and approvals, we may be required to prepare and present to federal, state or local authorities data pertaining to the effect or impact that any proposed production or processing of coal may have upon the environment. The authorization, permitting and implementation requirements imposed by any of these authorities may be costly and time consuming and may delay commencement or continuation of mining operations. Regulations also provide that a mining permit or modification can be delayed, refused or revoked if an officer, director or a shareholder with a 10% or greater interest in the entity is affiliated with another entity that has outstanding permit violations. Thus, past or ongoing violations of federal and state mining laws could provide a basis to revoke existing permits and to deny the issuance of additional permits.

In order to obtain mining permits and approvals from state regulatory authorities, mine operators must submit a reclamation plan for restoring, upon the completion of mining operations, the mined property to its prior condition, productive use or other permitted condition. Typically, we submit the necessary permit applications several months before we plan to begin mining a new area. Some of our required permits are becoming increasingly more difficult and expensive to obtain, and the application review processes are taking longer to complete and becoming increasingly subject to challenge.

Under some circumstances, substantial fines and penalties, including revocation or suspension of mining permits, may be imposed under the laws described above. Monetary sanctions and, in severe circumstances, criminal sanctions may be imposed for failure to comply with these laws. Compliance with these laws has increased the cost of coal mining for domestic coal producers.

Mine Health and Safety Laws

We are proud of our safety record. We comply with the rules and regulation issued by the Mine Safety and Health Administration (MSHA) and also state rules and regulations. We applaud all reasonable rules and regulation that promote mine safety and keep our miners out of harm’s way. Complying with these existing rules and proposed rules add to our mining costs.

Clean Air Act and Related Regulations

The federal Clean Air Act and similar state laws and regulations which regulate emissions into the air, affect coal mining, coal handling and processing, primarily through permitting and/or emissions control requirements.

The Clean Air Act also indirectly affects coal mining operations by extensively regulating the air emissions of the coal-fired electric power generating plants operated by our customers. Coal contains impurities, such as sulfur, mercury and other constituents, many of which are released into the air when coal is burned. Carbon dioxide, a greenhouse gas (GHG), is also emitted when coal is burned. Environmental regulations governing emissions from coal-fired electric generating plants could affect demand for coal as a fuel source and affect the volume of our sales. For example, the federal Clean Air Act places limits on sulfur dioxide, nitrogen dioxide, and mercury emissions from electric power plants.

The installation of additional control measures to achieve regulatory emission reductions makes it more costly to operate coal-fired power plants and could make coal a less attractive fuel. In order to meet the proposed new limits for sulfur dioxide emissions from electric power plants, many coal users need to install scrubbers, use sulfur dioxide emission allowances (some of which they may purchase), blend high sulfur coal with low sulfur coal or switch to low sulfur coal or other fuels. More strict emission limits mean few coals can be burned without the installation of supplemental environmental control technology in the form of scrubbers.

These types of regulations and requirements and proposed such regulations and requirements could significantly increase our customers’ costs and cause them to reduce their demand for coal, which may materially impact our results of operations.

Other

We have no significant patents, trademarks, licenses, franchises or concessions.

Other than the 333 Sunrise Coal employees in Indiana, our CEO, CFO, controller, geologist, land person and two part time administrative staff work in the Denver office.

Our Denver office is located at 1660 Lincoln Street, Suite 2700, Denver, Colorado 80264, phone 303.839.5504 and Sunrise Coal's corporate office is located at 1183 Canvasback Drive, Terre Haute, Indiana 47802, phone 812.299.2800. Terre Haute is approximately 70 miles west of Indianapolis. Our website is www.halladorenergy.com and Sunrise Coal’s is www.sunrisecoal.com.

ITEM 1A. RISK FACTORS.

Smaller reporting companies are not required to provide the information required by this item.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Smaller reporting companies are not required to provide the information required by this item; however, there were none.

ITEM 2. PROPERTIES.

The Carlisle mine, located near the town of Carlisle in Sullivan County, Indiana, is an underground mine which became operational in January 2007. The coal is accessed with a slope to a depth of 340'. The coal is mined in the Indiana Coal V seam which is highly volatile bituminous coal.

Our current mine plan indicates 15,100 acres of mineable coal with an approximate 4' to 7' thickness in the project area. Of the 15,100 acres, 13,600 are currently under lease to Sunrise. The Indiana V seam has been extensively mined by underground and surface methods in the general area and is the most economically significant coal in Indiana.

Findings are based on generally accepted engineering principles and professional experience in the mining industry. All judgments are based on the facts that are available at this time.

Assigned Coal Reserve Estimates- Carlisle Mine

We estimate that, as of December 31, 2011, the Carlisle Mine had total recoverable reserves of approximately 46 million tons consisting of both proven (36 million) and probable (10 million) reserves. “Reserves” are defined by the SEC Industry Guide 7 (Guide 7) as that part of a mineral deposit, which could be economically and legally extracted or produced at the time of the reserve determination. “Recoverable” reserves mean coal that is economically recoverable using existing equipment and methods under federal and state laws currently in effect. “Proven (measured) reserves” are defined by Guide 7 as reserves for which (a) quantity is computed from dimensions revealed in outcrops, trenches, workings or drill holes; grade and/or quality are computed from the results of detailed sampling and (b) the sites for inspection, sampling and measurement are spaced so closely and the geologic character is so well defined that size, shape, depth and mineral content of reserves are well-established. “Probable reserves” are defined by Guide 7 as reserves for which quantity and grade and/or quality are computed from information similar to that used for proven (measured) reserves, but the sites for inspection, sampling, and measurement are farther apart or are otherwise less adequately spaced. The degree of assurance, although lower than that for proven reserves, is high enough to assume continuity between points of observation.

Unassigned New Coal Reserves – Allerton

See page three for a discussion of Allerton.

Our reserve estimates were prepared by Samuel Elder and Jacob Gennicks, two of our mining engineers. Mr. Elder is a licensed Professional Engineer in the State of Indiana and has over 25 years experience estimating coal reserves. Mr. Gennicks is a licensed Professional Engineer in the State of Indiana and Illinois and has three years experience estimating coal reserves.

The reserve estimates for all leased acres was made utilizing Carlson Mining 2009 (software developed by Carlson Software). To convert volumes of coal to an in-place tonnage, a weight of 80 pounds/cubic foot was used for both reserve areas. To convert Carlisle reserve to product tonnage, a 53% mine recovery and an average of 79% washed recovery (coal only recovery, no out-of- seam dilution included) were used.

Example: In-place tonnage x 53% x 79% = product tonnage.

To convert Allerton reserve to product tonnage, a 45% mine recovery and an average of 77% washed recovery (coal only recovery, no out-of- seam dilution included) were used.

Example: In-place tonnage x 45% x 77% = product tonnage.

Standards set forth by the USGS were used to place areas of the mine reserves into the Proven (measured) and Probable (indicated) categories. Under these standards, coal within 1,320' of a data point is considered to be proven, and coal within 1,320' to 3,960' is placed in the Probable category. All reserves are stated as a final salable product.

ADDITIONAL DISCLOSURES FOR THE CARLISLE MINE

1. The Carlisle mine currently has road frontage on State Highway 58, and is adjacent to the CSX railroad. The Carlisle mine has a double 100 car loop facility. Substantially all of our coal is shipped by rail.

2. Currently only the Indiana V seam is planned to be mined, and all of the controlled tonnage is leased to Sunrise. Most leases have unlimited terms once mining has begun, and yearly payments or earned royalties are kept current. Mineable coal thickness used is greater than four feet. The current Carlisle mine plan is broken into four areas– North Main – South Main – West Main – 2 South Main. Approximately 84% of the total mine plan is currently under lease ("controlled"). It is believed that all additional property that would be required to access all lease areas can be obtained but, if some properties cannot be leased, some modification of the current mine plan would be required. All coal should be mined within the terms of the leases. Leasing programs are continuing by our staff.

3. The Carlisle mine has a dual-use slope for the main coal conveyor and the moving of supplies and personnel. There are two 8' diameter shafts at the base of the slope for mine ventilation. Two additional air shafts (8’ and 10.5’ diameter) were completed about three miles north of the original air shaft in 2009 to facilitate the mine expansion. The slope (9° or 15% grade) is 18' wide with concrete and steel arch construction. A 16’ hoist is now open (spring 2011) approximately four miles north of the main slope. The hoist is currently facilitating two production units by efficiently moving personnel and materials into the north main and north main addition areas of the reserve. All underground mining equipment is powered with electricity and underground compliant diesel.

4. The new slurry impoundment continues to be under construction, due in part to design modifications, but is currently approved for, and being utilized for slurry disposal. When final construction is completed in 2012 the structure will handle disposal for roughly 36 million clean tons of coal.

5. Current production capabilities are projected to be in the range of 3 to 3.3 million tons per year giving the mine a reserve life of about 15 years. The mine plan is basic room-and-pillar using a synchronized continuous miner section with no retreat mining. Plans are for pillars to be centered on a 60'x80' pattern with 18' entries for our mains, and pillars on 60'x60' centers with 20' entries in the rooms.

6. The Carlisle mine has been in production since February 2007. The North Main, Sub Main #1, and the South Main have been developed with four units currently in production.

7. The Carlisle mine has two wash plants capable of 950 tons/hour of raw feed.

Inaccuracies in our estimates of our coal reserves could result in decreased profitability from lower than expected revenues or higher than expected costs.

Our future performance depends on, among other things, the accuracy of our estimates of our proven and probable coal reserves. We base our estimates of reserves on engineering, economic and geological data assembled, analyzed and reviewed by internal engineers. We update our estimates of the quantity and quality of proven and probable coal reserves annually to reflect the production of coal from the reserves, updated geological models and mining recovery data, the tonnage contained in new lease areas acquired and estimated costs of production and sales prices. There are numerous factors and assumptions inherent in estimating the quantities and qualities of, and costs to mine, coal reserves, including many factors beyond our control, including the following:

- quality of the coal;

- geological and mining conditions, which may not be fully identified by available exploration data and/or may differ from our experiences in areas where we currently mine;
- the percentage of coal ultimately recoverable;
- the assumed effects of regulation, including the issuance of required permits, taxes, including severance and excise taxes and royalties, and other payments to governmental agencies;
- assumptions concerning the timing for the development of the reserves; and
- assumptions concerning equipment and productivity, future coal prices, operating costs, including for critical supplies such as fuel, tires and explosives, capital expenditures and development and reclamation costs.

As a result, estimates of the quantities and qualities of economically recoverable coal attributable to any particular group of properties, classifications of reserves based on risk of recovery, estimated cost of production, and estimates of future net cash flows expected from these properties as prepared by different engineers, or by the same engineers at different times, may vary materially due to changes in the above factors and assumptions. Actual production recovered from identified reserve areas and properties, and revenues and expenditures associated with our mining operations, may vary materially from estimates.

ITEM 3. LEGAL PROCEEDINGS. None

ITEM 4. MINE SAFETY DISCLOSURES

See Exhibit 95 to this Form 10-K for a listing of our mine safety violations.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is traded on the NASDAQ Capital Market under the symbol HNRG. Prior to May 27, 2010 we were traded on the OTC Bulletin Board under the symbol HPCO.OB. The following table sets forth the high and low closing sales price for the periods indicated:

	High	Low
2012		
(January 1 through February 29, 2012)	$ 10.45	$ 9.54
2011		
Fourth quarter	10.47	8.55
Third quarter	10.22	8.25
Second quarter	12.05	9.42
First quarter	11.43	9.79
2010		
Fourth quarter	12.64	10.47
Third quarter	12.10	7.36
Second quarter	13.00	8.25
First quarter	9.80	7.50

During May 2010 we declared our first cash dividend of $0.10 per common share of which there were 27,782,028 outstanding. Furthermore, our board approved that the dividend would also apply to the 1,150,000 outstanding restricted stock units (RSUs) and to the 434,167 outstanding stock options on that date. The total cash payment for all the outstanding securities was about $2.9 million. During May 2011 we declared another special dividend of $0.12 per share. As was done last year, the dividend also applied to our outstanding RSUs and stock options. The total cash payment for all the outstanding securities was about $3.5 million. We evaluated our cash position and capital requirements and decided to declare another special cash dividend of $.14 per share payable in April 2012. The total payment, which also covers our outstanding RSUs and options, will be about $4.1million.

At February 29, 2012, we had 251 shareholders of record of our common stock; this number does not include the shareholders holding stock in "street name." We estimate we have over 300 street name holders. On February 29, 2012 our stock closed at $10.10.

Equity Compensation Plan Information

On January 7, 2011 we allowed four Denver employees (non officers) an opportunity to relinquish 100% of their vested options (234,167) for 181,261 shares of our common stock. The exchange ratio was based on the intrinsic value of their options. These shares were issued under our Stock Bonus Plan which was created in December 2009. Under such plan employees are allowed to relinquish shares to pay for their income taxes; accordingly, 41,645 shares were relinquished.

Currently we have 200,000 outstanding stock options to our CEO with an exercise price of $2.30. The options are fully vested and expire in April 2015.

At December 31, 2011 we had 636,000 RSUs outstanding and about 922,000 available for future issuance. Our RSU and stock option plans were approved by our BODs and collectively they and their affiliates control about 77% of our stock.

ITEM 6. SELECTED FINANCIAL DATA.

Smaller reporting companies are not required to provide the information required by this item.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.

Overview

The largest portion of our business is devoted to underground coal mining in the state of Indiana through Sunrise Coal LLC (a wholly-owned subsidiary) serving the electric power generation industry. We also own a 45% equity interest in Savoy Energy, L.P., a private oil and gas company with operations in Michigan. In late December 2010 we invested $2.4 million for a 50% interest in Sunrise Energy, LLC which then purchased existing gas reserves and gathering equipment from an unrelated third party with plans to develop and operate such reserves. Sunrise Energy also plans to develop and explore for coal-bed methane gas reserves on or near our underground coal reserves. Development is pending an increase in nat-gas prices. The primary reason we consummated this purchase was to protect our coal reserves from unwanted fracking by unrelated third parties. We account for our investments in Savoy and Sunrise Energy using the equity method. Through our Denver operations we also lease oil and gas mineral rights with the intent to sell the prospects to third parties and retain an overriding royalty interest (ORRI) or carried interest. Occasionally, we participate in the drilling of oil and gas wells. Further below are discussions of Savoy, our successful lease play in North Dakota and our ORRIs in Wyoming.

Our largest contributor to revenue and earnings is the Carlisle underground coal mine located in western Indiana, about thirty miles south of Terre Haute. The Carlisle mine was in the development stage through January 31, 2007. Coal shipments began February 5, 2007.

Outlook

Headwinds created by low natural gas prices, mild weather, and weaker domestic economies impacted coal markets during the year, and market weakness continues as we enter 2012.

The current exceptionally mild winter has dramatically decreased demand for electricity: since October 2011, heating degree days are down by 17 percent compared to normal, and electricity demand is estimated to be down by 3.3 percent. This lack of demand is a major factor behind the current low near-term gas and coal prices. Unless there is a dramatic cold snap, these conditions are expected to persist until the summer. For 2012 we will continue to focus on maintaining our low cost structure and leasing and permitting new reserves.

We do see an increasing demand for coal produced in the ILB in the future. Demand for coal produced in the ILB is expected to grow at a rate faster than overall U.S. coal demand, due to ILB coal having higher heating content than PRB and lower cost structure than Central App coal. Many utilities are scrubbing to meet emission requirements beyond just sulfur compliance, even utilities that burn exclusively PRB. Once scrubbed, those utilities are usually capable of burning ILB coal. It is this trend of new scrubber installations coupled with rising Central App cost structure that is leading to increased switching from Central App coal to ILB coal. Some fuel switching will also occur from PRB to ILB in newly scrubbed utilities located near ILB coal supply.

Growth in international coal import demand has resulted primarily from increased demand for thermal coal for electricity generation by emerging global economies, particularly by Asian countries in the Pacific market where coal is the primary fuel source for new power generation. We believe that the widening of the Panama Canal in 2014 should lower freight rates which would enhance coal exports to Asia.

In Europe, domestic coal supply has declined due to reduction in domestic production as a result of the region's declining coal reserve base and a reduction in government subsidies for coal mining, particularly in Poland, Germany and Spain. Additionally, the International Atomic Energy Agency projects slower global growth in nuclear power capacity following the 2011 earthquake in Japan and related nuclear incident. Germany, in particular, has closed certain older facilities and is planning to shut down its remaining nuclear plants by 2022. Coal-fired generation is expected to meet a large portion of this additional demand. We believe that the decline in domestic production in Europe, coupled with an expected increase in coal-fired power generation, will result in an increase in thermal coal imports.

Due to the location of our coal mine, we expect to continue concentrating our efforts on supplying the domestic market. We expect as more coal is exported from the ILB, the coal that remains for the domestic market will increase in value.

As discussed further under “Competitive Pressures” on page nine, natural gas has increased its share as a fuel in electrical generation in recent years.

Yorktown Distribution

As previously disclosed, each time after we filed our 2011 Form 10-Qs for the first three quarters, we were advised by Yorktown Energy Partners VI, L.P., an investor for the last sixyears, that it had distributed shares of our common stock to its limited and general partners. First and second quarter distributions were 750,000 shares each and the third quarter distribution was 556,000 shares for a total of 2,056,000 shares. After the three distributions, Yorktown and its affiliates collectively hold about 13 million shares of our common stock representing about 46% of total shares outstanding.

While we do not know Yorktown’s ultimate strategy to realize the value of their Hallador investment for their partners, we expect that over time distributions such as these will improve our liquidity and float. If and when we are advised of another Yorktown distribution after this Form 10-K is filed, we will timely report such on a Form 8-K.

Our consolidated financial statements should be read in conjunction with this discussion.

Prospective Information

See page four of this report for a table that illustrates the status of our current coal contracts.

Liquidity and Capital Resources

For 2011 we generated $61 million in cash from operations which enabled us to reduce our bank debt by $10 million, invest $24 million in the Carlisle mine, buy land for about $9 million for the Allerton project and pay a special dividend of $3.5 million. For 2012 we are scheduled to extinguish our bank debt in December and we anticipate our capital expenditures for the Carlisle mine falling to $10-12 million. We expect next year’s cash from operations to be lower due to the non-recurring gain of $10.7 million. Future cash flow from operations could be negatively impacted depending on the final outcome of our contract negotiations as discussed on page four of this report. Our cash flow from operations will also be negatively impacted by payments of state and federal income taxes.

We do not anticipate any liquidity issues in the foreseeable future. Eventually, when we develop a new reserve, we intend to incur additional debt and restructure our existing credit facility.

We have no material off-balance sheet arrangements.

During May 2010 we declared our first cash dividend of $0.10 per common share of which there were 27,782,028 outstanding. Furthermore, our board approved that the dividend would also apply to the 1,150,000 outstanding RSUs and to the 434,167 outstanding stock options on that date. The total cash payment for all the outstanding securities was about $2.9 million. During May 2011 we declared another special dividend of $0.12 per share. As was done last year, the dividend also applied to our outstanding RSUs and stock options. The total cash payment for all the outstanding securities was about $3.5 million. We evaluated our cash position and capital requirements and decided to declare another special cash dividend of $.14 per share payable in April 2012. The total payment, which also covers our outstanding RSUs and options, will be about $4.1million.

In late August 2010 we decided to drop the property insurance on our underground mining equipment. We feel comfortable with this decision as such equipment is allocated among four mining units spread out over eight miles. The historical cost of such equipment is about $93 million.

Project Update

New Reserve (unassigned) – Allerton

See page three of this report for a discussion of our Allerton project.

MSHA Reimbursements

Two of our major contracts allow us to pass on certain costs incurred resulting from changes in costs to comply with mandates issued by MSHA or other government agencies. In late December 2010, we submitted a report which was reviewed by an outside consulting firm engaged by our customers. In January 2011 the two customers agreed to reimburse us about $1.9 million for costs incurred by us during 2008 and 2009. During those years we were not able to accurately estimate what the ultimate outcome of these reimbursable costs would be so we did not record them until we were certain of the amounts and certain of collection. Such amounts were recorded during the first quarter of 2011.

We submitted our incurred costs for 2010 in September of 2011 for $4 million. One of the customers paid $2 million in February 2012 and we continue discussions with the other customer. Accounting recognition for these 2010 reimbursements will be made in 2012.

Oil and Gas Properties

ORRI

We have an ORRI of about 2% on 22,500 acres and a 4% ORRI on 2,500 acres in Laramie County, Wyoming. This ORRI was obtained from leases we sold to SM Energy Company (formerly St. Mary Land) (NYSE:SM) in October 2008. This is a Niobrara oil shale play in the northern D-J Basin. During 2010, SM Energy drilled a discovery well (the Atlas 1-19) on this acreage. Through 2011 this well has produced 121,000 barrels of oil. During 2011 three additional wells were drilled and completed on our acreage with mixed results. It is uncertain how many more wills be drilled by SM. For 2011 we received $114,000 from these ORRI's.

North Dakota Lease Play (Patriots Prospect)

We invested about $2.5 million in a lease play located in Slope, Hettinger and Stark counties of North Dakota which resulted in the purchase of about 10,600 net acres of oil and gas leases. On June 10, 2011, we signed a letter of intent with Chesapeake Energy Corporation (NYSE:CHK) to sell such acreage and on July 29, 2011, the deal closed. CHK purchased a 90% working interest for $13.2 million resulting in a pre-tax gain of about $10.6 million considering selling expenses and non-executive employee bonuses; due to some post-closing curative work about $1.5 million of the gain was recognized during the fourth quarter. We retained a 10% working interest and an approximate 3% average ORRI. If and when a well is proposed, we expect to participate in the drilling.

Results of Operations

For 2011, we sold 3,307,000 tons at an average price of $41.71/ton. For 2010 we sold 3,050,000 tons at an average price of $42.31/ton. Our average price for 2012, based on our contracts, is expected to be about $42.35/ton.

The 2011 "other income" is due to the MSHA reimbursements discussed above. The 2010 "other loss" of $772,000 was attributable primarily to our participating in the drilling of a dry hole in Michigan on a gas prospect developed by Savoy. Our share of the dry hole was about $1 million.

Operating costs and expenses averaged $23.31/ton in 2011 compared to $23.69 in 2010. We expect such costs to average $24-25/ton for 2012.

The increase in DD&A was due to additions to plant and equipment.

SG&A increased primarily due to higher expenses related to the new Allerton reserve, increases in certain salaries and increases in attending industry and investor conferences. Also we incurred higher curative costs to perfect our coal leases.

Our effective tax rate for 2011 and 2010 was in the 37-39% range and we expect such rate to be in the 32-36% range for 2012.

45% Ownership in Savoy

Savoy operates almost exclusively in Michigan. They have an interest in the Trenton-Black River Play in Southern Michigan. They hold 200,000 gross acres (about 100,000 net) in Hillsdale and Lenawee counties. During 2011 Savoy drilled 17 gross wells in this play of which 8 were dry and 9 were successful. During 2012 Savoy plans on drilling 25 additional wells in the play. Drilling locations in this play are identified based on the evaluation of extensive 3-D seismic shoots. Savoy operates their own wells and their working interest averages between 40 and 50% and their net revenue interest averages between 34 and 42%. Savoy’s net daily oil production currently averages about 805 barrels of oil and 340 (Mcf) of gas. Savoy has an interest in about 63 wells (25 net). LOE was about $8 per barrel of oil.

Savoy’s proved reserves are stated below and also in Note 5 to the financial statements. The pre-tax (Savoy is a partnership) present value of their future cash flows discounted at 10% (PV10) was about $97 million. Investors should note that the above numbers are to the 100%; our ownership in Savoy is about 45% so our share of the PV10 using SEC prices would be about $44 million.

The 2011 reserve report was prepared by Netherland, Sewell & Associates, Inc. (NSAI). See Note 5 for the qualifications of NSAI. The 2010 reserve report was prepared by Timothy Lovseth, our full-time geologist who has 30 years of experience in the oil and gas industry. Mr. Lovseth has no ownership in Savoy.

The table below illustrates the growth in Savoy over the last two years; such unaudited amounts are to the 100%, in other words not shown proportionate to our 45% interest (financial statement data in thousands):

	2011	2010
Revenue:		
Oil	$25,781	$11,138
Gas	566	760
NGLs (natural gas liquids)	868	227
Contract drilling	4,336	1,735
Gain on sale of unproved properties		2,225
Other	446	587
Total revenue	31,997	16,672
Costs and expenses:		
LOE (lease operating expenses)	2,257	1,725
Severance tax	2,037	818
Contract drilling costs	2,559	1,445
DD&A (depreciation, depletion & amortization)	4,733	3,147
Geological and geophysical costs	1,973	2,632
Dry hole costs	1,852	808
Impairment of unproved properties	2,963	2,543
Other exploration costs	357	204
G&A (general & administrative)	1,166	1,116
Total expenses	19,897	14,438
Net income	$12,100	$2,234
The information below is not in thousands:		
Oil production in barrels	283,000	149,000
4th quarter oil production in barrels	76,600	57,000
Gas production in Mcf	134,500	173,000
Average oil prices/barrel	$91	$75
Average gas prices/Mcf	$4.20	$4.38
Oil reserves (Bbls)	1,921,000	774,000
Gas reserves (Mcf)	2,491,000	787,000
PV 10 using SEC dictated average oil prices of $93.60 and $74	$97 million	$34 million

Critical Accounting Estimates and Significant Accounting Policies

We believe that the estimates of our coal reserves and our deferred tax assets and liability accounts are our only critical accounting estimates. Since the Carlisle mine has only been in production since February 2007 we do not have a long history to rely on. The reserve estimates are used in the DD&A calculation, in our impairment test and in our internal cash flow projections. If these estimates turn out to be materially under or over-stated; our DD&A expense and impairment test may be affected. Furthermore, if our coal reserves are materially overstated our liquidity and stock price could be adversely affected.

We have analyzed our filing positions in all of the federal and state jurisdictions where we are required to file income tax returns, as well as all open tax years in these jurisdictions. We identified our federal tax return and our Indiana state tax return as “major” tax jurisdictions. None of our corporate tax returns have been examined in the last ten years. We were recently advised by the IRS that they will perform an examination of our 2009 and 2010 tax returns; such exam is to commence in mid-March 2012. We were also notified by Indiana tax representatives that they will examine our 2008-2010 tax returns; such exam is to commence this summer. We believe that our income tax filing positions and deductions will be sustained on audit and do not anticipate any adjustments that will result in a material change to our consolidated financial position. Therefore, no reserves for uncertain income tax positions have been recorded.

Our significant accounting policies are set forth in Note 1 to the Financial Statements.

New Accounting Pronouncements

None of the recent FASB pronouncements will have any material effect on us.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Smaller reporting companies are not required to provide the information required by this item.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

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Smaller reporting companies are not required to provide supplementary data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Hallador Energy Company
Denver, Colorado

We have audited the accompanying consolidated balance sheet of Hallador Energy Company and Subsidiaries (the “Company”) as of December 31, 2010 and 2011, and the related consolidated statements of operations, cash flows, and stockholders' equity for each of the years in the two year period ended December 31, 2011. 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 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. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 Hallador Energy Company and Subsidiaries, as of December 31, 2010 and 2011, and the results of their operations and their cash flows for each of the years in the two year period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

Ehrhardt Keefe Steiner & Hottman PC

March 2, 2012
Denver, Colorado

Consolidated Balance Sheet
As of December 31,
(in thousands, except per share data)

	2011	2010
ASSETS		
Current assets:		
Cash and cash equivalents	$37,542	$10,277
Certificates of deposit		1,291
Prepaid Federal income taxes		3,853
Accounts receivable	6,689	5,450
Coal inventory	1,863	2,100
Parts and supply inventory	2,202	2,411
Other	580	850
Total current assets	48,876	26,232
Coal properties, at cost:		
Land, buildings and equipment	137,707	114,476
Mine development	66,614	59,351
	204,321	173,827
Less - accumulated DD&A	(42,493)	(28,435)
	161,828	145,392
Investment in Savoy	12,133	7,717
Investment in Sunrise Energy	3,297	2,375
Other assets (Note 8)	6,294	4,948
	$232,428	$186,664
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of bank debt	$17,500	10,000
Accounts payable and accrued liabilities	10,411	8,809
Income taxes	5,125	
Other	60	692
Total current liabilities	33,096	19,501
Long-term liabilities:		
Bank debt, net of current portion		17,500
Deferred income taxes	31,100	17,435
Asset retirement obligations	2,276	1,150
Other	4,963	4,345
Total long-term liabilities	38,339	40,430
Total liabilities	71,435	59,931
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.10 par value, 10,000 shares authorized; none issued		
Common stock, $.01 par value, 100,000 shares authorized; 28,309 and 27,924 outstanding, respectively	283	279
Additional paid-in capital	85,984	84,073
Retained earnings	74,685	42,381
Accumulated other comprehensive income	41	
Total stockholders' equity	160,993	126,733

	$232,428	$186,664

See accompanying notes.

Consolidated Statement of Operations
For the years ended December 31,
(in thousands, except per share data)

	2011	2010
Revenue:		
Coal sales	$137,998	$129,003
Gain on sale of unproved oil and gas properties	10,653	
Equity income - Savoy	5,476	1,005
Equity income - Sunrise Energy	922	
Other income (loss) (Note 8)	2,305	(772)
	157,354	129,236
Costs and expenses:		
Operating costs and expenses	77,094	72,527
DD&A	14,096	11,818
Coal exploration costs	1,132	780
SG&A	7,004	5,556
Interest	1,288	1,926
	100,614	92,607
Income before income taxes	56,740	36,629
Less income taxes:		
Current	7,266	885
Deferred	13,665	13,369
	20,931	14,254
Net income	$35,809	$22,375
Net income per share:		
Basic	$1.27	$.81
Diluted	$1.25	$.78
Weighted average shares outstanding:		
Basic	28,135	27,790
Diluted	28,694	28,571

See accompanying notes.

Consolidated Statement of Cash Flows
For the years ended December 31,
(in thousands)

	2011	2010
Operating activities:		
Net income	$35,809	$22,375
Gain on sale	(10,653)	
Deferred income taxes	13,665	13,369
Equity income – Savoy and Sunrise Energy	(6,398)	(1,005)
Cash distributions from Savoy	1,060	
DD&A	14,096	11,818
Change in fair value of interest rate swaps	(632)	(712)
Stock-based compensation	2,331	2,194
Other	576	
Taxes paid on vesting of RSUs	(1,661)	(746)
Change in current assets and liabilities:		
Accounts receivable	221	(163)
Coal inventory	236	66
Income tax accounts	8,978	(2,807)
Accounts payable and accrued liabilities	1,751	1,415
Other	1,341	(259)
Cash provided by operating activities	60,720	45,545
Investing activities:		
Proceeds from sale of unproved oil and gas properties	13,195	
Capital expenditures for coal properties	(32,995)	(34,714)
Capital expenditures for unproved oil and gas properties	(1,710)	(915)
Investment in Sunrise Energy		(2,375)
Investment in Savoy		(453)
Change in CDs	1,291	2,167
Marketable securities	(2,257)	
Other	1,284	(752)
Cash used in investing activities	(21,192)	(37,042)
Financing activities:		
Payments of bank debt	(10,000)	(10,000)
Dividends	(3,505)	(2,937)
Stock option buy-out		(679)
Tax benefit from stock-based compensation	1,242	327
Other		(163)
Cash used in financing activities	(12,263)	(13,452)
Increase (decrease) in cash and cash equivalents	27,265	(4,949)
Cash and cash equivalents, beginning of year	10,277	15,226
Cash and cash equivalents, end of year	$37,542	$10,277
Cash paid for interest	$1,508	$2,255
Cash paid for income taxes	$100	$4,400
Changes in accounts payable for coal properties	$(358)	$(2,088)

See accompanying notes.

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Consolidated Statement of Stockholders' Equity
(in thousands)

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	AOCI*	Total
Balance January 1, 2010	27,782	$ 277	$ 85,245	$ 23,105		$ 108,627
Stock issued to board member for director services	9	1	99			100
Stock-based compensation			2,194			2,194
Stock issued on vesting of RSUs	133	1				1
Taxes paid on vesting of RSUs			(746)			(746)
Tax benefit from stock-based compensation			327			327
Stock option buy out for cash			(679)			(679)
Reduction in deferred tax asset resulting from Sunrise acquisition			(2,367)			(2,367)
Cash distributions to former noncontrolling interests for personal income taxes				(162)		(162)
Dividends				(2,937)		(2,937)
Net income				22,375		22,375
Balance December 31, 2010	27,924	$ 279	$ 84,073	$ 42,381		$ 126,733
Stock issued to board member for director services	11		100			100
Stock-based compensation			2,231			2,231
Exercise of employee stock options for shares	181	1	(1)			
Taxes paid for shares issued to employees	(41)		(469)			(469)
Stock issued on vesting of RSUs	345	3				3
Taxes paid on vesting of RSUs	(111)		(1,192)			(1,192)
Tax benefit from stock-based compensation			1,242			1,242
Increase in value of marketable securities available for sale, net of taxes					$ 41	41
Dividends				(3,505)		(3,505)
Net income				35,809		35,809
Balance December 31, 2011	28,309	$ 283	$ 85,984	$ 74,685	$ 41	$ 160,993

See accompanying notes.

Net income	$35,809
OCI	41
Comprehensive income	$35,850

*Accumulated Other Comprehensive Income

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The consolidated financial statements include the accounts of Hallador Energy Company (the "Company") and its wholly-owned subsidiary Sunrise Coal, LLC (Sunrise). All significant intercompany accounts and transactions have been eliminated. We are engaged in the production of steam coal from an underground mine located in western Indiana. We own a 45% equity interest in Savoy Energy L.P., a private oil and gas company which has operations in Michigan and a 50% interest in Sunrise Energy LLC, a private entity engaged in natural gas operations in the same vicinity as our coal mine. We purchased our interest in Sunrise Energy in December 2010.

Reclassification

To maintain consistency and comparability, certain amounts in the 2010 financial statements have been reclassified to conform to current year presentation.

Inventories

Coal and supplies inventories are valued at the lower of average cost or market. Coal inventory costs include labor, supplies, equipment costs and overhead.

Advance Royalties

Coal leases that require minimum annual or advance payments and are recoverable from future production are generally deferred and charged to expense as the coal is subsequently produced.

Coal Properties

Coal properties are recorded at cost. Interest costs applicable to major asset additions are capitalized during the construction period. Expenditures that extend the useful lives or increase the productivity of the assets are capitalized. The cost of maintenance and repairs that do not extend the useful lives or increase the productivity of the assets are expensed as incurred. Other than land and underground mining equipment, coal properties are depreciated using the units-of-production method over the estimated recoverable reserves. Surface and underground mining equipment is depreciated using estimated useful lives ranging from five to twenty years.

If facts and circumstances suggest that a long-lived asset may be impaired, the carrying value is reviewed for recoverability. If this review indicates that the carrying value of the asset will not be recoverable through estimated undiscounted future net cash flows related to the asset over its remaining life, then an impairment loss is recognized by reducing the carrying value of the asset to its estimated fair value.

Mine Development

Costs of developing new coal mines, including asset retirement obligation assets, or significantly expanding the capacity of existing mines, are capitalized and amortized using the units-of-production method over estimated recoverable (proved and probable) reserves.

Asset Retirement Obligations (ARO) - Reclamation

At the time they are incurred, legal obligations associated with the retirement of long-lived assets are reflected at their estimated fair value, with a corresponding charge to mine development. Obligations are typically incurred when we commence development of underground mines, and include reclamation of support facilities, refuse areas and slurry ponds.

Obligations are reflected at the present value of their future cash flows. We reflect accretion of the obligations for the period from the date they are incurred through the date they are extinguished. The asset retirement obligation assets are amortized using the units-of-production method over estimated recoverable (proved and probable) reserves. We are using a 6% discount rate.

Federal and state laws require that mines be reclaimed to their previous condition in accordance with specific standards and approved reclamation plans, as outlined in mining permits. Activities include reclamation of pit and support acreage at surface mines, sealing portals at underground mines, and reclamation of refuse areas and slurry ponds.

We assess our ARO at least annually and reflect revisions for permit changes, changes in our estimated reclamation costs and changes in the estimated timing of such costs.

The table below (in thousands) reflects the changes to our ARO:

	2011	2010
Balance beginning of year	$1,150	$922
Accretion	76	66
Change in cost estimate		
Additions	1,050	162
Balance end of year	$2,276	$1,150

Statement of Cash Flows

Cash equivalents include investments with maturities when purchased of three months or less.

Income Taxes

Income taxes are provided based on the liability method of accounting. The provision for income taxes is based on pretax financial income. Deferred tax assets and liabilities are recognized for the future expected tax consequences of temporary differences between income tax and financial reporting and principally relate to differences in the tax basis of assets and liabilities and their reported amounts, using enacted tax rates in effect for the year in which differences are expected to reverse.

Earnings per Share

Basic earnings per share are computed on the basis of the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed on the basis of the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and restricted stock units.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual amounts could differ from those estimates. The most significant estimates included in the preparation of the financial statements are related to deferred income tax assets and liabilities and coal reserves.

Revenue Recognition

We recognize revenue from coal sales at the time risk of loss passes to the customer at contracted amounts and amounts are deemed collectible.

Long-term Contracts

We evaluate each of our contracts to determine whether they meet the definition of a derivative and they do not. As of December 31, 2011, we are committed to supply to three customers about 7 million tons of coal during the next three years. These contracts represent about 15% of our recoverable reserves for the Carlisle mine. During 2011 and 2010, three of our customers accounted for 90% or more of our sales: for 2011 one customer accounted for 43%, the second for 29%, and the third for 17%; for 2010 one customer accounted for 45%, the second for 36%, and the third for 17%. We are paid every two to four weeks and do not expect any credit losses.

Stock-based Compensation

Stock-based compensation is measured at the grant date based on the fair value of the award and is recognized as expense over the applicable vesting period of the stock award (generally three to four years) using the straight-line method.

New Accounting Pronouncements

None of the recent FASB pronouncements will have any material effect on us.

Subsequent Events

We have evaluated all subsequent events through the date the financial statements were issued. No material recognized or non-recognizable subsequent events were identified.

(2) Income Taxes (in thousands)

Our income tax is different than the expected amount computed using the applicable federal and state statutory income tax rates. The reasons for and effects of such differences for the years ended December 31 are below:

	2011	2010
Expected amount	$ 19,859	$ 12,820
State income taxes, net of federal benefit	2,950	1,808
Other	(1,878)	(374)
	$ 20,931	$ 14,254

The deferred tax assets and liabilities resulting from temporary differences between book and tax basis are comprised of the following at December 31:

	2011	2010
Long-term deferred tax assets:		
AMT credit carryforwards	$1,137	$1,162
Stock-based compensation	596	113
Investment in Savoy	960	1,575
Oil and gas properties	1,540	873
Net long-term deferred tax assets	4,233	3,723
Long-term deferred tax liabilities:		
Coal properties	(35,333)	(21,158)
Net deferred tax liability	$31,100	$17,435

For financial accounting purposes the 2009 Sunrise Coal buyout was treated as an equity transaction among members of a controlled group. For income tax purposes we were able to increase our tax basis in the coal properties and will receive future tax deductions; accordingly, a deferred tax asset of $13 million was recognized with the credit recorded directly to additional paid-in capital. Upon further analysis, in preparing the 2010 tax provision we determined that the tax basis of the incremental assets acquired was less than that originally calculated. As such, in 2010, we reduced our deferred tax assets by $2.37 million with an offset to additional paid-in capital.

We have AMT credit carryforwards of about $1 million.

We have analyzed our filing positions in all of the federal and state jurisdictions where we are required to file income tax returns, as well as all open tax years in these jurisdictions. We identified our federal tax return and our Indiana state tax return as "major" tax jurisdictions. None of our corporate tax returns have been examined in the last ten years. We were recently advised by the IRS that they will perform an examination of our 2009 and 2010 tax returns; such exam is to commence in mid-March 2012. We were also notified by Indiana tax representatives that they will examine our 2008-2010 tax returns; such exam is to commence this summer. We believe that our income tax filing positions and deductions will be sustained on audit and do not anticipate any adjustments that will result in a material change to our consolidated financial position. Therefore, no reserves for uncertain income tax positions have been recorded.

(3) Stock Compensation Plans

Restricted Stock Units

At December 31, 2011 we had 636,000 Restricted Stock Units (RSUs) outstanding and about 922,000 available for future issuance. The outstanding RSUs have a value of about $6.4 million based on our current stock price of about $10. During April 2010 we issued 126,500 RSUs with cliff vesting over three years. On the date of issuance of the RSUs our stock was selling for $8.40. During 2011, 30,000 RSUs were granted with cliff vesting over three years; our stock closed at about $11 on grant date. We expect 268,000 RSUs to vest during 2012 under our current vesting schedule. Every two years we consider granting RSUs to our mine managers; we expect to issue grants in 2012 but have yet to decide the amount.

During December 2011 and 2010, 195,000 RSUs vested each year. On vesting date the shares had a value of about $2 million for 2011 and about $2.3 million for 2010. Under our RSU plan participants are allowed to relinquish shares to pay for their required minimum statutory income taxes.

Stock based compensation expense for 2011 and 2010 was about $2.2 million for each year. For 2012 based on existing RSUs outstanding, stock based compensation expense will be about $2.1 million.

Stock Options

On January 7, 2010 we allowed four Denver employees (non officers) a one-time opportunity to relinquish 1/3 of their vested options (115,833) for cash of $679,000; the intrinsic value on such date. This transaction was treated as a charge to equity. On January 7, 2011 we allowed the same four Denver employees (non officers) the opportunity to exchange their remaining vested options (234,167) for 181,261 shares of our common stock. The exchange ratio was based on the intrinsic value of their options. These shares were issued under our Stock Bonus Plan. Under such plan our employees are allowed to relinquish shares to pay for their required minimum statutory income taxes.

Currently we have 200,000 outstanding stock options to our CEO with an exercise price of $2.30. The options are fully vested and expire in April 2015.

Stock Bonus Plan

Our stock bonus plan was authorized by our BODs in late 2009 with 250,000 shares. As mentioned above under Stock Options, during January 2011, about 140,000 shares were issued. Currently, we have about 86,000 shares left in such plan.

(4) Notes Payable

In December 2008, we entered into a new loan agreement with a bank consortium that provides for a $40 million term loan and a $30 million revolving credit facility. At December 31, 2011, we owed $17.5 million on the term loan and nil on the revolver. The debt matures in December of 2012. We pay a .5% commitment fee on the unused revolver. Substantially all of Sunrise's assets are pledged under this loan agreement and we are the guarantor. The loan agreement requires customary covenants, required financial ratios and restrictions on distributions. Closing costs on this loan agreement were about $1.2 million and are being amortized using the effective interest method over its term which ends near the end of 2012. The current interest rate is LIBOR-one month (0.25%) plus 2.50% or 2.75%.

Considering our two interest rate swap agreements, commitment fees and amortization of the closing costs, our effective interest rates for 2011 and 2010 were about 6.6% each year. One of the swaps expired in December 2011 and the other will expire in July 2012. Assuming interest rates remain stable, we expect our interest rate, not including fees and the amortization of the closing costs, to be about 3% for the last half of 2012. The recorded value of our bank debt approximates fair value as it bears interest at a floating rate.

We expect to negotiate a new loan agreement with our banks sometime before the end of the year.

(5) Equity Investment in Savoy

We own a 45% interest in Savoy Energy L.P., a private company engaged in the oil and gas business primarily in the State of Michigan. Savoy uses the successful efforts method of accounting. We account for our interest in Savoy using the equity method of accounting.

Below (in thousands) to the 100% is a condensed balance sheet at December 31, for both years and a condensed statement of operations for both years.

Condensed Balance Sheet

	2011	2010
Current assets	$16,200	$ 9,103
Oil and gas PP&E, net	17,973	15,978
Other	2,152	2,048
	$36,325	$ 27,129
Total liabilities	$9,469	$ 10,004
Partners' capital	26,856	17,125
	$36,325	$ 27,129

Condensed Statement of Operations

	2011	2010
Revenue	$31,997	$14,447
Gain on sale of unproved properties		2,225
Expenses	(19,897)	(14,438)
Net income	$12,100	$2,234

Unaudited Oil and Gas Reserve Quantity and Value Information (in thousands)

The data below is shown proportionate to our approximate 45% ownership in Savoy.

Costs incurred are as follows:

	2011
Unproved property acquisition	$1,202
Development	1,024
Exploration	3,990
Total	$6,216

	Oil (Bbls)	NGLs (Bbls)	Natural Gas (Mcf)
January 1, 2011	350	6	356
Extensions and discoveries	509	21	689
Production	(128)	(6)	(61)
Revisions to previous estimates	138	22	143
December 31, 2011	869	43	1,127
Proved developed reserves	361	22	438
Proved undeveloped reserves	508	21	689

	Proved Developed	PUDs	Total Proved
Future cash flows:			
Oil	$33,760	$47,619	$81,379
NGLs	1,452	1,435	2,887
Gas	2,170	3,199	5,369
Total cash flows	37,382	52,253	89,635
Future production costs	(10,866)	(12,122)	(22,988)
Future development costs	(385)	(5,196)	(5,581)
Future income tax (none since Savoy is a pass-through entity for income tax purposes)	0	0	0
Future net cash flows	26,131	34,935	61,066
10% annual discount for estimated timing of cash flows	(6,106)	(10,870)	(16,976)
Standardized measure of discounted future net cash flows	$20,025	$24,065	$44,090

Beginning of year	$15,496
Sale of oil and gas produced, net of production costs	(10,374)
Net changes in prices and production costs	4,806
Extension, discoveries and improved recoveries	24,066
Revisions of previous quantity estimates	8,547
Accretion of discount	1,549
End of year	$44,090
Average wellhead prices	
Oil (per Bbl)	$93.60
NGLs (per Bbl)	$66.95
Gas (per Mcf)	$4.76

The 2011 reserve estimates shown above have been independently evaluated by Netherland, Sewell & Associates, Inc. (NSAI), a worldwide leader of petroleum property analysis for industry and financial organizations and government agencies. NSAI was founded in 1961 and performs consulting petroleum engineering services under Texas Board of Professional Engineers Registration No. F-2699. Within NSAI, the technical person primarily responsible for preparing the estimates set forth in the NSAI reserves report incorporated herein is Mr. G. Lance Binder. Mr. Binder has been practicing consulting petroleum engineering at NSAI since 1983. Mr. Binder is a Licensed Professional Engineer in the State of Texas (No. 61794) and has over 33 years of experience in the estimation and evaluation of reserves. He graduated from Purdue University in 1978 with a Bachelor of Science Degree in Chemical Engineering. He meets or exceeds the education, training, and experience requirements set forth in the Standards Pertaining to the Estimating and Auditing of Oil and Gas Reserves Information promulgated by the Society of Petroleum Engineers; he is proficient in judiciously applying industry standard practices to engineering evaluations as well as applying SEC and other industry reserves definitions and guidelines.

The estimates of proved reserves are inherently imprecise and are continually subject to revision based on production history, results of additional exploration and development, price changes and other factors.

(6) Equity Investment in Sunrise Energy

In late December 2010 we invested $2.4 million for a 50% interest in Sunrise Energy, LLC which then purchased existing gas reserves and gathering equipment from an unrelated third party with plans to develop and operate such reserves. Sunrise Energy also plans to develop and explore for coal-bed methane gas reserves on or near our underground coal reserves. Development is pending an increase in nat-gas prices. The primary reason we consummated this purchase was to protect our coal reserves from unwanted fracking by unrelated parties. They use the successful efforts method of accounting. We account for our interest using the equity method of accounting. Operations for 2010 were not material.

Below (in thousands) to the 100% is a condensed balance sheet at December 31, 2011 and a condensed statement of operations for the year then ended. Sunrise Energy's proved oil and gas reserves are not material.

Condensed Balance Sheet

	2011
Current assets	$1,916
Oil and gas properties, net	6,236
	$8,152
Total liabilities	$1,558
Members' capital	6,594
	$8,152

Condensed Statement of Operations

	2011
Revenue	$3,951
Expenses	(2,107)
Net income	$1,844

(7) Employee Benefits

We have no defined benefit pension plans or any post-retirement benefit plans. We offer our employees a 401(k) Plan, where we match 100% of the first 4% that an employee contributes, a bonus plan based on meeting certain production levels and a discretionary Deferred Bonus Plan for certain key employees. We also offer health benefits to all employees and their families. Our 2011 costs for the 401(k) matching were about $458,000 and our costs for health benefits were about $3.1 million. Our 2010 costs for the 401(k) matching were about $320,000 and our costs for health benefits were about $2.1 million. The 2011 amortized costs for the Deferred Bonus Plan were about $254,000 and the 2010 amortized costs were about $180,000. The costs for the production bonus plan were $910,000 in 2011 and $328,000 in 2010.

Our mine employees are also covered by workers' compensation and such costs for 2011 and 2010 were about $1.3 million and $1.5 million, respectively. Workers' compensation is a no-fault system by which individuals who sustain work related injuries or occupational diseases are compensated. Benefits and coverage are mandated by each state which include disability ratings, medical claims, rehabilitation services, and death and survivor benefits. Our operations are protected from these perils through insurance policies. Our maximum annual exposure is limited to $1 million per employee with a $4 million aggregate deductible. Based on discussions and representations from our insurance carrier we believe that our reserve for our workers' compensation benefits are adequate. We have a safety conscious work force and our worker's compensation injuries have been minimal. Our mine has been in operation for about five years.

(8) Other Long-term Assets and Other Income (loss)

	2011	2010
Long-term assets:		
Oil and gas properties	$ 336	$ 1,744
Advance coal royalties	3,205	1,863
Deferred financing costs, net	295	616
Marketable equity securities available for sale (restricted)*	2,326	
Miscellaneous	132	725
	$ 6,294	$ 4,948

*Held by Sunrise Indemnity, Inc., our wholly-owned captive insurance company.

	2011	2010
Other income (loss):		
MSHA reimbursements**	$ 1,900	
Exploration and dry hole costs	(677)	$ (1,302)
Oil and gas sales, net of expenses	231	172
Miscellaneous	851	358
	$ 2,305	$ (772)

**See "MSHA Reimbursements" in our MD&A section for a discussion of the $1.9 million.

(9) Self Insurance

In late August 2010 we decided to drop the property insurance on our underground mining equipment. We feel comfortable with this decision as such equipment is allocated among four mining units spread out over eight miles. The historical cost of such equipment is about $93 million.

(10) Gain on Sale

See “North Dakota Lease Play” in our MD&A section for a discussion of the $10.7 million gain on sale.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES.

Disclosure Controls

We maintain a system of disclosure controls and procedures that are designed for the purposes of ensuring that information required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our CEO and CFO as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our CEO and CFO of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective for the purposes discussed above.

Internal Control Over Financial Reporting (ICFR)

We are responsible for establishing and maintaining adequate ICFR. We assessed the effectiveness of our ICFR based on criteria for effective ICFR described in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on our assessment, we concluded that we maintained effective ICFR as of December 31, 2011.

There has been no change in our internal control over financial reporting during the quarter ended December 31, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

This annual report does not include an attestation report from Ehrhardt Keefe Steiner & Hottman PC (EKSH), our auditors, regarding ICFR. Our report was not subject to attestation by EKSH pursuant to existing rules of the SEC that permits us to provide only our report in this annual report.

ITEM 9B. OTHER INFORMATION

None.

PART III

The information required for Items 10-14 are hereby incorporated by reference to that certain information in our Information Statement to be filed with the SEC during March 2012.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

ITEM 11. EXECUTIVE COMPENSATION

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

See Item 8 for an index of our financial statements.

Because we are a smaller reporting company we are not required to provide financial statement schedules.

Our exhibit index is as follows:

3.1	Second Restated Articles of Incorporation of Hallador Energy Company effective December 24, 2009. (1)
3.2	By-laws of Hallador Energy Company, effective December 24, 2009 (1)
10.1	Purchase and Sale Agreement dated December 31, 2005 between Hallador Petroleum Company, as Purchaser and Yorktown Energy Partners II, L.P., as Seller relating to the purchase and sale of limited partnership interests in Savoy Energy Limited Partnership (2)
10.2	Letter of Intent dated January 5, 2006 between Hallador Petroleum Company and Sunrise Coal, LLC (3)
10.3	Subscription Agreement - by and between Hallador Petroleum Company and Yorktown Energy Partners VI, L.P., et al dated February 22, 2006. (2)
10.4	Subscription Agreements - by and between Hallador Petroleum Company and Hallador Alternative Assets Fund LLC, et al dated February 14, 2006. (3)
10.5	Continuing Guaranty, dated April 19, 2006, by Hallador Petroleum Company in favor of Old National Bank (6)
10.6	Collateral Assignment of Hallador Master Purchase/Sale Agreement, dated April 19, 2006, among Hallador Petroleum Company, Hallador Petroleum, LLLP, and Hallador Production Company and Old National Bank (6)
10.7	Reimbursement Agreement, dated April 19, 2006, between Hallador Petroleum Company and Sunrise Coal, LLC (6)
10.8	Membership Interest Purchase Agreement dated July 31, 2006 by and between Hallador Petroleum Company and Sunrise Coal, LLC. (7)
10.9	Subscription Agreements - by and between Hallador Petroleum Company and Yorktown Energy Partners VII, L.P., et al dated October 5, 2007 (7)
10.10	Purchase and Sale Agreement dated effective as of October 5, 2007 between Hallador Petroleum Company, as Purchaser and Savoy Energy Limited Partnership, as Seller (11)

10.11	First Amendment to Credit Agreement, Waiver and Ratification of Loan Documents dated June 28, 2007 by and between Sunrise Coal, LLC, Hallador Petroleum Company and Old National Bank (9)
10.12	Amended and Restated Continuing Guaranty, dated as of June 28, 2007, between Hallador Petroleum Company, Sunrise Coal, LLC, and Old National Bank. (10)
10.13	Hallador Petroleum Company Restricted Stock Unit Issuance Agreement dated as of June 28, 2007, between Hallador Petroleum Company and Victor P. Stabio(10)*
10.14	Hallador Petroleum Company Restricted Stock Unit Issuance Agreement dated as of July 19, 2007, between Hallador Petroleum Company and Brent Bilsland(11)*
10.15	Hallador Petroleum Company 2008 Restricted Stock Unit Plan. (12)*
10.16	Form of Amended and Restated Purchase and Sale Agreement dated July 24, 2008 to purchase additional minority interest from Sunrise Coal, LLC's minority members (13)
10.17	Form of Hallador Petroleum Company Restricted Stock Unit Issuance Agreement dated July 24, 2008 (13)*
10.18	Credit Agreement dated December 12, 2008, by and among Sunrise Coal, LLC, Hallador Petroleum Company as a Guarantor, PNC Bank, National Association as administrative agent for the lenders, and the other lenders party thereto. (14)
10.19	Continuing Agreement of Guaranty and Suretyship dated December 12, 2008, by Hallador Petroleum Company in favor of PNC Bank, National Association (14)
10.20	Amended and Restated Promissory Note dated December 12, 2008, in the principal amount of $13,000,000, issued by Sunrise Coal, LLC in favor of Hallador Petroleum Company (14)
10.21	Form of Purchase and Sale Agreement dated September 16, 2009 (15)
10.22	Form of Subscription Agreement dated September 15, 2009 (15)
10.23	Form of Hallador Petroleum Company Restricted Stock Unit Issuance Agreement. (15)*
10.24	2009 Stock Bonus Plan(16)*
14	Code Of Ethics For Senior Financial Officers. (5)
21.1	List of Subsidiaries (17)
23.1	Consent of EKSH, our auditors (17)
23.2	Consent of Netherland, Sewell & Associates, Inc. (17)
31	SOX 302 Certifications (17)
32	SOX 906 Certification (17)
95	Mine Safety Disclosure (17)
99	Report of Netherland, Sewell & Associates, Inc. (17)

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(1) IBR to Form 8-K dated December 31, 2009.	(10) IBR to Form 8-K dated July 2, 2007.
(2) IBR to Form 8-K dated January 3, 2006.	(11) IBR to Form 10-KSB dated December 31, 2007.
(3) IBR to Form 8-K dated January 6, 2006.	(12) IBR to March 31, 2007 Form 10-Q.
(4) IBR to Form 8-K dated February 27, 2006.	(13) IBR to Form 8-K dated July 24, 2008.
(5) IBR to the 2005 Form 10-KSB.	(14) IBR to Form 8-K dated December 12, 2008.
(6) IBR to Form 8-K dated April 25, 2006.	(15) IBR to Form 8-K dated September 18, 2009.
(7) IBR to Form 8-K dated August 1, 2006.	(16) IBR to Form S-8 dated December 1, 2009.
(8) IBR to Form 10-QSB dated September 30, 2007.	(17) Filed herewith.
(9) IBR to Form 10-QSB dated June 30, 2007.	

* Management contracts or compensatory plans.

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.

HALLADOR ENERGY COMPANY

Date: March 2, 2012

/s/W. ANDERSON BISHOP
W. Anderson Bishop, CFO and CAO

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.

/s/DAVID HARDIE David Hardie	Chairman	March 2, 2012
/s/VICTOR P. STABIO Victor P. Stabio	CEO and Director	March 2, 2012
/s/BRYAN LAWRENCE Bryan Lawrence	Director	March 2, 2012
/s/BRENT BILSLAND Brent Bilsland	President and Director	March 2, 2012
/s/JOHN VAN HEUVELEN John Van Heuvelen	Director	March 2, 2012

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Conditions to the Completion of the Merger

The parties respective obligations to complete the merger are subject to the satisfaction or, to the extent legally permissible, the waiver of the following conditions in the Merger Agreement:

the receipt of the approval of the Merger Agreement by Tutor-Saliba shareholders by delivery of the written consent of Tutor-Saliba shareholders (which was delivered in connection with the execution and delivery of the Merger Agreement), and the receipt of the approval by Perini shareholders of the share issuance proposal and the articles amendment proposal;

the receipt of the required statutory approvals, including the expiration or termination of the waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976;

the absence of any law, judgment, injunction, decree or other order by a governmental entity that is in effect challenging the merger or the other transactions contemplated by the Merger Agreement, having the effect of making the merger or the other transactions contemplated by the Merger Agreement illegal, otherwise preventing the consummation of the merger or any of the other transactions contemplated by the Merger Agreement or that seeks to retrain, prohibit or effect the rescission of the merger or the other transactions contemplated by the Merger Agreement;

the receipt of the approval for listing by the NYSE of Perini common stock to be issued pursuant to the merger, subject to official notice of issuance; and

the articles of amendment of the Perini amended and restated articles of organization having been filed with the Massachusetts Secretary of State and declared effective.

In addition, individually, the parties respective obligations to effect the merger are subject to the satisfaction or, to the extent legally permissible, the waiver of the following additional conditions:

the representations and warranties of the other party being true and correct as of the date of the Merger Agreement and as of the closing date of the merger unless, other than in the case of representations and warranties regarding capitalization, such failures to be true and correct (without giving effect to any materiality or material adverse effect qualifications or exceptions) in respect of those representations and warranties have not had and are not reasonably likely to result in a material adverse effect on the other party;

the other party having performed and complied in all material respects with all covenants required to be performed and complied with by it under the Merger Agreement;

the absence of a material adverse effect on the other party since the date of the Merger Agreement;

the receipt by both parties of all consents under any contracts or permits in connection with the Merger Agreement and the transactions contemplated thereby, except those consents the failure of which to obtain would not have a material adverse effect;

the execution and delivery by Perini and each shareholder of Tutor-Saliba of the Shareholders Agreement, and the Shareholders Agreement being in full force and effect;

the execution and delivery by Mr. Tutor and Perini of the Employment Agreement, and there being no constructive or anticipatory notice of termination of service thereunder;

in the case of Perini, the receipt by Perini of a certification by Tutor-Saliba to the effect that Tutor-Saliba is not and has not been a United States Real Property Holding Corporation within the meaning of Section 897(c)(2) of the Internal Revenue Code;

the receipt of an opinion of the party s counsel which provides that the merger will qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code;

in the case of Perini, the receipt by Perini of certain Tutor-Saliba audited financial statements by April 30, 2008, which audited financial statements do not differ in any material respect from the unaudited financial statements previously made available to Perini, except as provided in the Merger Agreement; and

the receipt by each party of a certificate from an executive officer of the other party with respect to the satisfaction of certain of the closing conditions.

The Merger Agreement provides that neither Perini nor Tutor-Saliba may rely on the failure of any closing condition to be satisfied if the failure was caused by its failure to use its reasonable best efforts to satisfy the closing conditions or any other material breach of any other provision of the Merger Agreement.

Termination of the Merger Agreement

Right to Terminate. The Merger Agreement may be terminated at any time prior to the completion of the merger in any of the following ways:

by mutual written consent of us and Tutor-Saliba;

by either us or Tutor-Saliba:

if the merger has not been completed by September 30, 2008; provided that this date is automatically extended to December 31, 2008 if the conditions relating to the receipt of shareholder approval for the merger proposals, the receipt of required statutory and regulatory approvals and/or the absence of injunctions or other legal or regulatory restraints and the filing of the amendment to the articles of organization have not been fulfilled but all other conditions to closing have been satisfied or waived or are then capable of being satisfied; provided, further, that a party may not terminate the Merger Agreement pursuant to this provision if its failure to fulfill in any material respect any of its obligations under the Merger Agreement has resulted in the failure of the merger to have been completed by the applicable termination date;

if a governmental entity has enacted, issued, promulgated, enforced or entered into a law, judgment, injunction, decree or other order that is in effect, has become final and non-appealable and has the effect of making the merger or the other transactions contemplated by the Merger Agreement illegal, otherwise preventing the consummation of the merger or any of the other transactions contemplated by the Merger Agreement or that seeks to restrain or prohibit the consummation of, or effect the rescission of the merger or the other transactions contemplated by the Merger Agreement; provided, that a party may not terminate the Merger Agreement pursuant to this provision if such party failed to use its reasonable efforts to resist or prevent the entry or passage, or to seek the removal or lifting of such law, judgment, injunctions, decree or order; or

if the Perini shareholders fail to approve the share issuance proposal or the amendment proposal at the annual meeting or any adjournment or postponement thereof at which a vote on the merger proposals was taken; or

by Perini:

if there has been an uncured breach or failure to perform in any material respect of any representation, warranty, covenant or other agreement made by Tutor-Saliba or any of its shareholders in the Merger Agreement, and the breach or failure to perform would result in the applicable closing condition to the merger not being satisfied; or

if the Perini board of directors has effected a change of recommendation if such change of recommendation is for the purposes of accepting or adopting an acquisition proposal or entering into an acquisition agreement; or

by Tutor-Saliba:

if there has been an uncured breach or failure to perform in any material respect of any representation, warranty, covenant or other agreement made by Perini in the Merger Agreement, and the breach or failure to perform would result in the applicable closing condition to the merger not being satisfied; or

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if the Perini board of directors has effected a change of recommendation.

Termination Fees/Reimbursement of Expenses. Perini will be required to pay a termination fee of $30 million to Tutor-Saliba:

- immediately upon termination of the Merger Agreement by Perini after it effects a change of recommendation for the purposes of accepting or adopting an acquisition proposal or entering into an acquisition agreement;

- within one business day following the consummation of an acquisition transaction if (i) Perini or Tutor-Saliba terminates the Merger Agreement due to any Perini change of recommendation other than a Perini change of recommendation described in the bullet immediately above, and (ii) Perini enters into an acquisition agreement, or an acquisition transaction is otherwise consummated, within twelve months following the termination of the Merger Agreement (provided however that for these purposes 20% and 80% in the definition of acquisition transaction and acquisition agreement should be substituted with 35% and 65%); or

- within one business day following the consummation of an acquisition transaction if (i) Perini or Tutor-Saliba terminates the Merger Agreement due to a failure to receive Perini shareholder approval at the Perini shareholders meeting and (ii) after the date of the Merger Agreement and before the Perini shareholders meeting, an acquisition proposal has been publicly announced and not withdrawn, and (iii) Perini enters into an acquisition agreement, or an acquisition transaction within twelve months following the termination of the Merger Agreement (provided however that for these purposes 20% and 80% in the definition of acquisition transaction and acquisition agreement should be substituted with 35% and 65%).

Perini will reimburse Tutor-Saliba for up to $5 million of Tutor-Saliba s reasonable, documented, out-of-pocket expenses if (i) Perini or Tutor-Saliba terminate the Merger Agreement due to a failure to receive Perini shareholder approval at the Perini shareholders meeting or (ii) Perini or Tutor-Saliba terminates the Merger Agreement due to any Perini change of recommendation. The reimbursement of expenses will not limit the obligation of Perini to pay the termination fee described above, if applicable.

The Shareholder Representative

Each Tutor-Saliba shareholder has appointed Mr. Tutor as the shareholder representative to serve as its and their true and lawful agent and attorney-in-fact. In such capacity, the shareholder representative may take any action on behalf of the shareholders of Tutor-Saliba, and may bind them under the Merger Agreement and any other related agreement.

Amendments, Extensions and Waivers

Amendments. The Merger Agreement may be amended by the parties, except that any amendment after the Perini shareholders meeting that by law requires approval by shareholders may not be made without such approval. The Merger Agreement may not be amended by Perini without the approval of the Special Committee or, if such committee shall no longer be constituted, a majority of the independent directors of Perini. All amendments to the Merger Agreement must be in writing signed by each party.

Extensions and Waivers. At any time prior to the completion of the merger, any party to the Merger Agreement may extend the time for the performance of any of the obligations or other acts of any other party; waive any inaccuracies in the representations and warranties of any other party contained in the Merger Agreement or in any document delivered pursuant to the Merger Agreement; or subject to the restrictions described in the immediately preceding paragraph, waive compliance by any other party with any of the agreements or conditions contained in the Merger Agreement. All extensions and waivers must be in writing and

signed by the party against whom the extension or waiver is to be effective. Any waiver of a condition to the merger by Perini would be made by Perini only if, in the judgment of the Perini board of directors, the waiver was in the best interests of Perini shareholders. Perini does not have any current intention to waive any condition to the merger and cannot predict the circumstances under which it would do so. Perini would re-solicit the votes of its shareholders if it decided to waive a material condition to the merger, including the condition that Perini receive an opinion of its counsel which provides that the merger will qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code.

Governing Law. The Merger Agreement is governed by the laws of New York, other than with respect to certain provisions and actions related thereto that are governed by the laws of California and Massachusetts, as appropriate.

The Shareholders Agreement

Simultaneously with the execution of the Merger Agreement, we entered into the Shareholders Agreement with Mr. Tutor, as the shareholder representative, and each of the Tutor-Saliba shareholders who will become shareholders of Perini upon completion of the merger. The Shareholders Agreement will become effective upon the completion of the merger.

The following is a summary of the material terms of the Shareholders Agreement. This summary does not purport to describe all the terms of the Shareholders Agreement and is qualified by reference to the complete Shareholders Agreement, which is attached as Annex B to this proxy statement and incorporated by reference in this proxy statement. All shareholders of Perini are urged to read the Shareholders Agreement carefully and in its entirety.

The Shareholder Representative

Mr. Tutor has agreed to serve as the shareholder representative of the former Tutor-Saliba shareholders under the Shareholders Agreement. He shall serve in such capacity until his resignation as the shareholder representative or his death or mental or physical incapacity. If Mr. Tutor ceases to serve as the shareholder representative under the Shareholders Agreement, the Tutor Group shall select a replacement shareholder representative.

Composition of the Board of Directors

The Shareholders Agreement provides that the shareholder representative will have the right to designate two nominees for election to the Perini board of directors for so long as the Tutor Group owns at least 22.5% of the outstanding shares of Perini common stock and one nominee if the Tutor Group owns less than 22.5% but more than 11.25% of the outstanding shares of Perini common stock. In addition, for so long as Mr. Tutor serves as the chief executive officer of Perini, he will be nominated for election to the Perini board of directors. The remaining members of the Perini board of directors will be nominated by the Nominating and Governance Committee of the Perini board of directors. At each meeting of Perini shareholders following the completion of the merger at which directors of Perini are to be elected, Perini has agreed to nominate for election to the Perini board of directors and recommend the election of the shareholder representative s designees and Mr. Tutor (as long as he serves as Perini s chief executive officer), subject to certain limitations to comply with law, governance requirements or eligibility for listing on a securities exchange or if a nominee is deemed to be unfit to serve as a director of an NYSE-listed company or otherwise does not meet applicable eligibility criteria.

The Tutor Group is expected to own approximately 43% of the outstanding shares of Perini common stock immediately following the closing of the merger. Pursuant to the Shareholders Agreement, the Perini board of directors at the effective time of the merger would be comprised of Mr. Tutor, two designees of the shareholder representative and eight other directors nominated by the Nominating and Governance Committee of the Perini board of directors (which are expected to include all of Perini s existing directors). Mr. Tutor has designated C.L. Max Nikias as one of the shareholder representative s board designees, and he will be appointed as a new

member of the Perini board of directors upon the completion of the merger. As of the date of this proxy statement, Mr. Tutor has not elected to exercise his right to nominate a second director for election, although he has not waived the right to do so in the future. Accordingly, Perini expects that, at the effective time of the merger, the Perini board of directors will be comprised of Mr. Tutor, Mr. Nikias and nine other directors recommended by the Nominating and Governance Committee of the Perini board of directors.

To the extent permitted by applicable law and the rules of the principal stock exchange on which Perini common stock is listed and to the extent determined by the Nominating and Governance Committee of the Perini board of directors, the shareholder representative will be entitled to have one of his designees serve on each committee of the Perini board of directors.

Voting Restrictions

Pursuant to the Shareholders Agreement, the Tutor Group will vote all of their shares of Perini common stock in support of the Perini board of directors slate of directors as described above.

In addition, on all other matters to be voted on by shareholders of Perini, the Shareholders Agreement provides that the Tutor Group will vote their shares of Perini common stock that are, in the aggregate, equal to up to 20% of the voting power of the outstanding shares of Perini common stock, in their discretion and the balance of their shares of Perini common stock in the same proportions as all other shares of Perini common stock (excluding the Tutor Group) are voted on such matter.

The Tutor Group has agreed not to grant any proxies with respect to Perini common stock or enter into any arrangement with respect to the voting of or taking action with respect to shares of Perini common stock other than as provided under the Shareholders Agreement.

These restrictions on voting remain in effect until the later of the third anniversary of the effective time of the merger or the date on which the Tutor Group owns less than 20% of the aggregate issued and outstanding shares of Perini common stock.

Standstill

Pursuant to the Shareholders Agreement, until the later of the third anniversary of the effective time of the merger or the date on which the Tutor Group owns less than 20% of the outstanding shares of Perini common stock, the Tutor Group may not take certain actions that may be deemed to be actions to obtain control of Perini, including:

- acquiring or offering to acquire shares of Perini common stock that will result in the Tutor Group collectively owning shares of Perini common stock equal to more than the percentage of the total outstanding shares of Perini common stock to be held by them at the effective time of the merger (approximately 43%);
- directly or indirectly soliciting proxies;
- forming a group within the meaning of the federal securities laws;
- granting any proxies or voting power with respect to their shares or depositing any shares in a voting trust;
- initiating shareholder proposals;
- seeking election of new board members or replacement of current board members;

seeking to call shareholder meetings;

making any public announcement or proposal with respect to any form of business combination transaction involving Perini; or

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seeking publicly to have Perini waive, amend or modify any of the standstill provisions contained in the Shareholders Agreement. These standstill restrictions will not prohibit or restrict any action taken by a director or designee of the shareholder representative as a member of the Perini board of directors or the exercise of any voting rights with regard to shares of Perini common stock.

Transfer Restrictions

The Shareholders Agreement provides that for six months after the completion of the merger, none of the former Tutor-Saliba shareholders may transfer or dispose of the shares of Perini common stock acquired pursuant to the merger other than to certain affiliated persons or pursuant to the exercise of piggyback registration rights described below following the decision by Perini to register shares of Perini common stock.

After the six-month anniversary of the completion of the merger, the Tutor Group will not be permitted to transfer shares of Perini common stock unless after doing so they continue to collectively own at least 70% of the shares of Perini common stock acquired by them pursuant to the merger. This restriction on the transfer of shares continues until the later of the fifth anniversary of the effective time of the merger or the date on which the Tutor Group owns less than 20% of the aggregate issued and outstanding shares of Perini common stock. After the fifth anniversary of the effective time of the merger or following the termination of Mr. Tutor s employment without Cause pursuant to the Employment Agreement, such restrictions lapse and the Tutor Group may transfer shares of Perini common stock so long as such transfers do not include a transfer of shares directly or indirectly equal to 15% of the total voting power of Perini to any person or group. In addition, all transfer restrictions under the Shareholders Agreement terminate on the date that is the later of the fifth anniversary of the completion of the merger and such time as the Tutor Group collectively ceases to own 20% of the aggregate issued and outstanding shares of Perini common stock. Notwithstanding the foregoing, the former Tutor-Saliba shareholders may transfer or dispose of shares of Perini common stock in any transactions approved by a majority of the Perini board of directors, excluding Mr. Tutor and the directors designated by him in his capacity as the shareholder representative.

Registration Rights

Pursuant to the Shareholders Agreement, Perini has agreed to give the Tutor-Saliba shareholders who will become Perini shareholders pursuant to the merger certain registration rights with respect to the shares of Perini common stock acquired pursuant to the merger.

Demand Registration. Following the six-month anniversary of the effective time of the merger and subject to the continuing effect of the transfer restrictions set forth in the Shareholders Agreement noted above, the shareholder representative may require Perini to register shares of Perini common stock issued to the Tutor Group in connection with the merger for resale under the Securities Act in an underwritten offering. The shareholder representative may exercise this demand registration right on up to three occasions. Perini will use its reasonable best efforts to qualify for registration on Form S-3. These demand registration rights are subject to customary conditions and limitations. Perini is responsible for paying the expenses of any such registration.

Piggyback Registration. If we propose to register any securities under the Securities Act, each Tutor-Saliba shareholder who will become Perini shareholders pursuant to the merger must receive notice of the registration and to include its shares of Perini common stock in the registration. These piggyback registration registration rights are subject to customary conditions and limitations, including the right of the underwriters of an offering to limit the number of shares included in such registration and Perini s right not to effect a requested registration. Perini is responsible for paying the expenses of any such registration.

Governing Law. The Shareholders Agreement is governed by the laws of Massachusetts.

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The Employment Agreement

Simultaneously with the execution of the Merger Agreement, we entered into the Employment Agreement with Mr. Tutor. The Employment Agreement will become effective upon the completion of the merger.

The following is a summary of the material terms of the Employment Agreement. This summary does not purport to describe all the terms of the Employment Agreement and is qualified by reference to the complete Employment Agreement, which is attached as Annex C to this proxy statement and incorporated by reference in this proxy statement. All shareholders of Perini are urged to read the Employment Agreement carefully and in its entirety.

Position; Compensation and Benefits. Under the Employment Agreement, Mr. Tutor will serve as chief executive officer of Perini, and as a member and the chairman of the Perini board of directors. Mr. Tutor has agreed to devote his reasonable best efforts and full business time to the performance of his duties under the Employment Agreement and the advancement of the business and affairs of Perini, other than his service on other boards of directors and charitable organizations and the maintenance of his family investments. He will receive an initial annual base salary of $1.5 million, subject to annual review and upward adjustment, an annual performance-based cash bonus opportunity equal to 175% of his base salary if target performance levels established by the Compensation Committee of the Perini board of directors are satisfied (with greater or lesser amounts paid if performance levels are above or below such target level), and will be eligible to participate in Perini s equity incentive plan to be adopted after the effective time of the merger.

Term. The initial term of the Employment Agreement is five years, commencing on the effective date of the merger. The term extends automatically for successive one-year periods, unless either party notifies the other at least 90 days in advance of the expiration of the Employment Agreement that it does not intend to renew the Employment Agreement.

Termination. If (i) we terminate Mr. Tutor s employment for any reason other than for Cause or disability, or (ii) Mr. Tutor terminates his employment for Good Reason (as such terms are defined in the Employment Agreement), Mr. Tutor will be entitled to receive a severance package consisting of the following payments and benefits:

- any earned but unpaid base salary and all other accrued benefits through the date of employment termination will be paid;
- Mr. Tutor will receive a pro rata bonus for the calendar year in which his employment ends equal to the amount of such bonus that would have been paid to him had he remained with Perini for that entire calendar year, pro rated for the portion of the year he worked prior to his termination;
- a cash payment equal to two times the sum of his base salary and target bonus for the year of termination;
- immediate vesting of all outstanding equity awards Mr. Tutor holds; and
- continued benefits for Mr. Tutor and his dependents for a period of 24 months.

If Mr. Tutor s employment is terminated other than for Cause or Disability during the two years following a Change of Control of Perini (as such terms are defined in the Employment Agreement) Mr. Tutor is entitled to the payments above, except that instead of receiving the cash payment equal to two times the sum of his base salary and target bonus for the year of termination, Mr. Tutor would receive a cash payment equal to three times the sum of his base salary and target bonus, and the continued benefits for Mr. Tutor and his dependents will continue for the greater of 36 months and the remaining term of his Employment Agreement.

If Mr. Tutor s employment is terminated due to his death or due to his Disability, then (i) any earned but unpaid base salary and all other accrued benefits through the date of employment termination will be paid, and (ii) all outstanding equity awards held by him shall immediately vest.

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Perini will generally have Cause to terminate Mr. Tutor s employment in the following circumstances: (i) his conviction of, or plea of nolo contendere to, a felony; (ii) his willful and continued failure to substantially perform his essential job functions; (iii) his material act of fraud or willful and material misconduct to Perini; (iv) his willful and material breach of the employment contract; (v) a material breach by him of any material written Perini policy; or (vi) a failure by him to cooperate in any investigation or audit regarding the accounting practices, financial statements, or business practices of Perini. For purposes of this provision, no act or failure to act, on the part of Mr. Tutor, shall be considered willful unless it is done, or omitted to be done, by Mr. Tutor in bad faith or without reasonable belief that his action or omission was in the best interest of Perini. Any termination for Cause generally requires written notice to Mr. Tutor and providing him with 10 days to cure the conduct after such notice. The Perini board of directors must also vote affirmatively that Mr. Tutor is to be terminated for Cause after giving him an opportunity to be heard by the full board.

Mr. Tutor will generally have Good Reason to terminate his employment under any of the following circumstances: (i) any adverse change in his titles; (ii) any reduction in his base salary; (iii) a material diminution in his authority, responsibilities or duties; (iv) the assignment of duties materially inconsistent with his position; (v) a relocation of his place of employment to a location more than 50 miles further from the current offices near Los Angeles, California; (vi) any other material breach of the terms the Employment Agreement or (vii) the failure of Perini to have his contract assumed after a merger, consolidation, sale or similar transaction. In order to invoke a termination for Good Reason, Mr. Tutor must notify Perini of the existence of the event of Good Reason within 90 days of its occurrence, Perini must fail to cure the event within 30 days of the notice, and Mr. Tutor must terminate his employment within 10 days of the expiration of such period.

Perquisites and Benefits. Mr. Tutor is entitled to various perquisites and benefits as set forth in the Employment Agreement; including, (i) 150 hours of flying time per calendar year of personal use of Perini s business jet, with any unused balance being carried forward to subsequent years while employed; (ii) use of an automobile and driver, and use of an apartment in Las Vegas, Nevada, in each case on terms and conditions to be determined by the Perini board of directors; (iii) participation in all fringe benefits and perquisites made available generally to senior executives of Perini, generally on the same terms and conditions, (iv) 30 days vacation; (v) participation in all pension, retirement, profit sharing, savings, 401(k), income deferral, life insurance, disability insurance, accidental death and dismemberment protection, travel accident insurance, hospitalization, medical, dental, vision and other employee benefit plans, programs and arrangements made available generally to other senior executives of the Perini, to the extent eligible. Furthermore, Perini will obtain, on behalf of Mr. Tutor, life insurance coverage under term or ordinary life insurance polici(es) (at his choice) with an aggregate annual premium cost not to exceed $175,000.

Non-Competition. Mr. Tutor has agreed that during the term of his employment with Perini and for two years after the end of his employment (unless his employment is terminated by Perini without Cause or he terminates his employment for Good Reason), he will not compete with Perini or solicit certain of its employees. Mr. Tutor has also agreed to be bound by customary restrictions on disclosure of confidential information.

Tax Gross Up. If Mr. Tutor s benefits and payments become subject to an excise tax under Section 4999 of the Internal Revenue Code in connection with a change in control of Perini, he will be entitled to an additional gross up payment to compensate him for the amount of this additional excise tax.

Governing Law. The Employment Agreement is governed by the laws of California.

Post-Merger Governance and Management

Board of Directors

As described above, upon the completion of the merger, Mr. Tutor (as the shareholder representative for the former Tutor-Saliba shareholders) will have the right to designate two nominees for election to the Perini board of directors and, for so long as Mr. Tutor serves as our chief executive officer, he will be nominated for election to the Perini board of directors. Please see The Shareholders Agreement beginning on page 84 for a description of the composition of the Perini board of directors following completion of the merger.

The Shareholders Agreement provides that the Perini board of directors at the effective time of the merger will be comprised of Mr. Tutor, two designees of the shareholder representative and eight other directors nominated by the Nominating and Governance Committee of the Perini board of directors (which are expected to include all of Perini s existing directors). It is expected that the eight current members of the board will be joined by Marilyn A. Alexander, Donald D. Snyder and Mr. Nikias. Mr. Tutor has designated Mr. Nikias as one of the shareholder representative s board designees, and he will be appointed as a new member of the Perini board of directors upon the completion of the merger. As of the date of this proxy statement, Mr. Tutor has not elected to exercise his right to nominate a second director for election, although he has not waived the right to do so in the future. Accordingly, Perini expects that at the effective time of the merger, the Perini board of directors will be comprised of Mr. Tutor, Mr. Nikias and nine other directors recommended by the Nominating and Governance Committee of the Perini board of directors. Mr. Tutor has advised the Perini board of directors that should he choose to designate a second person for appointment to the board of directors at a time when the board already included eleven members, he would support a temporary expansion of the board to twelve members to accommodate such additional member. Such expansion would continue until the next meeting of shareholders at which directors are elected, at which time he would expect the size of the board to be reduced back to eleven members (as contemplated by the Shareholders Agreement) and the slate of nominees for election to be adjusted accordingly.

Following the closing of the merger, and assuming the Perini shareholders elect the four director-nominees listed in Proposal 3 and assuming that Mr. Tutor appoints Mr. Nikias to serve as a director, the Perini board of directors will be classified in accordance with our By-Laws as follows:

Class I directors (with terms expiring in 2009): Robert Band, Michael R. Klein, and Robert L. Miller.

Class II directors (with terms expiring in 2010): Williard W. Brittain, Jr., Robert A. Kennedy, C.L. Max Nikias and Ronald N. Tutor.

Class III directors (with terms expiring in 2011): Marilyn A. Alexander, Peter Arkley, Raymond R. Oneglia and Donald D. Snyder.

Voting Restrictions

Pursuant to the Shareholders Agreement, Mr. Tutor has agreed to certain restrictions on his rights to vote the shares of Perini common stock that he will control following the completion of the merger. Please see The Shareholders Agreement beginning on page 84 for a description of the restrictions applicable to Mr. Tutor s voting rights pursuant to the Shareholders Agreement.

Management

Other than the Employment Agreement, as of the date of this proxy statement, neither we nor any of our affiliates has entered into any employment agreements with our management in connection with the merger, nor amended or modified any existing employment agreements. Upon completion of the merger, Mr. Tutor will continue to serve as chief executive officer and as a member and chairman of the Perini board of directors, subject to the terms and conditions of the Employment Agreement. We currently intend to retain members of our management team following the merger.

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INFORMATION ABOUT TUTOR-SALIBA

Tutor-Saliba Business

Tutor-Saliba is a leading civil infrastructure and commercial building construction company that focuses on large, complex projects, usually ranging from $100 million to $1 billion or more in size. Tutor Saliba manages all aspects of these projects, including design-build, design-bid-build and pre-construction services for project owners. These capabilities, together with its significant capacity to self-perform critical construction specialties such as concrete forming and placement, site excavation and support of excavation, and electrical and mechanical services, are the core strengths of Tutor-Saliba.

Tutor-Saliba operates in three segments: domestic building, domestic civil and international. Its domestic building operations are predominately in Nevada and California, where Tutor-Saliba maintains large offices. Its domestic civil operations have been historically focused primarily in California and New York, and it plans to expand by pursuing attractive infrastructure opportunities elsewhere in the United States. Its international operations are conducted primarily on the island of Guam and in the Philippines.

Tutor-Saliba disposed of the property comprising its commercial real estate segment in January 2008, as discussed below. The real estate operations are classified in discontinued operations. Accordingly, Tutor-Saliba did not discuss the impact of that segment on its overall performance.

Tutor-Saliba s growth has been driven by its success in winning contracts and effectively performing public infrastructure development and public and private sector building construction projects over many years. In 2007, Tutor-Saliba experienced growth in revenues and earnings in all of its business segments.

Below is a list of key factors that Tutor-Saliba believes will affect its future performance:

- In its domestic building segment, the availability of opportunities for major construction projects depends on significant capital spending commitments by project sponsors in the markets served by Tutor-Saliba. For example, Tutor-Saliba s business in recent periods has benefited significantly from two ongoing projects in Las Vegas (the Wynn Encore and Planet Hollywood Tower), which were awarded in 2006. These projects will continue to drive Tutor-Saliba s operating performance in 2008. Tutor-Saliba believes that it can capitalize on its success on these projects and win significant additional casino hotel project opportunities in Las Vegas and elsewhere. The number and size of these future opportunities will be determined in part by consumer demand for upscale casino hotel gaming experiences, and by the availability of financing in the capital markets for project sponsors. Tutor-Saliba believes there will be continuing opportunities for public and private sector building construction in other fields as, for example, inefficient government buildings are replaced (such as the Los Angeles Police Headquarters building Tutor-Saliba is completing) and as the continuing growth of the healthcare sector and the aging of the baby boom creates demand for modern hospitals.

- The pace of investment in infrastructure and the timing and availability of opportunities for its domestic civil segment to win new contracts in any particular period is a function of many factors including annual appropriations, development schedules, the availability of federal matching funds, administrative approvals and governmental priorities, which can in turn be affected by state and local budget conditions. There is widespread consensus that infrastructure in the United States has been substantially undercapitalized, as evidenced by major legislative initiatives in the United States Congress, California and other states and municipalities in recent years. These legislative initiatives have earmarked significant funds for highway, bridge, airport and other infrastructure projects that Tutor-Saliba believes will present it with significant opportunities for continued expansion.

- Tutor-Saliba is expanding its international segment on the island of Guam, where it is the largest contractor in the market, to take advantage of the announced planned relocation of 8,000 United States Marines and other military personnel from Okinawa, Japan. These Guam activities will generate an estimated $10.3 billion of projects for the construction industry over a period of approximately seven years beginning in 2009.

Tutor-Saliba s senior management team is directly involved in each bidding process, and no major bid is submitted and no major contract is entered into without the approval of Tutor-Saliba s senior management, including its president and chief executive officer, Ronald N. Tutor. Tutor-Saliba s approach is to bid selectively on projects that are consistent with its profitability goals, and not to pursue low-margin projects or projects that have schedules or other requirements that it believes pose unacceptable performance risks. As a result of its experience in bidding, negotiating and performing large, complex projects over many years, its familiarity with key suppliers and subcontractors in its markets, its ability to self-perform many construction specialties, and its track record of performing its projects on time and on budget, Tutor-Saliba has been able to achieve substantial returns for its shareholders.

Management s Discussion and Analysis of Financial Condition and Results of Operations

Most of Tutor-Saliba s business is conducted under fixed price and guaranteed maximum price contracts. Tutor-Saliba s profitability therefore depends to a large degree on its ability to accurately forecast costs and timetables for a potential project when it bids or negotiates the contract, and to successfully control project costs and meet project schedules when it performs the contract. Tutor-Saliba s ability to accurately estimate and provide for the necessary workforce, materials and subcontractors for each project directly affects its contract profitability. If Tutor-Saliba underestimates its costs, or if it fails to meet its projected schedules, its performance can be adversely affected, and the impact on a particular quarter or year can be significant under percentage-of-completion accounting, as discussed under Critical Accounting Policies beginning on page 95.

Tutor-Saliba s estimating process is extensive, and it maintains separate estimating departments for its domestic civil, domestic building and international segments. Tutor-Saliba s estimating function benefits from its long relationships with union and non-union labor providers and subcontractors in Tutor-Saliba s key markets, and Tutor-Saliba generally contracts for its principal estimated material needs (e.g., concrete and steel) at the beginning of each job. In some of Tutor-Saliba s contracts, it is able to pass certain cost increases (through contingency and escalation clauses) along to the customer. Tutor-Saliba requires many subcontractors to obtain performance bonds, and Tutor-Saliba often obtains bonding to protect against materials delivery defaults (through materials supply bonds) and subcontractor non-performance (through contractor default insurance), with premiums for any such bonds and insurance included in its bids, subject to deductibles at its risk. Tutor-Saliba owns substantially all of its equipment fleet, and the depreciation and amortization expense it incurs for equipment is substantially less than what rental cost would be for the same fleet. Tutor-Saliba does not maintain a separate sales force, as the size of its projects generally requires direct, extensive management involvement with project sponsors in each bid proposal.

Tutor-Saliba s ability to estimate performance schedules is also of critical importance, as it can earn additional profit if it completes a project ahead of schedule, whether through contractual bonuses and/or avoiding anticipated costs. If Tutor-Saliba fails to meet contractual performance schedules it may be subject to additional costs that reduce its profitability and/or liquidated damages to the project owner.

Because Tutor-Saliba works on very large projects that are generally completed over a period of 30 to 42 months, its revenues and earnings at any point in time are frequently concentrated in a few projects in each segment. For example, in the three months ended March 31, 2008, Tutor-Saliba s domestic building segment generated 56.1% and 19.0% of revenues, from the Las Vegas Wynn Encore and Las Vegas Planet Hollywood Tower projects, respectively. Similarly, in that same period, Tutor-Saliba s domestic civil segment generated 39.2% of its revenues from the Los Angeles International Airport Runway and Taxiway Improvements project. Tutor-Saliba s customers are either government agencies or large, well-financed private entities and it has not historically had any meaningful customer credit issues and does not presently maintain any reserve for doubtful accounts. Tutor-Saliba s government customers generally require contractors bidding on major projects to pre-qualify based on financial strength, experience and other factors, and it has been able to consistently pre-qualify and win repeat contracts with Caltrans and other state agencies and educational institutions when it has been the

low bidder. For private sector work, Tutor-Saliba maintains strong relationships with clients who appreciate Tutor-Saliba s ability to deliver projects. Tutor-Saliba continuously evaluates new opportunities with customers that have major building needs and selects the best opportunity to replace its large existing projects as they are completed in order to replenish its backlog and continue expanding.

In certain of its projects, particularly in its domestic civil segment, Tutor-Saliba enters into joint venture arrangements with other contractors. Since 1977, Tutor-Saliba has been involved in 35 joint ventures with Perini with aggregate project values over $3 billion. Each of the joint venture participants is usually committed to supply a predetermined percentage of capital and bonding capacity, as required, and to share in a predetermined percentage of the income or loss of the project. Depending on geographic location, one of the venture partners generally takes operating control of the project, with the other partners primarily providing financial support. Tutor-Saliba typically has management responsibility for joint ventures located in the western United States, while other partners have had operational control of joint ventures in the eastern United States. Historically, Tutor-Saliba accounted for joint ventures using the equity method of accounting. In 2007, Tutor-Saliba changed its method of reporting its interests in joint ventures to the proportionate consolidation method, with its financial statements reflecting its proportionate interest in the assets, liabilities and results of operations of each venture. Ordinarily, joint ventures are structured as general partnerships, and each participant is fully liable for the obligations of the joint venture. Tutor-Saliba will continue to seek out attractive joint venture opportunities in its existing markets and throughout the United States.

Tutor-Saliba elected to be taxed as a subchapter S corporation effective January 1, 1996. The provision for taxes reflected in Tutor-Saliba s historical financial statements in this proxy statement relates primarily to its subsidiary, Black Construction Corporation, which conducts Tutor-Saliba s international segment operations and is not subject to Tutor-Saliba s subchapter S corporation election. Tutor-Saliba will cease to be a subchapter S corporation upon the completion of the merger.

Recent Developments and Expected 2008 Events

Acquisitions

In late 2007 and early 2008, Tutor-Saliba completed two acquisitions of subcontractors and the acquisition of certain assets to establish an aggregates production operation. It intends to continue to consider acquisition opportunities that expand its ability to self-perform construction specialties and to expand its geographic reach in the United States. When Tutor-Saliba acquires subcontractors, it expects that they will generally continue to subcontract for jobs on projects other than Tutor-Saliba s projects as an additional source of revenue.

Desert Plumbing & Heating Co., Inc. On January 4, 2008, Tutor-Saliba completed the stock purchase of Desert Plumbing & Heating Co., Inc. (DPH), located in Las Vegas, Nevada, for $35 million in cash. In addition to this cash consideration, Tutor-Saliba has also agreed to pay the former owner of DPH a percentage of DPH s earnings over the next three years, up to a maximum of $4 million annually. Upon the completion of the merger, this amount will become fixed at $12 million in the aggregate and will no longer be contingent upon DPH s earnings and will be payable in annual installments of $4 million in each of 2008, 2009 and 2010 (assuming completion of the merger in 2008). Tutor-Saliba has the right to pay this $12 million amount in cash or stock. Based on preliminary purchase accounting estimates, at December 31, 2007, DPH had $24.7 million in liabilities, making the total value of the transaction $59.7 million (before the contingent payment), resulting in intangible assets (including goodwill) of $27.5 million (plus $12 million for the contingent payment on a pro forma basis) and additional tangible assets of $32.2 million, subject to final completion of purchase accounting adjustments.

Powerco Electric Corp. On September 12, 2007, Tutor-Saliba completed the stock purchase of Powerco Electric Corp., an electrical subcontractor, for $3.3 million in cash. The acquisition was effective as of September 30, 2007 and included the assumption of $25.7 million in Powerco s liabilities for a total consideration of $29 million, which included intangibles (including goodwill) of $7 million and tangible assets of

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$22 million. Substantially all of Powerco s work prior to acquisition was as a subcontractor for Tutor-Saliba, and most of Powerco s contracts with Tutor-Saliba were not profitable to Powerco. Tutor-Saliba had previously advanced working capital funds to Powerco starting in May 2005 to help mitigate its cash flow difficulties on several of its subcontracts on Tutor-Saliba s projects. At the effective date of the acquisition, the sum of these advances had reached $17.8 million. These liabilities and Tutor-Saliba s related receivable were eliminated on consolidation.

North Valley Commerce Center, Building G. On October 30, 2007, Tutor-Saliba entered into an agreement to purchase the North Valley Commerce Center, Building G, in Sylmar, California for $6.5 million in cash. The property will include an office and warehouse facility, which are currently under construction. As of January 25, 2008, Tutor-Saliba had made initial deposits for the property totaling $0.3 million into an escrow account. The purchase is expected to close upon substantial completion of the office and warehouse facility.

Aggregates Business. On March 7, 2008, Tutor-Saliba entered into an agreement for the transfer and purchase of certain mineral material mining contracts, equipment, and material stockpiles used to operate All Star Aggregate, Inc. s existing business in Sloan Pit, which is located in Clark County, Nevada, for a purchase price of $5.2 million in cash. In connection with that transaction, on March 12, 2008, Tutor-Saliba entered into a ten-year renewable contract with the Bureau of Land Management (BLM) for the extraction of 19.5 million tons of limestone aggregate on land located at Mount Diablo Meridian, Nevada. Pursuant to Tutor-Saliba s September 12, 2007 bid of $0.90 per ton and a $0.01 per ton administrative fee, the contract price totals approximately $17.7 million and requires a 5% deposit of $0.9 million prior to beginning extraction. The balance of the contract price will be paid monthly over the contract term based upon the value of materials removed in the prior month. In addition, Tutor-Saliba is obligated under a separate agreement to pay a third-party finders fee related to the transaction in the amount of $0.3 million.

Amended and Restated Credit Agreement

On September 17, 2007, Tutor-Saliba entered into a new Senior Secured Revolving Credit Facility with Comerica Bank, as administrative agent, and two participant lenders. Subsequently, on May 12, 2008, Tutor-Saliba executed the First Amendment to Revolving Credit Agreement. For a description of Tutor-Saliba s new agreement, please see Liquidity and Capital Resources Cash and Working Capital beginning on page 101. Tutor-Saliba expects to enter into an amendment to this credit agreement, or enter into a new credit agreement, in connection with the merger.

Subchapter S Dividends; Termination of Subchapter S Status

In January and April of 2008, Tutor-Saliba distributed $27.9 million and approximately $11.6 million, respectively, to its shareholders to facilitate their payment of income taxes attributed to them as a result of Tutor-Saliba s status as a subchapter S corporation. In connection with the consummation of the merger, Tutor-Saliba will distribute an estimated $120 million in cash or notes to its shareholders, as its final subchapter S distribution. This amount represents a return of invested capital (with respect to certain shareholders), earnings and profits from years prior to Tutor-Saliba s S election and amounts of its net income that have been or will be subject to taxes to its shareholders in respect of periods prior to December 31, 2007, less distributions previously made to its shareholders with respect to such net income. Tutor-Saliba will cease to be a subchapter S corporation upon the consummation of the merger.

Distribution of Commercial Real Estate; Distribution of Residential Real Estate

Effective January 1, 2008, Tutor-Saliba transferred its interest in its commercial real estate segment, comprised of an interest in an office building, of which one of its subsidiaries was the majority owner, in exchange for the 2% beneficial interest in Black Construction Company that it did not already own. The property was transferred to the minority interest holder, which is owned by Mr. Tutor. The net book value of the property and equipment transferred was $26.8 million at December 31, 2007 and the minimum future rental income as of

December 31, 2007 was $18.3 million. The transferee is assuming mortgage debt of $24.4 million. As a result of this transaction, the assets, liabilities and operating results associated with this business will be reflected in Tutor-Saliba s consolidated financial statements as discontinued operations. Prior to completion of the merger, Tutor-Saliba will also distribute to its shareholders a residential property in Ketchum, Idaho for its fair market value of approximately $3.5 million.

2008 Compensation Charge for 2007 Sale of Stock

In October, 2007, a trust controlled by Mr. Tutor sold an aggregate of 34,500 shares of Tutor-Saliba common stock, representing 3.8% of Tutor-Saliba s outstanding common equity, to certain Tutor-Saliba executives for an aggregate purchase price of $9.6 million, paid in the form of recourse notes payable by such executives. There are buy-sell agreements between the executives and the trust that allow the trust to repurchase the shares at cost or such other price as the trust may determine, and these provisions will lapse upon completion of the merger with Perini. This lapse will result in a non-cash compensation charge to Tutor-Saliba s 2008 earnings in the quarter in which the merger is completed. The determination of such a charge and its amount, which could be significant, will be calculated in accordance with Statement of Financial Accounting Standards No. 123R, *Share-Based Payments* .

Backlog Analysis for 2005, 2006 and 2007

Tutor-Saliba includes a project in its backlog when the contract has been signed and financing is in place. Tutor-Saliba reduces backlog as revenue is recognized in accordance with its application of percentage-of-completion accounting. In Tutor-Saliba s domestic operations, it received significant new contract awards in 2006 for the $1.3 billion Las Vegas Wynn Encore and the $488 million Las Vegas Planet Hollywood Tower, scheduled for completion in 2009. These projects increased Tutor-Saliba s year-end backlog to a record of $2.3 billion at December 31, 2006, up from $508.7 million at December 31, 2005. These large projects required Tutor-Saliba to establish a permanent office in Las Vegas and otherwise expand to provide the necessary administrative and logistical support necessary to meet its contractual obligations and production schedules. These projects were in full production during all of 2007 and should be substantially completed by the end of 2008 (even though the Las Vegas projects are not scheduled for final completion until 2009). Tutor-Saliba continues to seek additional major projects in 2008 to build up its backlog for work in 2008 and beyond. In Tutor-Saliba s international operations, it was awarded three major projects in 2007 totaling $106.4 million (Home Depot Guam, Old Apra Housing and USN Global Hawk Aircraft Maintenance Facility), with all of these projects having started construction in 2007 and continuing into 2008 and beyond. In Tutor-Saliba s civil operations, its largest new project is the $241 million Los Angeles International Airport Runway and Taxiway Improvements project, awarded in late 2005.

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The following tables provide a summary of Tutor-Saliba s backlog by segment for the years ended December 31, 2005, 2006 and 2007, and for the three months ended March 31, 2008. Tutor-Saliba expects that 95% of its March 31, 2008 backlog will be recognized as revenue within the next 18 months.

	Backlog at December 31, 2007	New Business Awarded (1)	Revenue Recognized	Backlog at March 31, 2008
		(in thousands)		
Domestic Building	$ 1,396,493	$ 88,377	$ 341,470	$ 1,143,400
Domestic Civil	95,429	24,935	34,196	86,168
Total Domestic	1,491,922	113,312	375,666	1,229,568
International	99,600	125	19,297	80,428
Total	$ 1,591,522	$ 113,437	$ 394,963	$ 1,309,996

	Backlog at December 31, 2006	New Business Awarded (1)	Revenue Recognized	Backlog at December 31, 2007
		(in thousands)		
Domestic Building	$ 2,034,037	$ 258,580	$ 896,124	$ 1,396,493
Domestic Civil	212,933	56,773	174,277	95,429
Total Domestic	2,246,970	315,353	1,070,401	1,491,922
International	35,348	145,675	81,423	99,600
Total	$ 2,282,318	$ 461,028	$ 1,151,824	$ 1,591,522

	Backlog at December 31, 2005	New Business Awarded (1)	Revenue Recognized	Backlog at December 31, 2006
		(in thousands)		
Domestic Building	$ 210,411	$ 2,144,029	$ 320,403	$ 2,034,037
Domestic Civil	278,560	76,248	141,875	212,933
Total Domestic	488,971	2,220,277	462,278	2,246,970
International	19,713	67,814	52,179	35,348
Total	$ 508,684	$ 2,288,091	$ 514,457	$ 2,282,318

	Backlog at January 1, 2005	New Business Awarded (1)	Revenue Recognized	Backlog at December 31, 2005
		(in thousands)		
Domestic Building	$ 363,314	$ 76,002	$ 228,905	$ 210,411
Domestic Civil	108,954	286,652	117,046	278,560
Total Domestic	472,268	362,654	345,951	488,971
International	27,963	33,389	41,639	19,713

Total	$ 500,231	$ 396,043	$ 387,590	$ 508,684

(1) New business awarded consists of the original contract price of projects added to Tutor-Saliba s backlog plus or minus subsequent changes to the estimated total contract price of existing contracts and the balance of existing contracts obtained through acquisitions.

Critical Accounting Policies

Tutor-Saliba s financial statements have been prepared in conformity with GAAP, which requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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Although Tutor-Saliba s significant accounting policies are described in Note 1, Significant Accounting Policies, of the Notes to Tutor-Saliba s Consolidated Financial Statements attached as *Annex H* to this proxy statement, the following discussion is intended to describe those accounting policies most critical to the preparation of its consolidated financial statements.

Method of Accounting for Contracts. Revenues and profits from Tutor-Saliba s contracts and construction joint venture contracts are recognized by applying percentages of completion for the period to the total estimated profits for the respective contracts. Percentage-of-completion is determined by relating the actual cost of the work performed to date to the current estimated total cost of the respective contracts. When the estimate on a contract indicates a loss, the entire loss is recorded during the accounting period in which it is estimated. In the ordinary course of business, at a minimum on a quarterly basis, Tutor-Saliba prepares updated estimates of the total forecasted revenue, cost and profit or loss for each contract. The cumulative effect of revisions in estimates of the total forecasted revenue and costs, including unapproved change orders and claims, during the course of the work is reflected in the accounting period in which the facts that caused the revision become known. The financial impact of these revisions to any one contract is a function of both the amount of the revision and the percentage-of-completion of the contract. An amount equal to the costs incurred that are attributable to unapproved change orders and claims is included in the total estimated revenue when realization is probable. Profit from unapproved change orders and claims is recorded in the accounting period such amounts are resolved.

Tutor-Saliba s balance sheet account Deferred Contract Revenue represents the excess of billings to date over the amount of contract costs and profits (or contract revenue) recognized to date on the percentage-of-completion accounting method. Another balance sheet account entitled Unbilled Work represents the excess of contract costs and profits (or contract revenue) recognized to date on the percentage-of-completion accounting method over billings to date. Unbilled Work results when (1) the appropriate contract revenue amount has been recognized in accordance with the percentage-of-completion accounting method, but a portion of the revenue recorded cannot be billed currently due to the billing terms defined in the contract and/or (2) costs, recorded at estimated realizable value upon determination that they are probable of collection, related to unapproved change orders or claims are incurred. For unapproved change orders or claims that cannot be resolved in accordance with the normal change order process as defined in the contract, Tutor-Saliba may employ other dispute resolution methods, including mediation, binding and non-binding arbitration, or litigation.

Use of Estimates. Among the many estimates, judgments and assumptions that management makes in preparing its financial statements in conformity with GAAP, there are none more critical than those made in the accounting for Tutor-Saliba s contracts. The key to establishing profitable contracts lies in management s ability to estimate expected costs and revenues on a contract by contract basis. Once contracts are in place, Tutor-Saliba accounts for them by using the percentage-of-completion method. Due to the long-term nature of Tutor-Saliba s contracts, cost and revenue estimates are updated each reporting period. The updated estimates relate to the projecting of total forecasted construction contract revenues, costs and profits in accordance with accounting for long-term contracts, and the recognition of potential liabilities in conjunction with certain contingencies, including the outcome of pending or future litigation, arbitration or other dispute resolution proceedings relating to contract claims. Actual results could differ from these estimates, and such differences could be material.

Tutor-Saliba believes, based on its experience, that its current systems of management and accounting controls allow management to produce materially reliable estimates of total contract revenue and cost during any accounting period. However, many factors can and do change during a contract performance period which can result in a change to contract profitability from one financial reporting period to another. Some of the factors that can change the estimate of total contract revenue and cost include differing site conditions (to the extent that contract remedies are unavailable), the availability of skilled contract labor, the ability of major material suppliers to deliver on time, the performance of major subcontractors, unusual weather conditions and the accuracy of the original bid estimate. Because Tutor-Saliba has multiple contracts in process at any given time, these changes in estimates can offset each other without impacting overall profitability. However, large changes

in cost estimates on larger, more complex construction projects can have a material impact on Tutor-Saliba s financial statements and are reflected in its results of operations when they become known. This impact could include reversal of profits recorded in prior periods.

When recording revenue on contracts relating to unapproved change orders and claims, Tutor-Saliba includes in revenue an amount equal to the amount of costs incurred to date for contract price adjustments that Tutor-Saliba sought to collect from customers for delays, errors in specifications or designs, change orders in dispute or unapproved as to scope or price, or other unanticipated additional costs, in each case when recovery of the costs is considered probable. When determining the likelihood of eventual recovery, Tutor-Saliba considers such factors as evaluation of entitlement, settlements reached to date and Tutor-Saliba s experience with the customer. The settlement of these issues often takes years depending upon whether the item can be resolved directly with the customer or involves litigation or arbitration. When new facts become known, an adjustment to the estimated recovery is made and reflected in the current period results.

The amount of unapproved change order and claim revenue is included in Tutor-Saliba s balance sheet as part of Unbilled Work. The amount of Unbilled Work relating to unapproved change orders and claims included in Tutor-Saliba s balance sheet at March 31, 2008 and December 31, 2007 is summarized below:

Unbilled Work at December 31, 2007 and March 31, 2008

	December 31, 2007	March 31, 2008
	(in thousands)	
Unbilled Costs and Profits	$ 3,545	$ 6,849
Unapproved Change Orders	14,123	13,855
Claims	11,351	11,682
Total	$ 29,019	$ 32,386

Of the balance of unapproved change orders and claims included in Unbilled Work at March 31, 2008, approximately half belong to Tutor-Saliba s recently purchased, wholly owned subsidiary, Powerco Electric Corp., which was acquired in September 2007. These amounts are management s estimate of the probable recovery from the disputed claims considering the factors noted above evaluation of entitlement, settlements reached to date and Tutor-Saliba s experience with the customer. In the event that future facts and circumstances, including the resolution of disputed claims, cause a reduction in the aggregate amount of Tutor-Saliba s estimated probable recovery from the disputed claims, the amount of such reduction against future earnings will be recorded in the relevant period.

Purchase Price Allocation. In accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations,* the purchase price of acquired properties is allocated to tangible and identified intangible assets and liabilities based on their respective fair values.

Tutor-Saliba s Powerco and Desert Plumbing acquisitions were stock purchases in which the price paid exceeded the value of the net tangible balance sheet assets purchased. The total price paid consisted of Tutor-Saliba s cash outlay and the assumption of the acquired balance sheet liabilities and, in the case of Desert Plumbing, contingent payments of $4 million for each of three years upon satisfaction of specific performance targets, or upon completion of the merger.

Tutor-Saliba works with an independent valuation firm in identifying and evaluating the intangible assets associated with its acquisitions. Any intangible asset that cannot be assigned a value within the framework of SFAS No. 141, is considered goodwill. The subsequent amortization of intangible assets, including the impairment testing of goodwill, is done in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets.*

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Accounting for Income Taxes. Tutor-Saliba accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes,* which requires the use of an asset and liability method of accounting for income taxes. Deferred income taxes are provided to reflect the tax effect of differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Tutor-Saliba elected to be treated as a subchapter S corporation effective January 1, 1996. As a result, taxable income, loss and credits flow directly to the shareholders and tax related assets and liabilities of Tutor-Saliba become the obligation of the shareholders of the subchapter S corporation and are no longer reflected in the financial statements. The deferred tax assets, liabilities and provision reflected in the financial statements are those that do not flow through to the shareholders, as they relate to taxable subsidiaries. The subchapter S corporation status will terminate on the effective date of the merger. As a result of that termination, taxable income, loss, credits and related deferred taxes will be reflected in the financial statements for periods reported after the completion of the merger.

Information relating to Tutor-Saliba s provision for income taxes and the status of its deferred tax assets and liabilities is presented in Note 6, Income Taxes of Notes to Tutor-Saliba s 2007 Consolidated Financial Statements attached as *Annex H* to this proxy statement.

Accounting for Joint Ventures. Prior to 2007, Tutor-Saliba s non-controlling interests in construction joint ventures were accounted for on an equity method in Tutor-Saliba s Consolidated Balance Sheets and Consolidated Statements of Cash Flow and on the proportionate consolidation method in the Consolidated Statements of Income. Beginning in 2007, construction joint venture interests are accounted for using the proportionate consolidation method in the Consolidated Balance Sheets as well as the Consolidated Statements of Income whereby Tutor-Saliba s proportionate share of each joint venture s assets, liabilities, revenues and cost of operations are included in the appropriate classifications in the consolidated financial statements. Tutor-Saliba believes the change, which results in presenting all joint venture activity using a consistent methodology in both Consolidated Balance Sheets and Consolidated Statements of Income, is preferable.

The change had no impact on the Consolidated Statements of Income for any period presented. Although the change impacted various classifications within the Consolidated Balance Sheets and Consolidated Statements of Income, there was no impact to Shareholders Equity. Prior years Consolidated Balance Sheets and Consolidated Statements of Cash flows have been changed to conform to the 2007 presentation.

Results of Operations Three Months Ended March 31, 2008 Compared to Three Months Ended March 31, 2007

	Revenues For The Three Months Ended March 31,		Change	
	2007	2008	$	%
	(in thousands)			
Domestic Building	$ 160,346	$ 341,470	$ 181,124	113.0%
Domestic Civil	56,135	34,196	(21,939)	(39.1)%
International	15,579	19,297	3,718	23.9%
Total Revenues	$ 232,060	$ 394,963	$ 162,903	70.2%

Revenues. For the three months ended March 31, 2008, total revenues were $395 million, compared to $232 million in the three months ended March 31, 2007, an increase of 70.2%. The revenue increase was driven by Tutor-Saliba s domestic building segment, which primarily benefited from the two major projects (Wynn Encore and Planet Hollywood Tower in Las Vegas) that were awarded in 2006 and which were in process throughout the 2007 period and performing at peak production levels during the first quarter of 2008, in addition to $29.6 million in revenues provided by Desert Plumbing & Heating and Powerco Electric, both of which Tutor-Saliba acquired since the first quarter of 2007. Domestic building revenues were $341 million in the 2008 period compared to $160 million in the 2007 period. Domestic civil revenues were $34 million in the 2008 period compared to $56 million in the 2007 period. Domestic civil segment revenues decreased during the period

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primarily due to the work on the Los Angeles International Airport Runway and Taxiway Improvements project, which started construction in late 2005 and was in the later stages of completion during 2008. International revenues increased to $19.3 million (or 24%) in the first three months of 2008 from $15.6 million in the first three months of 2007 primarily as a result of the performance of the British Embassy project in the Philippines that was awarded in 2007 and is scheduled to be completed in the first half of 2008.

Gross Profit. Overall gross profit increased to $34.6 million in the three months ended March 31, 2008 from $20.7 million in the prior year, with gross margin decreasing slightly to 8.8% for the 2008 three-month period from 8.9% in the prior year. Gross margin declined due primarily to a larger proportion of the revenues in the first three months of 2008 being from the domestic building segment, which has a lower overall gross margin as compared to the domestic civil segment. The domestic civil segment had a decline in revenues in the first three months of 2008 as compared to 2007.

Depreciation and Amortization Expense. Depreciation and amortization expense increased to $2.9 million in the three months ended March 31, 2008 from $1.1 million in the prior year period. This increase is primarily in the domestic segments and results from a full period of depreciation from assets acquired in 2007, which were necessary to support Tutor-Saliba s increased volume of work, and the amortization of $1.2 million of intangible assets recorded in connection with the purchase accounting for the Powerco Electric and Desert Plumbing & Heating acquisitions.

General and Administrative Expense. Tutor-Saliba s general and administrative expenses increased to $13.6 million (3.4% of revenue) in the three months ended March 31, 2008 from $7.8 million (3.3% of revenue) in the three months ended March 31, 2007. Nonetheless, Tutor-Saliba s general and administrative expenses increased at a lower rate than revenue indicating that it was able to leverage its corporate overhead over a much larger revenue base. The 2008 increase included an increase in costs in legal, accounting and other professional services in the amount of $1.8 million, primarily related to the work performed in preparation for the merger and other potential strategic transactions.

The most significant costs in Tutor-Saliba s G&A expenses are employment-related.

In addition to a $1.1 million increase in salaries and other related benefit costs paid in 2008 driven by the increase in number of personnel necessary to support Tutor-Saliba s expanding operations and increases in salaries and bonuses necessary to reward and retain existing personnel, there was a compensation charge incurred in the amount of $1.1 million as a result of distributions made to certain shareholder executives being recorded as compensation pursuant to the provisions of Statement of Financial Accounting Standards No. 123R, Share-Based Payments.

The revenue and expense trends discussed above resulted in the following trends in income from operations performance.

	Income From Operations For The Three Months Ended March 31,		Change	
	2007	2008	$	%
	(in thousands)			
Domestic Building	$ 6,722	$ 21,644	$ 14,922	222.0%
Domestic Civil	6,308	6,560	252	4.0%
International	1,555	1,269	(286)	(18.4)%
Subtotal	$ 14,585	$ 29,473	$ 14,888	102.1%
Less: Corporate	(1,633)	(8,277)	(6,644)	406.9%
Total Income From Operations	$ 12,952	$ 21,196	$ 8,244	63.7%

Other Income. Total other income, net decreased to $0.5 million in the three months ended March 31, 2008 from $11.1 million in the three months ended March 31, 2007, primarily as a result of a gain on sale of marketable securities of $11.4 million being recognized in the 2007 period.

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Interest and Other Income. Interest and other income increased to $1.4 million in the first three months of 2008 from $0.8 million in the first three months of 2007 as a result of higher cash balances made possible by the sale of marketable securities, which increased available balances for investment in the 2008 period. The increase in available investment balances more than offset lower interest yields during the period.

Interest Expense. Interest expense decreased to $0.8 million in the first three months of 2008 from $1.0 million in the first three months of 2007 as Tutor-Saliba used a portion of its excess cash to reduce debt, including paying off a $10 million term loan prior to entering into a new credit agreement. Interest expense also benefited from lower rates in the 2008 period as compared to the same period in 2007.

Income Taxes. Tutor-Saliba s provision for income taxes decreased to $0.6 million in the three months ended March 31, 2008 from $0.8 million in the three months ended March 31, 2007 due to a decrease in taxable income in 2008, primarily in Tutor-Saliba s foreign subsidiaries. Although Tutor-Saliba Corporation is a subchapter S corporation that passes most of its taxes through to its shareholders, a decrease in subsidiary income in Guam, taxed at 35%, resulted in the majority of the tax provision decrease. Tutor-Saliba will cease to be a subchapter S corporation upon the consummation of the merger, which it expects will have the impact described in the pro forma financial statements included elsewhere in this proxy statement.

Income from Continuing Operations. Tutor-Saliba s improved operating performance in the three months ended March 31, 2008 partially offset the $11.4 million net gain recognized on the sale of marketable securities in the same period in 2007, resulting in income from continuing operations of $21.1 million for the period in 2008, as compared to $23.3 million for the same period in 2007.

Results of Operations Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Unless stated otherwise, all references to 2007, 2006, and 2005 refer to our fiscal years ended, or the dates as of December 31, 2007, December 31, 2006, and December 31, 2005.

	Revenues For The Year Ended December 31,		Change	
	2006	2007	$	%
	(in thousands)			
Domestic Building	$ 320,403	$ 896,124	$ 575,722	179.7%
Domestic Civil	141,875	174,277	32,402	22.8%
International	52,179	81,423	29,243	56.0%
Total Revenues	$ 514,457	$ 1,151,824	$ 637,367	123.9%

Revenues. For the year ended December 31, 2007, total revenues were $1.15 billion, compared to $514.5 million in the year ended December 31, 2006, an increase of 124%. The revenue increase was driven primarily by Tutor-Saliba s domestic building segment, which had revenue of $896.1 million in 2007, as compared to $320.4 million in 2006. The increase was primarily due to two major Las Vegas projects, the Wynn Encore ($581.2 million) and the Planet Hollywood Tower ($112.9 million), that Tutor-Saliba was awarded in 2006 and which were in progress throughout 2007. In 2006, only the Wynn Encore had significant activity and produced revenue in the last six months of 2006 totaling $120.2 million.

Domestic civil revenues were $174.3 million in 2007 compared to $141.9 million in 2006. The increase was primarily due to the full-period work on the Los Angeles International Airport runway project performed at full capacity, which generated $90.6 million of revenue in 2007, as compared to $64.7 in 2006. This project started construction in late 2005 and only produced significant revenue in the second half of 2006. This 2007 increase more than offset the impact of projects that were completed, or were in the later stages of completion, during 2006 and 2007.

International revenues increased to $81.4 million in 2007 from $52.2 million in 2006 primarily as a result of two projects, the Alpha Bravo Wharf Improvements project which was awarded in 2006 and which produced a

full-period of work in 2007, and the Home Depot project which was awarded in early 2007 and produced revenues of $22.2 million during the fiscal year.

Gross Profit. Total gross profit increased to $88.2 million in 2007 from $29 million in 2006, with gross margin improving to 7.7% for 2007 from 5.6% the prior year. Gross margin improved due primarily to the higher margins obtained on the new contracts acquired in 2006 in both the domestic and international segments, the increased revenues in the higher margin domestic civil segment and the larger proportion of domestic building segment revenues in 2007 from higher margin projects than Tutor-Saliba s 2006 project mix.

Depreciation and Amortization Expense. Depreciation and amortization expense increased to $6.1 million in 2007 from $3.7 million in 2006. This increase is primarily in the domestic segments and results from a full period of depreciation from assets acquired in 2006 and the additional depreciation from additional assets acquired in 2007, all of which were necessary to support Tutor-Saliba s increased volume of work, and the amortization of $1.2 million of intangible assets recorded in the purchase accounting for the acquisition of Powerco Electric.

General and Administrative Expense. Tutor-Saliba s general and administrative expenses increased to $36.2 million (3.1% of revenue) in 2007 from $26.8 million (5.2% of revenue) in 2006. Tutor-Saliba s general and administrative expenses increased at a lower rate than revenue as it was able to leverage its corporate overhead over a much larger revenue base. The 2007 increase included the cost of expanding Tutor-Saliba s Las Vegas office to add support for its expanding operations in that city, increased costs incurred in accounting, legal and other professional services in preparation for a contemplated capital markets transaction and the negative impact of fuel costs during the period. The 2006 period was significantly impacted by the cost of starting up Tutor-Saliba s Las Vegas operations and opening an office there. The most significant cost in Tutor-Saliba s general and administrative expenses are employment-related. In addition to a $1.1 million increase in bonuses paid in 2007, salaries and other related benefit costs increased by $2.8 million. These increases were driven by the increase in number of personnel necessary to support Tutor-Saliba s expanding operations and increases in salaries and bonuses necessary to reward and retain existing personnel.

The revenue and expense trends discussed above resulted in the following trends in operating income performance:

	Income From Operations For The Year Ended December 31,		Change	
	2006	2007	$	%
	(in thousands)			
Domestic Building	$ 4,840	$ 39,651	$ 34,811	719.2%
Domestic Civil	9,061	26,135	17,074	188.4%
International	4,796	7,832	3,036	63.3%
Subtotal	$ 18,697	$ 73,618	$ 54,921	293.7%
Less: Corporate	(16,043)	(21,189)	(5,146)	32.1%
Total Income From Operations	$ 2,654	$ 52,429	$ 49,775	1,875.5%

Other Income. Total other income, net increased to $95 million in 2007 from $6.2 million in 2006 as a result of a gain on sale of marketable securities of $94.1 million in 2007, generated from the sale of Tutor-Saliba s remaining 3 million shares of Perini common stock.

Interest and Other Income. Interest and other income increased to $6.1 million in 2007 from $3.4 million in 2006 as a result of higher cash balances made possible by the sale of marketable securities and the increased available balances for investment in 2007.

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Interest Expense. Interest expense decreased to $4.2 million in 2007 from $5.3 million in 2006 as a portion of excess cash was used to reduce debt, including paying off a $10 million term loan prior to entering into a new credit agreement.

Income Taxes. The provision for income taxes increased to $4.4 million in 2007 from $1.7 million in 2006 due to the increase in taxable income in 2007. Although Tutor-Saliba is a subchapter S corporation that passes most of its taxes through to its shareholders, increases in subsidiary income in Guam, taxed as a C corporation at 35%, resulted in the tax provision increase. Tutor-Saliba will cease to be a subchapter S corporation upon completion of the merger, which it expects will have the impact described in its pro forma financial statements included elsewhere in this proxy statement.

Income from Continuing Operations. Overall improved operating performance and gains recognized on the sale of Perini common stock resulted in income from continuing operations of $142.9 million for 2007, as compared to $7.2 million in 2006.

Results of Operations Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

	Revenues For The Year Ended December 31,		Change	
	2005	2006	$	%
	(in thousands)			
Domestic Building	$ 228,905	$ 320,403	$ 91,498	40.0%
Domestic Civil	117,046	141,875	24,829	21.2%
International	41,639	52,179	10,540	25.3%
Total Revenues	$ 387,590	$ 514,457	$ 126,867	32.7%

Revenues. Total revenues increased to $514.5 million in 2006 from $387.6 million in 2005. This increase was due mainly to an increase in domestic building construction revenues of $91.5 million (or 40.0%) to $320.4 million in 2006 from $228.9 million in 2005, reflecting the increased volume of work in the hospitality and gaming market where Tutor-Saliba commenced work on two major projects (Wynn Encore and Planet Hollywood Towers) in Las Vegas in 2006 as well as the start of construction on a major building project in Los Angeles (Los Angeles Police Headquarters). Revenues earned in 2006 from the Wynn Encore project totaled $120.2 million.

Civil construction revenues increased by $24.8 million (or 21.2%) to $141.9 million in 2006 from $117 million in 2005 due primarily to $64.7 million of revenue produced from a full year s production at the Los Angeles International Airport Runway and Taxiway Improvements project during 2006. The runway project more than offset the impact of projects that were completed, or were in the later stages of completion, during 2005 and 2006.

International revenues increased by $10.5 million to $52.2 million in 2006 from $41.6 million in 2005 as the island of Guam operations rebounded from a relatively down year in 2005 when several major projects either were completed, or were in the latter stages of completion. Operations benefited from revenue totaling $18 million from the start of the Alpha Bravo Wharf improvements project on the island of Guam as well as obtaining additional new work on the surrounding Micronesian Islands.

Gross Profit. Total gross profit increased to $29 million in 2006 from $16.3 million in 2005, with gross margin improving to 5.6% for 2006 from 4.2% in 2005 primarily due to higher margins on contracts entered into in 2006 in the domestic and international segments. Gross profit margin is a function of the mix of projects ongoing throughout each period. Typically, civil projects, which are usually performed for state and local governments and are typically obtained through competitive bidding, tend to produce higher gross profit margins than do building projects, which include both public and private customers, and are either competitively bid or are awarded under negotiated contract arrangements.

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Depreciation and Amortization Expense. Depreciation and amortization expense increased to $3.7 million in 2006 from $2.9 million in 2005. The increase reflects an expansion in Tutor-Saliba s equipment fleet necessary to support its increased workload from major contracts acquired in 2006, primarily the Wynn Encore and Planet Hollywood Towers in Las Vegas. In 2006 we purchased $22.1 million of property and equipment, compared to $6.7 million in 2005.

General and Administrative Expense. Tutor-Saliba s general and administrative expenses increased to $26.8 million (5.2% of revenue) in 2006 from $26.4 million (6.8% of revenue) in 2005. Tutor-Saliba s general and administrative expenses increased at a lower rate than revenue as it was able to leverage its corporate overhead over a much larger revenue base.

Litigation Settlement Expense. In 2005, Tutor-Saliba recorded a charge of $14.7 million in its domestic building segment to settle contract litigation relating to its completed project at the San Francisco International Airport. Tutor-Saliba had no litigation settlement related costs for this matter in 2006.

The revenue and expense trends discussed above resulted in the following trends in operating income performance.

	Income (Loss) From Operations For The Year Ended December 31,		Change	
	2005	2006	$	%
	(in thousands)			
Domestic Building	$ (14,838)	$ 4,840	$ 19,678	n.a.
Domestic Civil	5,894	9,061	3,167	53.7%
International	1,476	4,796	3,320	224.9%
Subtotal	$ (7,468)	$ 18,697	$ 26,165	n.a.
Less: Corporate	(9,756)	(16,043)	(6,287)	64.4%
Total Income (Loss) From Operations	$ (17,224)	$ 2,654	$ 19,878	n.a.

Other Income. Total other income, net decreased to $6.2 million in 2006 primarily due to the gain on sale of marketable securities of $8.9 million in 2006 being far less than the combined gains of $38.3 million on sale of marketable securities and derivatives relating to such marketable securities in 2005.

Interest and Other Income. Interest and other income increased to $3.4 million in 2006 from $2.7 million in 2005 as a result of increased amounts in retention escrow accounts and higher yields on funds invested.

Interest Expense. Interest expense increased to $5.3 million in 2006 from $3.4 million in 2005 as Tutor-Saliba increased borrowings, particularly in the second half of 2006 to support its increased working capital requirements associated with starting new large projects as discussed above, and the effect of higher interest rates during the period.

Income Taxes. Our provision for income taxes increased to $1.7 million in 2006 from $0.8 million in 2005. Although Tutor-Saliba Corporation is a subchapter S corporation that passes most of its taxes through to its shareholders, increases in subsidiary income in Guam, taxed as a C corporation at 35%, resulted in the tax provision increase.

Income from Continuing Operations. Income from continuing operations decreased to $7.2 million in the year ended December 31, 2006 from $19 million in the year ended December 31, 2005, as the decline in the other income more than offset the impact of Tutor-Saliba s improved operating performance.

Liquidity and Capital Resources

Cash and Working Capital

Cash and cash equivalents as reported in Tutor-Saliba s Consolidated Statements of Cash Flows consist of amounts held by Tutor-Saliba as well as its proportionate share of amounts held by construction joint ventures. Cash held by Tutor-Saliba is available for general corporate purposes while cash held by construction joint ventures is available only for joint venture-related uses. Cash held by construction joint ventures is distributed from time to time to Tutor-Saliba and to the other joint venture participants in accordance with their respective percentage interests after the joint venture partners determine that a cash distribution is prudent. Cash distributions received by Tutor-Saliba from construction joint ventures are then available for Tutor-Saliba s general corporate purposes. At March 31, 2008 and 2007, cash held by Tutor-Saliba and available for general corporate purposes was $110.3 million and $51.6 million, respectively, and Tutor-Saliba s proportionate share of cash held by joint ventures and available only for joint venture-related uses was $11.5 million and $23 million, respectively. In the first quarter of 2008, Tutor-Saliba used $35 million in cash to acquire Desert Plumbing & Heating and $27.9 million to pay a distribution to its shareholders in respect of 2007 income attributable to them as owners of a subchapter S corporation, offset in part by continuing strong cash flow from operations. Tutor-Saliba expects to use a substantial portion of its available cash balance to fund a final subchapter S distribution to Tutor-Saliba s shareholders prior to consummation of the merger.

Billing procedures in the construction industry generally are based on the specific billing terms of each contract. For example, billings may be based on various measures of performance, such as cubic yards excavated, architect s estimates of completion, costs incurred on cost-plus type contracts or weighted progress from a cost loaded construction time schedule. Billings are generally on a monthly basis and are reviewed and approved by the customer prior to submission. Therefore, once a bill is submitted, Tutor-Saliba is generally able to collect amounts owed to it in accordance with the payment terms of the contract. In addition, receivables of a contractor usually include retentions, or amounts that are held back until contracts are completed or until specified contract conditions or guarantees are met. Retentions are governed by contract provisions and are typically a fixed percentage (for example, 5% or 10%) of each billing. Tutor-Saliba generally follows the policy of paying its vendors and subcontractors on a particular project after it receives payment from its customer.

Tutor-Saliba s primary uses of cash have been for increases in working capital to fund new projects and investments in joint ventures, purchases of equipment and distributions to shareholders. When Tutor-Saliba commences a new project, it generally uses cash for approximately two months as it obtains materials and incurs payroll and other costs pending its first billing to and payment from the customer. In September 2007 and January 2008, Tutor-Saliba used cash resources to acquire two subcontractors (Powerco Electric Corp. and Desert Plumbing & Heating), in the amount of $3.3 million and $35 million, respectively. Tutor-Saliba s primary sources of cash have been from operations, particularly in periods where it is able to reduce working capital as existing projects move beyond their startup phase, borrowings, and the sale of marketable securities. A summary of cash flows for each of the three months ended March 31, 2008 and 2007 is set forth below:

	Three Months Ended March 31,	
	2007	2008
	Unaudited	
	(in millions)	
Cash flows from:		
Operating activities	$ (0.4)	$ 2.2
Investing activities	19.9	(51.3)
Financing activities	(5.5)	(33.4)
Net increase (decrease) in cash	$ 14.0	$ (82.5)
Cash at beginning of period	37.6	192.8
Cash at end of period	$ 51.6	$ 110.3

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In the first three months of 2008, Tutor-Saliba generated $2.2 million in cash flow in operating activities and used $51.3 million in cash flow from investing activities and $33.4 million in financing activities for a net decrease in its cash balance of $82.5 million. Tutor-Saliba s positive cash flow from operating activities primarily reflects net income less the increase in receivables of $39.7 million and the increase in other assets of $2 million, partially offset by depreciation and amortization expense of $2.9 million, a $21.2 million increase in payables resulting from costs incurred on its construction projects, and $1.7 million of unbilled work on other projects. Cash flow from investing activities primarily reflects a $12.8 million of cash used for purchases of property and equipment, $15.3 million of advances to related parties, and $31.8 million for acquisitions, partially offset by proceeds from the sale of property and equipment of $0.7 million and $8.0 million of cash becoming unrestricted during the period. Cash used in financing activities includes a $2.7 million net reduction in debt and $30.7 million in shareholder distributions.

In the first three months of 2007, Tutor-Saliba generated $19.9 million from investing activities while using $0.4 million for operating activities and funding $5.5 million in financing activities for a net increase in its cash balance of $14.0 million. Tutor-Saliba s use of cash in operating activities primarily reflects increases in accounts receivable and unbilled work of $42.6 million and $8 million, respectively, a deduction from net income for a gain on sale of marketable securities of $11.4 million, and an increase in other assets of $2.4 million, offset by an increase in accounts payable and other liabilities of $38.3 million, and an increase in deferred contract revenue of $1.6 million. Cash provided from investing activities was primarily from proceeds from sales of marketable securities of $23.8 million, partially offset by net purchases of property and equipment of $3.9 million. Cash flow from financing activities primarily reflects net proceeds from long-term debt of $2.4 million, offset by principal payments of long-term debt of $6.1 million and distributions to shareholders of $1.8 million.

A summary of cash flows for each of the years ended December 31, 2007, 2006 and 2005 is set forth below:

	Year Ended December 31,		
	2005	**2006**	**2007**
		(in millions)	
Cash flows from:			
Operating activities	$ 6.3	$ (28.8)	$ 115.2
Investing activities	35.2	0.6	104.4
Financing activities	(28.0)	10.0	(64.4)
Net increase (decrease) in cash	13.5	(18.2)	155.2
Cash at beginning of year	42.3	55.8	37.6
Cash at end of year	$ 55.8	$ 37.6	$ 192.8

During 2007, Tutor-Saliba generated $115.2 million from operating activities and $104.4 million from investing activities while using $64.4 million from financing activities, for an increase in its cash balance of $155.2 million. Cash provided by operating activities resulted primarily from net income being offset by the non-operating gain on sale of securities of $94.1 million and a $59 million increase in receivables due to new projects started during the year, offset in part by depreciation and amortization of $6.6 million, an increase in accounts payable of $111.2 million and a $4.1 million increase in deferred contract revenue. Cash provided by investing activities reflects proceeds from sales of marketable securities of $147.7 million and proceeds from the sale of property and equipment of $4.6 million, partially offset by purchases of property and equipment of $23.8 million and $24 million of cash being designated as restricted. The use of cash for financing activities primarily reflects principal payments of long-term debt of $21.1 million, paydown on credit line of $10 million, and distributions to shareholders totaling $51.8 million, partially offset by proceeds from long-term debt of $18.5 million.

During 2006, Tutor-Saliba generated $10 million in cash flow from financing activities and $0.6 million from investing activities, while using $28.8 million for operating activities for a net decrease in its cash balance

of $18.2 million. Cash flow from financing activities primarily reflects a $30 million increase in net borrowings offset in part by $20 million in shareholder distributions. Cash used in operating activities resulted primarily from net income being offset by the non-operating gain on sale of securities of $8.9 million and a $59.1 million increase in receivables due to new projects started during the year, offset in part by depreciation and amortization of $5.4 million, an increase in accounts payable of $9.4 million, and a $16 million increase in deferred contract revenue, and a $2.2 million decrease in unbilled work. The cash flow from investing activities reflects net purchases of property and equipment of $19.3 million and advances to related parties of $1.3 million, offset by proceeds from the sale of marketable securities of $21.2 million.

During 2005, Tutor-Saliba generated $35.2 million from investing activities and $6.3 million from operating activities and consumed $28 million in financing activities for a net increase its cash balance of $13.5 million. Cash flow from operating activities resulted primarily from net income being offset by the non-operating gains on the sale of securities, property and equipment, and derivatives of $21.4 million, $8.3 million, and $16.9 million, respectively, and an increase in other assets of $4.8 million partially offset by a decrease in receivables of $21.1 million, a decrease in unbilled work of $1.8 million, an increase in accounts payable and other liabilities of $4.8 million, an increase in deferred contract revenue of $5.2 million, and non-cash depreciation and amortization expense of $4.4 million. Cash flow from investing activities primarily reflects proceeds from sale of marketable securities in the amount of $29.3 million, and the net proceeds from the sale of equipment in the amount of $6.4 million. The cash flow used in financing activities comes from the net reduction of long-term debt of $13.2 million and shareholder distributions of $14.8 million.

Revolving Credit Agreement

On September 17, 2007, Tutor-Saliba entered into a Revolving Credit Agreement with Comerica Bank, as administrative agent, and two participant lenders (referred to in this proxy statement as the Credit Agreement). Subsequently, on May 12, 2008, Tutor-Saliba executed the First Amendment to Revolving Credit Agreement.

The Credit Agreement as amended provides for a secured revolving credit facility (the Revolving Facility) of up to $50 million with an $8 million sublimit for commercial and standby letters of credit and a term loan in the amount of $25 million. This represents an increased borrowing capacity from Tutor-Saliba s prior agreement, which provided for a revolving credit facility of $25 million, plus a term loan in the original amount of $10 million, all of which was outstanding at December 31, 2006. The $10 million term loan was paid in full on June 4, 2007.

Tutor-Saliba s interest rate alternatives include a prime-based rate, as well as Eurocurrency rate-based options. The Credit Agreement also supports letters of credit of up to $8 million, which reduces availability under the Revolving Facility on a dollar-for-dollar basis. The termination date of the Revolving Facility is August 31, 2009, and the $25 million term loan maturity date is May 1, 2011, with mandatory principal payments of $5 million on May 1, 2009 and $10 million on May 1, 2010 and 2011 .

The Credit Agreement as amended requires Tutor-Saliba to comply with certain financial and other covenants at the end of each fiscal quarter, including:

tangible net worth of at least $130 million as of March 31, 2008, increased to $150 million as of the first fiscal quarter ending September 30, 2008, and again increased to $185 million as of the fiscal quarter ending December 31, 2008 through maturity;

a minimum current ratio of at least 1.20:1.00;

minimum core operating profitability of at least $25 million for the two quarter period ending June 30, 2008; $100 million for the fiscal year ending December 31, 2008 and $150 million for the fiscal year-to-date period ending December 31, 2009 and thereafter; and

maintain, at all times, a minimum liquidity (cash and/or marketable securities) of $40 million.

The Credit Agreement also includes operational covenants customary for facilities of this type, including limitations on incurring additional indebtedness and liens, as well as restrictions on types of investments and the purchase and sale of assets outside of the normal course of business. Tutor-Saliba s obligations under the Credit Agreement are guaranteed by Mr. Tutor, and Tutor-Saliba s subsidiary, Black Construction, and are secured by substantially all of Tutor-Saliba s assets. Tutor-Saliba expects to substantially amend or replace its credit facility prior to completion of the merger. Pursuant to the terms of the Merger Agreement, Perini has agreed to use its commercially reasonable efforts to remove or release Mr. Tutor and his affiliates as obligors, guarantors or sureties of any obligations of Tutor-Saliba or its subsidiaries under certain contacts, including the Credit Agreement, and any similar obligation incurred from and after the date of the Merger Agreement.

Off-Balance Sheet Arrangements

Tutor-Saliba does not have any financial partnerships with unconsolidated entities, such as entities often referred to as structured finance, special purpose entities or variable interest entities which are often established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Accordingly, Tutor-Saliba is not exposed to any financing, liquidity, market or credit risk that could arise if Tutor-Saliba had such relationships.

Long-Term Debt

Total debt at March 31, 2008, including current maturities, was $38.7 million, a decrease of $35.1 million from March 31, 2007, due primarily to distribution of the debt associated with a commercial office building that was distributed to an affiliate of Mr. Tutor in the amount of $24.4 million, and pay off of the term loan and the outstanding line of credit under Tutor-Saliba s prior credit agreement of $6 million and $10 million, respectively. These pay offs were offset by the financing of additional purchases of more equipment to meet the demands of increased project work.

Contractual Obligations

Tutor-Saliba s outstanding contractual obligations as of March 31, 2008 are summarized in the following table:

	Total	Less Than 1 Year	1 3 years	3 5 years	>5 Years
		(in thousands)			
Long-term debt (1)	$ 46,981	$ 14,629	$ 22,814	$ 9,538	$
Capital leases	1,547	615	853	79	
Operating leases (2)	43,985	5,754	10,838	10,833	16,560
Other long-term liabilities (3)	7,008	2,628	4,380		
Total contractual obligations	$ 99,521	$ 23,626	$ 38,885	$ 20,450	$ 16,560

(1) Includes estimated interest payments, which are based on our projected interest rates and estimated principal amounts outstanding for the period presented.
(2) Operating leases primarily consist of a corporate aircraft and our corporate office space in Sylmar, California
(3) Consists of payments related to legal settlement with the City and County of San Francisco (see footnote 13)

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Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 increases the relevancy and comparability of financial reporting by clarifying the way companies account for uncertainty in measuring income taxes. FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. FIN 48 only allows a favorable tax position to be included in the calculation of tax liabilities and expenses if a company concludes that it is more likely than not that its adopted tax position will prevail if challenged by tax authorities. FIN 48 also provides guidance on the accounting for and recording of interest and penalties on uncertain tax positions. Tutor-Saliba adopted FIN 48 on January 1, 2007, and the adoption of FIN 48 did not have a material impact on Tutor-Saliba s financial condition and results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), which clarifies the definition of fair value, describes methods used to appropriately measure fair value, and expands fair value disclosure requirements. SFAS No. 157 applies under other accounting pronouncements that currently require or permit fair value measurements. SFAS No. 157 is effective as of the beginning of the first fiscal year after November 15, 2007. In February 2008, the FASB issued FASB Staff Position (FSP) No. FAS 157-1 and FSP No. FAS 157-2, affecting implementation of FASB Statement No. 157. FSP No. FAS 157-1 excludes FASB Statement No. 13, *Accounting for Leases*, and other accounting pronouncements that address fair value measurements under FASB Statement No. 13, from the scope of FASB Statement No. 157. FSP No. FAS 157-2 delays the effective date of FASB Statement No. 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value on a recurring basis, to fiscal years beginning after November 15, 2008. The adoption of FASB Statement No. 157 did not have a material impact on Tutor-Saliba s financial condition and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of the guidance is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective as of the beginning of the first fiscal year after November 15, 2007. The adoption of SFAS No. 159 did not have a material impact on Tutor-Saliba s financial condition and results of operations.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141(R)). SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. Tutor-Saliba will apply the provisions of SFAS No. 141(R) prospectively as of that date.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements-an amendment of Accounting Research Bulletin No. 51* (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. Tutor-Saliba is currently evaluating the potential impact, if any, of the adoption of SFAS No. 160 on Tutor-Saliba s financial condition and results of operations.

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Selected Financial Information

The selected financial data set forth below is derived in part from and should be read in conjunction with Tutor-Saliba s consolidated financial statements, the related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this proxy statement. The consolidated statement of income data for each of the years ended December 31, 2005, 2006 and 2007 and the consolidated balance sheet data as of December 31, 2006 and 2007 were derived from Tutor-Saliba s audited consolidated financial statements appearing elsewhere in this proxy statement. The consolidated statement of income data for the three-month periods ended March 31, 2007 and 2008 and the consolidated balance sheet data as of March 31, 2007 and 2008 were derived from Tutor-Saliba s unaudited consolidated financial statements appearing elsewhere in this proxy statement. This information is unaudited but, in management s opinion, has been prepared on the same basis as the audited consolidated financial statements and related notes included elsewhere in this proxy statement and includes all adjustments, consisting only of normal recurring adjustments, that Tutor-Saliba s management considers necessary for a fair presentation of the information for the periods presented. Historical results are not necessarily indicative of results to be expected for future periods.

	Three Months Ended March 31,		Year Ended December 31,				
	2008	2007	2007	2006	2005	2004	2003
			(in thousands, except share data)				
Consolidated statement of income data:							
Revenues:							
Domestic civil	$ 34,196	$ 56,135	$ 174,277	$ 141,875	$ 117,046	$ 194,082	$ 208,543
Domestic building	341,470	160,346	896,124	320,403	228,905	250,836	204,275
International	19,297	15,579	81,423	52,179	41,639	71,118	66,126
Total	394,963	232,060	1,151,824	514,457	387,590	516,036	478,944
Cost of revenues	360,359	211,404	1,063,603	485,434	371,334	495,103	448,338
Gross profit	34,604	20,656	88,221	29,023	16,256	20,933	30,606
Gain on sale of property and equipment	(149)	(50)	(446)	(454)	(7,524)		
Cost of contract litigation settlement					14,652(4)		
General and administrative expenses	13,557	7,754	36,237	26,823	26,352	22,739	21,702
Income (loss) from operations	21,196	12,952	52,430	2,654	(17,224)	(1,806)	8,904
Other income, net (1)	1,263	12,142	99,206	11,479	40,504	17,114	11,593
Interest expense	(779)	(1,005)	(4,197)	(5,257)	(3,414)	(3,750)	(4,519)
Income before minority interest and income taxes	21,680	24,089	147,439	8,876	19,866	11,558	15,978
Provision for income taxes (3)	(619)	(797)	(4,399)	(1,663)	(849)	(309)	(2,166)
Income before minority interest	21,061	23,292	143,040	7,213	19,017	11,249	13,812
Minority interest		(20)	(111)	(40)	(16)	(204)	(29)
Income from continuing operations	21,061	23,272	142,929	7,173	19,001	11,045	13,783
Income (loss) from discontinued operations, net of taxes (2)		(39)	226	(36)	1,407	11,803	(79)
Net income	$ 21,061	$ 23,233	$ 143,155	$ 7,137	$ 20,408	$ 22,848	$ 13,704
Income per share from continuing operations	$ 23.40	$ 25.85	$ 158.80	$ 7.97	$ 21.11	$ 12.27	$ 15.31
Income (loss) per share from discontinued operations, net of taxes		(0.04)	0.25	(0.04)	1.56	13.11	(0.09)
Net income per share	$ 23.40	$ 25.81	$ 159.05	$ 7.93	$ 22.67	$ 25.38	$ 15.22

Book value per share	$ 205.01	$ 208.99	$ 235.13	$ 179.67	$ 183.26	$ 177.71	$ 146.37

(1) Primarily reflects unrealized holding gains and gains on sales of marketable securities.

(2) Reflects the results of operations associated with equipment and real estate operations unrelated to construction activities, including a gain on sale of equipment of $11.8 million in 2004.

(3) Since January 1, 1996, Tutor-Saliba has been a subchapter S Corporation and has been exempt from paying federal income taxes. In addition, from and after the day Tutor-Saliba elected or was otherwise treated as a subchapter S corporation for state tax purposes, Tutor-Saliba has paid certain state taxes at a reduced rate.

(4) Represents charge recorded related to settlement of contract litigation on the San Francisco International Airport project.

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	March 31,			December 31,			
	2008	2007	2007	2006	2005	2004	2003
				(in thousands)			
Consolidated balance sheet data:							
Working capital	$ 96,311	$ 151,352	$ 147,541	$ 126,885	$ 133,659	$ 137,381	$ 47,305
Current ratio	1.26x	1.61x	1.45x	1.60x	1.80x	1.94x	1.26x
Long term debt, less current maturities	26,905	60,038	53,617	60,221	38,456	50,398	61,582
Shareholders equity	184,515	188,096	211,630	161,713	164,939	159,948	131,740
Ratio of long-term debt to equity	.15x	.32x	.25x	.37x	.23x	.32x	.47x
Total assets	603,980	503,741	601,493	441,757	382,748	364,956	379,476

UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL STATEMENTS

The unaudited pro forma condensed combined balance sheet as of March 31, 2008 and the unaudited pro forma condensed combined statements of income for the year ended December 31, 2007 and the three months ended March 31, 2008 are based on the separate historical consolidated financial statements of Perini and Tutor-Saliba. These unaudited pro forma condensed combined financial statements reflect the merger and related events using the purchase method of accounting and apply the assumptions and adjustments described in the accompanying notes to the unaudited pro forma condensed combined financial statements. The unaudited pro forma condensed combined balance sheet as of March 31, 2008 reflects the merger and related events as if they had been consummated on March 31, 2008. The unaudited pro forma condensed combined statements of income for the year ended December 31, 2007 and the three months ended March 31, 2008 reflect the merger and related events as if they had been consummated on January 1, 2007, the beginning of Perini s 2007 fiscal year.

The pro forma adjustments are based upon available information and assumptions that the managements of Perini and Tutor-Saliba believe reasonably reflect the merger. We present the unaudited pro forma condensed combined financial statements for informational purposes only. The pro forma condensed combined financial statements are not necessarily indicative of what our financial position or results of operations actually would have been had we completed the merger as of the dates indicated. In addition, the unaudited pro forma condensed combined financial statements do not purport to project the future financial position or operating results of the combined company. You should read this information together with the following:

- the accompanying notes to the unaudited pro forma condensed combined financial statements;
- the separate historical unaudited financial statements of Perini as of and for the three months ended March 31, 2008 included in Perini s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2008, which are incorporated by reference into this proxy statement;
- the separate historical audited financial statements of Perini as of and for the fiscal year ended December 31, 2007 included in Perini s Annual Report on Form 10-K for the fiscal year ended December 31, 2007, which are incorporated by reference into this proxy statement;
- the separate historical unaudited financial statements of Tutor-Saliba as of and for the three months ended March 31, 2008, which are included in the annexes to this proxy statement; and
- the separate historical audited financial statements of Tutor-Saliba as of and for the fiscal year ended December 31, 2007, which are included in the annexes to this proxy statement.

We prepared the unaudited pro forma condensed combined financial statements using the purchase method of accounting, with Perini as the acquirer. Accordingly, the total estimated purchase price, calculated as described in Note 1 to the unaudited pro forma condensed combined financial statements, is allocated to the net tangible and identifiable intangible assets of Tutor-Saliba acquired in connection with the merger, based on their respective fair values. Should there be an increase in the fair value of the Tutor-Saliba tangible and/or intangible assets as of the closing date of the merger, the amount of the purchase price allocated to these assets will increase accordingly, resulting in a decrease in the amount of goodwill recorded and an increase in depreciation expense and/or amortization expense. A 10% increase in the fair value of the depreciable tangible assets could increase depreciation expense by approximately $0.1 million per year. A 10% increase in the fair value of amortizable intangible assets could increase amortization expense by $1.1 million per year.

The allocation is dependent upon valuations and other studies that have not progressed to a stage where there is sufficient information to make a definitive allocation. Accordingly, the purchase price allocation pro forma adjustments are preliminary and have been made solely for the purpose of providing unaudited pro forma condensed combined financial statements. The final purchase price allocation, which will be determined subsequent to the closing of the merger, and its effect on results of operations may differ significantly from the pro forma amounts included in the unaudited pro forma condensed combined financial statements. These amounts represent the managements best estimate as of the date of this proxy statement. In order to provide a definitive accounting of the purchase price allocation as of the date of the closing of the merger, Perini will retain

valuation specialists to help establish the fair value of the net tangible and intangible assets of Tutor-Saliba as of the closing date. These valuations will primarily include valuations of the fair value of fixed assets, intangible assets such as trade name, existing customer relationships, favorable lease terms on existing leases and existing construction contract backlog. In addition, Perini will review and adjust the effective tax rate as required, and adjust estimated transaction costs to actual. Statement of Financial Accounting Standards No. 141 Business Combinations allows the acquiring company one year to complete the final analysis and accounting for the purchase price allocation related to a business combination.

In connection with the plan to integrate the operations of Perini and Tutor-Saliba, we anticipate that non-recurring charges, such as costs associated with systems implementation, relocation expenses, severance and other costs associated with exit or disposal activities, will be incurred. We are not able to determine the timing, nature and amount of these charges as of the date of this proxy statement/prospectus. However, these charges could affect the combined results of operations of Perini and Tutor-Saliba, as well as those of the combined company following the merger, in the period in which they are recorded. The unaudited pro forma condensed combined financial statements do not include the effects of the costs associated with any restructuring or integration activities resulting from the transaction, as they are non-recurring in nature and not factually supportable at the time that the unaudited pro forma condensed combined financial statements were prepared. In addition, the unaudited pro forma condensed combined financial statements do not include the realization of any cost savings from operating efficiencies or synergies resulting from the transaction, nor do they include any potential incremental revenues and earnings that may be achieved with the combined capabilities of the companies.

UNAUDITED PRO FORMA CONDENSED COMBINED BALANCE SHEET

MARCH 31, 2008

	Perini Corporation (historical)	Tutor-Saliba (historical)	Pro Forma Adjustments (In thousands)	Note 2	Pro Forma Combined
ASSETS:					
Cash and cash equivalents	$ 349,749	$ 110,328	$ (64,290)	(g)	$ 395,496
			(291)	(h)	
Restricted cash		16,000			16,000
Short-term investments	110,337				110,337
Accounts receivable, including retainage	1,013,399	286,906	(8,002)	(i)	1,291,903
			(400)	(g)	
Costs and estimated earnings in excess of billings	93,577	32,386			125,963
Advances to related parties		15,310	(15,310)	(g)	
Deferred income taxes	5,964	193			6,157
Other current assets	3,764	11,290	3,300	(a)	18,354
Total current assets	1,576,790	472,413	(84,993)		1,964,210
Property and equipment, net	98,698	85,198	16,133	(a)	197,412
			(2,617)	(h)	
Goodwill	27,268	21,181	746,397	(b)	773,665
			(21,181)	(b)	
Purchased intangible assets, net	3,916	10,689	234,900	(c)	238,816
			(10,689)	(c)	
Mineral right assets		12,850			12,850
Other assets	23,507	1,649	(294)	(f)	24,862
	$ 1,730,179	$ 603,980	$ 877,656		$ 3,211,815

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UNAUDITED PRO FORMA CONDENSED COMBINED BALANCE SHEET (continued)

MARCH 31, 2008

	Perini Corporation (historical)	Tutor-Saliba (historical)	Pro Forma Adjustments (In thousands)	Note 2	Pro Forma Combined
LIABILITIES AND STOCKHOLDERS EQUITY:					
Current maturities of long-term debt	$ 5,683	$ 11,822			$ 17,505
Accounts payable, including retainage	959,168	278,850	(8,002)	(i)	1,230,016
Billings in excess of costs and estimated earnings	186,470	57,613			244,083
Accrued expenses	128,447	27,817	30,212	(f)	186,476
Total current liabilities	1,279,768	376,102	22,210		1,678,080
Long-term debt, less current maturities included above	13,635	26,905	(291)	(h)	40,249
Deferred income taxes	471	1,311	87,395	(d)	107,770
			18,593	(d	