

MDC HOLDINGS INC
Form 10-Q
August 07, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2006

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

**Commission File No. 1-8951
M.D.C. HOLDINGS, INC.**

(Exact name of Registrant as specified in its charter)

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

**84-0622967
(I.R.S. employer
identification no.)**

**4350 South Monaco Street, Suite 500
Denver, Colorado
(Address of principal executive offices)**

**80237
(Zip code)**

(303) 773-1100

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

As of June 30, 2006, 44,967,000 shares of M.D.C. Holdings, Inc. common stock were outstanding.

M.D.C. HOLDINGS, INC. AND SUBSIDIARIES
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2006
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M.D.C. HOLDINGS, INC.
Consolidated Balance Sheets
(In thousands)
(Unaudited)

	June 30, 2006	December 31, 2005
ASSETS		
Corporate		
Cash and cash equivalents	\$ 70,665	\$ 196,032
Property and equipment, net	29,238	30,660
Deferred income taxes	71,131	54,319
Deferred debt issue costs, net	6,596	6,937
Other assets, net	11,675	10,792
	189,305	298,740
Homebuilding		
Cash and cash equivalents	18,851	16,671
Restricted cash	6,855	6,742
Home sales and other accounts receivable	98,629	134,270
Inventories, net		
Housing completed or under construction	1,512,009	1,320,106
Land and land under development	1,760,077	1,677,948
Prepaid expenses and other assets, net	131,150	139,529
	3,527,571	3,295,266
Financial Services		
Cash and cash equivalents	1,968	1,828
Mortgage loans held in inventory	163,373	237,376
Other assets, net	74,719	26,640
	240,060	265,844
Total Assets	\$ 3,956,936	\$ 3,859,850

The accompanying Notes are an integral part of the Unaudited Consolidated Financial Statements.

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M.D.C. HOLDINGS, INC.
Consolidated Balance Sheets
(In thousands, except share amounts)
(Unaudited)

	June 30, 2006	December 31, 2005
LIABILITIES		
Corporate		
Accounts payable and accrued liabilities	\$ 93,193	\$ 117,767
Income taxes payable	30,933	102,656
Related party liabilities		8,100
Senior notes, net	996,486	996,297
	1,120,612	1,224,820
Homebuilding		
Accounts payable	226,433	203,592
Accrued liabilities	301,977	291,827
Line of credit		
	528,410	495,419
Financial Services		
Accounts payable and accrued liabilities	13,518	30,970
Line of credit	168,163	156,532
	181,681	187,502
Total Liabilities	1,830,703	1,907,741

COMMITMENTS AND CONTINGENCIES**STOCKHOLDERS EQUITY**

Preferred stock, \$0.01 par value; 25,000,000 shares authorized; none issued or outstanding

Common stock, \$0.01 par value; 250,000,000 shares authorized; 44,981,000 and 44,967,000 shares issued and outstanding, respectively, at June 30, 2006 and 44,642,000 and 44,630,000 shares issued and outstanding, respectively, at December 31, 2005

Additional paid-in capital	450	447
Retained earnings	746,637	722,291
Unearned restricted stock	1,382,427	1,232,971
Accumulated other comprehensive loss	(2,000)	(2,478)
	(622)	(622)

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Less treasury stock, at cost; 14,000 and 12,000 shares, respectively, at June 30,
2006 and
December 31, 2005

	(659)	(500)
Total Stockholders' Equity	2,126,233	1,952,109
Total Liabilities and Stockholders' Equity	\$ 3,956,936	\$ 3,859,850

The accompanying Notes are an integral part of the Unaudited Consolidated Financial Statements.

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M.D.C. HOLDINGS, INC.
Consolidated Statements of Income
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
REVENUE				
Homebuilding	\$ 1,213,037	\$ 1,033,294	\$ 2,337,891	\$ 1,954,624
Financial services	19,716	12,812	37,124	24,410
Corporate	183	234	615	1,222
Total Revenue	1,232,936	1,046,340	2,375,630	1,980,256
COSTS AND EXPENSES				
Homebuilding	1,079,763	845,669	2,030,848	1,604,489
Financial services	9,480	8,685	18,575	17,436
Corporate	21,332	27,946	49,689	58,262
Related party expenses	127	63	1,803	163
Total Costs and Expenses	1,110,702	882,363	2,100,915	1,680,350
Income before income taxes	122,234	163,977	274,715	299,906
Provisions for income taxes	(45,743)	(61,354)	(102,803)	(112,652)
NET INCOME	\$ 76,491	\$ 102,623	\$ 171,912	\$ 187,254
EARNINGS PER SHARE				
Basic	\$ 1.70	\$ 2.35	\$ 3.83	\$ 4.30
Diluted	\$ 1.66	\$ 2.25	\$ 3.74	\$ 4.10
WEIGHTED-AVERAGE SHARES OUTSTANDING				
Basic	44,939	43,718	44,880	43,584
Diluted	45,972	45,703	45,967	45,649
DIVIDENDS DECLARED PER SHARE	\$ 0.25	\$ 0.18	\$ 0.50	\$ 0.33

The accompanying Notes are an integral part of the Unaudited Consolidated Financial Statements.

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M.D.C. HOLDINGS, INC.
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six Months Ended June 30,	
	2006	2005
OPERATING ACTIVITIES		
Net income	\$ 171,912	\$ 187,254
Adjustments to reconcile net income to net cash used in operating activities		
Amortization of deferred marketing costs	19,086	14,750
Depreciation and amortization of long-lived assets	9,423	6,836
Amortization of debt discount	189	149
Deferred income taxes	(16,812)	(1,409)
Stock-based compensation expense	7,142	699
Excess tax benefits from stock-based compensation	(1,486)	
Net changes in assets and liabilities		
Home sales and other accounts receivable	35,641	(38,382)
Housing completed or under construction	(191,903)	(332,028)
Land and land under development	(82,129)	(193,156)
Prepaid expenses and other assets	(14,989)	(42,255)
Mortgage loans held in inventory	74,003	16,814
Accounts payable and accrued liabilities	(72,626)	52,795
Restricted cash	(113)	(1,941)
Other, net	(49,609)	1,830
Net cash used in operating activities	(112,271)	(328,044)
INVESTING ACTIVITIES		
Net purchase of property and equipment	(4,331)	(11,724)
FINANCING ACTIVITIES		
Lines of credit		
Advances	437,531	386,300
Principal payments	(425,900)	(380,899)
Excess tax benefits from stock-based compensation	1,486	
Dividend payments	(22,456)	(14,647)
Proceeds from exercise of stock options	2,894	9,412
Net cash (used in) provided by financing activities	(6,445)	166
Net decrease in cash and cash equivalents	(123,047)	(339,602)
Cash and cash equivalents		
Beginning of period	214,531	400,959
End of period	\$ 91,484	\$ 61,357

The accompanying Notes are an integral part of the Unaudited Consolidated Financial Statements.

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Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements****1. Basis of Presentation**

The Unaudited Consolidated Financial Statements of M.D.C. Holdings, Inc. (MDC or the Company, which refers to M.D.C. Holdings, Inc. and its subsidiaries) have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Accordingly, they do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These statements reflect all normal and recurring adjustments which, in the opinion of management, are necessary to present fairly the financial position, results of operations and cash flows of MDC at June 30, 2006 and for all periods presented. These statements should be read in conjunction with MDC's Consolidated Financial Statements and Notes thereto included in MDC's Annual Report on Form 10-K for the year ended December 31, 2005. Certain prior year balances have been reclassified to conform to the current year's presentation.

The Company has experienced significant seasonality and quarter-to-quarter variability in homebuilding activity levels. In general, the number of homes closed and associated home sales revenue historically have increased during the third and fourth quarters, compared with the first and second quarters. The Company believes that this seasonality reflects the historical tendency of homebuyers to purchase new homes in the spring with the goal of closing in the fall or winter, as well as the scheduling of construction to accommodate seasonal weather conditions. Also, the Company has experienced seasonality in the financial services operations because loan originations correspond with the closing of homes in the homebuilding operations. The Consolidated Statements of Income for the three and six months ended June 30, 2006 and Consolidated Statements of Cash Flows for the six months ended June 30, 2006 are not necessarily indicative of the results to be expected for the full year. Refer to economic conditions described under the caption

Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q and Risk Factors Relating to our Business in Item 1A of the Company's December 31, 2005 Annual Report on Form 10-K. There are no assurances as to the results of operations for the third or fourth quarter of 2006.

The following table summarizes, by quarter, information concerning the home sales revenue associated with homes closed during 2006, 2005 and 2004 (in thousands).

	Three Months Ended			
	March 31,	June 30,	September 30,	December 31,
2006				
Home sales revenue	\$ 1,119,308	\$ 1,195,083	N/A	N/A
2005				
Home sales revenue	\$ 916,831	\$ 1,029,553	\$ 1,147,757	\$ 1,708,734
2004				
Home sales revenue	\$ 746,429	\$ 861,537	\$ 1,007,134	\$ 1,316,913

2. Recent Accounting Pronouncements

On July 13, 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 is an interpretation of Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. FIN 48 provides interpretive guidance for the financial statement recognition and measurement of a tax position taken, or expected to be taken, in a tax return. FIN 48 requires the affirmative evaluation that it is more-likely-than-not, based on the technical merits of a tax position, that an enterprise is entitled to economic benefits resulting from positions taken in income tax returns. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements. FIN 48 also requires companies to disclose additional quantitative and qualitative information in their financial statements about

Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)**

uncertain tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006, and the cumulative effect of applying FIN 48 shall be reported as an adjustment to the opening balance of retained earnings for that fiscal year. The Company is currently evaluating the impact, if any, that FIN 48 may have on its financial position, results of operations or cash flows.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments*, an amendment of FASB Statements No. 133 and 140 (SFAS 155). SFAS 155 eliminates the exemption from applying SFAS 133 to interests in securitized financial assets so that similar instruments are accounted for similarly regardless of the form of the instrument. SFAS 155 also allows a preparer to elect fair value measurement at acquisition, at issuance, or when a previously recognized financial instrument is subject to a remeasurement event, on an instrument-by-instrument basis, in cases in which a derivative would otherwise be bifurcated. At the adoption of SFAS 155, any difference between the total carrying amount of the individual components of any existing hybrid financial instrument and the fair value of the combined hybrid financial instrument should be recognized as a cumulative-effect adjustment to the Company's beginning retained earnings. SFAS 155 is effective for the Company for all financial instruments acquired or issued after January 1, 2007. The Company is currently evaluating the impact, if any, that SFAS 155 may have on its financial position, results of operations or cash flows.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* (SFAS 156), an amendment of SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS 156 requires that servicing assets and servicing liabilities be recognized at fair value, if practicable, when the Company enters into a servicing agreement and allows two alternatives, the amortization and fair value measurement methods, as subsequent measurement methods. This accounting standard is effective for all new transactions occurring as of the beginning of fiscal years beginning after September 15, 2006. The Company is currently evaluating the impact, if any, that SFAS 156 may have on its financial position, results of operations or cash flows.

3. Stock-Based Compensation

Stock-Based Compensation Policy Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), using the modified prospective transition method and, therefore, has not restated results for prior periods. Under this transition method, stock-based compensation expense for the three and six months ended June 30, 2006 includes compensation expense for all share-based payment awards granted prior to, but not yet vested at December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). Stock-based compensation expense for all share-based payment awards granted after December 31, 2005 is based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). The Company recognizes these compensation costs net of an estimated annual forfeiture rate and recognizes the compensation costs for only those awards expected to vest on a straight-line basis over the requisite service period of the award, which is currently the option vesting term of up to seven years. Prior to the adoption of SFAS 123(R), the Company recognized stock-based compensation expense in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25).

In March 2005, the SEC issued Staff Accounting Bulletin No. 107, *Share-Based Payment* (SAB 107), regarding the SEC's interpretation of SFAS 123(R) and the valuation of share-based payment awards for public companies. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R). Additionally, upon the adoption of SFAS 123(R), tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are classified as financing cash flows.

Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)**

Prior to the adoption of SFAS 123(R), the Company presented the tax benefit of stock option exercises as operating cash flows.

As a result of adopting SFAS 123(R), income before income taxes for the three and six months ended June 30, 2006 were \$3.0 million and \$6.0 million lower, respectively, and net income for the three and six months ended June 30, 2006 were \$1.9 million and \$3.8 million lower, respectively, than if the Company had continued to account for share-based payment awards under APB 25. The Company has recorded all stock-based compensation expense to general and administrative expenses for each of the Company's segments included in Note 10.

Pro Forma Disclosures Pursuant to SFAS 123 As of December 31, 2005, the Company had only granted stock options with exercise prices that were equal to or greater than the fair market value of the Company's common stock on the date of grant. Accordingly, prior to January 1, 2006, stock-based compensation expense was recorded only in association with the vesting of restricted stock and unrestricted stock awards and was recorded to expense ratably over the associated service period, which was generally the vesting term. Additionally, prior to January 1, 2006, the Company provided pro forma disclosure amounts in accordance with SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (SFAS 148), as if the fair value method defined by SFAS 123 had been applied to all share-based payment awards. The following table illustrates the effect on net income and earnings per share if the fair value method prescribed by SFAS 123, as amended by SFAS 148, had been applied to all outstanding and unvested share-based payment awards during the three and six months ended June 30, 2005 (in thousands, except per share amounts).

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net income, as reported	\$ 102,623	\$ 187,254
Deduct stock-based compensation expense determined using the fair value method, net of related tax effects	(2,599)	(5,016)
Pro forma net income	\$ 100,024	\$ 182,238
Earnings per share		
Basic as reported	\$ 2.35	\$ 4.30
Basic pro forma	\$ 2.29	\$ 4.18
Diluted as reported	\$ 2.25	\$ 4.10
Diluted pro forma	\$ 2.19	\$ 3.99

Determining Fair Value of Share-Based Awards As part of the adoption of SFAS 123(R), the Company examined its historical pattern of option exercises in an effort to determine if there were any discernable activity patterns based on certain employee and non-employee populations. Based upon this evaluation, the Company identified three distinct populations: (1) executives consisting of the Company's Chief Executive Officer, Chief Operating Officer, Chief Financial Officer and General Counsel (collectively, the Executives); (2) non-executive employees (Non-Executives); and (3) non-employee members of the Company's board of directors (Directors). The Company has used the Black-Scholes option pricing model to value stock options for each of these populations.

Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)**

The fair values for stock options granted during the three and six months ended June 30, 2006 and 2005 were estimated using the Black-Scholes option pricing model with the following weighted-average assumptions.

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2006	2005	2006	2005
Expected volatility	46.1%	44.2%	46.0%	44.6%
Risk-free interest rate	4.7%	3.8%	4.7%	3.8%
Dividend yield rate	1.2%	0.6%	1.2%	0.7%
Expected lives of options	3.8yrs.	6.0yrs.	3.8yrs.	6.0yrs.

Based on calculations using the Black-Scholes option pricing models, the weighted average grant date fair value of stock options was \$22.03 and \$30.50 for the three months ended June 30, 2006 and 2005, respectively, and \$22.41 and \$31.79 for the six months ended June 30, 2006 and 2005, respectively. These assumptions were used for the stock options granted only to Non-Executives during the three and six months ended June 30, 2006 and 2005. No stock option awards were granted during these periods to Executives or Directors.

The expected volatility is based on the historical volatility in the price of the Company's common stock over the most recent period commensurate with the estimated expected life of the Company's stock options, adjusted for the impact of unusual fluctuations not reasonably expected to recur and other relevant factors. The risk-free interest rate assumption is determined based upon observed interest rates appropriate for the expected term of the Company's employee stock options. The dividend yield assumption is based on the Company's history and expectation of dividend payouts. The expected life of employee stock options represents the weighted-average period for which the stock options are expected to remain outstanding and are derived primarily from historical exercise patterns.

SFAS 123(R) requires an annual forfeiture rate to be estimated at the time of grant for all share-based payment awards granted subsequent to January 1, 2006, and revised, if necessary, in subsequent periods if the actual forfeiture rate differs from the Company's estimate. Additionally, in accordance with SFAS 123(R), the Company has estimated an annual forfeiture rate to be applied to all share-based payment awards which were unvested as of December 31, 2005 in determining the number of awards expected to vest in the future. The Company estimated the annual forfeiture rate to be 25% for share-based payment awards granted to Non-Executives and 0% for share-based payment awards granted to Executives and Directors, based on the terms of their awards, as well as historical forfeiture experience. In the Company's pro forma information required under SFAS 123 for the periods prior to 2006, the Company accounted for forfeitures as they occurred.

Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)**

Stock Option Award Activity - Stock option activity under the Company's option plans at June 30, 2006 and changes during the six months ended June 30, 2006 were as follows.

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2005	5,659,766	\$ 40.54		
Granted	25,000	\$ 60.15		
Exercised	(133,610)	\$ 21.66		
Cancelled	(200,669)	\$ 54.16		
Outstanding at June 30, 2006	5,350,487	\$ 40.59	6.40	\$ 62,407

The following table summarizes information concerning stock options granted to Executives, Non-Executives and Directors that are vested at June 30, 2006, as well as stock options granted but unvested at June 30, 2006 that the Company expects will vest in future periods.

Vested and Expected to Vest at June 30, 2006

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Executives	3,875,815	\$ 36.24		
Non-Executives	523,887	\$ 43.48		
Directors	303,325	\$ 61.41		
Total	4,703,027	\$ 38.67	6.22	\$ 62,363

The following table summarizes information concerning stock options granted to Executives, Non-Executives and Directors that are exercisable at June 30, 2006.

Exercisable at June 30, 2006

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Executives	1,513,209	\$ 19.82		
Non-Executives	175,255	\$ 21.43		
Directors	303,325	\$ 61.41		

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Total	1,991,789	\$	26.30	5.02	\$	51,050
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The following table summarizes information concerning outstanding and exercisable stock options at June 30, 2006.

Range of Exercise Price	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted-Average Remaining Contractual Life (in years)	Weighted- Average Exercise Price	Number Exercisable	Weighted- Average Exercise Price
\$ 7.92 - \$23.77	2,227,778	4.44	\$ 19.96	1,549,740	\$ 19.33
\$23.78 - \$31.69	283,895	1.74	\$ 26.69	146,048	\$ 26.94
\$31.70 - \$47.53	910,914	7.36	\$ 44.31	73,501	\$ 40.86
\$47.54 - \$71.30	1,787,900	8.88	\$ 63.62	97,500	\$ 57.66
\$71.31 - \$79.22	140,000	9.24	\$ 78.78	125,000	\$ 78.89
Total	5,350,487	6.40	\$ 40.59	1,991,789	\$ 26.30

The aggregate intrinsic values in the tables above represent the total pre-tax intrinsic values (the difference between the closing price of MDC's common stock on the last trading day of the 2006 second quarter and the exercise price, multiplied by the number of in-the-money stock options) that would have been received by the option holders had all outstanding stock options been exercised on June 30, 2006. This amount changes based on changes in the fair market value of the Company's common stock. The total intrinsic value of options exercised and total fair value of stock options vested during the six months ended June 30, 2006 were \$4.0 million and \$0.3 million, respectively.

Total stock-based compensation expense relating to stock options granted by the Company was \$3.0 million and \$6.0 million, respectively, for the three and six months ended June 30, 2006. At June 30, 2006, \$41.0 million of total unrecognized compensation cost related to stock options is expected to be recognized as an expense by the Company in the future over a weighted-average period of 4.3 years.

Cash received from stock option exercises was \$2.9 million and the associated tax benefit realized totaled \$1.5 million for the six months ended June 30, 2006.

Restricted and Unrestricted Stock Award Activity Non-vested restricted stock awards at June 30, 2006 and changes during the six months ended June 30, 2006 were as follows.

	Number of Shares	Weighted-Average Grant Date Fair Value
Non-vested at December 31, 2005	43,312	\$ 57.16
Granted	31,851	\$ 64.58
Vested	(17,365)	\$ 60.94
Forfeited	(5,623)	\$ 60.55
Non-vested at June 30, 2006	52,175	\$ 60.07

Total stock-based compensation expense relating to restricted stock and unrestricted stock awards was \$0.2 million and \$0.1 million for the three months ended June 30, 2006 and 2005, respectively, and was \$1.1 million and \$0.7 million for the six months ended June 30, 2006 and 2005, respectively. At June 30, 2006, there was \$2.2 million

of unrecognized stock-based compensation expense related to non-vested restricted stock awards that is expected to be recognized as an expense by the Company in the future over a weighted-average period of 3.0 years.

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A summary of the Company's equity incentive plans follows:

Employee Equity Incentive Plans In April 1993, the Company adopted the Employee Equity Incentive Plan (the Employee Plan). The Employee Plan provided for an initial authorization of 2,100,000 shares of MDC common stock for issuance thereunder, subject to adjustment for stock dividends and stock splits, plus an additional annual authorization equal to 10% of the then authorized shares of MDC common stock under the Employee Plan as of each succeeding annual anniversary of the date the Employee Plan was adopted. Under the Employee Plan, the Company could grant awards of restricted stock, incentive and non-statutory stock options and dividend equivalents, or any combination thereof, to officers and employees of the Company or any of its subsidiaries. The incentive and non-statutory stock options granted under the Employee Plan are exercisable at prices not less than the market value on the date of grant and vest over periods of up to four years and expire within six years. The Company's ability to make further grants under the Employee Plan terminated pursuant to its terms on April 20, 2003.

Effective March 2001, the Company adopted the M.D.C. Holdings, Inc. 2001 Equity Incentive Plan (the Equity Incentive Plan). The Equity Incentive Plan provided for an initial authorization of 2,000,000 shares of MDC common stock for issuance thereunder, subject to adjustment for stock dividends and stock splits, plus an additional annual authorization equal to 10% of the then authorized shares of MDC common stock under the Equity Incentive Plan as of each succeeding annual anniversary of the date the Equity Incentive Plan was adopted. In April 2003, an additional 1,000,000 shares (also subject to adjustment for stock dividends and stock splits) were authorized for issuance by vote of the Company's shareowners. The Equity Incentive Plan provides for the grant of non-qualified stock options, incentive stock options, stock appreciation rights, restricted stock, stock bonuses and other stock grants to employees of the Company. Incentive stock options granted under the Equity Incentive Plan must have an exercise price that is at least equal to the fair market value of the common stock on the date the incentive stock option is granted. Non-qualified option awards generally vest over periods of up to seven years and expire in ten years. Restricted stock awards are granted with vesting terms of up to four years.

Director Equity Incentive Plan Effective March 2001, the Company adopted the M.D.C. Holdings, Inc. Stock Option Plan for Non-Employee Directors (the Director Stock Option Plan). Under the Director Stock Option Plan, non-employee directors of the Company are granted non-qualified stock options. The Director Stock Option Plan provided for an initial authorization of 500,000 shares of MDC common stock for issuance thereunder, subject to adjustment for stock dividends and stock splits, plus an additional annual authorization equal to 10% of the then authorized shares of MDC common stock under the Director Stock Option Plan as of each succeeding annual anniversary of the date the Director Stock Option Plan was adopted. Pursuant to the Director Stock Option Plan, on October 1 of each year, each non-employee director of the Company is granted options to purchase 25,000 shares of MDC common stock. Each option granted under the Director Stock Option Plan vests immediately and expires ten years from the date of grant. The option exercise price must be equal to the fair market value (as defined in the plan) of MDC common stock on the date of grant of the option. In October 2003, the Director Stock Option Plan, which was approved by the shareowners on May 21, 2001, was amended to terminate on May 21, 2011.

Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)****5. Balance Sheet Components**

The following tables set forth information relating to corporate and homebuilding accounts payable and accrued liabilities (in thousands).

	June 30, 2006	December 31, 2005
Corporate		
Accrued compensation and related expense	\$ 39,148	\$ 66,885
Warranty reserves	11,038	10,693
Accrued pension liability	12,287	11,687
Other accounts payable and accrued liabilities	30,720	28,502
Total Corporate accounts payable and accrued liabilities	\$ 93,193	\$ 117,767
	June 30, 2006	December 31, 2005
Homebuilding		
Accounts payable		
Construction accounts payable	\$ 223,115	\$ 195,803
Non-construction accounts payable	3,318	7,789
Total accounts payable	226,433	203,592
Accrued liabilities		
Warranty reserves	\$ 80,972	\$ 71,545
Land and home construction accrual	52,746	74,955
Customer and escrow deposits	46,791	56,186
Insurance reserves	38,187	32,166
Accrued compensation and related expense	33,699	32,656
Other accrued liabilities	49,582	24,319
Total accrued liabilities	301,977	291,827
Total Homebuilding accounts payable and accrued liabilities	\$ 528,410	\$ 495,419

Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)****6. Earnings Per Share**

Pursuant to SFAS No. 128, Earnings per Share, the computation of diluted earnings per share takes into account the effect of dilutive stock options. The basic and diluted earnings per share calculations are shown below (in thousands, except per share amounts).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Basic Earnings Per Share				
Net income	\$ 76,491	\$ 102,623	\$ 171,912	\$ 187,254
Basic weighted-average shares outstanding	44,939	43,718	44,880	43,584
Per share amounts	\$ 1.70	\$ 2.35	\$ 3.83	\$ 4.30
Diluted Earnings Per share				
Net income	\$ 76,491	\$ 102,623	\$ 171,912	\$ 187,254
Basic weighted-average shares outstanding	44,939	43,718	44,880	43,584
Stock options, net	1,033	1,985	1,087	2,065
Diluted weighted-average shares outstanding	45,972	45,703	45,967	45,649
Per share amounts	\$ 1.66	\$ 2.25	\$ 3.74	\$ 4.10

7. Interest Activity

The Company capitalizes interest incurred on its corporate and homebuilding debt during the period of active land development and through the completion of construction of its homebuilding inventories. All corporate and homebuilding interest incurred was capitalized during the three and six months ended June 30, 2006 and 2005. Interest incurred by the financial services segment is charged to interest expense, which is deducted from interest income and reported as net interest income in Note 10.

Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)**

Interest activity, in total and by business segment, is shown below (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Total Interest Incurred				
Corporate and homebuilding	\$ 15,002	\$ 11,110	\$ 29,843	\$ 21,925
Financial services	2,317	654	4,281	1,138
Total interest incurred	\$ 17,319	\$ 11,764	\$ 34,124	\$ 23,063
 Corporate/Homebuilding Interest Capitalized				
Interest capitalized in homebuilding inventory, beginning of period	\$ 47,222	\$ 27,741	\$ 41,999	\$ 24,220
Interest incurred	15,002	11,110	29,843	21,925
Previously capitalized interest included in home cost of sales	(13,655)	(8,558)	(23,273)	(15,852)
Interest capitalized in homebuilding inventory, end of period	\$ 48,569	\$ 30,293	\$ 48,569	\$ 30,293
 Financial Services Net Interest Income				
Interest income	\$ 3,440	\$ 1,382	\$ 6,260	\$ 2,393
Interest expense	(2,317)	(654)	(4,281)	(1,138)
Net interest income	\$ 1,123	\$ 728	\$ 1,979	\$ 1,255

Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)****8. Warranty Reserves**

Warranty reserves presented in the table below relate to general and structural reserves, as well as reserves for known, unusual warranty-related expenditures not covered by the Company's general and structural warranty reserve. Warranty reserves are reviewed at least quarterly, using historical data and other relevant information, to determine the reasonableness and adequacy of both the reserve and the per unit reserve amount originally included in home cost of sales, as well as the timing of the reversal of any excess reserve. If warranty payments for an individual house exceed the related reserve, then payments in excess of the reserve are evaluated in the aggregate to determine if an adjustment to the warranty reserve should be recorded, which could result in a corresponding adjustment to home cost of sales. Warranty reserves are included in corporate accounts payable and accrued liabilities and homebuilding accrued liabilities in the Consolidated Balance Sheets, and totaled \$92.0 million and \$82.2 million, at June 30, 2006 and December 31, 2005, respectively. In addition, the reserves include additional qualified settlement fund warranty reserves created pursuant to litigation settled in 1996. Warranty reserve activity for the three and six months ended June 30, 2006 and 2005 is shown below (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Warranty reserve balance at beginning of period	\$ 85,613	\$ 64,102	\$ 82,238	\$ 64,424
Warranty expense provision	11,797	7,200	23,293	16,487
Warranty cash payments	(7,790)	(10,552)	(15,911)	(20,161)
Warranty reserve adjustments	2,390		2,390	
Warranty reserve balance at end of period	\$ 92,010	\$ 60,750	\$ 92,010	\$ 60,750

9. Insurance Reserves

The Company records expenses and liabilities for costs to cover liabilities related to: (1) insurance policies issued by StarAmerican Insurance Ltd. and Allegiant Insurance Company, Inc., A Risk Retention Group; (2) self-insurance; (3) deductible amounts under the Company's insurance policies; and (4) losses and loss adjustment expenses associated with claims in excess of coverage limits or not covered by insurance policies. The establishment of the provisions for outstanding losses and loss adjustment expenses is based on actuarial studies that include known facts and interpretation of circumstances, including the Company's experience with similar cases and historical trends involving claim payment patterns, pending levels of unpaid claims, product mix or concentration, claim severity, frequency patterns such as those caused by natural disasters, fires, or accidents, depending on the business conducted and changing regulatory and legal environments.

Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)**

The following table summarizes the insurance reserve activity for the three and six months ended June 30, 2006 and 2005 (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Insurance reserve balance at beginning of period	\$ 33,888	\$ 23,680	\$ 32,166	\$ 21,188
Insurance expense provisions	2,529	2,983	5,091	5,550
Insurance cash payments	(118)	(70)	(958)	(145)
Insurance reserve adjustments	1,888	202	1,888	202
Insurance reserve balance at end of period	\$ 38,187	\$ 26,795	\$ 38,187	\$ 26,795

10. Information on Business Segments

The Company has three operating segments – homebuilding, financial services and corporate. The primary business of the homebuilding segment is owning and managing subsidiary companies that sell and build homes under the name Richmond American Homes in certain markets located within the United States. The homebuilding segment also provides title agency services through American Home Title and Escrow Company (American Home Title) to the Company's homebuyers in certain states. The financial services segment includes HomeAmerican Mortgage Corporation (HomeAmerican), which originates mortgage loans primarily for the Company's homebuyers, and American Home Insurance Agency, Inc. (American Home Insurance), which offers third party insurance products to the Company's homebuyers. The corporate segment incurs general and administrative expenses that are not identifiable specifically to another operating segment.

Operating segments are defined as components of an enterprise for which discrete financial information is available and is reviewed regularly by the chief operating decision-making group to evaluate performance and make operating decisions. The Company has identified its chief operating decision-makers as the Chief Executive Officer, Chief Operating Officer and Chief Financial Officer. These executives review the financial position and results of operations for the Company's operating segments.

Included in homebuilding general and administrative expenses are supervisory fees charged by the Company's corporate segment to both the homebuilding and financial services segments. Supervisory fees represent costs incurred by the Company's corporate segment associated with certain departments which support the Company's homebuilding and financial services segment operations. Supervisory fees included in general and administrative expense for the homebuilding segment were \$11.2 million and \$21.9 million for the three and six months ended June 30, 2006, respectively, and \$8.1 million and \$15.3 million for the three and six months ended June 30, 2005, respectively. Supervisory fees included in general and administrative expense for the financial services segment were \$0.1 million and \$0.3 million for each of the three and six months ended June 30, 2006 and 2005, respectively. Transfers between segments are recorded at cost. Identifiable segment assets are shown on the face of the Consolidated Balance Sheets.

Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)**

A summary of the Company's operating segments is shown below (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Homebuilding				
Revenue				
Home sales	\$ 1,195,083	\$ 1,029,553	\$ 2,314,391	\$ 1,946,384
Land sales	13,639		15,476	1,296
Other revenue	4,315	3,741	8,024	6,944
Total Homebuilding Revenue	1,213,037	1,033,294	2,337,891	1,954,624
Home cost of sales	917,414	734,772	1,732,003	1,391,552
Land cost of sales	13,400		15,774	790
Marketing expenses	31,568	25,008	60,603	47,326
Commission expenses	37,394	28,680	70,237	54,526
General and administrative expenses	79,987	57,209	152,231	110,295
Total Homebuilding Expenses	1,079,763	845,669	2,030,848	1,604,489
Homebuilding Operating Profit	133,274	187,625	307,043	350,135
Financial Services				
Revenue				
Net interest income	1,123	728	1,979	1,255
Broker origination fees	2,343	2,665	4,423	4,833
Gain on sale of mortgage loans, net	15,439	8,749	28,466	16,647
Other revenue	811	670	2,256	1,675
Total Financial Services Revenue	19,716	12,812	37,124	24,410
General and Administrative Expenses	9,480	8,685	18,575	17,436
Financial Services Operating Profit	10,236	4,127	18,549	6,974
Total Operating Profit	143,510	191,752	325,592	357,109
Corporate				
Interest and other revenue	183	234	615	1,222
General and administrative expenses	(21,332)	(27,946)	(49,689)	(58,262)
Related party expenses	(127)	(63)	(1,803)	(163)

Net Corporate Expenses	(21,276)	(27,775)	(50,877)	(57,203)
Income Before Income Taxes	\$ 122,234	\$ 163,977	\$ 274,715	\$ 299,906

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Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)****11. Other Comprehensive Income**

Total other comprehensive income includes net income plus unrealized gains or losses on securities available for sale and minimum pension liability adjustments which have been reflected as a component of stockholders' equity and have not affected consolidated net income. The Company's other comprehensive income was \$76.5 million and \$171.9 million for the three and six months ended June 30, 2006, respectively, and \$102.6 million and \$187.3 million for the three and six months ended June 30, 2005, respectively.

12. Commitments and Contingencies

The Company often is required to obtain bonds and letters of credit in support of its obligations relating to subdivision improvement, homeowner association dues and start-up expenses, warranty work, contractor license fees and earnest money deposits. At June 30, 2006, MDC had issued and outstanding performance bonds and letters of credit totaling \$456.4 million and \$88.9 million, respectively, including \$24.7 million in letters of credit issued by HomeAmerican, a wholly owned subsidiary of MDC. In the event any such bonds or letters of credit issued by third parties are called, MDC would be obligated to reimburse the issuer of the bond or letter of credit.

13. Lines of Credit and Total Debt Obligations

Homebuilding The Company's homebuilding line of credit (Homebuilding Line) is an unsecured revolving line of credit with a group of lenders for support of our homebuilding operations. On March 22, 2006, the Company amended and restated the Homebuilding Line, increasing the aggregate commitment amount to \$1.25 billion, and extending the maturity date to March 21, 2011. The facility's provision for letters of credit is available in the aggregate amount of \$500 million. The amended and restated facility permits an increase in the maximum commitment amount to \$1.75 billion upon the Company's request, subject to receipt of additional commitments from existing or additional participant lenders. Interest rates on outstanding borrowings are determined by reference to LIBOR, with a spread from LIBOR which is determined based on changes in the Company's credit ratings and leverage ratio, or to an alternate base rate. At June 30, 2006, the Company did not have any borrowings and had \$61.4 million in letters of credit issued under the Homebuilding Line.

Mortgage Lending The Company's mortgage line of credit (Mortgage Line) has a borrowing limit of \$225 million with terms that allow for increases of up to \$175 million in the borrowing limit to a maximum of \$400 million, subject to concurrence by the participating banks. The terms of the Mortgage Line are set forth in the Third Amended and Restated Warehousing Credit Agreement dated as of October 31, 2003, as amended. Available borrowings under the Mortgage Line are collateralized by mortgage loans and mortgage-backed securities and are limited to the value of eligible collateral, as defined. At June 30, 2006, \$168.2 million was borrowed and an additional \$31.4 million was collateralized and available to be borrowed. The Mortgage Line is cancelable upon 120 days notice.

General The agreements for the Company's bank lines of credit and the indentures for the Company's senior notes require compliance with certain representations, warranties and covenants. The Company believes that it is in compliance with these requirements, and the Company is not aware of any covenant violations. The agreements containing these representations, warranties and covenants for the bank lines of credit and the indentures for the Company's senior notes are on file with the SEC and are listed in the Exhibit Table in Part IV of the Company's Annual Report on Form 10-K for the year ended December 31, 2005 and in Part II, Item 6, of the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2006.

Table of Contents**M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements (Continued)**

The Company's debt obligations at June 30, 2006 and December 31, 2005 are as follows (in thousands):

	June 30, 2006	December 31, 2005
7% Senior Notes due 2012	\$ 148,891	\$ 148,821
5 1/2% Senior Notes due 2013	349,318	349,276
5 3/8% Medium Term Senior Notes due 2014	248,597	248,532
5 3/8% Medium Term Senior Notes due 2015	249,680	249,668
Total Senior Notes	996,486	996,297
Homebuilding Line		
Total Corporate and Homebuilding Debt	996,486	996,297
Mortgage Line	168,163	156,532
Total Debt	\$ 1,164,649	\$ 1,152,829

14. Related Party Transactions

During the first quarter of 2006, the Company accrued \$1.6 million of contributions which were made to the MDC/Richmond American Homes Foundation (the Foundation), a Delaware non-profit corporation. These contributions were paid during the second quarter of 2006. No contributions to the Foundation were accrued in the 2006 second quarter.

15. Income Taxes

The Company's overall effective income tax rates were 37.4% for the three and six months ended June 30, 2006, and were 37.4% and 37.6% for the three and six months ended June 30, 2005, respectively.

16. Stockholders' Equity

On April 27, 2006, the Company amended the Certificate of Incorporation, as authorized by the Company's shareowners on April 24, 2006, thereby increasing the number of authorized shares of the Company's common stock from 100 million shares to 250 million shares.

17. Other Events