



2005 ANNUAL REPORT

It All Begins
With
A Vision

GRANITE



Granite Construction

Founded in 1922, Granite Construction is one of the largest heavy-civil contractors in the United States. Granite builds roads, bridges, dams, and other transportation-related projects. In addition, Granite is a major producer of construction materials, ready-mix and asphalt concrete, and other road-building and construction materials. Unique among large contractors, Granite builds both large and small jobs through its two operating divisions, the Branch Division and the Heavy Construction Division.

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*Cover: Stonebrae Country Club Project,
Hayward California*

*This page: Reservoir, Earthen Dam
and Spillway Project,
Napa County California*

At Granite, every project starts with a vision—of what we are going to build and how we are going to build it. Of the hundreds of components that go into building a project, our most vital ingredient—the resource that transforms plans and materials into roads, bridges, and other infrastructure projects—is people. The approximately 7,000 employees of Granite represent a wealth of knowledge and experience, integrity and commitment—they possess the skills necessary to turn a vision into reality.

Last year was a year of great accomplishment for Granite. In 2005, the Board declared its 63rd consecutive quarterly dividend, our net income rose 46%, and our shareholders were rewarded with a 37% total investment return. While we are proud of the value we have provided to shareholders, our vision goes beyond looking at what we have done. We are looking ahead to what we are capable of doing. That's what we're focused on as we head into 2006, a year we believe offers great potential for Granite. We have the capabilities to take advantage of a growing demand for infrastructure projects: a proven business model, a growing materials business, and a solid record of performance. We will pursue these many opportunities with our most important resource: the people of Granite.



Granite is building the transportation infrastructure across America.

STATE ROUTE 22 PROJECT, ORANGE COUNTY CALIFORNIA

Economic growth depends on a robust transportation system to get goods and people from where they are to where they need to be. From roads, highways, and bridges to rapid transit systems, railroads, and airports, we've been in the business of building transportation infrastructure since our founding in 1922. Our experience, capabilities, and resources make us particularly well positioned to tap the opportunities represented by the positive climate for transportation funding, including the passage of the federal highway bill as well as improved state Department of Transportation budgets.







INTERSTATE 494 PROJECT, MINNETONKA MINNESOTA

Granite's Heavy Construction Division handles the largest, most demanding projects.

Large-scale projects—typically, ranging in value from \$50 million to \$250 million and generally extending more than two years—are the primary focus of the five regional offices of Granite's Heavy Construction Division. Today, we are bidding more projects in more parts of the country than ever before. Although the number of projects HCD handles is small (generally less than 50 active projects) relative to our Branch Division, their revenue contribution is significant (approximately 40% of total revenue in 2005). Fundamental to our business plan is to seek only those projects that will deliver a fair return. Profitability, not volume, is where we are placing our major emphasis.





**Granite's
Branch Division
handles
thousands of
projects each
year.**

HIGHWAY 33 PROJECT,
DOS PALOS CALIFORNIA

Of the 3,700 projects Granite worked on in 2005, the vast majority of them were managed by one or more of 12 Branch Division offices, primarily located in high-growth regions in the West. The branches operate as decentralized highly autonomous profit centers and compete for a wide variety of work from sealing residential driveways to major airport and highway construction. The branches serve an array of clients from homeowners to city and county governments to local and national developers. Granite's Branch Division structure enables the company to diversify risk across a number of geographic markets, customers, and types of projects while providing the resources and expertise of a major construction company in each of the communities we serve.

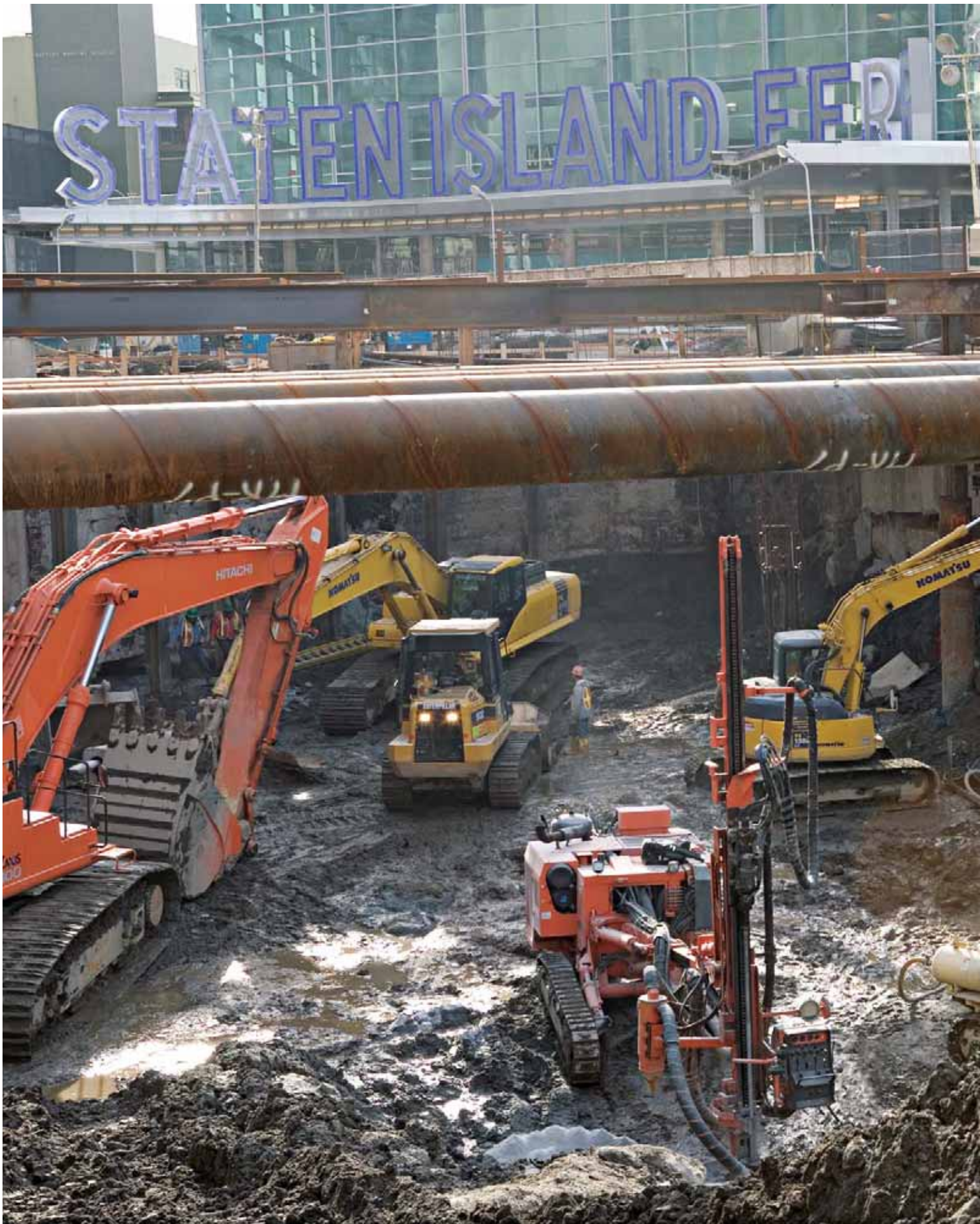


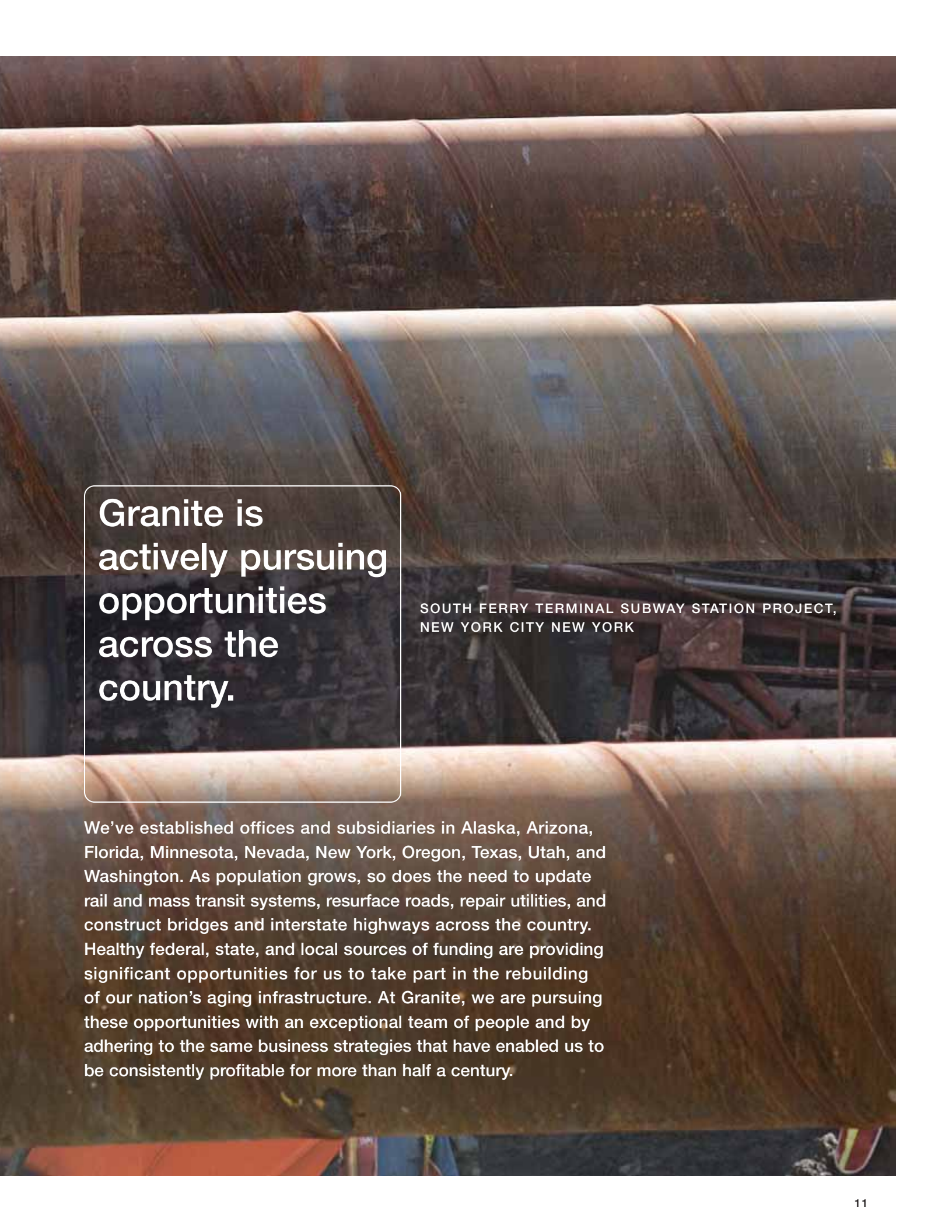
**Granite's
materials
business is
a source
of profitable
growth.**

CAPAY MATERIALS PLANT,
ESPARTO CALIFORNIA

The ownership of construction materials—such as rock, gravel, asphalt, and concrete—is an integral part of our business model and an advantage that few in our industry enjoy. We continue to reinforce the long-held strategic decision to increase our supply of aggregate reserves to improve our competitiveness and increase our margins. Over the past several years, between 40% and 50% of what we produced has been used internally on our own projects, with the remainder sold to outside customers. Using our own materials enables us to ensure availability to Granite projects at the right price, the right time, and the highest quality.






The background of the entire page is a photograph of large, horizontal industrial pipes, likely for a subway station project. The pipes are dark and show signs of rust and wear. They are supported by metal brackets and scaffolding. The lighting is somewhat dim, giving the image a gritty, industrial feel.

**Granite is
actively pursuing
opportunities
across the
country.**

SOUTH FERRY TERMINAL SUBWAY STATION PROJECT,
NEW YORK CITY NEW YORK

We've established offices and subsidiaries in Alaska, Arizona, Florida, Minnesota, Nevada, New York, Oregon, Texas, Utah, and Washington. As population grows, so does the need to update rail and mass transit systems, resurface roads, repair utilities, and construct bridges and interstate highways across the country. Healthy federal, state, and local sources of funding are providing significant opportunities for us to take part in the rebuilding of our nation's aging infrastructure. At Granite, we are pursuing these opportunities with an exceptional team of people and by adhering to the same business strategies that have enabled us to be consistently profitable for more than half a century.




KENAI RIVER BRIDGE PROJECT, SOLDOTNA ALASKA

Granite is
committed to
ensuring our
work sites are
the safest in
the industry.

We continue to diligently ensure that our core safety systems, beliefs, and values remain the foundation of our safety culture. Our safety incident rate has historically been well below the industry average. But this is an attribute of our business that we can never be fully satisfied with, and each year we set new goals for safety. To help us improve, in 2005 we set even more ambitious performance expectations. As a result we saw continued improvement in the reduction of both the frequency and severity of accidents. We reduced our OSHA Recordable Incident Rate by 27% and our Lost Time Incident Rate by 45% compared with our own five-year average. The protection of our people, property, the public, and the environment are essential to the successful completion of every project we undertake.





Granite gets the job done.

RETRAC RAILROAD PROJECT, RENO NEVADA

Occasionally, Granite's Heavy Construction Division works hand-in-hand with the Branch Division. Teaming up allows us to leverage the capabilities of both divisions for particularly challenging projects located near one of our branch operations. (An example would be the job pictured here in Reno, Nevada.) The two divisions complement each other in a variety of ways. While HCD has substantial expertise with large, complex projects, the branches have greater knowledge of their local markets. The branches provide HCD with valuable information regarding larger projects in their respective areas, as well as a reliable and competitively priced source of construction materials.







GEORGE BUSH TOLLROAD PROJECT, CARROLLTON TEXAS

**Granite
continues to
expand its
reach—and
to invest in its
people.**

Over 40% of our revenues come from the construction of highways and roads, and we've been particularly active in states with growing populations, like Arizona, Florida, Nevada, Texas, and Utah as well as the state of California (traditionally our single largest customer has been the California Department of Transportation). Completing these large-scale projects on time and on budget requires experience, teamwork, and a commitment to quality. One of the key strategic mandates at Granite is to invest in the development and growth of our people, which is the goal of our Employee Development Initiative, now six years old. Many of our employees have a long tenure at Granite; it's a good place to work, and they know that we'll help them in every possible way to have a long, rewarding career. It's good for our employees, but it's great for our customers, our investors, and our company.

Granite is one of the most successful transportation contractors in the business.

LETTER TO SHAREHOLDERS When we prepared our letter to shareholders last year, we contrasted the excellent performance of our Branch Division with the challenges of our Heavy Construction Division (HCD). At the risk of sounding repetitive, our performance in 2005 reflected a very similar dynamic: the Branch Division turned in record results, while HCD continued to struggle in terms of profitability. Nevertheless, 2005 was a very good year for Granite: we grew our revenues, we posted record earnings, and we made solid strategic progress in the turnaround of HCD. In addition, the economic environment that fuels the strength of our market and our potential for growth improved substantially in 2005. In short, we know we've got plenty of work to do to reach our full earnings potential, but we are very optimistic about the prospects for Granite in 2006 and beyond.

A SUPERB YEAR FOR OUR BRANCH DIVISION In 2005, the twelve offices of our Branch Division worked on more than 3,700 projects ranging from road and highway construction to site development. The division also supplies aggregate construction materials, an increasingly important component of our core business, both on Granite projects as well as the retail market. In financial terms, it was an outstanding year for the Branch Division by virtually any measure: revenue grew to \$1.6 billion, an increase of 24% over the \$1.3 billion we reported last year, and the division's operating income of \$154 million represented a 45% increase over the \$106 million in 2004, an impressive improvement.

As we look ahead, the Branch Division's backlog is at record levels and we expect this division to continue to grow and perform well. From a strategic standpoint, we are seeking continued growth in our materials business to lead geographic expansion of the Branch Division. We are actively exploring opportunities to add aggregate reserves, strengthen our positions in markets we already serve, and expand into new ones. We are very

optimistic about the Branch Division, and we take this opportunity to thank our employees for their hard work and commitment in 2005.

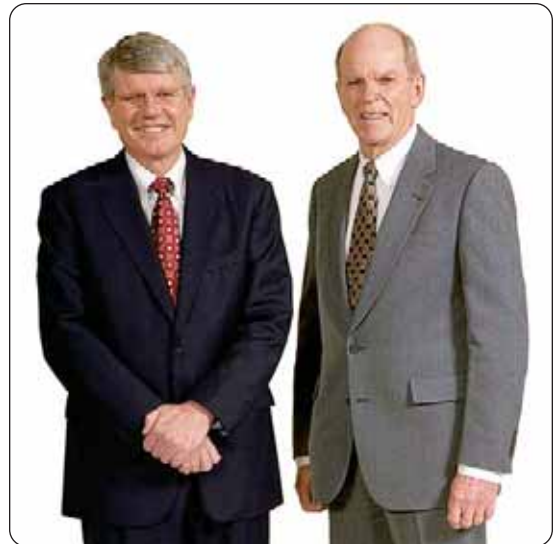
TURNING AROUND HCD 2005 was another tough year for our Heavy Construction Division. We are optimistic about its potential—though we obviously have plenty of work to do in this division. In 2005, the division worked on fewer than 50 projects, but these very large projects generated 40% of Granite’s total 2005 revenues. However, while the division generated \$1 billion in 2005 revenue, its operating income was only \$12 million, an improvement over 2004, but not nearly good enough.

Let me just say that the people we have in place are very good and are working extremely hard to improve this business. As a company, we are working diligently to build the depth of management talent and the infrastructure support that will handle HCD’s volume with the kind of efficiency and effectiveness necessary to deliver consistent project performance. Improving the bottom line of this business is the focal point of all our HCD efforts and strategies. We remain confident that this segment is a good business for Granite, and we know that the people within HCD are working as hard as they can to turn things around.

THE OUTLOOK IS POSITIVE One of the reasons our Branch Division performed so well during 2005 is the generally improved climate for public works spending on transportation. For example, the California Department of Transportation has significantly increased its funding, and with the continued strength of the housing market throughout the West, this is creating more demand for the kind of infrastructure projects we build. In addition, the reauthorization of the federal transportation funding bill, a six-year \$286 billion spending initiative designed to upgrade the country’s transportation infrastructure, was signed into law in August, we believe this foundation of solid public funding will provide favorable market conditions for our HCD business.

OUR MESSAGE IS CLEAR We’ve referred to several aspects of our strategy throughout this letter, but it’s worth articulating the highlights here:

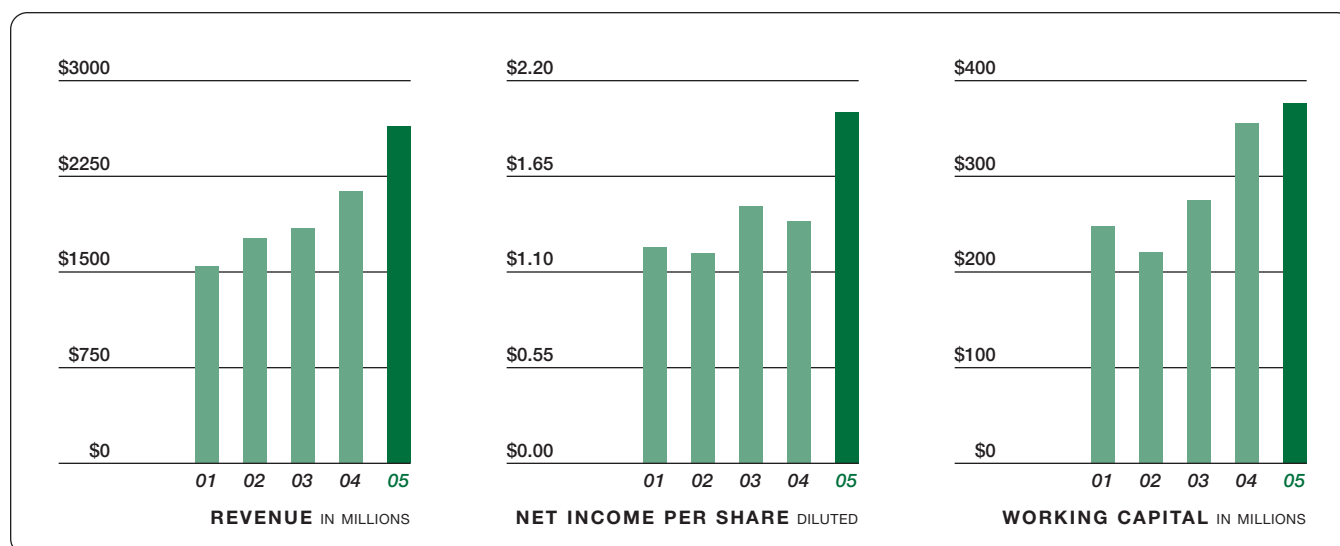
- In our Branch Division, we seek growth. We will focus on leading with our materials business which is the foundation of our “vertical integration” business model. We also seek to expand this already geographically diversified business by exploring new markets as well as expanding in markets we already serve.
- In our Heavy Construction Division, we are focused on improving the bottom line while maintaining our backlog and market positions. As we develop a consistent record of



William G. Dorey and David H. Watts

acceptable profitability, we will seek to expand the business through our five regions: Western, Texas, Southeast, National, and Northeast.

Our goal is to build the most respected, best performing vertically integrated construction company in the country. Critical to our ability to perform is the Granite culture, which is one of our most cherished assets. We've built an environment that demands and rewards accountability and integrity. We pursue projects that fit our skills and capabilities and offer the kind of profit potential we demand. We have set some lofty goals for our people and we will do everything we can to help them achieve those goals. We are committed to employee development as an ongoing imperative for Granite, which accounts, in part, for our superior reputation as an employer and our ability to hire and retain outstanding people. We are also extremely proud that Granite was once again recognized on *FORTUNE's* list of the "100 Best Companies to Work For."



Our people accomplished a great deal in 2005, and we thank them for their dedication and energy. We also want to acknowledge the confidence and support of our shareholders—we will do our level best to continue to earn that confidence and support in 2006 and beyond.

William G. Dorey,
President and Chief Executive Officer

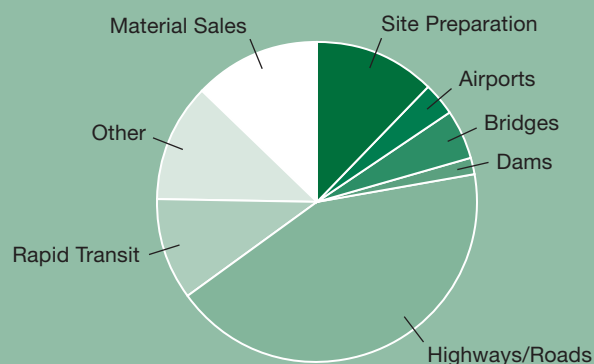
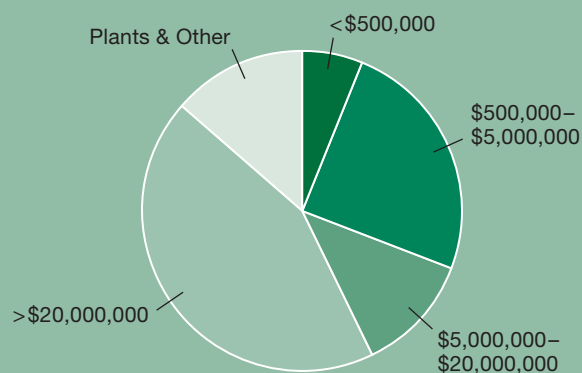
David H. Watts,
Chairman of the Board

Selected Consolidated Financial Data

Years Ended December 31,	2005	2004*	2003	2002	2001
<i>(In thousands, except per share data)</i>					
OPERATING SUMMARY					
Revenue	\$ 2,641,352	\$ 2,136,212	\$ 1,844,491	\$ 1,764,742	\$ 1,547,994
Gross profit	319,372	222,021	226,450	224,584	183,616
As a percent of revenue	12.1%	10.4%	12.3%	12.7%	11.9%
General and administrative expenses	183,392	157,035	151,879	146,467	119,282
As a percent of revenue	6.9%	7.4%	8.2%	8.3%	7.7%
Net income	83,150	57,007	60,504	49,279	50,528
As a percent of revenue	3.2%	2.7%	3.3%	2.8%	3.3%
Net income per share:					
Basic	\$ 2.05	\$ 1.41	\$ 1.51	\$ 1.23	\$ 1.27
Diluted	2.02	1.39	1.48	1.21	1.24
Weighted average shares of common stock:					
Basic	40,614	40,390	40,175	40,016	39,794
Diluted	41,249	41,031	40,808	40,723	40,711
BALANCE SHEET SUMMARY					
Total assets	\$ 1,472,230	\$ 1,277,954	\$ 1,060,410	\$ 983,819	\$ 929,684
Cash, cash equivalents, and marketable securities	301,381	277,692	201,985	182,694	193,233
Working capital	367,801	355,927	274,947	220,396	248,413
Current maturities of long-term debt	26,888	15,861	8,182	8,640	8,114
Long-term debt	124,415	148,503	126,708	132,380	131,391
Other long-term liabilities	46,556	40,641	29,938	13,742	10,026
Shareholders' equity	621,560	550,474	504,891	454,869	418,502
Book value per share	\$ 14.91	\$ 13.23	\$ 12.16	\$ 11.03	\$ 10.19
Dividends per share	0.40	0.40	0.40	0.32	0.32
Common shares outstanding	41,682	41,612	41,528	41,257	41,089
Backlog	\$ 2,331,540	\$ 2,437,994	\$ 1,985,788	\$ 1,856,451	\$ 1,377,172

*Effective January 1, 2004, we adopted Financial Accounting Standards Board Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (see Note 5 of the "Notes to the Consolidated Financial Statements").

GRANITE'S BROAD PROJECT CAPABILITIES



BOARD OF DIRECTORS

David H. Watts
Chairman of the Board

William G. Dorey
President and Chief Executive Officer,
Granite Construction Incorporated

James W. Bradford
Dean and Ralph Owen Professor for the
School of Management,
Owen School of Management,
Vanderbilt University

Gary M. Cusumano
Retired Chairman, Newhall Land and
Farming Company

Linda Griego
President and Chief Executive Officer,
Griego Enterprises, Inc.

David H. Kelsey
Senior Vice President and
Chief Financial Officer,
Sealed Air Corporation

Rebecca A. McDonald
President, Gas & Power BHP Billiton

Raymond E. Miles*
Professor Emeritus and former Dean,
Walter A. Haas School of Business,
University of California, Berkeley

J. Fernando Niebla
President, International Technology Partners
L.L.C.

William H. Powell
Chairman and Chief Executive Officer,
National Starch and Chemical Company

George B. Searle
President, Searle Associates, Inc.

**Presiding Director*



STANDING L TO R J. Fernando Niebla, George B. Searle, Gary M. Cusumano, Linda Griego, William G. Dorey, William H. Powell, and Rebecca A. McDonald. SEATED L TO R Raymond E. Miles, David H. Watts, and David H. Kelsey. Not pictured James W. Bradford.

CORPORATE OFFICERS

David H. Watts
Chairman of the Board

William G. Dorey
President and Chief Executive Officer

Mark E. Boitano
Executive Vice President and
Chief Operating Officer

William E. Barton
Senior Vice President and
Chief Financial Officer

Michael F. Donnino
Senior Vice President and Manager,
Heavy Construction Division

James H. Roberts
Senior Vice President and Manager,
Branch Division

Roxane C. Allbritton
Vice President and Treasurer

John A. Franich
Vice President and Branch Division
Manager of Construction

Michael Futch
Vice President, General Counsel
and Secretary

Darryl W. Goodson
Vice President and Assistant Manager,
Heavy Construction Division

Brian C. Kaub
Vice President and Assistant Manager,
Heavy Construction Division

Randy J. Kremer
Vice President and Branch Division Manager
of Construction Materials

Mary McCann-Jenni
Vice President, Controller and
Assistant Financial Officer

David R. Grazian
Director of Corporate Taxation and
Assistant Secretary

Granite Construction 2005 Financial Results

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Management's Discussion and Analysis of Financial Condition and Results of Operation

GENERAL

We are one of the largest heavy civil contractors in the United States and are engaged in the construction of highways, dams, airport infrastructure, mass transit facilities and other infrastructure-related projects. We have offices in Alaska, Arizona, California, Florida, Minnesota, Nevada, New York, Oregon, Texas, Utah and Washington. Our business involves two operating segments: the Branch Division and the Heavy Construction Division.

Our contracts are obtained primarily through competitive bidding in response to advertisements by federal, state and local agencies and private parties and to a lesser extent through negotiation with private parties. Our bidding activity is affected by such factors as backlog, current utilization of equipment and other resources, ability to obtain necessary surety bonds and competitive considerations. Bidding activity, backlog and revenue resulting from the award of new contracts may vary significantly from period to period.

The two primary economic drivers of our business are (1) federal, state and local public funding levels and (2) the overall health of the economy, both nationally and locally. The level of demand for our services will have a direct correlation to these drivers. For example, a weak economy will generally result in a reduced demand for construction in the private sector. This reduced demand increases competition for fewer private sector projects and will ultimately also increase competition in the public sector as companies migrate from bidding on scarce private sector work to projects in the public sector. Greater competition can reduce revenue growth and/or increase pressure on gross profit margins. A weak economy also tends to produce less tax revenue, thereby decreasing the funds available for spending on public infrastructure improvements. There are funding sources that have been specifically earmarked for infrastructure spending, such as gasoline taxes, which are not necessarily directly impacted by a weak economy. However, even these funds can be temporarily at risk as state and local governments struggle to balance their budgets. Conversely, higher public funding and/or a robust economy will increase demand for our services and provide opportunities for revenue growth and margin improvement.

Our general and administrative costs include salaries and related expenses, incentive compensation, discretionary profit sharing and other variable compensation, as well as other overhead costs to support our overall business. In general, these costs will increase in response to the growth and the related increased complexity of our business. These costs may also vary depending on the number of projects in process in a particular area and the corresponding level of estimating activity. For example, as large projects are completed or if the level of work slows down in a particular area, we will often re-assign project employees to estimating and bidding activities until another project gets underway, temporarily moving their salaries and related costs from cost of revenue to general and administrative expense. Additionally, our compensation strategy for selected management personnel is to rely heavily on a variable cash and restricted stock performance-based incentive element. The cash portion of these incentives is expensed when earned while the restricted stock portion is expensed over the vesting period of the stock (generally five years). Depending on the mix of cash and restricted stock, these incentives can have the effect of increasing general and administrative expenses in very profitable years and decreasing expenses in less profitable years.

CURRENT YEAR OVERVIEW

COMPARATIVE FINANCIAL SUMMARY

Years Ended December 31,

(In thousands)

	2005	2004	2003
Revenue	\$ 2,641,352	\$ 2,136,212	\$ 1,844,491
Gross Profit	319,372	222,021	226,450
General and Administrative Expenses	183,392	157,035	151,879
Provision for Legal Judgement	9,300	—	—
Gain On Sale of Property and Equipment	8,235	18,566	4,714
Operating Income	134,915	83,552	79,285
Net Income	83,150	57,007	60,504

Management's Discussion and Analysis of Financial Condition and Results of Operation

Our results of operations for the year ended December 31, 2005 reflect significantly higher operating income from our branch division compared with the corresponding period in 2004, which were primarily driven by the strong private sector market in the west and the ability to work well into the fourth quarter due to mild weather conditions. Branch Division operating results also include the recognition of a provision related to an unfavorable legal judgment in the second quarter of 2005. Our Heavy Construction Division did experience some improvement in operating income in 2005 compared with 2004. HCD gross profit in 2005 and 2004 includes a reduction in gross profit for the net effects of changes in estimates of project profitability of \$31.0 million and \$40.0 million, respectively.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Our estimates, judgments and assumptions are continually evaluated based on available information and experience; however actual amounts could differ from those estimates.

Certain of our accounting policies and estimates require higher degrees of judgment than others in their application. These include the recognition of revenue and earnings from construction contracts, the valuation of long-lived assets and insurance estimates. We evaluate all of our estimates and judgments on an on-going basis.

Revenue Recognition for Construction Contracts: Our contracts with our customers are primarily either "fixed unit price" or "fixed price." Under fixed unit price contracts, we are committed to provide materials or services required by a project at fixed unit prices (for example, dollars per cubic yard of concrete poured or cubic yards of earth excavated). While the fixed unit price contract shifts the risk of estimating the quantity of units required for a particular project to the customer, any increase in our unit cost over the expected unit cost in the bid, whether due to inflation, inefficiency, faulty estimates or other factors, is borne by us unless otherwise provided in the contract. Fixed price contracts are priced on a lump-sum basis under which we bear the risk that we may not be able to perform all the work profitably for the specified contract amount. The percentage of fixed price contracts in our backlog has increased from approximately 58.0% at December 31, 2004 to approximately 63.0% at December 31, 2005. All state and federal government contracts and many of our other contracts provide for termination of the contract for the convenience of the party contracting with us, with provisions to pay us for work performed through the date of termination.

We use the percentage of completion accounting method for construction contracts in accordance with the American Institute of Certified Public Accountants Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts." Revenue and earnings on construction contracts, including construction joint ventures, are recognized using the percentage of completion method in the ratio of costs incurred to estimated final costs. Revenue in an amount equal to cost incurred is recognized prior to contracts reaching 25% completion. The related profit is deferred until the period in which such percentage completion is attained. It is our judgment that until a project reaches 25% completion, there is insufficient information to determine what the estimated profit on the project will be with a reasonable level of assurance. Revenue from contract claims is recognized when we have a signed settlement agreement and payment is assured. Revenue from contract change orders, which occur in most large projects, is recognized when the owner has agreed to the change order in writing. Provisions are recognized in the statement of income for the full amount of estimated losses on uncompleted contracts whenever evidence indicates that the estimated total cost of a contract exceeds its estimated total revenue. Contract cost consists of direct costs on contracts, including labor and materials, amounts payable to subcontractors, direct overhead costs and equipment expense (primarily depreciation, fuel, maintenance and repairs). Depreciation is provided using accelerated methods for construction equipment. Contract cost is recorded as incurred and revisions in contract revenue and cost estimates are reflected in the accounting period when known. The 25% threshold is applied to all percentage of completion projects without exception unless and until we project a loss on the project, in which case the estimated loss is immediately recognized.

Management's Discussion and Analysis of Financial Condition and Results of Operation

The accuracy of our revenue and profit recognition in a given period is almost solely dependent on the accuracy of our estimates of the cost to complete each project. Our cost estimates for all of our significant projects use a highly detailed "bottom up" approach and we believe our experience allows us to produce materially reliable estimates. However, our projects can be highly complex and in almost every case the profit margin estimates for a project will either increase or decrease from the amount that was originally estimated at the time of bid. Because we have many projects of varying levels of complexity and size in process at any given time (during 2005 we worked on over 3,700 projects) these changes in estimates can offset each other without materially impacting our overall profitability. However, large changes in cost estimates, particularly in the bigger, more complex projects in our Heavy Construction Division, have had and can in future periods have a significant effect on profitability.

There are a number of factors that can contribute to changes in estimates of contract cost and profitability. The most significant of these include the completeness and accuracy of the original bid, costs associated with added scope changes, extended overhead due primarily to owner and weather delays, subcontractor performance issues, changes in productivity expectations, site conditions that differ from those assumed in the original bid (to the extent contract remedies are unavailable), the availability and skill level of workers in the geographic location of the project and a change in the availability and proximity of equipment and materials. The foregoing factors as well as the stage of completion of contracts in process and the mix of contracts at different margins may cause fluctuations in gross profit between periods and these fluctuations may be significant.

Valuation of Long-Lived Assets: Long-lived assets, which include property, equipment and acquired identifiable intangibles, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment evaluations involve management estimates of asset useful lives and future cash flows. Actual useful lives and cash flows could be different from those estimated by management and this could have a material effect on our operating results and financial position.

We had approximately \$27.9 million in goodwill at December 31, 2005, \$18.0 million relating to HCD and \$9.9 million relating to our Branch Division. We perform goodwill impairment tests on an annual basis and more frequently when events and circumstances occur that indicate a possible impairment of goodwill. In determining whether there is an impairment of goodwill, we calculate the estimated fair value of the reporting unit in which the goodwill is recorded using a discounted future cash flow method. We then compare the resulting fair value to the net book value of the reporting unit, including goodwill. If the net book value of a reporting unit exceeds its fair value, we would measure the amount of the impairment loss by comparing the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. To the extent that the carrying amount of a reporting unit's goodwill exceeds its implied fair value, we recognize a goodwill impairment loss. We performed our annual impairment test in 2005 and we determined that no impairment had occurred. The discounted future cash flow method used in the first step of our impairment test involves significant estimates including future cash inflows from estimated revenues, future cash outflows from estimated project cost and general and administrative costs, estimates of timing of collection and payment of various items and future growth rates as well as discount rate and terminal value assumptions. Although we believe the estimates and assumptions that we used in testing for impairment are reasonable and supportable, significant changes in any one of these assumptions could produce a significantly different result.

Insurance estimates: We carry insurance policies to cover various risks, primarily general liability and workers compensation, under which we are liable to reimburse the insurance company for a portion of each claim paid. The amounts that we are liable for generally range from the first \$250,000 to \$1.0 million per occurrence. We accrue for the estimated ultimate liability for incurred losses, both reported and unreported, using actuarial methods based on historic trends modified, if necessary, by recent events. Changes in our loss assumptions caused by changes in actual experience would result in a change in our assessment of the ultimate liability that could have a material effect on our operating results and financial position.

Management's Discussion and Analysis of Financial Condition and Results of Operation

CURRENT YEAR

Revenue

TOTAL REVENUE

Years Ended December 31,	2005		2004		2003	
(In thousands)	Amount	Percent	Amount	Percent	Amount	Percent
Revenue by Division:						
Branch Division	\$ 1,591,545	60.3%	\$ 1,287,615	60.3%	\$ 1,152,726	62.5%
Heavy Construction Division	1,030,109	39.0%	848,597	39.7%	691,765	37.5%
Other	19,698	0.7%	—	—	—	—
Total	\$ 2,641,352	100.0%	\$ 2,136,212	100.0%	\$ 1,844,491	100.0%

BRANCH DIVISION REVENUE

Years Ended December 31,	2005		2004		2003	
(In thousands)	Amount	Percent	Amount	Percent	Amount	Percent
California:						
Public sector	\$ 374,642	43.0%	\$ 397,349	53.9%	\$ 377,195	55.2%
Private sector	282,752	32.4%	174,282	23.6%	146,460	21.4%
Material sales	214,520	24.6%	165,379	22.5%	160,182	23.4%
Total	\$ 871,914	100.0%	\$ 737,010	100.0%	\$ 683,837	100.0%
West (excluding California):						
Public sector	437,677	60.8%	\$ 355,143	64.5%	\$ 303,564	64.7%
Private sector	164,821	22.9%	97,641	17.7%	73,988	15.8%
Material sales	117,133	16.3%	97,821	17.8%	91,337	19.5%
Total	\$ 719,631	100.0%	\$ 550,605	100.0%	\$ 468,889	100.0%
Total Branch Division Revenue:						
Public sector	812,319	51.0%	\$ 752,492	58.4%	\$ 680,759	59.1%
Private sector	447,573	28.1%	271,923	21.1%	220,448	19.1%
Material sales	331,653	20.9%	263,200	20.5%	251,519	21.8%
Total	\$ 1,591,545	100.0%	\$ 1,287,615	100.0%	\$ 1,152,726	100.0%

Branch Division Revenue: Revenue from our Branch Division increased \$303.9 million, or 23.6%, in the year ended December 31, 2005 from the year ended December 31, 2004. This increase was largely driven by the strong housing market, particularly in California and Nevada. A strong housing market increases demand for our services, including housing and commercial site development and related infrastructure such as roads and sewer systems. This private sector demand was also a major factor in the increased sales of materials in California, which grew by \$49.1 million, or 29.7%, in the year ended December 31, 2005 from the year ended December 31, 2004. A portion of the Branch Division increase was also attributable to mild weather in the fourth quarter of 2005 which enabled many of our locations to complete more work in the quarter than in the fourth quarter of 2004.

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HCD REVENUE

Years Ended December 31,	2005		2004		2003	
<i>(In thousands)</i>	<i>Amount</i>	<i>Percent</i>	<i>Amount</i>	<i>Percent</i>	<i>Amount</i>	<i>Percent</i>
Revenue by Geographic Area:						
South	\$ 231,133	22.4%	\$ 168,803	19.9%	\$ 162,586	23.5%
West	205,480	19.9%	69,124	8.1%	88,382	12.8%
Southeast	176,088	17.1%	167,925	19.8%	158,554	22.9%
Northeast	324,477	31.5%	346,704	40.9%	216,741	31.3%
Other	92,931	9.1%	96,041	11.3%	65,502	9.5%
Total	\$ 1,030,109	100.0%	\$ 848,597	100.0%	\$ 691,765	100.0%
Revenue by Market Sector:						
Public sector	995,707	96.7%	\$ 800,605	94.3%	\$ 658,294	95.2%
Private sector	31,765	3.1%	46,839	5.5%	32,245	4.7%
Material sales	2,637	0.2%	1,153	0.2%	1,226	0.1%
Total	\$ 1,030,109	100.0%	\$ 848,597	100.0%	\$ 691,765	100.0%
Revenue by Contract Type						
Fixed unit price	323,048	31.4%	\$ 338,790	39.9%	\$ 286,902	41.5%
Fixed price, including design/build	704,424	68.4%	508,654	59.9%	403,278	58.3%
Other	2,637	0.2%	1,153	0.2%	1,585	0.2%
Total	\$ 1,030,109	100.0%	\$ 848,597	100.0%	\$ 691,765	100.0%

HCD Revenue: Revenue from our Heavy Construction Division increased \$181.5 million, or 21.4%, in the year ended December 31, 2005 from the year ended December 31, 2004, due primarily to the increase in volume from a higher backlog at the beginning of 2005 and several large project awards received in the first quarter of 2005. Revenue generated from projects with a contract value greater than \$100 million increased to 57.6% of total HCD revenue in 2005 from 39.8% in 2004 and our minority partners' share of our consolidated joint venture revenue increased to approximately \$175.0 million in 2005 from approximately \$111.6 million in 2004. Geographically, the largest increase was seen in the west, due primarily to a large design/build project in California that was awarded in 2004. Revenue from fixed price contracts increased from 59.9% of HCD revenue in 2004 to 68.4% of HCD revenue in 2005 due primarily to growth in design/build projects in our backlog.

Backlog

TOTAL BACKLOG

December 31,	2005		2004	
<i>(In thousands)</i>	<i>Amount</i>	<i>Percent</i>	<i>Amount</i>	<i>Percent</i>
Backlog by Division:				
Heavy Construction Division	\$ 1,603,284	68.8%	\$ 1,876,091	77.0%
Branch Division	728,256	31.2%	561,903	23.0%
Total	\$ 2,331,540	100.0%	\$ 2,437,994	100.0%

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HCD BACKLOG

December 31,

(In thousands)

Backlog by Geographic Area:

	2005		2004	
	<i>Amount</i>	<i>Percent</i>	<i>Amount</i>	<i>Percent</i>
South	\$ 354,400	22.1%	\$ 288,914	15.4%
West	455,927	28.4%	397,617	21.2%
Southeast	224,549	14.0%	378,262	20.2%
Northeast	491,944	30.7%	650,247	34.7%
Other	76,464	4.8%	161,051	8.5%
Total	\$ 1,603,284	100.0%	\$ 1,876,091	100.0%

Backlog by Market Sector:

Public sector	1,546,370	96.5%	\$ 1,814,037	96.7%
Private sector	56,914	3.5%	62,054	3.3%
Total	\$ 1,603,284	100.0%	\$ 1,876,091	100.0%

Backlog by Contract Type

Fixed unit price	391,494	24.4%	\$ 623,554	33.2%
Fixed price, including design/build	1,211,790	75.6%	1,252,537	66.8%
Total	\$ 1,603,284	100.0%	\$ 1,876,091	100.0%

HCD Backlog: Backlog in our Heavy Construction Division at December 31, 2005 was \$1,603.3 million, a decrease of \$272.8 million, or 14.5%, from backlog at December 31, 2004. Additions to HCD backlog in the fourth quarter of 2005 included a \$14.4 million levee repair project in New Orleans and HCD's portion of a \$182.9 million consolidated joint venture highway project in Utah which is being shared with the Branch Division. Subsequent to December 31, 2005, HCD was awarded a \$266.8 million joint venture bridge replacement project in Mississippi and a 20% share of a joint venture project to construct a transportation hub at the World Trade Center in New York for which the total expected revenue is not yet determined.

BRANCH DIVISION BACKLOG

December 31,

(In thousands)

California:

Public sector	\$ 266,767	66.7%	\$ 159,520	60.9%
Private sector	133,202	33.3%	102,261	39.1%
Total	\$ 399,969	100.0%	\$ 261,781	100.0%

West (excluding California):

Public sector	270,687	82.5%	\$ 232,226	77.4%
Private sector	57,600	17.5%	67,896	22.6%
Total	\$ 328,287	100.0%	\$ 300,122	100.0%

Total Branch Division Backlog

Public sector	537,454	73.8%	\$ 391,746	69.7%
Private sector	190,802	26.2%	170,157	30.3%
Total Branch Division Backlog	\$ 728,256	100.0%	\$ 561,903	100.0%

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Branch Division Backlog: Branch Division backlog at December 31, 2005 was \$728.3 million, an increase of \$166.4 million, or 29.6%, from December 31, 2004. The increase was due primarily to higher backlog in California, particularly from contracts in the public sector, including a \$62.6 million freeway reconstruction project for the California Department of Transportation ("Caltrans") that was awarded in the fourth quarter 2005. Branch Division awards in the fourth quarter of 2005 also included a \$14.7 million road construction project in California. Subsequent to December 31, 2005, our Branch Division was awarded a \$81.8 million joint venture highway reconstruction project in Northern California, a \$44.9 million road construction project near Bakersfield, California and a \$21.3 million residential site development project in Nevada.

Gross Profit

Years Ended December 31,	2005	2004	2003
(In thousands)			
Branch Division gross profit	\$ 253,890	\$ 185,509	\$ 170,024
Percent of division revenue	16.0%	14.4%	14.7%
Heavy Construction Division gross profit	\$ 50,470	\$ 41,036	\$ 56,920
Percent of division revenue	4.9%	4.8%	8.2%
Other	\$ 15,012	\$ (4,524)	\$ (494)
Total gross profit	\$ 319,372	\$ 222,021	\$ 226,450
Percent of revenue	12.1%	10.4%	12.3%

Gross Profit: As more fully described under "Critical Accounting Estimates" we recognize revenue only equal to cost, deferring profit recognition, until a project reaches 25% completion. Because we have a large number of projects at various stages of completion in our Branch Division, this policy generally has very little impact on the Branch Division's gross profit on a quarterly or annual basis. However, HCD has fewer projects in process at any given time and those projects tend to be much larger than Branch Division projects. As a result, HCD gross profit as a percent of revenue can vary significantly in periods where one or several very large projects reach 25% completion and the deferred profit is recognized or conversely, in periods where backlog is growing rapidly and a higher percentage of projects are in their early stages with no associated gross margin recognition. Revenue from projects less than 25% complete, for which no margin has been recognized, is as follows:

REVENUE FROM CONTRACTS LESS THAN 25% COMPLETE

Years Ended December 31,	2005	2004	2003
(In thousands)			
Branch Division	\$ 19,457	\$ 21,085	\$ 12,773
Heavy Construction Division	\$ 56,655	\$ 111,126	\$ 95,091
Total revenue from contracts less than 25% complete	\$ 76,112	\$ 132,211	\$ 107,864

Additionally, as we also describe under "Critical Accounting Estimates" we do not recognize revenue from contract claims until we have a signed agreement and payment is assured and we do not recognize revenue from contract change orders until the contract owner has agreed to the change order in writing. However, we do recognize the costs related to any contract claims or pending change orders when they are incurred. As a result, our gross profit as a percent of revenue can vary during periods where a large volume of change orders or contract claims are pending resolution (reducing gross profit percent) or, conversely, during periods where large change orders or contract claims are agreed or settled (increasing gross profit percent). Although this variability can occur in both our Branch Division and HCD, it can be much more pronounced in HCD because of the larger size of their projects.

Management's Discussion and Analysis of Financial Condition and Results of Operation

Gross profit as a percent of revenue in our Branch Division increased to 16.0% in 2005 from 14.4% in 2004. Gross profit margins for both construction and the sale of materials in the Branch Division reflected our ability to capitalize on the continued strong private development market in many of the Division's locations.

HCD gross profit as a percent of revenue in 2005 and 2004 of 4.9% and 4.8%, respectively, reflected the impact of downward revisions in the estimated profitability of certain contracts. The net impact of these estimate changes on recognized gross profit during 2005 was a reduction in gross profit of approximately \$31.0 million. This compares with a net reduction in gross profit in 2004 of approximately \$40.0 million (see Note 2 of the "Notes to the Consolidated Financial Statements"). We believe we have entitlement to additional compensation related to some of these projects and are actively pursuing these claims with the contract owners. However, the amount and timing of any future recovery is highly uncertain. While we recognize the impact of estimated costs immediately when known, under our accounting policies we do not recognize revenue from contract changes until we have a signed change order or executed claim settlement.

Other gross profit in 2005 is primarily related to sales of certain real estate development projects by consolidated subsidiaries of approximately \$12.3 million. The minority partners' share of this gross profit amount was approximately \$6.1 million.

General and Administrative Expenses

Years Ended December 31,	2005	2004	2003
<i>(In thousands)</i>			
Salaries and related expenses	\$ 94,901	\$ 84,490	\$ 80,154
Incentive compensation, discretionary profit sharing and other variable compensation	28,294	23,356	26,987
Other general and administrative expenses	60,197	49,189	44,738
Total	\$ 183,392	\$ 157,035	\$ 151,879
Percent of revenue	6.9%	7.4%	8.2%

General and Administrative Expenses: General and administrative expenses increased by \$26.4 million, or 16.8%, from 2004 to 2005. Salaries and related expenses increased in 2005 due primarily to additional staffing needed to support a higher volume of work. Incentive compensation, discretionary profit sharing and other variable compensation increased in 2005 due to higher profitability. The increase in other general administrative costs in 2005 related primarily to increased bidding activity and other costs related to higher revenue volume. Additionally, other general and administrative expense includes \$3.5 million related to a reserve recorded in the fourth quarter of 2005 against a \$3.5 million receivable that we accepted as a partial payment for work on a large private mass transit project which became operational in the latter half of 2004. The receivable is part of a series of bonds that formed the basis for the project owners' funding for the entire project and is payable out of future fare revenues. In March 2005, one of the two services rating a series of these bonds reduced their rating to below investment grade. On February 10, 2006, the second rating service also reduced its rating, citing serious concerns about whether the project's fare revenues would be adequate to pay the series of bonds that we hold. There is currently no market for these bonds and we have determined that a reserve of 100% of the carrying amount is appropriate. Other general and administrative costs also includes information technology, occupancy, office equipment and supplies, depreciation, travel and entertainment, outside services, advertising and marketing, training and other miscellaneous expenses, none of which individually exceeded 10% of total general and administrative expenses.

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Provision For Legal Judgment

Years Ended December 31,	2005	2004	2003
<i>(In thousands)</i>			
Provision for legal judgment	\$ 9,300	\$ —	\$ —

Provision for Legal Judgment: In June 2005, we recorded a provision of \$9.3 million related to an unfavorable judgment in a legal proceeding (see Note 15 of the "Notes to the Consolidated Financial Statements").

Gain on Sales of Property and Equipment

Years Ended December 31,	2005	2004	2003
<i>(In thousands)</i>			
Gain on sales of property and equipment	\$ 8,235	\$ 18,566	\$ 4,714

Gain on Sales of Property and Equipment: Gain on sales of property and equipment for the year ended December 31, 2004 included a \$10.0 million gain on the sale of certain assets related to our redi-mix concrete business in Utah in March 2004.

Other Income (Expense)

Years Ended December 31,	2005	2004	2003
<i>(In thousands)</i>			
Interest income	\$ 11,573	\$ 7,962	\$ 6,422
Interest expense	(6,932)	(7,191)	(8,577)
Equity in income of affiliates	1,497	6,162	17,657
Other, net	1,258	4,439	2,738
Total	\$ 7,396	\$ 11,372	\$ 18,240

Other Income (Expense): Interest income increased \$3.6 million, or 45.4%, in the year ended December 31, 2005 compared with the year ended December 31, 2004 due primarily to a higher average yield on higher interest bearing investments. The decrease in equity in income of affiliates in 2005 was due to approximately \$6.7 million in gain recorded in 2004 related to the sale of certain assets by two partnerships in which we hold an equity method investment. The decrease in other, net in 2005 was due to a gain recognized in the fourth quarter of 2004 on the sale of certain shares of T.I.C. Holdings, Inc. ("TIC") back to TIC (see Note 6 of the "Notes to the Consolidated Financial Statements").

Provision for Income Taxes

Years Ended December 31,	2005	2004	2003
<i>(In thousands)</i>			
Provision for income taxes	\$ 41,413	\$ 28,477	\$ 35,304
Effective tax rate	29.1%	30.0%	36.2%

Provision for Income Taxes: Our effective tax rate decreased to 29.1% in 2005 from 30.0% in 2004 due in part to an increase in our partners' share of consolidated construction joint venture income. Generally, our construction joint ventures are not subject to income taxes on a stand-alone basis. Also contributing to the decreased effective tax rate in 2005 was the impact of a deduction based on income from qualified domestic production activities under the American Jobs Creation Act of 2004.

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Minority Interest In Consolidated Subsidiaries

Years Ended December 31,	2005	2004	2003
(In thousands)			
Minority interest in consolidated subsidiaries	\$ (17,748)	\$ (9,440)	\$ (1,717)

Minority Interest in Consolidated Subsidiaries: Our minority interest in consolidated subsidiaries represents the minority owners' share of the income of our consolidated subsidiaries, primarily Wilder Construction Company, certain real estate development entities and various consolidated construction joint ventures. The increase in minority interest in 2005 compared with 2004 is due to higher profitability of these entities in 2005.

OUTLOOK

As we begin our 2006 construction season, we are encouraged by the strong demand for our goods and services, the improved outlook for public funding of transportation projects and the momentum of our Branch Division business in the West. We are also encouraged by the work our team in our Heavy Construction Division has been doing to turn this business around and we expect to see continued incremental bottom line improvement going forward.

HCD is experiencing significant bidding opportunities across the U.S. While we are not focusing on growing the division's revenues, the current market is allowing us to exhibit more discipline on bid day in an effort to improve the profitability of our projects. Our strategy is to prepare quality bids, execute on our project plan and deliver the bottom line performance improvement we need from this business.

Our Branch Division is experiencing the best market we have seen in many years. Both the public and private sector markets are strong in most of the areas in which we work and are contributing to a healthy demand for our construction services and materials. In the public sector, funding for transportation, particularly in California, our largest market, is promising. According to Caltrans, new Caltrans contracting was approximately \$900 million in fiscal 2004–05 and is expected to increase to \$3.0 billion in fiscal 2005–06 once allocations by the California Transportation Commission are completed. With additional funding from the recently passed highway bill and proposed early repayment of Proposition 42 loans, it is anticipated that Caltrans contracting levels may reach the \$4.0 billion range in fiscal 2006–07. Caltrans funding for transportation projects is primarily driven by revenues from taxes on gasoline, truck weight fees and federal programs.

We continue to be busy in the private sector market as well. We have worked hard over the past several years to cultivate relationships in this market and believe those efforts are paying off. It is also important to note that in addition to the benefits provided directly to our business, a strong private sector market absorbs capacity in the marketplace as well. As we have historically seen, this tends to help create a market which typically will support higher margins.

We anticipate our aggregates business will remain strong. The ownership of aggregate materials is proving to be extremely valuable both as a resource for our core construction business as well as a strategic and profitable retail business. Our long term plan is to continue to invest in this part of our business by acquiring additional aggregate reserves, permitting or "green fielding" new facilities and expanding our existing operations.

Our industry continues to be challenged with a shortage of skilled labor and we expect the industry will continue to face this challenge as the demand for construction-related services remains strong or grows across the United States. At Granite, we are working diligently to implement specialized training programs to develop our people and improve their skills. Our investment in our employee development initiative is an important strategy that we believe will allow us to turn the shortage of labor in the marketplace into an advantage for Granite.

As we have stated previously, we are subject to oil price volatility as it relates to our use of liquid asphalt and diesel fuel. Some of our projects are indexed and include price escalation clauses that provide protection in the event that petroleum product prices increase significantly. Although we are exposed to price spikes in projects that do not include such clauses, we have historically been able to recover some or all of those costs when prices come down. With respect to steel, we are exposed to price increases and steel delivery delays on some of our HCD projects that are currently under construction. While we do have some exposure in these areas of our business, we have not been materially adversely impacted to date. In an effort to minimize our exposure on future projects, we are closely monitoring the industry's outlook on future pricing so that we can properly reflect anticipated future price escalation in our bids.

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In summary, we look forward to the year ahead. We are encouraged by the strength of our markets and the opportunities for our Branch Division business in both the private and public sectors. Our top priority for HCD remains the safe and successful execution of our work and the incremental improvement of our bottom line financial performance.

PRIOR YEARS

Revenue: Revenue from our Branch Division increased \$134.9 million, or 11.7%, in the year ended December 31, 2004 from the year ended December 31, 2003. The increase in Branch Division revenue primarily reflected increases in private sector construction revenue and sales of construction materials as a result of the increase in demand created by the continuing strong housing market in California and other Branch Division locations. The increase in revenue from construction materials was also due to increases in both unit volume and average sales price of certain products, which we believe reflected an appreciation in the market for the growing scarcity of finite aggregate resources and the results of our strategic focus on maximizing revenue from external sales of materials. Public sector revenue as a percent of total branch revenue remained relatively unchanged compared with 2003 as increased local government agency revenue was largely offset by a reduction in state government agency work, particularly in California. We continued to experience reduced awards from the California State Department of Transportation due to ongoing budgetary uncertainty in the state.

Revenue from our Heavy Construction Division increased \$156.8 million, or 22.7%, in the year ended December 31, 2004 from the year ended December 31, 2003. Included in HCD revenue for the year ended December 31, 2004 was \$104.3 million (all in the public sector) resulting from the consolidation of our partners' share of construction joint venture revenue under FIN 46 (see Note 5 of the "Notes to the Consolidated Financial Statements"). The remainder of the increase over 2003 was due primarily to results from a higher backlog at the beginning of 2004, particularly in the Northeast.

Backlog: Backlog in our Heavy Construction Division at December 31, 2004 was \$1,876.1 million, an increase of \$346.7 million, or 22.7%, from backlog at December 31, 2003. Included in HCD backlog at December 31, 2004 was \$280.5 million resulting from the consolidation of our partners' share of construction joint venture backlog under FIN 46 (see Note 5 of the "Notes to the Consolidated Financial Statements"). The remainder of the increase resulted from new awards in California and in the South, partially offset by a reduction in the Northeast and reflected changes primarily in public sector backlog. Additions to HCD backlog in the fourth quarter of 2004 included a \$147.8 million design/build bridge project in Florida, a \$131.1 million highway project in Texas and a \$49.8 million transit structure project in New York.

Branch Division backlog at December 31, 2004 was \$561.9 million, an increase of \$105.5 million, or 23.1%, from the December 31, 2003 level. The increase was due primarily to higher backlog in the private sector for projects located throughout the West, including California, due largely to the continued strong demand in the housing sector. Public sector backlog increases in states other than California were generally offset by a decrease in California, where ongoing budgetary issues have had a negative impact on the amount of funding available for infrastructure projects. Branch Division awards in the fourth quarter of 2004 included a \$28.3 million bridge project in Alaska and a \$16.3 million sewer pipeline project in California.

Gross Profit: Revenue from projects that were less than 25% complete was \$132.2 million in 2004 and \$107.9 million in 2003. Included in revenue from projects less than 25% complete for the year ended December 31, 2004 is \$24.2 million resulting from the consolidation of our partners' share of construction joint venture backlog under FIN 46 (see Note 5 of the "Notes to the Consolidated Financial Statements"). This increase in revenue from projects less than 25% complete had the effect of reducing our overall gross margin. No significant claim revenue was recognized in either 2004 or 2003.

Gross profit as a percent of revenue in our Branch Division decreased slightly in 2004 as compared with 2003 reflecting normal variability in the mix of work performed during the year.

The decrease in HCD gross profit as a percent of revenue in 2004 as compared with 2003 was due primarily to downward revisions in certain profit forecasts due to additional estimated costs to complete. The net impact of these estimate changes on recognized gross profit during 2004 was a reduction in gross profit of approximately \$40.0

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million, of which approximately \$10.0 million was recognized in the fourth quarter. Included in the net impact of this change in estimate in both the quarter and year ended December 31, 2004 was approximately \$2.0 million representing our partners' proportionate share (see Note 5 of the "Notes to the Consolidated Financial Statements"). The majority of this change in estimate related to downward revisions of ten projects. The amount attributable to each project ranged from approximately \$1.4 million to \$11.6 million. The cost estimate changes resulted from a variety of factors including costs associated with added scope changes, extended overhead due to owner and weather delays, design problems on design/build projects, subcontractor performance issues, changes in productivity expectations and higher estimated liquidated damages on two projects. At December 31, 2004, six of these projects were greater than 90% complete, two were greater than 85% complete and the remaining two projects averaged 59% complete.

General and Administrative Expenses: General and administrative expenses increased by \$5.2 million from 2003 to 2004. Salaries and related expenses increased in 2004 due primarily to additional staffing needed to support a higher volume of work. Incentive compensation, discretionary profit sharing and other variable compensation decreased in 2004 due to lower profitability in 2004. The increase in other general administrative costs in 2004 related to increased bidding activity and higher revenue volume as well as costs associated with complying with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. Other general and administrative costs included information technology, occupancy, office equipment and supplies, depreciation, travel and entertainment, outside services, advertising and marketing, training and other miscellaneous expenses, none of which individually exceeded 10% of total general and administrative expenses.

Gain on Sales of Property and Equipment: Gain on sales of property and equipment increased by \$13.9 million from 2003 to 2004 due primarily to the \$10.0 million gain on sale of certain assets related to our redi-mix concrete business in Utah in March 2004.

Other Income (Expense): Equity in income of affiliates primarily comprised income from our equity method investment in two land development partnerships in the year ended December 31, 2004 and \$18.4 million in income related to the sale of the State Route 91 Toll Road Franchise by the California Private Transportation Corporation, of which we are a 22.2% limited partner in the year ended December 31, 2003.

Provision for Income Taxes: Our effective tax rate decreased to 30.0% in 2004 from 36.2% in 2003 due primarily to the inclusion in our pre-tax income of the minority interest in the income of our consolidated construction joint ventures as required by FIN 46, which are generally not subject to income taxes on a stand-alone basis, and a lower overall state tax rate, net of federal tax benefit, due to changes in the mix of earnings in differing tax jurisdictions.

LIQUIDITY AND CAPITAL RESOURCES

December 31,	2005	2004	2003
(In thousands)			
Cash and cash equivalents	\$ 199,881	\$ 161,627	\$ 69,919
Net cash provided by (used in):			
Operating activities	146,501	79,233	77,589
Investing activities	(64,785)	(41,427)	(33,039)
Financing activities	(43,462)	(15,812)	(26,663)
Capital expenditures	102,829	89,636	62,805
Working capital	367,801	355,927	274,947

Our primary sources of liquidity are cash flows from operations and borrowings under our credit facilities. We expect the principal use of funds for the foreseeable future will be for capital expenditures, working capital, debt service, acquisitions and other investments. We have budgeted \$93.5 million for capital expenditures in 2006, which includes amounts for construction equipment, aggregate and asphalt plants, buildings, leasehold improvements and the purchase of land and aggregate reserves.

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Our cash and cash equivalents and short-term and long-term marketable securities totaled \$301.4 million at December 31, 2005 and included \$52.4 million of cash from our consolidated joint ventures (see Note 5 of the "Notes to the Consolidated Financial Statements"). This joint venture cash is for the working capital needs of each joint venture's project. The decision to distribute cash must generally be made jointly by all of the partners. We believe that our current cash and cash equivalents, short-term investments, cash generated from operations and amounts available under our existing credit facilities will be sufficient to meet our expected working capital needs, capital expenditures, financial commitments and other liquidity requirements associated with our existing operations through the next 12 months and beyond. If we experience a significant change in our business such as the execution of a significant acquisition, we would likely need to acquire additional sources of financing, which may be limited by the terms of our existing debt covenants, or may require the amendment of our existing debt agreements.

Cash provided by operating activities of \$146.5 million for the year ended December 31, 2005 represents a \$67.3 million increase from the amount provided by operating activities in 2004. Contributing to this increase were higher net income in the year ended December 31, 2005, an increase in net billings in excess of costs and estimated earnings and an increase in accounts payable and accrued expenses at December 31, 2005 compared with December 31, 2004. The increase in billings in excess of costs and estimated earnings was due primarily to cash payments received to mobilize several projects in the early stages of construction and the increase in accounts payable and accrued expenses was largely due to growth in costs related to revenue growth in 2005. Partially offsetting these items was an increase in accounts receivable of \$118.9 million from December 31, 2004 to December 31, 2005. Included in this increase is approximately \$46.1 million related to an increase in accounts receivable retention provisions in our contracts, which are generally due upon completion of the projects and acceptance by the project owner. The growth in retention receivable is largely due to an increase in the number of large HCD projects that were nearing completion at December 31, 2005 compared with the same period in 2004.

Cash used by investing activities of \$64.8 million in 2005 represents a \$23.4 million increase from the amount used by investing activities in 2004. The increase was largely due to higher net additions to property and equipment in 2005 compared with 2004.

Cash used by financing activities was \$43.5 million in 2005, an increase of \$27.7 million from 2004. The increase was mainly due to lower proceeds from long-term debt in 2005 compared with 2004, which included \$25 million advanced under our bank revolving line of credit. This was partially offset by lower net distributions to our minority partners in our consolidated construction joint ventures.

CONTRACTUAL OBLIGATIONS

The following table summarizes our significant contractual obligations outstanding as of December 31, 2005:

CONTRACTUAL OBLIGATIONS

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
<i>(In thousands)</i>					
Long term debt (1)	\$ 151,303	\$ 26,888	\$ 36,940	\$ 55,356	\$ 32,119
Operating leases (2)	39,499	7,071	7,646	4,748	20,034
Purchase obligations under construction contracts (3)	1,319,181	918,336	400,717	128	—
Other purchase obligations (4)	18,952	18,850	102	—	—
Deferred compensation obligations (5)	24,830	1,491	3,404	7,178	12,757
Wilder stock repurchase obligation (6)	19,217	1,244	1,546	1,046	15,381
Total	\$ 1,572,982	\$ 973,880	\$ 450,355	\$ 68,456	\$ 80,291

Management's Discussion and Analysis of Financial Condition and Results of Operation

- (1) These obligations represent the aggregate minimum principal maturities of long-term debt and do not include interest. See Note 10 of the "Notes to the Consolidated Financial Statements."
- (2) These obligations represent the minimum rental commitments and minimum royalty requirements under all noncancellable operating leases. See Note 15 of the "Notes to the Consolidated Financial Statements."
- (3) These obligations represent our best estimate of future purchases of materials and subcontract services related to our current contract backlog.
- (4) These obligations represent firm purchase commitments for equipment and other goods and services not connected with our construction backlog which are individually greater than \$10,000 and have an expected purchase after February 28, 2006.
- (5) The timing of expected payment of deferred compensation is based on estimated dates of retirement. Actual dates of retirement could be different and would cause the timing of payments to change.
- (6) The timing of expected payment for redemptions is based on estimates including dates of retirement which could differ from actual dates of retirement and would cause the timing of payments to change. See Note 15 of the "Notes to the Consolidated Financial Statements."

In 2002, our Board of Directors authorized us to repurchase up to \$25.0 million of our common stock of which \$22.8 million remained at December 31, 2005. In addition, we are authorized to purchase shares for contribution to our Employee Stock Ownership Plan ("ESOP").

We had standby letters of credit totaling approximately \$6.4 million outstanding at December 31, 2005, all of which expire between February 2006 and October 2006. We are generally required by the beneficiaries of these standby letters of credit to replace them upon expiration. Additionally, we generally are required to provide various types of surety bonds that provide an additional measure of security under certain public and private sector contracts. At December 31, 2005, approximately \$2.2 billion of our backlog was bonded and performance bonds totaling approximately \$8.7 billion were outstanding. Performance bonds do not have stated expiration dates; rather, we are generally released from the bonds when each contract is accepted by the owner. The ability to maintain bonding capacity to support our current and future level of contracting requires that we maintain cash and working capital balances satisfactory to our sureties.

On June 24, 2005, we entered into an agreement for a \$150.0 million bank revolving line of credit, which replaced the \$100.0 million line of credit we entered into in June 2003. The new revolving line of credit allows for unsecured borrowings for up to five years through June 24, 2010, with interest rate options. Interest on outstanding borrowings under the revolving line of credit is at our choice of selected LIBOR rates plus a margin that is recalculated quarterly. The margin was 0.75% at December 31, 2005. The unused and available portion of this line of credit was \$118.6 million at December 31, 2005.

Restrictive covenants under the terms of our debt agreements require the maintenance of certain financial ratios and the maintenance of tangible net worth (as defined) (see Note 10 of the "Notes to the Consolidated Financial Statements"). We were in compliance with these covenants at December 31, 2005. Additionally, our Wilder subsidiary has restrictive covenants (on a Wilder stand-alone basis) under the terms of its debt agreements that include the maintenance of certain ratios of working capital, liabilities to net worth and tangible net worth and restricts Wilder capital expenditures in excess of specified limits. Wilder was in compliance with these covenants at December 31, 2005. Failure to comply with these covenants could cause the amounts due under the debt agreements to become currently payable.

JOINT VENTURES

We participate in various construction joint venture partnerships in order to share expertise, risk and resources for certain highly complex projects. Generally, each construction joint venture is formed to accomplish a specific project and is jointly controlled by the joint venture partners. We select our joint venture partners based on our analysis of the prospective venturers' construction and financial capabilities, expertise in the type of work to be performed and

Management's Discussion and Analysis of Financial Condition and Results of Operation

past working relationships with us, among other criteria. The joint venture agreements typically provide that our interests in any profits and assets, and our respective share in any losses and liabilities that may result from the performance of the contract are limited to our stated percentage interest in the project.

The venture's contract with the project owner typically requires joint and several liability among the joint venture partners. Our agreements with our joint venture partners provide that each party will assume and pay its full proportionate share of any losses resulting from a project; however, if one of our partners is unable to pay its proportionate share we would be fully liable under our contract with the project owner. Circumstances that could lead to a loss under these guarantee arrangements include a partner's inability to contribute additional funds to the venture in the event that the project incurred a loss or additional costs that we could incur should the partner fail to provide the services and resources toward project completion that had been committed to in the joint venture agreement.

Under each joint venture agreement, one partner is designated as the sponsor. The sponsoring partner typically provides all administrative, accounting and most of the project management support for the project and generally receives a fee from the joint venture for these services. We have been designated as the sponsoring partner in certain of our current joint venture projects and are a non-sponsoring partner in others.

We also participate in various "line item" joint venture agreements under which each partner is responsible for performing certain discrete items of the total scope of contracted work. The revenue for these discrete items is defined in the contract with the project owner and each venture partner bears the profitability risk associated with its own work. All partners in a line item joint venture are jointly and severally liable for the completion of the total project under the terms of the contract with the project owner. There is not a single set of books and records for a line item joint venture. Each partner accounts for its items of work individually as it would for any self-performed contract. We account for our portion of these contracts as project revenues and costs in our accounting system and include receivables and payables associated with our work in our consolidated financial statements.

Although our agreements with our joint venture partners for both construction joint ventures and line item joint ventures provide that each party will assume and pay its share of any losses resulting from a project, if one of our partners was unable to pay its share we would be fully liable under our contract with the project owner. Circumstances that could lead to a loss under these guarantee arrangements include a partner's inability to contribute additional funds to the venture in the event that the project incurred a loss or additional costs that we could incur should the partner fail to provide the services and resources toward project completion that had been committed to in the joint venture agreement. At December 31, 2005 approximately \$243.9 million of work representing either our partners' proportionate share of unconsolidated construction joint ventures or work that our partners' are directly responsible for in line item joint ventures, had yet to be completed. We have never incurred a loss under these joint and several liability provisions, however, it is possible that we could in the future and such a loss could be significant.

OFF-BALANCE-SHEET ARRANGEMENTS

See "Joint Ventures" above.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 1 of the "Notes to the Consolidated Financial Statements" for a description of recent accounting pronouncements, including the expected dates of adoption and effects on our financial position, results of operations and cash flows.

QUARTERLY RESULTS

The following table sets forth selected unaudited financial information for the eight quarters in the two-year period ended December 31, 2005. This information has been prepared on the same basis as the audited financial statements and, in the opinion of management, contains all adjustments necessary for a fair statement thereof.

Management's Discussion and Analysis of Financial Condition and Results of Operation

QUARTERLY FINANCIAL DATA

2005 Quarters Ended

(Unaudited—In thousands, except per share data)

	Dec. 31	Sept. 30	June 30	March 31
Revenue	\$ 679,552	\$ 864,162	\$ 676,704	\$ 420,934
Gross profit	106,024	109,701	76,707	26,940
As a percent of revenue	15.6%	12.7%	11.3%	6.4%
Net income (loss)	35,812	40,651	14,954	(8,267)
As a percent of revenue	5.3%	4.7%	2.2%	(2.0%)
Net income (loss) per share:				
Basic	\$ 0.88	\$ 1.00	\$ 0.37	\$ (0.20)
Diluted	\$ 0.86	\$ 0.98	\$ 0.36	\$ (0.20)
Dividends per share	\$ 0.10	\$ 0.10	\$ 0.10	\$ 0.10
Market price				
High	\$ 39.88	\$ 38.42	\$ 28.20	\$ 28.15
Low	\$ 31.50	\$ 27.97	\$ 22.00	\$ 24.01

2004 Quarters Ended

(Unaudited—In thousands, except per share data)

	Dec. 31	Sept. 30	June 30	March 31
Revenue	\$ 540,615	\$ 699,825	\$ 558,754	\$ 337,018
Gross profit	56,245	95,348	59,744	10,684
As a percent of revenue	10.4%	13.6%	10.7%	3.2%
Net income (loss)	19,525	32,785	13,806	(9,109)
As a percent of revenue	3.6%	4.7%	2.5%	(2.7%)
Net income (loss) per share:				
Basic	\$ 0.48	\$ 0.81	\$ 0.34	\$ (0.23)
Diluted	\$ 0.47	\$ 0.80	\$ 0.34	\$ (0.23)
Dividends per share	\$ 0.10	\$ 0.10	\$ 0.10	\$ 0.10
Market price				
High	\$ 27.90	\$ 23.99	\$ 24.18	\$ 24.61
Low	\$ 22.91	\$ 17.17	\$ 17.52	\$ 20.64

Net income (loss) per share calculations are based on the weighted average common shares outstanding for each period presented. Accordingly, the sum of the quarterly net income (loss) per share amounts may not equal the per share amount reported for the year.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks due largely to changes in interest rates, which we have managed primarily by managing the maturities in our investment portfolio. We currently do not have any material business transactions in foreign currencies.

The fair value of our short-term held-to-maturity investment portfolio and related income would not be significantly impacted by changes in interest rates since the investment maturities are short and the interest rates are primarily fixed. The fair value of our long-term held-to-maturity investment portfolio may be impacted by changes in interest rates. Our mutual fund portfolio of \$26.0 million is exposed to equity price risks.

We had senior notes payable of \$33.3 million at December 31, 2005 which carry a fixed interest rate of 6.54% per annum with principal payments due in nine equal annual installments that began in 2002 and senior notes payable of \$66.7 million at December 31, 2005 which carry a fixed interest rate of 6.96% per annum with principal payments due in nine equal annual installments which began in 2005.

We had amounts outstanding under our line of credit of \$25.0 million at December 31, 2005 which bear interest at six month LIBOR plus a margin of 0.75%. The interest rate resets every six months and all amounts outstanding are due in June 2010. At December 31, 2005 the note bore interest at 5.45%.

The table below presents principal amounts and related weighted average interest rates by year for our cash and cash equivalents, held-to-maturity investments and significant debt obligations:

	2006	2007	2008	2009	2010	Thereafter	Total
<i>(In thousands)</i>							
Assets							
Cash, cash equivalents and held-to-maturity investments	\$ 242,395	\$ 32,802	\$ 9	\$ 149	\$ —	\$ —	\$ 275,355
Weighted average interest rate	4.00%	3.87%	3.28%	2.50%	—%	—%	3.98%
Liabilities							
Fixed rate debt							
Senior notes payable	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 25,000	\$ 100,000
Weighted average interest rate	6.77%	6.77%	6.77%	6.77%	6.77%	6.96%	6.82%
Variable rate debt							
Revolving line of credit	\$ —	\$ —	\$ —	\$ —	\$ 25,000	\$ —	\$ 25,000
Weighted average interest rate	—%	—%	—%	—%	5.45%	—%	5.45%

The estimated fair value of our cash, cash equivalents and short-term held-to-maturity investments approximate the principal amounts reflected above based on the generally short maturities of these financial instruments. The estimated fair value of our long-term held-to-maturity investments approximates the principal amounts above due to the relatively minor difference between the effective yields of these investments and rates currently available on similar instruments. Rates currently available to us for debt with similar terms and remaining maturities are used to estimate fair value of existing debt. Based on the lower fixed borrowing rates currently available to us for bank loans with similar terms and average maturities, the fair value of the senior notes payable was approximately \$104.9 million as of December 31, 2005 and \$126.1 million as of December 31, 2004. The estimated fair value of amounts payable under our revolving line of credit at December 31, 2005 approximates the principal amount reflected above since the variable interest rate approximates the rate currently available to us for a loan with similar terms.

CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures: We carried out an evaluation, under the supervision of and with the participation of management, including our Chief Executive Officer and our Chief Financial Officer, of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2005, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting: During the fourth quarter of 2005, there have been no changes in our internal control over financial reporting that have materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

Management’s Report on Internal Control Over Financial Reporting: Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in “Internal Control—Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation our management concluded that our internal control over financial reporting was effective as of December 31, 2005.

Our management’s assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of Granite Construction Incorporated:

We have completed integrated audits of Granite Construction Incorporated's 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of 2005, and an audit of its 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

CONSOLIDATED FINANCIAL STATEMENTS

In our opinion, the consolidated financial statements appearing on pages 44 to 66 present fairly, in all material respects, the financial position of Granite Construction Incorporated and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing on page 41, that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

Report of Independent Registered Public Accounting Firm

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

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

A handwritten signature in cursive script, reading "PricewaterhouseCoopers LLP", is displayed within a light gray rectangular box.

PRICEWATERHOUSECOOPERS LLP

San Jose, California

March 1, 2006

Consolidated Balance Sheets

December 31,	2005	2004
<i>(In thousands, except share and per share data)</i>		
ASSETS		
Current assets		
Cash and cash equivalents	\$ 199,881	\$ 161,627
Short-term marketable securities	68,540	102,237
Accounts receivable, net	476,453	357,842
Costs and estimated earnings in excess of billings	43,660	54,384
Inventories	33,161	31,711
Deferred income taxes	22,996	21,012
Equity in construction joint ventures	27,408	20,895
Other current assets	104,849	75,630
Total current assets	976,948	825,338
Property and equipment, net	397,111	376,197
Long-term marketable securities	32,960	13,828
Investments in affiliates	15,855	10,725
Other assets	49,356	51,866
Total assets	\$ 1,472,230	\$ 1,277,954
LIABILITY AND SHAREHOLDERS' EQUITY		
Current liabilities		
Current maturities of long-term debt	\$ 26,888	\$ 15,861
Accounts payable	232,807	191,782
Billings in excess of costs and estimated earnings	208,883	144,401
Accrued expenses and other current liabilities	140,569	117,367
Total current liabilities	609,147	469,411
Long-term debt	124,415	148,503
Other long-term liabilities	46,556	40,641
Deferred income taxes	37,325	44,135
Commitments and contingencies		
Minority interest in consolidated subsidiaries	33,227	24,790
Shareholders' equity		
Preferred stock, \$0.01 par value, authorized 3,000,000 shares, none outstanding	—	—
Common stock, \$0.01 par value, authorized 100,000,000 shares; issued and outstanding 41,682,010 shares in 2005 and 41,612,319 shares in 2004	417	416
Additional paid-in capital	80,619	76,766
Retained earnings	549,101	482,635
Accumulated other comprehensive income	1,602	1,475
Unearned compensation	(10,179)	(10,818)
Total shareholders' equity	621,560	550,474
Total liabilities and shareholders' equity	\$ 1,472,230	\$ 1,277,954

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

Consolidated Statements of Income

Years Ended December 31,	2005	2004	2003
<i>(In thousands, except share and per share data)</i>			
Revenue:			
Construction	\$ 2,307,062	\$ 1,871,859	\$ 1,591,746
Material sales	334,290	264,353	252,745
Total revenue	2,641,352	2,136,212	1,844,491
Cost of revenue:			
Construction	2,060,680	1,701,277	1,413,538
Material sales	261,300	212,914	204,503
Total cost of revenue	2,321,980	1,914,191	1,618,041
Gross Profit	319,372	222,021	226,450
General and administrative expenses	183,392	157,035	151,879
Provision for legal judgment	9,300	—	—
Gain on sales of property and equipment	8,235	18,566	4,714
Operating income	134,915	83,552	79,285
Other income (expense):			
Interest income	11,573	7,962	6,422
Interest expense	(6,932)	(7,191)	(8,577)
Equity in income of affiliates	1,497	6,162	17,657
Other, net	1,258	4,439	2,738
Total other income (expense)	7,396	11,372	18,240
Income before provision for income taxes and minority interest	142,311	94,924	97,525
Provision for income taxes	41,413	28,477	35,304
Income before minority interest	100,898	66,447	62,221
Minority interest in consolidated subsidiaries	(17,748)	(9,440)	(1,717)
Net income	\$ 83,150	\$ 57,007	\$ 60,504
Net income per share			
Basic	\$ 2.05	\$ 1.41	\$ 1.51
Diluted	\$ 2.02	\$ 1.39	\$ 1.48
Weighted average shares of common stock			
Basic	40,614	40,390	40,175
Diluted	41,249	41,031	40,808
Dividends per share	\$ 0.40	\$ 0.40	\$ 0.40

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

Consolidated Statements of Shareholders' Equity and Comprehensive Income

Years Ended December 31, 2003, 2004 and 2005	Outstanding Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Compre- hensive Income (loss)	Unearned Compen- sation	Total
<i>(In thousands, except share data)</i>							
Balances, December 31, 2002	41,257,015	\$ 413	\$ 69,390	\$ 398,383	\$ (1,402)	\$ (11,915)	\$ 454,869
Comprehensive income:							
Net income	—	—	—	60,504	—	—	
Other comprehensive income:							
Changes in net unrealized gains on investments	—	—	—	—	1,478	—	
Total comprehensive income							61,982
Restricted stock issued	349,090	4	5,202	—	—	(5,559)	(353)
Amortized restricted stock	—	—	—	—	—	5,951	5,951
Repurchase of common stock	(82,695)	(2)	(1,314)	—	—	—	(1,316)
Cash dividends on common stock	—	—	—	(16,615)	—	—	(16,615)
Stock options exercised and other	4,907	—	373	—	—	—	373
Balances, December 31, 2003	41,528,317	415	73,651	442,272	76	(11,523)	504,891
Comprehensive income:							
Net income	—	—	—	57,007	—	—	
Other comprehensive income:							
Changes in net unrealized gains on investments	—	—	—	—	1,399	—	
Total comprehensive income							58,406
Restricted stock issued	166,650	2	4,367	—	—	(5,306)	(937)
Amortized restricted stock	—	—	—	—	—	6,011	6,011
Repurchase of common stock	(293,239)	(3)	(6,424)	—	—	—	(6,427)
Cash dividends on common stock	—	—	—	(16,644)	—	—	(16,644)
Common stock contributed to ESOP	192,000	2	3,987	—	—	—	3,989
Stock options exercised and other	18,591	—	1,185	—	—	—	1,185
Balances, December 31, 2004	41,612,319	416	76,766	482,635	1,475	(10,818)	550,474
Comprehensive income:							
Net income	—	—	—	83,150	—	—	
Other comprehensive income:							
Changes in net unrealized gains on investments	—	—	—	—	127	—	
Total comprehensive income							83,277
Restricted stock issued	187,563	2	5,019	—	—	(5,318)	(297)
Amortized restricted stock	—	—	—	—	—	5,957	5,957
Repurchase of common stock	(204,543)	(2)	(5,261)	—	—	—	(5,263)
Cash dividends on common stock	—	—	—	(16,684)	—	—	(16,684)
Common stock contributed to ESOP	85,200	1	1,993	—	—	—	1,994
Stock options exercised and other	1,471	—	2,102	—	—	—	2,102
Balances, December 31, 2005	41,682,010	\$ 417	\$ 80,619	\$ 549,101	\$ 1,602	\$ (10,179)	\$ 621,560

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

Consolidated Statements of Cash Flows

Years Ended December 31,	2005	2004	2003
<i>(In thousands)</i>			
Operating Activities			
Net income	\$ 83,150	\$ 57,007	\$ 60,504
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation, depletion and amortization	65,801	62,459	65,693
Bad debt expense	3,606	454	18
Gain on sales of property and equipment	(8,235)	(18,566)	(4,714)
Change in deferred income taxes	(8,839)	(5,868)	4,089
Amortization of unearned compensation	5,957	6,011	5,951
Common stock contributed to ESOP	1,994	3,989	—
Minority interest in consolidated subsidiaries	17,748	9,440	1,717
Equity in income of affiliates	(1,497)	(6,162)	(17,657)
Gain on sale of equity investment	(1,187)	(3,288)	(1,853)
Changes in assets and liabilities, net of the effects of acquisitions and FIN 46 consolidations:			
Accounts receivable	(118,861)	(28,676)	(22,332)
Inventories	(1,450)	(1,833)	106
Equity in construction joint ventures	(6,513)	(208)	(17,921)
Other assets	(29,132)	(23,699)	(29,708)
Accounts payable	41,025	38,431	16,655
Billings in excess of costs and estimated earnings, net	75,206	(25,037)	5,389
Accrued expenses and other liabilities	27,728	14,779	11,652
Net cash provided by operating activities	146,501	79,233	77,589
Investing Activities			
Purchases of marketable securities	(96,877)	(96,975)	(190,957)
Maturities and sales of marketable securities	111,975	113,243	191,863
Additions to property and equipment	(102,829)	(89,636)	(62,805)
Proceeds from sales of property and equipment	25,012	24,389	8,498
Proceeds from sales of equity investment	1,759	7,463	6,033
(Contributions to) distributions from affiliates, net	(4,736)	9,308	14,152
Acquisition of minority interest	—	(9,219)	—
Other investing activities	911	—	177
Net cash used by investing activities	(64,785)	(41,427)	(33,039)
Financing Activities			
Proceeds from long-term debt	29,100	70,703	20,480
Repayments of long-term debt	(44,498)	(52,142)	(31,511)
Repurchase of common stock	(5,263)	(6,427)	(1,316)
Dividends paid	(16,675)	(16,636)	(15,763)
Contributions from minority partners	946	5,601	1,548
Distributions to minority partners	(7,451)	(17,229)	(420)
Other financing activities	379	318	319
Net cash used in financing activities	(43,462)	(15,812)	(26,663)
Increase in cash and cash equivalents	38,254	21,994	17,887
Cash and cash equivalent added in FIN 46 consolidations	—	69,714	—
Cash and cash equivalents at beginning of year	161,627	69,919	52,032
Cash and cash equivalents at end of year	\$ 199,881	\$ 161,627	\$ 69,919
Supplementary Information			
Cash paid during the period for:			
Interest	\$ 6,801	\$ 7,000	\$ 8,935
Income taxes	49,551	29,557	30,096
Non-cash investing and financing activity:			
Restricted stock issued for services, net	\$ 5,021	\$ 4,369	\$ 5,206
Dividends accrued but not paid	4,170	4,161	4,153
Financed acquisition of assets	2,337	14,680	4,004
Notes received from sale of assets	—	8,893	—

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

Notes to the Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business: Granite Construction Incorporated is a heavy civil contractor engaged in the construction of highways, dams, airport infrastructure, mass transit facilities, real estate site development and other infrastructure related projects with offices in Alaska, Arizona, California, Florida, Minnesota, Nevada, New York, Oregon, Texas, Utah and Washington. Unless otherwise indicated, the terms “we,” “us,” “our,” and “Granite” refer to Granite Construction Incorporated and its consolidated subsidiaries.

Principles of Consolidation: The consolidated financial statements include the accounts of Granite Construction Incorporated and its wholly owned and majority owned subsidiaries. All material inter-company transactions and accounts have been eliminated. We use the equity method of accounting for affiliated companies where we have the ability to exercise significant influence, but not control. Additionally, we participate in joint ventures with other construction companies. We have consolidated these joint ventures where we have determined that through our participation in these joint ventures we have a variable interest and are the primary beneficiary as defined by Financial Accounting Standards Board Interpretation No. 46 (revised December 2003) “Consolidation of Variable Interest Entities,” (“FIN 46”). Where we have determined we are not the primary beneficiary we account for our share of the operations of jointly controlled construction joint ventures on a pro rata basis in the consolidated statements of income and as a single line item in the consolidated balance sheets in accordance with Emerging Issues Task Force Issue 00-01, “Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures.”

Use of Estimates in the Preparation of Financial Statements: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition: Our contracts with our customers are primarily either “fixed unit price” or “fixed price.” Under fixed unit price contracts, we are committed to provide materials or services required by a project at fixed unit prices (for example, dollars per cubic yard of concrete poured or cubic yards of earth excavated). While the fixed unit price contract shifts the risk of estimating the quantity of units required for a particular project to the customer, any increase in our unit cost over the expected unit cost in the bid, whether due to inflation, inefficiency, faulty estimates or other factors, is borne by us unless otherwise provided in the contract. Fixed price contracts are priced on a lump-sum basis under which we bear the risk that we may not be able to perform all the work profitably for the specified contract amount. The percentage of fixed price contracts in our backlog increased from approximately 58.0% at December 31, 2004 to approximately 63.0% at December 31, 2005. All state and federal government contracts and many of our other contracts provide for termination of the contract for the convenience of the party contracting with us, with provisions to pay us for work performed through the date of termination.

We use the percentage of completion accounting method for construction contracts in accordance with the American Institute of Certified Public Accountants Statement of Position 81-1, “Accounting for Performance of Construction-Type and Certain Production-Type Contracts.” Revenue and earnings on construction contracts, including construction joint ventures, are recognized on the percentage of completion method in the ratio of costs incurred to estimated final costs. Revenue in an amount equal to cost incurred is recognized prior to contracts reaching 25% completion. The related profit is deferred until the period in which such percentage completion is attained. It is our judgment that until a project reaches 25% completion, there is insufficient information to determine what the estimated profit on the project will be with a reasonable level of assurance. Revenue from contract claims is recognized when we have a signed settlement agreement and payment is assured. Revenue from contract change orders, which occur in most large projects, is recognized when the owner has agreed to the change order in writing. During 2005 we settled various contract issues for which the associated cost was included in prior periods (see Note 2). Provisions are recognized in the statement of income for the full amount of estimated losses on uncompleted contracts whenever evidence indicates that the estimated total cost of a contract exceeds its estimated total revenue.

Notes to the Consolidated Financial Statements

Contract cost consists of direct costs on contracts, including labor and materials, amounts payable to subcontractors, direct overhead costs and equipment expense (primarily depreciation, fuel, maintenance and repairs). Depreciation is provided using accelerated methods for construction equipment. Contract cost is recorded as incurred and revisions in contract revenue and cost estimates are reflected in the accounting period when known. The 25% threshold is applied to all percentage of completion projects without exception unless and until we project a loss on the project, in which case the estimated loss is immediately recognized.

Revenue from the sale of materials is recognized when delivery occurs and risk of ownership passes to the customer.

Balance Sheet Classifications: We include in current assets and liabilities amounts receivable and payable under construction contracts (principally retentions) that may extend beyond one year. Additionally, we include the cost of property purchased for development and sale in current assets. A one-year time period is used as the basis for classifying all other current assets and liabilities.

Cash and Cash Equivalents: Cash equivalents are securities having maturities of three months or less from the date of purchase.

Marketable Securities: We determine the classification of our marketable securities at the time of purchase and reevaluate these determinations at each balance sheet date. Debt securities are classified as held-to-maturity when we have the positive intent and ability to hold the securities to maturity. Held-to-maturity investments are stated at amortized cost. Debt securities for which we do not have the positive intent or ability to hold to maturity are classified as available-for-sale, along with any investments in equity securities. Securities available-for-sale are carried at fair value with the unrealized gains and losses, net of income taxes, reported as a separate component of other comprehensive income until realized. We have no investments that qualify as trading.

The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity, which is included in interest income. Realized gains and losses are included in other income, net. The cost of securities sold is based on the specific identification method.

Financial Instruments: The carrying value of marketable securities approximates their fair value as determined by market quotes. Rates currently available to us for debt with similar terms and remaining maturities are used to estimate the fair value of existing debt. The carrying value of receivables and other amounts arising out of normal contract activities, including retentions, which may be settled beyond one year, is estimated to approximate fair value.

Concentrations: We maintain the majority of cash balances and all of our marketable securities with several financial institutions. We invest with high credit quality financial institutions and, by policy, limit the amount of credit exposure to any financial institution. A significant portion of our labor force is subject to collective bargaining agreements. Collective bargaining agreements covering approximately 21% of our labor force at December 31, 2005 will expire during 2006.

Revenue earned by both the Branch Division and the Heavy Construction Division from federal, state and local government agencies amounted to \$1,808.0 million (68.5%) in 2005, \$1,553.1 million (72.7%) in 2004 and \$1,339.1 million (72.6%) in 2003. Revenue from the California Department of Transportation represented \$127.1 million (4.8%) in 2005, \$134.5 million (6.3%) in 2004 and \$166.5 million (9.0%) in 2003. At December 31, 2005 and 2004, we had significant amounts receivable from these agencies. We perform ongoing credit evaluations of our customers and generally do not require collateral, although the law provides us the ability to file mechanics' liens on real property improved for private customers in the event of non-payment by such customers. We maintain an allowance for potential credit losses and such losses have been within management's expectations. We have no foreign operations.

Inventories: Inventories consist primarily of quarry products valued at the lower of average cost or market.

Property and Equipment: Property and equipment are stated at cost. Depreciation for construction and other equipment is primarily provided using accelerated methods over lives ranging from three to ten years and the straight-line method over lives from three to twenty years for the remaining depreciable assets. We believe that accelerated methods best approximate the service provided by the construction and other equipment. Depletion of quarry property is based on the usage of depletable reserves. We frequently sell property and equipment that has reached the end of its

Notes to the Consolidated Financial Statements

useful life or no longer meets our needs, including depleted quarry property. Such property is held in property and equipment until sold. The cost and accumulated depreciation or depletion of property sold or retired is removed from the accounts and gains or losses, if any, are reflected in earnings for the period. We capitalized interest costs related to certain self-constructed assets of \$3.3 million in 2005, \$1.9 million in 2004 and \$823,000 in 2003. Maintenance and repairs are charged to operations as incurred.

Long-Lived Assets: Long-lived assets held and used by us are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recorded when the asset's carrying value exceeds its estimated undiscounted future cash flows.

We perform goodwill impairment tests annually during our fourth quarter and more frequently when events and circumstances occur that indicate a possible impairment of goodwill. In determining whether there is an impairment of goodwill, we calculate the estimated fair value of the reporting unit in which the goodwill is recorded using a discounted future cash flow method. We then compare the resulting fair value to the net book value of the reporting unit, including goodwill. If the net book value of a reporting unit exceeds its fair value, we measure the amount of the impairment loss by comparing the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. To the extent that the carrying amount of a reporting unit's goodwill exceeds its implied fair value, we recognize a goodwill impairment loss. We performed our annual impairment test in 2005 and we determined that no impairment had occurred.

Other intangible assets include covenants not to compete, permits and trade name which are being amortized on a straight-line basis over terms from two to fifteen years.

Reclamation Costs: We account for the costs related to legal obligations to reclaim aggregate mining sites and other facilities in accordance with Statement of Financial Accounting Standards No. 143 ("SFAS 143"), "Accounting for Asset Retirement Obligations," which was effective for our fiscal year beginning January 1, 2003. Accordingly, we record our estimated reclamation liability when incurred, capitalize the estimated liability as part of the related asset's carrying amount and allocate it to expense over the asset's useful life. The adoption of SFAS 143 in 2003 did not have a material effect on our financial position, results of operations or cash flows.

Warranties: Many of our construction contracts contain warranty provisions covering defects in equipment, materials, design or workmanship that generally run from six months to one year after our customer accepts the project. Because of the nature of our projects, including contract owner inspections of the work both during construction and prior to acceptance, we have not experienced material warranty costs for these short-term warranties and therefore, do not believe an accrual for these costs is necessary. Certain construction contracts carry longer warranty periods, ranging from two to ten years for which we have accrued an estimate of warranty cost. The warranty cost is estimated based on our experience with the type of work and any known risks relative to the project. However, these accrued costs were not material at December 31, 2005 or December 31, 2004.

Accrued Insurance Costs: We carry insurance policies to cover various risks, primarily general liability and workers compensation, under which we are liable to reimburse the insurance company for a portion of each claim paid. The amounts that we are liable for generally range from the first \$250,000 to \$1.0 million per occurrence. We accrue for the estimated ultimate liability for incurred losses, both reported and unreported, using actuarial methods based on historic trends modified, if necessary, by recent events.

Stock Compensation: As more fully described in Note 12, we maintain an equity incentive plan that allows for the grant of restricted common stock and incentive and nonqualified stock options to employees and our Board of Directors. Restricted stock compensation cost is measured as the stock's fair value at the date of grant. The compensation cost is recognized ratably over the vesting period—generally five years. We account for options granted under this plan under the fair value recognition provisions of Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123").

Income Taxes: Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss carry-forwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and

Notes to the Consolidated Financial Statements

liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Computation of Earnings Per Share: Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding, excluding restricted common stock. Diluted earnings per share is computed giving effect to all dilutive potential common shares that were outstanding during the period. Dilutive potential common shares consist of the incremental common shares issuable upon the exercise of stock options, warrants and upon the vesting of restricted common stock.

Reclassifications: Certain financial statement items have been reclassified to conform to the current year's format. These reclassifications had no impact on previously reported net income, financial position or cash flows.

Recent Accounting Pronouncements: In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123-R"), which is a revision of SFAS 123. SFAS 123-R supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and amends FASB Statement No. 95, "Statement of Cash Flows." Generally, the approach to accounting for share-based payments in SFAS 123-R is similar to the approach described in SFAS 123. However, SFAS 123-R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values (i.e., pro forma disclosure is no longer an alternative to financial statement recognition). SFAS 123-R is effective for Granite beginning in fiscal year 2006. On March 29, 2005 the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 107 ("SAB 107") which provides the SEC Staff's views regarding interactions between SFAS 123-R and certain SEC rules and regulations and provides interpretations of the valuation of share-based payments for public companies. We are currently reviewing the impact of implementing SFAS 123-R and SAB 107 on our consolidated financial statements.

In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" ("FIN 47"), which is an interpretation of FASB Statement No. 143, "Accounting for Asset Retirement Obligations," and requires an entity to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. This Interpretation was effective for fiscal years ending after December 15, 2005 and its adoption did not have a material effect on our financial position, results of operation or cash flows.

In March 2005, the FASB ratified Emerging Issues Task Force Issue 04-06, Accounting for Stripping Costs in the Mining Industry ("EITF 04-06"). EITF 04-06 clarifies that post-production stripping costs, which represent the costs of removing overburden and waste materials to access mineral deposits, should be considered costs of the extracted minerals under a full absorption costing system and recorded as a component of inventory to be recognized in costs of sales in the same period as the revenue from the sale of the inventory. EITF 04-06 is effective January 1, 2006 and is not expected to have a material effect on our financial position, results of operations or cash flows.

2. CHANGE IN ACCOUNTING ESTIMATE

Our gross profit in the years ended December 31, 2005 and 2004 includes the effects of significant changes in the estimates of the profitability of certain of our Heavy Construction Division ("HCD") projects. The net effect of these estimate changes decreased gross profit in each period.

HEAVY CONSTRUCTION DIVISION CHANGE IN ACCOUNTING ESTIMATE

Years Ended December 31,

	2005	2004
Net reduction in gross profit <i>(In millions)</i>	\$ 31.0	\$ 40.0
Number of projects with significant downward estimate changes	13	10
Range of reduction to gross profit from each project <i>(In millions)</i>	\$ 1.8 – 8.4	\$ 1.4 – 11.6
Number of projects with significant upward estimate changes	4	3
Range of increase to gross profit from each project <i>(In millions)</i>	\$ 1.4 – 11.6	\$ 1.5 – 7.5
Total number of active projects	43	50

Notes to the Consolidated Financial Statements

During the year ended December 31, 2005, the changes that resulted in reduced estimated project profitability resulted primarily from site conditions that differed from our expectations, changes in estimated liquidated damages, design issues on design/build projects, changes in productivity assumptions, costs associated with owner directed added scope changes, subcontractor performance issues, increased overhead due to owner and weather delays and changes in cost expectations in response to market factors for labor and certain materials. The 13 HCD projects with significant downward changes in estimated project profitability during the year were at various stages of completion at December 31, 2005 ranging from 45.0% to 99.0%. Four of the 13 projects also had significant downward estimate changes for 2004.

The impact of these downward changes on gross profit in 2005 was partially offset by an increase in estimated profitability from four other projects. The majority of the increased profitability related to the settlement of outstanding issues for which the associated cost was recognized in prior periods and included settlements related to three of the ten projects with significant downward estimate changes in 2004. This amount included recognition of approximately \$5.0 million related to recovery of liquidated damages paid in 2004. We had purchased insurance coverage to provide reimbursement for any liquidated damages on this project. However, we did not recognize the receivable for this reimbursement at that time because the insurance company was contesting coverage and the issue was taken to binding arbitration. The arbitrators have since decided the issue unanimously in our favor and we have received payment from the insurance company. Although the insurance company has filed for leave to appeal the arbitrators' decision, we consider their chances for success highly remote.

We believe we are entitled to additional compensation related to some of our downward estimate changes and are actively pursuing these issues with the contract owners. However, the amount and timing of any future recovery is highly uncertain. While we recognize the impact of estimated costs immediately when known, under our accounting policies we do not recognize revenue from contract changes until we have a signed change order or executed claim settlement. We believe that our estimates of the gross profit are achievable. However, it is possible that the actual cost to complete will vary from our current estimate and any future estimate changes could be significant.

3. MARKETABLE SECURITIES

The carrying amounts of marketable securities were as follows at December 31, 2005 and 2004:

	Held-to-Maturity		Available-for-Sale		Total	
	2005	2004	2005	2004	2005	2004
<i>(In thousands)</i>						
Securities classified as current:						
U.S. Government and agency obligations	\$ 6,540	\$ 25,213	\$ —	\$ —	\$ 6,540	\$ 25,213
Commercial paper	19,880	32,931	—	—	19,880	32,931
Municipal bonds	16,094	18,966	—	—	16,094	18,966
Domestic banker's acceptance	—	2,829	—	—	—	2,829
Mutual funds	—	—	26,026	22,298	26,026	22,298
Total current marketable securities	42,514	79,939	26,026	22,298	68,540	102,237
Securities classified as long-term:						
U.S. Government and agency obligations	21,922	6,538	—	—	21,922	6,538
Municipal bonds	11,038	7,290	—	—	11,038	7,290
Total long-term marketable securities	32,960	13,828	—	—	32,960	13,828
Total marketable securities	\$ 75,474	\$ 93,767	\$ 26,026	\$ 22,298	\$ 101,500	\$ 116,065

Notes to the Consolidated Financial Statements

Held-to-maturity investments are carried at amortized cost, which approximates fair value. Unrealized holding gains and losses for all debt securities were insignificant for the years ended December 31, 2005 and 2004. We recognized unrealized holding gains of \$172 (\$127 after tax), \$2,304 (\$1,399 after tax) and \$2,310 (\$1,478 after tax) related to our available-for-sale investment in mutual funds as a component of the other comprehensive income for the years ended December 31, 2005, 2004 and 2003, respectively. At December 31, 2005 and 2004, none of our investments in our mutual fund portfolio were in an unrealized loss position.

At December 31, 2005, scheduled maturities of held-to-maturity investments were as follows (*in thousands*):

Within one year	\$ 42,514
After one year through five years	32,960
Total	\$ 75,474

For the years ended December 31, 2005 and 2004, changes in our marketable securities were as follows:

	December 31, 2005			December 31, 2004		
	Held-to-Maturity	Available-for-Sale	Total	Held-to-Maturity	Available-for-Sale	Total
(In thousands)						
Purchases	\$ 90,110	\$ 6,767	\$ 96,877	\$ 88,222	\$ 8,753	\$ 96,975
Maturities and sales	(108,764)	(3,211)	(111,975)	(110,475)	(2,768)	(113,243)
Amortization and other	361	—	361	(2,037)	—	(2,037)
Unrealized gains	—	172	172	—	2,304	2,304
Net Change	\$ (18,293)	\$ 3,728	\$ (14,565)	\$ (24,290)	\$ 8,289	\$ (16,001)

4. ACCOUNTS RECEIVABLE

December 31,

(In thousands)

Construction contracts:

Completed and in progress

Retentions

Total construction contracts

Construction material sales

Other

Total gross accounts receivable

Less: allowance for doubtful accounts

Total net accounts receivable

2005

2004

\$ 258,402 \$ 185,411

167,973 134,460

426,375 319,871

43,232 31,157

8,452 8,668

478,059 359,696

1,606 1,854

\$ 476,453 \$ 357,842

Accounts receivable includes amounts billed and billable for public and private contracts and do not bear interest. The balances billed but not paid by customers pursuant to retainage provisions in construction contracts generally become due upon completion of the contracts and acceptance by the owners. Retainage amounts of \$168.0 million at December 31, 2005 are expected to be collected as follows: \$138.2 million in 2006, \$23.9 million in 2007, \$5.2 million in 2008 and \$0.7 million in 2009.

Notes to the Consolidated Financial Statements

5. CONSTRUCTION JOINT VENTURES

We participate in various construction joint venture partnerships. Generally, each construction joint venture is formed to accomplish a specific project and is jointly controlled by the joint venture partners. The joint venture agreements typically provide that our interests in any profits and assets, and our respective share in any losses and liabilities that may result from the performance of the contract is limited to our stated percentage interest in the project. Although the venture's contract with the project owner typically requires joint and several liability, our agreements with our joint venture partners provide that each partner will assume and pay its full proportionate share of any losses resulting from a project. We have no significant commitments beyond completion of the contract.

We have determined that certain of these joint ventures are variable interest entities as defined by FIN 46. Accordingly, we have consolidated those joint ventures where we have determined that we are the primary beneficiary on a prospective basis beginning January 1, 2004. The joint ventures we have consolidated are engaged in construction projects with total contract values ranging from \$14.6 million to \$398.8 million. Our proportionate share of the consolidated joint ventures ranges from 52.0% to 70.0%.

Consistent with Emerging Issues Task Force Issue 00-01, "Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures," we account for our share of the operations of construction joint ventures in which we have determined we are not the primary beneficiary on a pro rata basis in the consolidated statements of income and as a single line item in the consolidated balance sheets. The joint ventures in which we hold a significant interest but are not the primary beneficiary are engaged in construction projects with total contract values ranging from \$3.9 million to \$264.5 million. Our proportionate share of equity in these joint ventures ranges from 25% to 40%, the most significant of which includes a 40% share of a rapid transit project in New York, a 30% share of a rapid transit project in Maryland and a 30% share of a rapid transit project in Florida.

We also participate in various "line item" joint venture agreements under which each partner is responsible for performing certain discrete items of the total scope of contracted work. The revenue for these discrete items is defined in the contract with the project owner and each venture partner bears the profitability risk associated with its own work. All partners in a line item joint venture are jointly and severally liable for the completion of the total project under the terms of the contract with the project owner. There is not a single set of books and records for a line item joint venture. Each partner accounts for its items of work individually as it would for any self-performed contract. We account for our portion of these contracts as project revenues and costs in our accounting system and include receivables and payables associated with our work in our consolidated financial statements.

The combined assets, liabilities and net assets of unconsolidated joint ventures in which we have determined we are not the primary beneficiary are as follows:

December 31,	2005	2004
<i>(In thousands)</i>		
Assets:		
Total	\$ 141,944	\$ 96,070
Less other venturers' interest	90,751	63,724
Company's interest	51,193	32,346
Liabilities:		
Total	63,027	33,229
Less other venturers' interest	39,242	21,778
Company's interest	23,785	11,451
Company's interest in net assets	\$ 27,408	\$ 20,895

Notes to the Consolidated Financial Statements

The revenue and costs of revenue of unconsolidated joint ventures in which we have determined we are not the primary beneficiary are as follows:

Years Ended December 31,	2005	2004	2003
<i>(In thousands)</i>			
Revenue:			
Total	\$ 228,180	\$ 229,265	\$ 473,918
Less other venturers' interest	152,980	159,631	261,405
Company's interest	75,200	69,634	212,513
Cost of revenue:			
Total	213,176	211,715	423,652
Less other venturers' interest	144,022	147,599	236,131
Company's interest	69,154	64,116	187,521
Company's interest in gross profit	\$ 6,046	\$ 5,518	\$ 24,992

6. INVESTMENTS IN AFFILIATES

We have investments in affiliates that are accounted for using the equity method. The most significant of these investments are a 50% interest in a limited liability company which owns and operates an asphalt terminal in Nevada, and a 25% interest in a limited partnership, which develops land and leases buildings in California. We have made advances to the asphalt terminal limited liability company of which \$5.7 million remained outstanding at December 31, 2005.

In January 2003, the California Private Transportation Company LP ("CPTC"), of which we are a 22% limited partner, closed the sale of the State Route 91 toll road franchise, CPTC's principle asset, to the Orange County Transportation Authority for \$72.5 million in cash and the assumption of \$135.0 million in long-term debt. We completed construction of the \$60.4 million project in 1995 and have maintained an equity interest in the partnership since its inception. Included in other income (expense) for the year ended December 31, 2003 is \$18.4 million related to this sale by CPTC.

At December 31, 2002, we held a minority interest in T.I.C. Holdings, Inc. ("TIC") of approximately 16%, which we accounted for under the cost method of accounting. In June 2003, TIC repurchased 0.3 million shares of the TIC shares held by us for a cash payment of \$6.0 million. The transaction reduced our interest in TIC to approximately 11% and resulted in a gain of \$1.9 million, which was included in other income (expense) for the year ended December 31, 2003. In December 2004, TIC repurchased an additional 0.3 million shares of the TIC shares held by us for a cash payment of \$7.5 million. The transaction reduced our interest in TIC to approximately 6% and resulted in a gain of \$3.3 million, which was included in other income (expense) for the year ended December 31, 2004.

Our investments in affiliates comprised:

Years Ended December 31,	2005	2004
<i>(In thousands)</i>		
Equity method investments in affiliates	\$ 11,680	\$ 6,548
Cost method investment in TIC	4,175	4,177
Total investments in affiliates	\$ 15,855	\$ 10,725

Notes to the Consolidated Financial Statements

The following table provides summarized combined financial information on a combined 100% basis for our affiliates accounted for under the equity method:

Years Ended December 31,	2005	2004	2003
<i>(In thousands)</i>			
Balance sheet data:			
Current assets	\$ 16,868	\$ 13,795	\$ 13,450
Long-term assets	94,371	87,961	129,699
Total assets	111,239	101,756	143,149
Current liabilities	5,827	6,080	5,802
Long-term liabilities	73,846	66,995	86,819
Total liabilities	79,673	73,075	92,621
Net assets	\$ 31,566	\$ 28,681	\$ 50,528
Earnings data:			
Revenue	\$ 30,732	\$ 138,222	\$ 124,547
Gross profit	8,616	73,828	9,034
Earnings before taxes	2,170	60,301	101,542
Net income	2,170	60,301	101,542
Company's interest in affiliates' net income	\$ 1,497	\$ 6,162	\$ 17,657

7. PROPERTY AND EQUIPMENT

December 31,	2005	2004
<i>(In thousands)</i>		
Land	\$ 54,782	\$ 53,974
Quarry property	104,662	101,545
Buildings and leasehold improvements	77,788	78,350
Equipment and vehicles	746,014	700,290
Office furniture and equipment	21,047	17,478
Gross property and equipment	1,004,293	951,637
Less accumulated depreciation, depletion and amortization	607,182	575,440
Net property and equipment	\$ 397,111	\$ 376,197

We have recorded liabilities associated with our legally required obligations to reclaim owned and leased quarry property and related facilities in accordance with SFAS 143. A reconciliation of these asset retirement obligations is as follows:

December 31,	2005	2004
<i>(In thousands)</i>		
Beginning balance	\$ 11,496	\$ 5,557
Liabilities incurred and revisions to estimates	8	5,847
Liabilities settled	(283)	(329)
Accretion	680	421
Ending balance	\$ 11,901	\$ 11,496

Notes to the Consolidated Financial Statements

8. INTANGIBLE ASSETS

The following table indicates the allocation of goodwill by reportable segment which is included in other assets on our consolidated balance sheets:

December 31,	2005	2004
(In thousands)		
Goodwill by segment:		
Heavy Construction Division	\$ 18,011	\$ 18,011
Branch Division	9,900	9,900
Total goodwill	\$ 27,911	\$ 27,911

The following intangible assets are included in other assets on our consolidated balance sheets:

December 31, 2005	Gross Value	Accumulated Amortization	Net Value
(In thousands)			
Amortized intangible assets:			
Covenants not to compete	\$ 439	\$ (383)	\$ 56
Permits	2,000	(628)	1,372
Tradenames	1,425	(565)	860
Other	200	(198)	2
Total amortized intangible assets	\$ 4,064	\$ (1,774)	\$ 2,290

December 31, 2004	Gross Value	Accumulated Amortization	Net Value
(In thousands)			
Amortized intangible assets:			
Covenants not to compete	\$ 1,139	\$ (781)	\$ 358
Permits	2,000	(494)	1,506
Tradenames	1,425	(361)	1,064
Other	622	(580)	42
Total amortized intangible assets	\$ 5,186	\$ (2,216)	\$ 2,970

Amortization expense related to these intangible assets for the years ended December 31, 2005, 2004 and 2003 was \$0.7 million, \$0.9 million and \$1.3 million, respectively. Amortization expense expected to be recorded in the future is as follows: \$369,000 in 2006, \$351,000 in 2007, \$339,000 in 2008, \$262,000 in 2009, \$224,000 in 2010 and \$745,000 thereafter.

9. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

December 31,	2005	2004
(In thousands)		
Payroll and related employee benefits	\$ 47,206	\$ 40,053
Accrued insurance	43,396	34,795
Other	49,967	42,519
Total	\$ 140,569	\$ 117,367

Notes to the Consolidated Financial Statements

10. LONG-TERM DEBT AND CREDIT ARRANGEMENTS

December 31,	2005	2004
<i>(In thousands)</i>		
Senior notes payable	\$ 100,000	\$ 115,000
Bank revolving line of credit	25,000	25,000
Mortgages	25,353	19,989
Other notes payable	950	4,375
Total debt	151,303	164,364
Less current maturities	26,888	15,861
Total long-term debt	\$ 124,415	\$ 148,503

The aggregate minimum principal maturities of long-term debt for each of the five years following December 31, 2005 are as follows *(in thousands)*: 2006 – \$26,888; 2007 – \$15,418; 2008 – \$21,522; 2009 – \$15,179; 2010 – \$40,177; and beyond 2010 – \$32,119.

Senior notes payable in the amount of \$33.3 million are due to a group of institutional holders. The notes are due in nine equal annual installments which began in 2002 and bear interest at 6.54% per annum. Additional senior notes payable in the amount of \$66.7 million are due to a second group of institutional holders. The notes are due in nine equal annual installments which began in 2005 and bear interest at 6.96% per annum. Based on the borrowing rates currently available to us for bank loans with similar terms and average maturities, the fair value of the senior notes payable was approximately \$104.9 million as of December 31, 2005 and \$126.1 million as of December 31, 2004.

On June 24, 2005, we entered into an agreement for a \$150.0 million bank revolving line of credit, which replaced the \$100.0 million line of credit we entered into in June 2003. The new revolving line of credit allows for unsecured borrowings for up to five years through June 24, 2010, with interest rate options. Interest on outstanding borrowings under the revolving line of credit is at our choice of selected LIBOR rates plus a margin that is recalculated quarterly. The margin was 0.750% at December 31, 2005. At December 31, 2005 we had \$25.0 million outstanding under this line of credit. Additionally, we have standby letters of credit totaling \$6.4 million that reduces the amount available under the line of credit. The unused and available portion of this line of credit was \$118.6 million at December 31, 2005. Additionally, our Wilder subsidiary has a bank revolving line of credit of \$10.0 million that expires in 2007, with borrowings collateralized by certain of Wilder's equipment, accounts receivable, inventory and general intangibles. Outstanding borrowings under this line are charged interest at the bank's prime rate (7.25% as of December 31, 2005) less 1.0%. There were no amounts outstanding at December 31, 2005.

Mortgages consist primarily of notes incurred in connection with the purchase of property. These notes are collateralized by the property purchased and bear interest at 5.56% to 8.75% per annum with principal and interest payable in installments through 2034. The carrying amount of property pledged as collateral was approximately \$46.4 million at December 31, 2005.

Restrictive covenants under the terms of our debt agreements require the maintenance of certain levels of working capital and cash flow, financial ratios and the maintenance of tangible net worth (as defined) of approximately \$477.6 million. We were in compliance with these covenants at December 31, 2005. Our Wilder subsidiary has restrictive covenants (on a Wilder stand-alone basis) under the terms of its debt agreements that include the maintenance of certain ratios of working capital, liabilities to net worth and tangible net worth and restricts Wilder capital expenditures in excess of specified limits. Wilder was in compliance with these covenants at December 31, 2005.

11. EMPLOYEE BENEFIT PLANS

Employee Stock Ownership Plan: Our Employee Stock Ownership Plan ("ESOP") covers all employees not included in collective bargaining agreements, except employees of our majority owned subsidiary, Wilder, and of our consolidated construction joint ventures. As of December 31, 2005, the ESOP owned 7,318,450 shares of our common stock. Dividends on shares held by the ESOP are charged to retained earnings and all shares held by the ESOP are treated as outstanding in computing our earnings per share.

Notes to the Consolidated Financial Statements

Contributions to the ESOP are discretionary and comprise shares of our stock that were purchased on the market and immediately contributed to the plan. Compensation cost is measured as the cost to purchase the shares (market value on the date of purchase and contribution). Contribution expense was \$2.0 million in each of the years ended December 31, 2005, 2004 and 2003.

Profit Sharing and 401k Plan: The plan is a defined contribution plan covering all employees not included in collective bargaining agreements, except employees of our majority owned subsidiary, Wilder, and our consolidated construction joint ventures. Each employee can elect to have up to 15% of gross pay contributed to the 401k plan on a before-tax basis. The plan allows for company matching and additional contributions at the discretion of the Board of Directors. Our contributions to the Profit Sharing and 401k Plan for the years ended December 31, 2005, 2004 and 2003 were \$7.0 million, \$6.2 million and \$5.9 million, respectively. Included in the contributions were 401k matching contributions of \$4.9 million, \$4.5 million and \$4.2 million, respectively. Additionally, Wilder provides a 401k plan covering all of its employees and a separate defined contribution plan covering employees not covered by other plans. Wilder's contributions under these plans totaled approximately \$2.4 million, \$2.1 million and \$2.0 million in the years ended December 31, 2005, 2004 and 2003, respectively.

Other: Two of our wholly owned subsidiaries, Granite Construction Company and Granite Construction Northeast, Inc. (formerly Granite Halmar Construction Company, Inc.) and our majority owned subsidiary, Wilder, also contribute to various multi-employer pension plans on behalf of union employees. Under the Employee Retirement Income Security Act, a contributor to a multi-employer plan is liable, upon termination or withdrawal from a plan, for its proportionate share of a plan's unfunded vested liability. We currently have no intention of withdrawing from any of the multi-employer pension plans in which we participate. Contributions to these plans for the years ended December 31, 2005, 2004 and 2003 were \$20.4 million, \$20.5 million and \$19.5 million, respectively. We also provide non-qualified deferred compensation plans to certain of our highly compensated employees that provide the participants the opportunity to defer payment of certain compensation as defined in the plan and provides for matching of certain amounts deferred as part of a retirement plan excess feature of the plan.

12. SHAREHOLDERS' EQUITY

1999 Equity Incentive Plan: Our Amended and Restated 1999 Equity Incentive Plan (the "Plan") provides for the grant of restricted common stock, incentive and nonqualified stock options, performance units and performance shares to employees and awards to members of our Board of Directors in the form of stock units or stock options ("Director Options"). A total of 4,250,000 shares of our common stock have been reserved for issuance under the Plan of which approximately 2,485,000 remained available as of December 31, 2005. The exercise price for incentive and nonqualified stock options granted to employees under the Plan may not be less than 100% and 85%, respectively, of the fair market value at the date of the grant. Employee options granted will be exercisable at such time and be subject to such restrictions/conditions as determined by the compensation committee and Director Options are immediately exercisable. No option will be exercisable later than ten years from the date of grant.

Restricted common stock is issued for services to be rendered and may not be sold, transferred or pledged for such period as determined by our compensation committee. At December 31, 2005, there were approximately 1,005,000 shares of restricted common stock outstanding. Restricted stock compensation cost is measured as the stock's fair value at the date of grant. The compensation cost is recognized ratably over the vesting period—generally three to five years. Restricted shares become fully vested when a holder reaches age 62. An employee may not sell or otherwise transfer unvested shares and, in the event that employment is terminated prior to the end of the vesting period, any unvested shares are surrendered to us. We have no obligation to repurchase restricted stock. Compensation expense related to restricted shares was approximately \$6.0 million for each the years ended December 31, 2005, 2004 and 2003.

Notes to the Consolidated Financial Statements

The exercise price for options granted to our directors under the Plan is 50.0% of the market price of our common stock at the date of grant and the fair market value of the option represents the value of the services provided in their role as directors. We granted Director Options under the Plan to purchase shares of our stock for the years ended December 31, 2005, 2004 and 2003 at a weighted average exercise price of \$15.11, \$11.33 and \$9.92, respectively. The options are immediately exercisable and options for 104,848 shares remain outstanding at December 31, 2005. Director Option transactions are summarized as follows:

December 31,	2005	2004	2003
Options outstanding, beginning of year	86,748	86,063	55,812
Options granted	19,571	17,151	35,158
Options exercised	(1,471)	(16,466)	(4,907)
Options outstanding, end of year	104,848	86,748	86,063

The fair value of each option grant was estimated at the grant date using the Black-Scholes option-pricing model. We recognized \$377,000, \$281,000 and \$330,000 of compensation expense related to grants of stock options in 2005, 2004 and 2003, respectively.

Dividend Reinvestment and Stock Purchase Plan: During 2001, we adopted a Dividend Reinvestment and Stock Purchase Plan (the "DRP Plan") under which 4,500,000 shares of common stock are authorized for purchase. The DRP Plan offers participation to holders of common stock or other interested investors. Under the DRP Plan, participants may buy additional shares of common stock by automatically reinvesting all or a portion of the cash dividends paid on their shares of common stock or by making optional cash investments.

13. WEIGHTED AVERAGE SHARES OUTSTANDING

A reconciliation of the weighted average shares outstanding used in calculating basic and diluted net income per share in the accompanying Consolidated Statements of Income is as follows:

Years Ended December 31,	2005	2004	2003
(In thousands)			
Weighted average shares outstanding:			
Weighted average common stock outstanding	41,678	41,580	41,464
Less weighted average restricted stock outstanding	1,064	1,190	1,289
Total basic weighted average shares outstanding	40,614	40,390	40,175
Diluted weighted average shares outstanding:			
Basic weighted average shares outstanding	40,614	40,390	40,175
Effect of dilutive securities:			
Common stock options and units	70	52	29
Restricted stock	565	589	604
Total weighted average shares outstanding assuming dilution	41,249	41,031	40,808

Restricted stock representing approximately 42,000 shares, 254,000 shares and 364,000 shares for the years ended December 31, 2005, 2004 and 2003, respectively, have been excluded from the calculation of diluted net income per share because their effects are anti-dilutive. We calculate dilutive shares on a quarterly basis and average the quarterly amounts to determine the year-end amount.

Notes to the Consolidated Financial Statements

14. INCOME TAXES

Provision for income taxes:

Years Ended December 31,	2005	2004	2003
<i>(In thousands)</i>			
Federal:			
Current	\$ 42,399	\$ 28,238	\$ 25,348
Deferred	(7,682)	(4,861)	3,496
Total federal	34,717	23,377	28,844
State:			
Current	7,853	6,107	5,867
Deferred	(1,157)	(1,007)	593
Total state	6,696	5,100	6,460
Total provision for income taxes	\$ 41,413	\$ 28,477	\$ 35,304

Reconciliation of statutory to effective tax rate:

Years Ended December 31,	2005	2004	2003
Federal statutory tax rate	35.0%	35.0%	35.0%
State taxes, net of federal tax benefit	3.2	3.5	4.6
Percentage depletion deduction	(2.8)	(2.3)	(1.2)
Minority interest in joint ventures	(4.1)	(3.2)	—
Other	(2.2)	(3.0)	(2.2)
Effective tax rate	29.1%	30.0%	36.2%

The impact on the effective tax rate related to minority interest in consolidated joint ventures is a result of the consolidation of construction joint ventures as required by FIN 46 (see Note 5), which are not subject to income taxes on a stand-alone basis.

Notes to the Consolidated Financial Statements

Deferred tax assets and liabilities:

December 31,	2005	2004
<i>(In thousands)</i>		
Deferred tax assets:		
Accounts receivable	\$ 1,625	\$ 1,262
Inventory	3,680	2,664
Property and equipment	373	408
Insurance	2,793	131
Deferred compensation	4,537	10,721
Other accrued liabilities	17,282	12,701
Contract recognition	1,831	64
Net operating loss carryforward	7,133	4,628
Valuation allowance	(7,133)	(4,628)
Total deferred tax assets	\$ 32,121	\$ 27,951
Deferred tax liabilities:		
Property and equipment	\$ 44,962	\$ 49,492
Other	1,488	1,582
Total deferred tax liabilities	\$ 46,450	\$ 51,074

The deferred tax asset for other accrued liabilities relates to various items including accrued vacation, accrued reclamation costs and accrued provision for legal judgment (see Note 15) which are deductible in future periods.

Our deferred tax asset for net operating loss carryforwards relates to state and local tax carryforwards for a subsidiary, which expire between 2021 and 2025. We have provided a valuation allowance on these assets because of uncertainty regarding their realizability due to recent losses and uncertainty regarding the impact of any future tax law changes. The increases in the carryforwards and associated valuation allowance for the years ended December 31, 2005, 2004 and 2003 were a result of taxable losses generated by the subsidiary in those years.

15. COMMITMENTS, CONTINGENCIES AND GUARANTEES

Leases: Minimum rental commitments and minimum royalty requirements under all noncancellable operating leases, primarily quarry property, in effect at December 31, 2005 were:

Years Ending December 31,	
<i>(In thousands)</i>	
2006	\$ 7,071
2007	4,817
2008	2,829
2009	2,687
2010	2,061
Later years (through 2046)	20,034
Total	\$ 39,499

Operating lease rental expense was \$9.5 million in 2005, \$8.0 million in 2004 and \$10.4 million in 2003.

Notes to the Consolidated Financial Statements

Litigation:

Eldredge – A \$9.3 million judgment was entered in June 2005 against our wholly owned subsidiary Granite Construction Company (“GCCO”) by the District Court Clark County; Nevada, in an action entitled *Eldredge vs. Las Vegas Valley Water District, GCCO, et al.* The civil lawsuit was initially brought by a former employee of GCCO against the Las Vegas Water District in June 2000. The plaintiff subsequently filed an amended complaint on June 10, 2003, bringing GCCO into the action and seeking compensation in addition to the worker’s compensation payments the employee previously accepted for injuries sustained when a trench excavation collapsed. The jury issued a verdict finding against GCCO on two causes of action, assault and battery and intentional infliction of emotional distress. The judgment awarded damages for past and future lost wages, medical expenses and pain and suffering. Although no punitive damages were assessed, GCCO’s insurance carriers have denied coverage for this judgment.

On June 23, 2005, GCCO filed several post-trial motions seeking reconsideration by the trial court as well as a reduction in the amount of the judgment. These post-trial motions were heard in September 2005. If we do not agree with the judge’s rulings on these post-trial motions, we intend to pursue an appeal. We anticipate that the appeal process will take between 12 and 18 months to complete. During the three months ended June 30, 2005, we recorded a provision of \$9.3 million, which was estimated based on the amount of the judgment described above. The judgment will accrue interest until it is satisfied.

After the verdict was issued, the plaintiff filed a motion seeking monetary sanctions against GCCO in the amount of \$26.8 million (a multiple of the jury verdict) based on allegations that GCCO and/or its trial counsel improperly withheld and/or attempted to influence testimony in respect to the case. GCCO’s opposition to the motion and the plaintiff’s reply have been filed with the Court. We believe that the plaintiff has failed to submit any meaningful proof to support these allegations, that the motion is without merit and that it is highly unlikely that the motion will be granted. The judge decided after the sanctions motion was heard in September 2005 to reserve any decision until after the appeal and calendared the motion for a status check in September 2006.

Wasatch Constructors – GCCO, as a member of a joint venture, Wasatch Constructors, is among a number of construction companies that were named along with the Utah Department of Transportation in a lawsuit filed in the United States District Court for the District of Utah. The plaintiffs are two independent contractor truckers who filed the lawsuit on behalf of the United States under the federal False Claims Act seeking to recover damages and civil penalties in excess of \$46.4 million.

The original complaint was filed in January 1999, and the third amended complaint was filed in February 2003.

On October 5, 2005, the District Court granted Wasatch Constructors’ motion to dismiss the entire case. The Court dismissed the case with prejudice and without leave to amend. The plaintiffs did not appeal the Court’s decision to dismiss, and the time to file such an appeal has expired.

Silica – GCCO is one of approximately 100 to 300 defendants in six active California Superior Court lawsuits, four of which were served against Granite in 2005 and two were served in 2006, in Alameda County (Riley v. A-1 Aggregates, et al.; Molina v. A-1 Aggregates, et al.; Dominguez v. A-1 Aggregates, et al.; Cleveland v. A. Teichert & Son, Inc.; Guido v. A. Teichert & Son, Inc.; and Williams v. A. Teichert & Son, Inc.). Each lawsuit was brought by a single plaintiff who, by way of various causes of action, including strict product and market share liability, alleges personal injuries caused by exposure to silica products and related materials during the plaintiffs’ use or association with sand blasting or grinding concrete. The plaintiff in each lawsuit has categorized the defendants as equipment defendants, respirator defendants, premises defendants and sand defendants. We have been identified as a sand defendant, meaning a party that manufactured, supplied or distributed silica-containing products. Our preliminary investigation revealed that we have not knowingly sold or distributed abrasive silica sand for sandblasting, and therefore, we believe the probability of these lawsuits resulting in an incurrence of a material liability is remote. We have been dismissed from seven other similar lawsuits, six of which were served in 2004 and one that was served in 2005. In addition, we have been apprised of two complaints that are based on similar allegations of exposure to silica containing products being filed, but not served, against GCCO and more than one hundred other defendants in California Superior Court. We are investigating the specific allegations against GCCO for these new complaints.

Notes to the Consolidated Financial Statements

Other – We are a party to a number of other legal proceedings arising in the normal course of business and believe that the nature and number of these proceedings are typical for a construction firm of our size and scope. Our litigation typically involves claims regarding public liability or contract related issues. While management currently believes, after consultation with counsel, that the ultimate outcome of these proceedings, individually and in the aggregate, will not have a material adverse effect on our financial position or overall trends in results of operations or cash flows, litigation is subject to inherent uncertainties. Were an unfavorable ruling to occur, there exists the possibility of a material adverse impact on the results of operations, cash flows and/or financial position for the period in which the ruling occurs.

Guarantees: As discussed in Note 5, we participate in various construction joint venture partnerships. All partners in these joint ventures are jointly and severally liable for completion of the total project under the terms of the contract with the project owner. Although our agreements with our joint venture partners for both construction joint ventures and line item joint ventures provide that each party will assume and pay its share of any losses resulting from a project, if one of our partners was unable to pay its share we would be fully liable under our contract with the project owner. Circumstances that could lead to a loss under these guarantee arrangements include a partner's inability to contribute additional funds to the venture in the event that the project incurred a loss or additional costs that we could incur should the partner fail to provide the services and resources toward project completion that had been committed to in the joint venture agreement. At December 31, 2005, approximately \$243.9 million of work representing either our partners' proportionate share of unconsolidated joint ventures or work that our partners' are directly responsible for in line item joint ventures, had yet to be completed. We have never incurred a loss under these joint and several liability provisions, however, it is possible that we could in the future and such a loss could be significant.

Wilder Common Stock: We currently own approximately 75% of the Wilder common shares. All of the remaining non-Granite held common shares are redeemable by the holders upon retirement, voluntary termination, death or permanent disability. Approximately 52% of these shares are held by Wilder founders or non-employees and are accounted for under Statement of Financial Accounting Standards No. 150 "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" and related pronouncements, and accordingly, the redemption value of these shares is included in other long-term liabilities. The remaining 48% are accounted for as stock-based compensation. Wilder generally has up to eight years to pay the redemption price following a redemption event, as defined in its shareholder agreements, and the redemption price is adjusted each year, primarily for the Wilder net income attributable to the shares. If all of these Wilder shares had been redeemed at the December 31, 2005 redemption price, a payment of \$19.2 million would have been required.

16. BUSINESS SEGMENT INFORMATION

We have two reportable segments: the Branch Division and HCD. The Branch Division is comprised of branch offices, including our majority owned subsidiary, Wilder Construction Company, that serve local markets, while HCD pursues major infrastructure projects throughout the nation. HCD focuses on building larger heavy civil projects with contract durations that are frequently greater than two years, while the Branch Division projects are typically smaller in size and shorter in duration. HCD has been the primary participant in our construction joint ventures. Substantially all of our revenue from the sales of materials is from the Branch Division.

The accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies (see Note 1). We evaluate performance based on operating profit or loss (excluding gain on sales of property and equipment), and do not include income taxes, interest income, interest expense or other income (expense). Unallocated other corporate expenses principally comprise corporate general and administrative expenses.

Included in HCD operating income for the years ended December 31, 2005 and 2004 is operating income from our consolidated joint ventures of \$11.0 million and \$7.1 million, respectively, (see Note 5). Branch Division operating income for the year ended December 31, 2005 includes a \$9.3 million provision for a legal judgment (see Note 15).

During 2005, we also recorded revenue of \$19.7 million related to sales of certain real estate development projects that are not part of either the Branch Division or HCD.

Notes to the Consolidated Financial Statements

Summarized segment information:

Years Ended December 31,	HCD	Branch	Total
<i>(In thousands)</i>			
2005			
Revenues from external customers	\$ 1,061,441	\$ 1,560,213	\$ 2,621,654
Intersegment revenue transfer	(31,332)	31,332	—
Net revenue	1,030,109	1,591,545	2,621,654
Depreciation, depletion and amortization	15,372	44,651	60,023
Operating income	12,472	153,675	166,147
Property and equipment	48,862	314,746	363,608
2004			
Revenues from external customers	\$ 872,812	\$ 1,263,400	\$ 2,136,212
Intersegment revenue transfer	(24,215)	24,215	—
Net revenue	848,597	1,287,615	2,136,212
Depreciation, depletion and amortization	14,386	42,581	56,967
Operating income	8,957	106,016	114,973
Property and equipment	47,829	298,223	346,052
2003			
Revenues from external customers	\$ 702,055	\$ 1,142,436	\$ 1,844,491
Intersegment revenue transfer	(10,290)	10,290	—
Net revenue	691,765	1,152,726	1,844,491
Depreciation, depletion and amortization	14,185	47,958	62,143
Operating income	26,246	91,860	118,106
Property and equipment	43,505	281,531	325,036

Reconciliation of segment operating income to consolidated totals:

Years Ended December 31,	2005	2004	2003
<i>(In thousands)</i>			
Total operating income for reportable segments	\$ 166,147	\$ 114,973	\$ 118,106
Other income	7,396	11,372	18,240
Gain on sales of property and equipment	8,235	18,566	4,714
Unallocated other corporate expenses	(48,894)	(48,297)	(41,998)
Other	9,427	(1,690)	(1,537)
Income before provision for income taxes and minority interest	\$ 142,311	\$ 94,924	\$ 97,525

Notes to the Consolidated Financial Statements

Reconciliation of segment assets to consolidated totals:

December 31,	2005	2004	2003
(In thousands)			
Total assets for reportable segments	\$ 363,608	\$ 346,052	\$ 325,036
Assets not allocated to segments:			
Cash and cash equivalents	199,881	161,627	69,919
Marketable securities	101,500	116,065	132,066
Deferred income taxes	22,996	21,012	22,421
Other current assets	685,531	540,462	435,442
Property and equipment	33,503	30,145	19,698
Other assets	65,211	62,591	55,828
Consolidated total assets	\$ 1,472,230	\$ 1,277,954	\$ 1,060,410

17. ACQUISITIONS

Wilder Construction Company: In April 2000 we began purchasing shares of common stock of Wilder Construction Company ("Wilder"). Our investment in Wilder was recorded under the equity method of accounting until April of 2002 when our interest in Wilder increased to above 50% and we began consolidating the financial position, results of operations and cash flows of Wilder. Through December 31, 2005 we have purchased a 75% interest in Wilder for cash totaling \$36.5 million, including a \$9.2 million purchase in 2004.

We have accounted for this step acquisition using the purchase method of accounting in accordance with Statement of Financial Accounting Standards No. 141, "Business Combinations." The purchase price was allocated to assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition and the excess purchase price over the estimated fair value of net assets acquired of \$8.8 million was allocated to goodwill.

18. SALE OF ASSETS

In March 2004, we sold certain assets related to our ready-mix concrete business in Utah for cash of \$10.0 million and promissory notes with an estimated fair value of \$8.9 million which are payable in installments through 2010, the first of which has been paid. The sale transaction resulted in the recognition of a gain of approximately \$10.0 million, which was included in gain on sales of property and equipment for the year ended December 31, 2004.

Investor Information

ANNUAL SHAREHOLDERS' MEETING

Annual report and proxy statements are mailed on or about April 14, 2006. Granite's annual meeting of shareholders will be held at 10:30 a.m. on May 22, 2006, at the Embassy Suites, 1441 Canyon Del Rey, Seaside, California.

DIVIDEND POLICY

The Company expects to pay a quarterly cash dividend of \$0.10 per share of common stock payable on April 14, 2006, to shareholders of record as of March 31, 2006. Declaration and payment of dividends is within the sole discretion of the Company's Board of Directors, subject to limitations imposed by Delaware law, and will depend on the Company's earnings, capital requirements, and financial condition, and other such factors as the Board deems relevant.

ELECTRONIC DEPOSIT OF DIVIDENDS

Registered holders of our common stock may have their quarterly dividends deposited to their checking or savings account free of charge. Call Registrar and Transfer Company at (800) 368-5948 to sign up for this service.

DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN

The Plan offers both existing registered shareholders and first-time investors an affordable alternative to investing in the Company, including the ability to participate in automatic reinvestment of dividends to purchase additional shares of our common stock. A prospectus describing the details of the Plan may be obtained by calling Registrar and Transfer Company at (800) 368-5948 or on their website at www.rtco.com.

COMPANY CONTACT

Jacqueline Underdown
Director of Investor Relations
(831) 761-4741
Jacque.Underdown@gcinc.com

REGISTRAR AND TRANSFER AGENT

Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016
(800) 368-5948

FORM 10-K

A copy of the Form 10-K, which is filed with the Securities and Exchange Commission, is available free of charge on our website or upon written request to:
Investor Relations
Granite Construction Incorporated
Box 50085
Watsonville, CA 95077-5085

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

PricewaterhouseCoopers LLP
Ten Almaden Blvd., Suite 1600
San Jose, CA 95113

INTERNET

An electronic version of this report can also be found on Granite's website, located at:
www.graniteconstruction.com

CERTIFICATIONS

Granite's Chief Executive Officer (CEO) and Chief Financial Officer (CFO) have each submitted certifications concerning the accuracy of financial and other information in Granite's annual report on Form 10-K, as required by Section 302(a) of the Sarbanes-Oxley Act of 2002. The certifications are filed as exhibits to Granite's 2005 annual report on Form 10-K. In addition, the New York Stock Exchange (NYSE) requires that the CEO of listed companies annually certify that he or she is not aware of any violation by the company of NYSE corporate governance listing standards. Granite's President and CEO, William G. Dorey, certified Granite's compliance with the NYSE corporate governance listing standards on February 28, 2006.

Company Locations

GRANITE CONSTRUCTION INCORPORATED

585 W. Beach Street
Box 50085
Watsonville, CA 95077-5085
(831) 724-1011
www.graniteconstruction.com

BRANCH DIVISION

Arizona

4115 E. Illinois Street
Tucson, AZ 85714
(520) 748-8000

Bakersfield

3000 James Road
Bakersfield, CA 93308
(661) 399-3361

Bay Area

715 Comstock Street
Santa Clara, CA 95054
(408) 327-7000

Central Valley

2716 Granite Court
Fresno, CA 93706
(559) 441-5700

Monterey Bay

580 W. Beach Street
Watsonville, CA 95076
(831) 763-6100

Nevada

1900 Glendale Avenue
Sparks, NV 89431
(775) 358-8792

Northern California

4001 Bradshaw Road
Sacramento, CA 95827
(916) 855-4400

Santa Barbara

5335 Debbie Lane
Santa Barbara, CA 93111
(805) 964-9951

Southern California

38000 Monroe Street
Indio, CA 92203
(760) 775-7500

Stockton

10500 S. Harlan Road
French Camp, CA 95231
(209) 982-4750

Utah

100 N. Warm Springs Road
Salt Lake City, UT 84116
(801) 526-6000

Wilder Construction Company

1525 East Marine View Drive
Everett, WA 98201
(425) 551-3100

AFFILIATES

Granite Land Company

8950 Cal Center Drive, Suite 201
Sacramento, CA 95826
(916) 362-8844

HEAVY CONSTRUCTION DIVISION

National Office

585 W. Beach Street
Watsonville, CA 95076
(831) 722-2716

Texas Regional Office

701 E. Main Street
Lewisville, TX 75057
(972) 874-8724

Southeast Regional Office

6215 E. Sligh Avenue
Tampa, FL 33617
(813) 623-5877

Western Regional Office

282 Cousteau Place, Suite 105
Davis, CA 95616
(530) 297-3100

Granite Construction Northeast, Inc.

160 W. Lincoln Avenue
Mount Vernon, NY 10550
(914) 668-9500

*For a complete listing of all affiliates,
please visit the Company's website at
www.graniteconstruction.com.*

Granite Construction Incorporated

www.graniteconstruction.com

GRANITE

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