

Edgar Filing: AMREIT - Form 10QSB

AMREIT
Form 10QSB
August 13, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-QSB

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

For the quarterly period ended June 30, 2004

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

For the transition period from _____ to _____

Commission File Number: 0-28378

AMREIT
(Name of Small Business Issuer in its Charter)

TEXAS
(State or Other Jurisdiction of
Incorporation or Organization)

76-0410050
(I.R.S. Employer Identification No.)

8 GREENWAY PLAZA, SUITE 1000
HOUSTON, TX
(Address of Principal Executive Offices)

77046
(Zip Code)

Indicate by check mark whether the issuer (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 issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

X Yes No

As of June 30, 2004 there were 3,321,903 class A, 2,315,890 class B, and 4,035,140 class C common shares of beneficial interest of AmREIT, \$.01 par value outstanding.

PART I - FINANCIAL INFORMATION

Edgar Filing: AMREIT - Form 10QSB

ITEM 1. FINANCIAL STATEMENTS

AMREIT AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
June 30, 2004
(unaudited)

ASSETS

Property:

Land	\$	37,
Buildings		32,
Tenant improvements		-----

Less accumulated depreciation and amortization		70,
		(2,

Net real estate held for investment		68,
Real estate held for sale, net		11,

Net investment in direct financing leases held for investment		19,
---	--	-----

Cash and cash equivalents		
Accounts receivable		1,
Accounts receivable - related party		1,
Notes receivable		
Escrow deposits		
Prepaid expenses, net		

Other assets:

Preacquisition costs		
Loan acquisition cost, net of \$166,365 in accumulated amortization		
Leasing costs, net of \$78,189 in accumulated amortization		
Furniture, fixtures and equipment, net of \$183,316 in accumulated depreciation		
Accrued rental income		
Intangible lease cost, net of \$105,808 in accumulated amortization		
Investment in non-consolidated affiliates		2,

Total other assets		4,

TOTAL ASSETS	\$	108,
		=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Liabilities:

Notes payable	\$	32,
Accounts payable		2,
Accounts payable - related party		
Construction payable		
Deferred gain		
Security deposit		
Prepaid rent		

TOTAL LIABILITIES		35,

Minority interest		1,
-------------------	--	----

Shareholders' equity:

Preferred shares, \$.01 par value, 10,000,000 shares authorized, none issued		
Class A Common shares, \$.01 par value, 50,000,000 shares authorized, 3,347,030 shares issued		
Class B Common shares, \$.01 par value, 3,000,000 shares authorized,		

Edgar Filing: AMREIT - Form 10QSB

2,315,890 shares issued
 Class C Common shares, \$.01 par value, 4,400,000 shares authorized,
 4,035,140 shares issued
 Capital in excess of par value
 Accumulated distributions in excess of earnings
 Deferred compensation
 Cost of treasury shares, 25,127 shares

85,
 (12,
 (
 (

 71,

 \$ 108,
 =====

TOTAL SHAREHOLDERS' EQUITY

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY

See Notes to Condensed Consolidated Financial Statements.

F-1

AMREIT AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF OPERATIONS
 (unaudited)

	QUARTER ENDED JUNE 30,		
	2004	2003	2002
	-----	-----	-----
Revenues:			
Rental income from operating leases	\$ 1,588,798	\$ 970,501	\$ 3,000,000
Earned income from direct financing leases	507,307	506,799	1,000,000
Real estate fee income	581,207	136,001	1,000,000
Securities commission income	1,648,326	441,052	3,000,000
Asset management fee income	73,622	46,616	1,000,000
Interest and other income	313,505	281	1,000,000
	-----	-----	-----
Total revenues	4,712,765	2,101,250	9,000,000
	-----	-----	-----
Expenses:			
General operating and administrative	1,587,601	783,210	3,000,000
Legal and professional	321,747	214,318	1,000,000
Securities commissions	1,337,593	331,286	2,000,000
Depreciation and amortization	270,330	171,155	1,000,000
Deferred merger costs	362,037	-	1,000,000
	-----	-----	-----
Total expenses	3,879,308	1,499,969	8,000,000
	-----	-----	-----
Operating income	833,457	601,281	1,000,000
Income from non-consolidated affiliates	172,207	45,033	1,000,000
Federal income tax (expense) benefit for taxable REIT subsidiary	(104,347)	(57,700)	(1,000,000)
Interest expense	(543,974)	(532,503)	(1,000,000)
Minority interest in income of consolidated joint ventures	(49,186)	(43,161)	(1,000,000)
	-----	-----	-----

Edgar Filing: AMREIT - Form 10QSB

Income (loss) before discontinued operations	308,157	12,950	
(Loss) income from discontinued operations	(452,877)	357,110	
Gain on sales of real estate acquired for resale	241,979	279,084	
	-----	-----	
(Loss) income from discontinued operations	(210,898)	636,194	
	-----	-----	
Net income (loss)	\$ 97,259	\$ 649,144	\$
Distributions paid to class B and class C shareholders	(1,105,814)	(439,124)	(1,
	-----	-----	
Net (loss) income available to class A shareholders	\$ (1,008,555)	\$ 210,020	\$ (2,
	=====	=====	
Net (loss) income per common share - basic and diluted			
Loss before discontinued operations	\$ (0.25)	\$ (0.15)	\$
(Loss) income from discontinued operations	\$ (0.06)	\$ 0.23	\$
	-----	-----	
Net (loss) income	\$ (0.31)	\$ 0.08	\$
	=====	=====	
Weighted average class A common shares used to compute net income per share, basic and diluted	3,235,449	2,790,492	3,
	=====	=====	

See Notes to Condensed Consolidated Financial Statements.

F-2

AMREIT AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	QUARTER ENDED JUNE 30,		
	2004	2003	
	-----	-----	
Cash flows from operating activities:			
Net income (loss)	\$ 97,259	\$ 649,144	\$
Adjustments to reconcile net income to net cash provided by operating activities:			
Investment in real estate acquired for resale	(1,533,452)	(7,233,907)	
Proceeds from sales of real estate acquired for sale	49,020	1,898,356	
Gain on sales of real estate acquired for resale	(241,979)	-	
Impairment charges	1,103,144	-	
Depreciation and amortization	305,039	237,319	
Amortization of deferred compensation	67,677	15,457	
Minority interest in income of consolidated joint			

Edgar Filing: AMREIT - Form 10QSB

ventures	169,807	43,161
Deferred merger costs	362,037	-
Decrease (increase) in accounts receivable	436,392	(151,253)
Decrease (increase) in accounts receivable- related party	336,777	(22,966)
(Increase) decrease in prepaid expenses, net	(28,436)	(30,536)
Cash receipts from direct financing leases (less) more than income recognized	(4,554)	(4,265)
Increase in accrued rental income	(76,571)	(30,328)
(Increase) decrease in other assets	(334,707)	(76,447)
Increase (decrease) in accounts payable	743,923	270,726
Increase (decrease) in accounts payable- related party	4,778	7,561
Increase in security deposits	56,633	-
Increase in prepaid rent	22,355	84,802
	-----	-----
Net cash provided by (used in) operating activities	1,635,142	(4,343,176)
	-----	-----
Cash flows from investing activities:		
Improvements to real estate	(93,771)	(121,806)
Acquisition of investment properties	(6,388,715)	-
Notes receivable collections	65,777	-
Additions to furniture, fixtures and equipment	(222,647)	(17,553)
Investment in non-consolidating affiliates	(137,048)	80,939
Proceeds from sale of investment property	693,515	-
Increase in preacquisition costs	(99,021)	18,703
	-----	-----
Net cash used in investing activities	(6,181,910)	(39,717)
	-----	-----
Cash flows from financing activities:		
Proceeds from notes payable	6,142,154	6,892,959
Payments of notes payable	(10,593,346)	(1,749,299)
Purchase of treasury shares	-	(75,425)
Issuance of common shares	10,276,145	-
Issuance costs	(1,096,470)	-
Common dividends paid	(1,488,660)	(749,437)
Distributions to minority interests	(26,056)	(25,031)
	-----	-----
Net cash provided by financing activities	3,213,767	4,293,767
	-----	-----
Net decrease in cash and cash equivalents	(1,333,001)	(89,126)
Cash and cash equivalents, beginning of period	2,179,002	825,560
	-----	-----
Cash and cash equivalents, end of period	\$ 846,001	\$ 736,434
	=====	=====

SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES

In 2004 the Company issued 134,695 shares of restricted stock to employees and trust managers as part of their compensation plan. The restricted stock vests over a four and three period re The Company recorded \$875,518 in deferred compensation related to the issuance of the restrict

In 2003 the Company issued 24,257 shares of restricted stock to employees and trust managers a as part of their compensation plan. The restricted stock vests over a four and three period re The Company recorded \$152,819 in deferred compensation related to the issuance of the restrict

SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION:

Cash paid during the year for:

Edgar Filing: AMREIT - Form 10QSB

Interest	528,604	603,232
Income taxes	-	-

See Notes to Condensed Consolidated Financial Statements.

F-3

AMREIT AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND 2003
(UNAUDITED)

1. DESCRIPTION OF BUSINESS AND NATURE OF OPERATIONS

AmREIT is a Texas real estate investment trust ("REIT") that has elected to be taxed as a REIT for federal income tax purposes. AmREIT is a self-managed, self-advised REIT with, along with its predecessor, a 19-year history and a record of investing in quality income producing retail real estate. AmREIT's class A common shares are traded on the American Stock Exchange under the symbol "AMY". AmREIT's business structure consists of the publicly traded REIT and three synergistic businesses that support the Company's platform of growth: a real estate operating and development business, a securities business and a retail partnership business. This unique combination provides AmREIT the opportunity to access capital through both Wall Street and the independent financial planning marketplace and strategically invest that capital in high quality properties for flexibility and more dependable growth.

We finance our growth and working capital needs with a combination of equity offerings and a conservative debt philosophy. Currently, the Company is raising capital through a series of publicly registered, non traded common share offerings, being offered exclusively through the independent financial planning community. As of June 30, 2004, the Company had raised approximately \$40.4 million through sales of its class C common shares since the offering commenced in August 2003, including shares issued through the dividend reinvestment program. On June 25, 2004, the Company launched its class D common share offering: a \$170 million publicly registered, non-traded common share offering with a stated yield of 6.5%. The class D common shares are convertible into the Company's class A common shares after a seven-year lock out period. Through its by-laws, the Company's debt is limited to 55% recourse debt as compared to its gross assets. As of June 30, 2004, the Company's debt to asset ratio was approximately 33%.

Our operating strategy and investment criteria discussed herein are reviewed by our Board of Trust Managers on a regular basis and may be modified or changed without a vote of our shareholders.

PORTFOLIO

We focus on acquiring "irreplaceable corners" - premier retail frontage properties in high-traffic, highly populated areas - which the Company expects will create dependable income and long-lasting value. These premium properties are expected to provide high leasing income and high occupancy rates for a strong income stream. As of June 30, 2004, the occupancy rate of our properties was 88.5%. Our properties attract a wide array of established commercial tenants, and offer attractive opportunities for dependable monthly income and potential capital appreciation. Management believes that the location and design

Edgar Filing: AMREIT - Form 10QSB

of its properties provide flexibility in use and tenant selection and an increased likelihood of advantageous lease renewal terms.

Our revenues are substantially generated by corporate retail tenants such as Starbucks, Landry's, CVS/pharmacy, International House of Pancakes ("IHOP"), Eckerd, Nextel, Washington Mutual, TGI Friday's, and others. We own, and may purchase in the future, fee simple retail properties (we own the land and the building), ground lease properties (we own the land, but not the building and receive rental income from the owner of the building) or leasehold estate properties (we own the building, but not the land, and therefore are obligated to make a ground lease payment to the owner of the land). AmREIT may also develop properties for its portfolio or enter into joint ventures, partnerships or co-ownership for the development of retail properties.

AmREIT owns a real estate portfolio consisting of 53 properties located in 19 states at June 30, 2004. Our multi-tenant shopping center properties are primarily located throughout Texas and are leased to national, regional and

F-4

local tenants. Our single tenant properties are located throughout the United States and are generally leased to corporate tenants where the lease is the direct obligation of the parent company, not just the local operator, and in most other cases, our leases are guaranteed by the parent company. In so doing, the dependability of the lease payments is based on the strength and viability of the entire company, not just the leased location. Properties that we acquire are generally newly constructed or recently constructed at the time of acquisition.

As of June 30, 2004, no single property accounted for more than 10% of the Company's total assets. For the year to date period ended June 30, 2004, IHOP accounted for 13.8% of the Company's total revenue and no other tenant accounted for more than 5% of the Company's total revenue.

REAL ESTATE OPERATING AND DEVELOPMENT COMPANY

AmREIT's real estate operating and development subsidiary, AmREIT Realty Investment Corporation ("ARIC"), comprised of a fully integrated real estate team, provides brokerage, leasing, construction management, development and property management services to our tenants as well as third parties. This operating subsidiary, which is a taxable REIT subsidiary, compliments our portfolio of retail properties by generating fee income from providing services to third parties and affiliated funds, providing a high level of service to our tenants, as well as maintaining our portfolio of properties to meet our standards.

Having an internal real estate group also helps secure strong tenant relationships for both us and our retail partnerships. Our growing roster of leases with well-known national and regional tenants includes Bank of America, Starbucks, TGI Friday's CVS/pharmacy, Nextel, Landry's, Eckerd, IHOP, Washington Mutual, and others. Equally important, we have affiliations with these parent company tenants that extend across multiple sites.

Not only does our real estate operating and development company create value through relationships, but it also provides an additional source of fee income and profits. Through the development, construction, management, leasing and brokerage services provided to our affiliated actively managed retail partnerships, as well as for third parties, our real estate team continues to generate fees and profits for us. Through ARIC, we are able to generate additional profits through the selective acquisitions and dispositions of

Edgar Filing: AMREIT - Form 10QSB

properties within twelve to eighteen months. These assets are listed as real estate held for sale on our consolidated balance sheet, and at June 30, 2004, these assets represented approximately \$4.0 million of the \$11.0 million reported as real estate held for sale.

SECURITIES COMPANY

The part of our business structure and operating strategy that really separates us from other publicly traded REITs is AmREIT Securities Company (ASC), a wholly owned subsidiary of ARIC. Through ASC, we are able to raise capital through the National Association of Securities Dealers (NASD) independent financial planning community. Traditionally, we have raised capital in two ways: first, for our actively managed retail partnerships, and second, directly for AmREIT through non-traded classes of common shares.

During 2003, ASC raised approximately \$15 million for AmREIT Monthly Income & Growth Fund, Ltd., an affiliated retail partnership sponsored by a subsidiary of AmREIT. Additionally, since August of 2003, ASC has raised approximately \$40.4 million, including shares issued through the dividend reinvestment program, directly for us through a class C common share offering. ASC is also the dealer manager on our newest offering, a \$170 million class D common share offering: publicly registered, non-traded common shares receiving a stated 6.5% annual dividend paid monthly. The class D common shares are non-cumulative and can convert into the class A common shares at a 7.7% premium on invested capital after a seven-year lock out period. We anticipate raising approximately \$25-30 million during 2004 through this class D common share offering. Since capital is the lifeblood of any real estate company, having the unique opportunity to raise capital through both Wall Street and the independent financial planning community adds additional financial flexibility and dependability to our income stream.

F-5

RETAIL PARTNERSHIPS

AmREIT has retail partnership subsidiaries that sell limited partnership interests to retail investors, in which AmREIT indirectly invests through both the general partner and as a limited partner. We wanted to create a structure that aligns the interest of our shareholders with that of our unit holders. Through our subsidiary general partners of the retail partnerships, value is created for AmREIT through managing money from the sponsored funds, and in return, receiving management fees and profit participation interests.

AmREIT's retail partnerships are structured so that an affiliate, as the general partner, receives a significant profit only after the limited partners in the retail partnerships have received their targeted return, again, linking AmREIT's success to that of its unit holders.

As of June 30, 2004, AmREIT directly managed, through its four actively managed and previously sponsored retail partnerships, over \$35 million in equity. These four partnerships have entered or will enter their liquidation phases in 2003, 2009, 2010, and 2011 respectively. As these partnerships enter into liquidation, we expect to receive economic benefit from our profit participation, after certain preferred returns have been paid to the partnership's limited partners. Unrealized gains associated with this potential profit participation, if any, have not been reflected on our balance sheet or statement of operations.

In August 2003 the Company began selling class C common shares. The offering is a \$44 million offering (\$40 million offered to the public and \$4 million reserved for the dividend reinvestment program), issued on a best efforts basis

Edgar Filing: AMREIT - Form 10QSB

through the independent financial broker dealer community. The Company will primarily use the proceeds for the acquisition of new properties and to pay down existing debt. Since August 2003, the Company had issued approximately 4.04 million shares (including shares issued through the dividend reinvestment program), representing approximately \$40.4 million in proceeds from selling class C shares.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-QSB and include all of the disclosures required by accounting principles generally accepted in the United States of America. The condensed consolidated financial statements reflect all normal and recurring adjustments, which are, in the opinion of management, necessary to present a fair statement of results for the six month periods ended June 30, 2004 and 2003. Operating results for the three and six months ended June 30, 2004 are not necessarily indicative of the results to be expected for the year ended December 31, 2004.

The condensed consolidated financial statements of AmREIT contained herein should be read in conjunction with the consolidated financial statements included in the Company's annual report on Form 10-KSB for the year ended December 31, 2003.

REAL ESTATE HELD FOR SALE

AmREIT constantly evaluates its real estate portfolio, identifying those assets that are non-core and no longer meet its investment objectives. Management has identified three portfolio properties that are considered non-core and are listed for sale. Further, management anticipates identifying an additional five to seven properties that it will list for sale during 2004.

Properties are classified as real estate held for sale if the properties were purchased with intent to sell the properties within twelve to eighteen months or if the properties are listed for sale. Additionally, if management has made the determination to dispose of an operating property, the associated property is reclassified to real estate held for sale

F-6

and depreciation is ceased. An evaluation for impairment is also performed. At June 30, 2004, AmREIT owned eight properties that are classified as real estate held for sale. The eight properties have a combined carrying value of \$11.0 million.

BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of AmREIT and its wholly or majority owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

NEW ACCOUNTING STANDARDS

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 ("FIN 46"), which was amended in December 2003. This Interpretation, as amended requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual return or both. As amended the interpretation requires disclosures about variable interest entities that a company is not required to consolidate, but in which it has a

Edgar Filing: AMREIT - Form 10QSB

significant variable interest. The adoption of FIN 46 for small business filers is effective no later than December 31, 2004. Management anticipates the adoption of FIN 46 will not have an impact on our consolidated financial position, results of operations, or cash flows.

In May 2003, the Financial Accounting Standards Board issued Statement No. 150 ("Statement 150") "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity". Statement 150 requires certain financial instruments that have characteristics of both liabilities and equity to be classified as a liability on the balance sheet. Statement 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Statement 150 will be effected by reporting the cumulative effect of a change in accounting principle for contracts created before the issuance date and still existing at the beginning of that interim period. The adoption of Statement 150 did not have an impact on our consolidated financial position, results of operations, or cash flows.

RECLASSIFICATION

Certain amounts in the interim unaudited 2003 condensed consolidated financial statements have been reclassified to conform to the presentation used in the interim unaudited 2004 condensed consolidated financial statements. Such reclassifications had no effect on previously reported net income or loss or shareholders' equity.

3. NOTES PAYABLE

In September 2003, the Company renewed its unsecured credit facility (the "Credit Facility"), which is being used to provide funds for the acquisition of properties and working capital. In June 2004, the Credit Facility was amended in order to increase the maximum availability and modify certain terms and conditions of the Credit Facility. Under the amended Credit Facility, which matures September 2004, the Company may borrow up to \$35 million subject to the value of unencumbered assets. The Company and the lender are in the process of renewing the Credit Facility for a one year period. Management believes that the Credit Facility will be renewed on terms and conditions substantially the same as the current Credit Facility. The Credit Facility contains covenants which, among other restrictions, require the Company to maintain a minimum net worth, a maximum leverage ratio, specified interest coverage and fixed charge coverage ratios and allow the lender to approve all distributions. Furthermore, the Credit Facility contains concentration covenants and limitations, limiting property level net operating income for any one tenant to no more than 15% (35% for IHOP) of total property net operating income. For the six months ended June 30, 2004, IHOP net operating income represented approximately 33% of total property net operating income. On June 30, 2004, the Company was in compliance with all financial covenants. The Credit Facility's annual interest rate varies depending upon the Company's debt to asset ratio, from LIBOR plus a spread of 1.40% to LIBOR plus a spread of 2.35%. As of June 30, 2004, the interest rate was LIBOR plus 2.0%. As of June 30, 2004, \$10.2 million was outstanding under the Credit Facility. Thus the Company has

F-7

approximately \$24.8 million available under its line of credit, subject to Lender approval on the use of the proceeds.

4. MAJOR TENANTS

As of June 30, 2004, there have been no significant changes in the tenant make-up from year end December 31, 2003, other than those delineated in Note 10.

Edgar Filing: AMREIT - Form 10QSB

5. EARNINGS PER SHARE

Basic earnings per share has been computed by dividing net income (loss) available to class A shareholders by the weighted average number of class A common shares outstanding. Diluted earnings per share has been computed by dividing net income (as adjusted) by the weighted average number of common shares outstanding plus the weighted average number of potentially dilutive common shares. Diluted earnings per share information is not applicable due to the anti-dilutive nature of the common class B and class C shares.

The following table presents information necessary to calculate basic and diluted earnings per share for the periods indicated:

	Quarter		Year to Date	
	2004	2003	2004	2003
BASIC EARNINGS PER SHARE				
Weighted average class A common shares outstanding (in thousands)	3,235	2,790	3,094	
Basic and diluted (loss) earnings per share *	\$(0.31)	\$0.08	\$(0.71)	
EARNINGS (LOSS) FOR BASIC AND DILUTIVE COMPUTATION				
(Loss) earnings to class A common shareholders (in thousands)	\$(1,009)	\$210	\$(2,187)	

* The operating results for the three and six months ended June 30, 2004 include a charge to earnings of \$362 thousand and \$1.7 million, respectively, which represents the market value of the class A common shares issued to H. Kerr Taylor, President and CEO, related to the sale of his advisory company to AmREIT in 1998. The charge was for the deferred merger cost due from this sale that was triggered by the issuance of additional class C common shares. Additionally, these operating results include an impairment charge of \$1.1 million, which represents a write-down in value of the vacant Warehouse Entertainment property located in Wichita, Kansas, which was sold during the quarter. For additional information see Footnote 6 - DISCONTINUED OPERATIONS.

6. DISCONTINUED OPERATIONS

The operations of fifteen properties were reported as discontinued operations for the six months period ended June 30, 2004. Eight of the properties were listed as held for sale at June 30, 2004, three of the properties were sold in

Edgar Filing: AMREIT - Form 10QSB

the current year, and five of the properties were sold in 2003. The following is a summary of our discontinued operations (in thousands, except for per share data):

F-8

	Quarter		Year
	2004	2003	2004
Rental revenue	\$ 176	\$ 294	\$ 317
Earned income from direct financing leases	34	164	143
Interest and other income	639	-	639
Gain on sale of real estate held for sale	242	279	850
General operating and administrative	(51)	(2)	(150)
Legal and professional	-	-	-
Depreciation and amortization	(25)	(38)	(39)
Interest expense	(2)	(61)	(41)
Minority interest	(121)	-	(121)
Impairment charge	(1,103)	-	(1,103)
(Loss) income from discontinued operations	(211)	636	495
Basic and diluted (loss) income from discontinued operations per common share	\$ (0.07)	\$ 0.23	\$ 0.16

On June 21, 2004, the Company sold its Warehouse Entertainment project located in Wichita, Kansas. The Company recorded an impairment charge to earnings of approximately \$1.10 million in the second quarter to reflect the loss incurred upon sale of the property, following the bankruptcy of its sole tenant. After a thorough remarketing during the quarter, the Company could not replace the previously existing value and determined to sell the asset and redeploy the proceeds into more productive investments.

Gain on real estate held for sale is a result of selling two properties, one acquired in 2003 and one acquired in 2004, with the intent to resell after a short holding period. Through a taxable REIT subsidiary, AmREIT actively seeks properties where there is an opportunity to purchase undervalued assets, and after a short holding period and value creation, dispose of the asset and capture the value created.

7. COMMITMENTS

The Company has signed a 63 month lease for office space. The lease commenced on May 14, 2004. The annual rent will be \$210 thousand. Rental expense for the six months ended June 30, 2004 and 2003 was \$60 thousand and \$45 thousand, respectively.

As of June 30, 2004, the Company has contracted to purchase approximately \$57.0 million of multi-tenant real estate projects that are anticipated to close during the third quarter of 2004. The acquisitions will be funded by cash and the assumption of debt.

8. SEGMENT REPORTING

The operating segments presented are the segments of AmREIT for which separate financial information is available, and revenue and operating performance is evaluated regularly by senior management in deciding how to allocate resources

Edgar Filing: AMREIT - Form 10QSB

and in assessing performance.

AmREIT evaluates the performance of its operating segments primarily on revenue. Because the real estate development and operating segment and securities and retail partnership segment are both revenue and fee intensive, management considers revenue the primary indicator in allocating resources and evaluating performance.

The portfolio segment consists of our portfolio of single and multi-tenant shopping center projects. This segment consists of 53 properties located in 19 states. Expenses for this segment include depreciation, interest, minority interest, legal cost directly related to the portfolio of properties and the property level expenses. The consolidated

F-9

assets of AmREIT are substantially all in this segment. Included in Corporate and Other are those costs and expenses related to general overhead and personnel that are not solely responsible for one of the reporting segments.

	Portfolio	Real estate operating & development	Securities retail partnersh
Six months ended June 30, 2004:			
Revenue	\$ 4,211	\$ 949	\$ 3,
Income from non- consolidated affiliates	-	-	
Expenses	(1,760)	(95)	(2,
Deferred merger cost	-	-	
Net income (loss) before discontinued operations	2,451	854	
Six months ended June 30, 2003:			
Revenue	\$ 2,941	\$ 267	\$
Income from non-consolidated affiliates	-	-	
Expenses	(1,495)	11	(
Net income (loss) before discontinued operations	1,446	278	
	Portfolio	Real estate operating & development	Securities retail partnersh
Three months ended June 30, 2004:			
Revenue	\$ 2,096	\$ 581	\$ 1,
Income from non- consolidated affiliates	-	-	
Expenses	(863)	(20)	(1,
Deferred merger cost	-	-	
Net income (loss) before discontinued operations	1,233	561	
Three months ended June 30, 2003:			
Revenue	\$ 1,477	\$ 136	\$
Income from non-consolidated affiliates	-	-	
Expenses	(747)	(41)	(

Edgar Filing: AMREIT - Form 10QSB

Net income (loss) before discontinued operations 730 95

9. PROPERTY ACQUISITIONS AND DISPOSITIONS

On June 15, 2004, AmREIT acquired The Courtyard at Post Oak, consisting of a 4,013 square-foot, free standing building occupied by Verizon Wireless (NYSE: VZ) and a 9,584 square-foot, multi-tenant shopping center occupied by Ninfa's Restaurant and Dessert Gallery. The property is located at the northwest intersection of Post Oak and San Felipe in Houston, Texas which is the heart of the Uptown Houston area, the most significant retail corridor in the Greater Houston area. The property was acquired for cash. The weighted average remaining lease term for the project is 5.2 years. The anticipated combined net operating income contribution is approximately \$450 thousand annually. Following is a summary of assets acquired and liabilities assumed as of the date of the Courtyard at Post Oak acquisition.

F-10

Summary of Assets Acquired and Liabilities Assumed
as of June 15, 2004
(In Thousands)

Assets	
Buildings	\$1,874
Land	4,376
Intangible lease costs	101

TOTAL ASSETS	\$6,351
	=====
Liabilities	\$91
Net assets acquired	\$6,260

The following selected unaudited pro forma consolidated statement of operations for AmREIT and subsidiaries gives effect to the acquisition of Uptown Plaza, which assumes that the acquisition occurred on January 1, 2003. Uptown Plaza, acquired in December 2003, is a 28,000 square foot retail complex located in Houston, Texas, including a free-standing CVS/pharmacy drugstore and a retail shopping center anchored by Grotto, a new concept of Landry's Restaurant, Inc.

	Three months ended June 30, 2003	Six months June 30,
Revenues		
Rental income and earned income	\$ 1,778	\$
Other income	624	
	-----	-----
Total Revenues	2,402	
	-----	-----
Total Expenses	1,573	
	-----	-----
Operating income	829	
Income before discontinued operations	241	

Edgar Filing: AMREIT - Form 10QSB

Income from discontinued operations	636	
Pro forma net income	877	
Distributions paid to class B and class C shareholders	(439)	
	-----	-----
Net income available to class A shareholders	\$ 438	\$
	=====	=====
Net income per common share - basic and diluted		
Loss before discontinued operations	(0.07)	
Income from discontinued operations	0.23	
	-----	-----
Net income	0.16	
Weighted average common shares used to compute net income per share, basic and diluted	2,790	
	=====	=====

F-11

10. SUBSEQUENT EVENTS

On July 1, 2004, AmREIT acquired Plaza in the Park, a 129,955 square-foot Kroger (NYSE: KR) anchored shopping center located on approximately 14.3 acres. The property is located at the southwest corner of Buffalo Speedway and Westpark in Houston, Texas. Plaza in the Park's Kroger is undergoing a 13,120 square-foot expansion. The property was acquired for cash and the assumption of long-term fixed rate debt. The weighted average remaining lease term for the project is 9.2 years. The Kroger lease is for 20 years, containing approximately 71,000 square feet, expiring in August 2017. The shopping center is 96.67 percent occupied.

On July 1, 2004, AmREIT acquired Cinco Ranch - Kroger, a 97,297 square-foot Kroger (NYSE: KR) anchored shopping center located on approximately 12.8 acres of land. The property is located at the northeast corner of Mason Road and Westheimer Parkway in Katy, Texas. The property was acquired for cash and the assumption of long-term fixed rate debt. The weighted average remaining lease term for the project is 14 years. The Kroger lease is for 20 years, containing approximately 63,000 square-feet, expiring in June 2023. The shopping center is 100 percent occupied.

On July 21, 2004, AmREIT acquired Bakery Square Shopping Center, a 34,704 square-foot retail project including a free standing Walgreen's and a shopping center anchored by Bank of America (NYSE:BOA). This is an infill property located just west of downtown Houston and includes other national tenants such as T-Mobile, Blockbuster Video and Boston Market. The property as acquired for cash and the assumption of long-term fixed rate debt. The weighted average remaining lease term for the shopping center is 4.9 years. The Walgreen's lease is for 60 years and will expire in October 2056. The shopping center is 100 percent occupied.

On July 21, 2004, AmREIT sold the IHOP property located in Grand Prairie, Texas. The project was sold to an unaffiliated, buyer for cash. The project generated approximately \$202 thousand in annual rental income from operating leases and earned income from direct financing leases, and was sold for a profit of approximately \$800 thousand.

Edgar Filing: AMREIT - Form 10QSB

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

FORWARD-LOOKING STATEMENTS

Certain information presented in this Form 10-QSB constitutes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Although the Company believes that the expectations reflected in these forward-looking statements are based upon reasonable assumptions, the Company's actual results could differ materially from those set forth in the forward-looking statements. Certain factors that might cause such a difference include the following: changes in general economic conditions, changes in real estate market conditions, continued availability of proceeds from the Company's debt or

F-12

equity capital, the ability of the Company to locate suitable tenants for its properties and the ability of tenants to make payments under their respective leases.

The condensed consolidated financial statements of AmREIT, and the following discussion contained herein should be read in conjunction with the consolidated financial statements and discussion included in the Company's annual report on Form 10-KSB for the year ended December 31, 2003. Historical results and trends which might appear should not be taken as indicative of future operations.

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto and the comparative summary of selective financial data appearing elsewhere in this report. Historical results and trends which might appear should not be taken as indicative of future operations.

EXECUTIVE OVERVIEW

AmREIT (AMEX: AMY) is a rapidly growing, self-managed and self-advised REIT with a 19-year history of delivering results to its investors. Its business model consists of a publicly traded REIT that is supported by three synergistic businesses - a real estate operating and development business, NASD-registered broker dealer securities business and a retail partnership business. This unique structure gives AmREIT access to the intellectual and financial capital required to support a rapid growth platform.

Operated as a wholly owned subsidiary, AmREIT's real estate operating and development business focuses on the development, acquisition, management, brokerage and ownership of high quality commercial retail real estate to generate monthly income and growth for our investors. The Company's in-house NASD-registered securities group gives the company direct access to the independent financial planning market, broadening AmREIT's avenues to raise capital. The retail partnership business combines the skills of our real estate team and our securities group to actively acquire and develop high quality properties, creating potential for increasing income and capital appreciation by opportunistically selling the properties within a defined time horizon.

The self-managed REIT focuses on the acquisition and development of "irreplaceable corners" - premier retail frontage properties in high-traffic, highly populated areas - to hold for long-term value. These properties are leased to tenants located in high-end multi-tenant shopping centers, grocery anchored centers and regional and national single tenants. AmREIT's retail partnership business incorporates an "active management" strategy to acquire, develop and sell high quality free-standing and shopping center properties to

Edgar Filing: AMREIT - Form 10QSB

create shorter-term added value.

AmREIT's goal is to deliver increasing, dependable, monthly income for its shareholders. In so doing, AmREIT strives to increase and maximize Funds From Operations ("FFO") by issuing long term capital through both the NASD independent financial planning marketplace as well as through Wall Street, and investing the capital in accretive real estate properties, acquired or developed, on irreplaceable corners. Additionally, we strive to maintain a conservative balance sheet. To that regard, we strive to maintain a debt to total asset ratio of less than 55%. As of June 30, 2004, our debt to total asset ratio was 33%.

At June 30, 2004, AmREIT owned a portfolio of 53 properties located in 19 states, subject to long term leases with retail tenants, either directly or through its interests in joint ventures or partnerships. Forty seven of the properties are single tenant properties, and represent approximately 74% of the rental income for the six months ended June 30, 2004. Six of the properties are multi-tenant and represent approximately 26% of the rental income for the six months ended June 30, 2004. In assessing the performance of the Company's properties, management evaluates the occupancy of the Company's portfolio. Occupancy for the total portfolio was 88.5% based on leaseable square footage as of June 30, 2004. Additionally, the Company anticipates that the majority of its rental income will consist of rental income generated from multi-tenant shopping centers by the end of 2004. We have been developing and acquiring multi-tenant shopping centers for over ten years in our retail partnership business. During that time, we believe we have developed the ability to recognize the high-end multi-tenant properties that

F-13

can create long-term value, and with the downward pressure on single tenant cap rates, resulting in higher priced real estate, management anticipates strategically increasing its holdings of multi-tenant shopping centers.

Management intends to increase total assets from \$101 million as of December 31, 2003 to approximately \$200 million at the end of 2004. Through June 30, 2004, the Company fully subscribed its \$40 million class C common share offering and began marketing its \$170 million class D common share offering. With the proceeds of the class C common share offering and the assumption of debt, the Company has purchased approximately \$70 million in real estate assets since December 31, 2003 including acquisitions subsequent to June 30, 2004 (see Footnote 10.).

Management intends to fund future acquisitions and development projects through a combination of equity offerings and debt financing. During 2004, the Company anticipates raising an additional \$25 to \$30 million of equity from various sources including Wall Street and the independent financial planning community.

Management expects that single tenant, credit leased properties, will continue to experience cap rate pressure during 2004 due to the low interest rate environment and increased buyer demand. Therefore, as it has been, our continued strategy will be to divest of properties which no longer meet our core criteria, and replace them with multi-tenant projects or the development of single tenant properties located on irreplaceable corners. With respect to additional growth opportunities, we have purchased approximately \$57.0 million in grocery anchored and multi-tenant shopping center projects subsequent to June 30, 2004 and have over \$50 million of projects in our pipeline at various stages of evaluation. Each potential acquisition is subjected to a rigorous due diligence process that includes site inspections, financial underwriting, credit analysis and market and demographic studies. Therefore, there can be no assurance that any or all of these projects will ultimately be purchased by AmREIT. Management anticipates,

Edgar Filing: AMREIT - Form 10QSB

and has budgeted for, an increase in interest rates during 2004. As of June 30, 2004, approximately 69% of our outstanding debt had a long term fixed interest rate with an average term of seven years. Our philosophy continues to be matching long term leases with long term debt structures while keeping our debt to total assets ratio less than 55%.

SUMMARY OF CRITICAL ACCOUNTING POLICIES

The results of operations and financial condition of the Company, as reflected in the accompanying financial statements and related footnotes, are subject to management's evaluation and interpretation of business conditions, retailer performance, changing capital market conditions and other factors, which could affect the ongoing viability of the Company's tenants. Management believes the most critical accounting policies in this regard are the accounting for lease revenues (including the straight line rent), the regular evaluation of whether the value of a real estate asset has been impaired and the allowance for doubtful accounts. We evaluate our assumptions and estimates on an on-going basis. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable based on the circumstances.

RENTAL INCOME RECOGNITION - In accordance with accounting principles generally accepted in the United States of America, the Company accounts for rental income under the straight line method, whereby we record rental income based on the average of the total rent obligation due under the primary term of the lease. The Company prepares a straight line rent schedule for each lease entered into. Certain leases contain a provision for percentage rent. Percentage rent is recorded in the period when the Company can reasonably calculate the amount of percentage rent owed, if any. Generally, the Company records percentage rent in the period in which the percentage rent payment is made, and can thereby be calculated and verified. For the six months ended June 30, 2004, the Company collected and recorded percentage rent from tenants of \$65 thousand.

REAL ESTATE VALUATION - Real estate assets are stated at cost less accumulated depreciation, which, in the opinion of management, is not in excess of the individual property's estimated undiscounted future cash flows, including estimated proceeds from disposition. Depreciation is computed using the straight-line method, generally over estimated useful lives of 39 years for buildings and over the primary term of the lease for tenant improvements.

F-14

Major replacements that extend the life of the property, or enhance the value of the property are capitalized and the replaced asset and corresponding accumulated depreciation are removed. All other maintenance items are charged to expense as incurred.

Upon the acquisition of real estate projects, the Company assesses the fair value of the acquired assets (including land, building, acquired, above and below market leases and in-place leases, as if vacant property value and tenant relationships) and acquired liabilities, and allocates the purchase price based on these assessments. The Company assesses fair value based on estimated cash flow projections that utilize appropriate discount and capitalization rates and available market information. Estimates of future cash flows are based on a number of factors including the historical operating results, known trends, and specific market and economic conditions that may affect the property. Factors considered by management in our analysis of determining the as if vacant property value include an estimate of carrying costs during the expected lease-up periods considering current market conditions, and costs to execute similar leases. In estimating carrying costs, management includes real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, up to 12 months depending on

Edgar Filing: AMREIT - Form 10QSB

the property location, tenant demand and other economic conditions. Management also estimates costs to execute similar leases including leasing commissions, tenant improvements, legal and other related expenses.

Costs incurred in the development of new operating properties, including preacquisition costs directly identifiable with the specific project, development and construction costs, interest and real estate taxes are capitalized into the basis of the project. The capitalization of such costs ceases when the property, or any completed portion, becomes available for occupancy.

AmREIT's properties are reviewed for impairment if events or changes in circumstances indicate that the carrying amount of the property may not be recoverable. In such an event, a comparison is made of the current and projected operating cash flows of each such property on an undiscounted basis, plus the residual value of the property upon disposition, to the carrying value of such property. The carrying value would then be adjusted, if needed, to estimate the fair value to reflect an impairment in the value of the asset. Following the bankruptcy of its sole tenant, and after a thorough remarketing during the quarter, the Company determined that it could not replace the previously existing value in its Warehouse Entertainment project located in Wichita, Kansas, and recorded an impairment charge to earnings of approximately \$1.10 million in the second quarter. Subsequent to the write-down in value, management sold the property during the current quarter.

VALUATION OF RECEIVABLES - An allowance for the uncollectible portion of accrued rents, property receivables and accounts receivable is determined based upon an analysis of balances outstanding, historical payment history, tenant credit worthiness, additional guarantees and other economic trends. Balances outstanding include base rents, tenant reimbursements and receivables attributed to the accrual of straight line rents. Additionally, estimates of the expected recovery of pre-petition and post-petition claims with respect to tenants in bankruptcy are considered in assessing the collectibility of the related receivables. During the six months ended June 30, 2004, the Company wrote off receivables totaling approximately \$67 thousand. The receivable is attributable to the accrual of straight line rents associated with Just for Feet. The write off of the receivable from Just for Feet is included in income from discontinued operations. The Company maintains a receivable related to Warehouse Entertainment of approximately \$126 thousand. Based on discussions with Warehouse Entertainment and Blockbuster Entertainment Corporation, the guarantor of the lease, and legal proceedings involving Warehouse Entertainment and Blockbuster Entertainment Corporation, the Company believes this receivable is collectable, and should be collected during 2004.

LIQUIDITY AND CAPITAL RESOURCES Cash flow from operating activities and financing activities have been the principal sources of capital to fund the Company's ongoing operations and dividends. As AmREIT deploys the capital raised, and expected to be raised

F-15

from its equity offerings, into income producing real estate, we anticipate that cash flow from operations will provide adequate resources for future ongoing operations and dividends. AmREIT's cash on hand, internally-generated cash flow, borrowings under our existing credit facilities, issuance of equity securities, as well as the placement of secured debt and other equity alternatives, is expected to provide the necessary capital to maintain and operate our properties as well as execute and achieve our growth strategies.

SOURCES AND USES OF FUNDS

Edgar Filing: AMREIT - Form 10QSB

Cash provided by operating activities as reported in the Consolidated Statements of Cash Flows increased \$6.0 million for the six months ended June 30, 2004 when compared to the six months ended June 30, 2003. Investment in real estate acquired for resale decreased by \$5.0 million. In addition, proceeds from sales of real estate acquired for sale increased by \$714 thousand. AmREIT sold two properties for a profit that were acquired for sale, one in the first quarter and one in the second quarter of 2004.

The increase in net cash provided by operating activities was primarily due to a decrease in investment in real estate acquired for resale. During 2003, the Company invested in five IHOP properties that were purchased as acquired for resale. For the six months ended June 30, 2004, the Company has invested approximately \$2.2 million in real estate acquired for resale. This decrease in investment in real estate acquired for resale was somewhat offset by a \$1.1 million non-cash impairment charge related to the Warehouse Entertainment property located in Wichita Kansas and a \$1.7 million non-cash increase in deferred merger costs. The deferred merger expense is a result of shares issued or payable to H. Kerr Taylor, our President and Chief Executive Officer, as a result of the merger, which shares represented a portion of consideration payable to Mr. Taylor as a result of the sale of his advisory company to AmREIT in 1998. Mr. Taylor has now earned 100% of the shares eligible under the deferred consideration agreement. Therefore, AmREIT's internal advisor has been fully paid for, 100% with Company shares as opposed to debt, and no further payments of shares or expense related to the issuance of shares will be made.

Cash flows used in investing activities has been primarily related to the acquisition or development of retail properties. During the second quarter of 2004, AmREIT purchased The Courtyard at Post Oak, consisting of a free standing building occupied by Verizon Wireless and a multi-tenant center occupied by Ninfa's Restaurant and Dessert Gallery. During the first quarter of 2004, AmREIT through one its taxable REIT subsidiaries, acquired a 25% equity interest in a 45 acre retail redevelopment in Houston, Texas. The other partners are affiliated partnerships. The investment was funded through a combination of the \$14.3 million of capital (net of \$1.8 million in issuance costs) raised through the class C common share offering and debt financing.

In addition, the Company received \$694 thousand in proceeds during the second quarter of 2004 from the sale of its Warehouse Entertainment project located in Wichita, Kansas. Prior to the sale, the Company recorded an impairment charge to earnings of approximately \$1.1 million to reflect the impaired value of the property. Cash flows used in investing activities as reported in the Consolidated Statements of Cash Flows increased from \$3.1 million in the first six months of 2003 to \$7.9 million in the first six months of 2004.

Cash flows provided by financing activities decreased from \$5.4 million through June 30, 2003 to \$4.8 million through June 30, 2004. Cash flows provided by financing activities were primarily generated from our class C common share offering. AmREIT fully subscribed its class C common share offering during the second quarter. 100% of the net proceeds have been used to purchase irreplaceable corners. AmREIT has begun to market its class D common share offering, a \$170 million common share offering, offered through the independent financial planning community. The class D common shares have a stated 6.5% annual dividend, paid monthly, are convertible into the Company's class A common shares at any time after a seven-year lock out period for a 7.7% premium on invested capital and are callable by the Company after one year. One advantage of raising capital through the independent financial planning marketplace is the capital is received on a monthly basis, allowing for a

F-16

scaleable matching of real estate projects. Our first priority is to deploy the

Edgar Filing: AMREIT - Form 10QSB

capital raised, and then to moderately leverage the capital, while maintaining our philosophy of a conservative balance sheet. The Company was able to reduce debt by almost \$25.1 million with the proceeds from its class C common share offering.

AmREIT has a \$35 million unsecured revolving credit facility, as amended in June 2004. The facility will mature on September 4, 2004, and the Company and Lender are in the process of renewing the Credit Facility for a one year period. Management believes that the Credit Facility will be renewed on terms and conditions substantially the same as the current Credit Facility. The Credit Facility contains covenants which, among other restrictions, require the Company to maintain a minimum net worth, a maximum leverage ratio, specified interest coverage and fixed charge coverage ratios and allow the lender to approve all distributions. Furthermore, the Credit Facility contains concentration covenants and limitations, limiting property level net operating income for any one tenant to no more than 15% (35% for IHOP) of total property net operating income. At June 30, 2004, IHOP net operating income represented approximately 33% of total property net operating income. At June 30, 2004, the Company was in compliance with all financial covenants. The Credit Facility's annual interest rate varies depending upon the Company's debt to asset ratio, from LIBOR plus a spread of 1.40% to LIBOR plus a spread of 2.35%. As of June 30, 2004, the interest rate was LIBOR plus 2.0%. As of June 30, 2004, \$10.2 million was outstanding under the Credit Facility. Thus the Company has approximately \$24.8 million available under its line of credit, subject to Lender approval on the use of the proceeds. In addition to the credit facility, AmREIT utilizes various permanent mortgage financing and other debt instruments. As of June 30, 2004, the Company had the following contractual debt obligations:

	2004 ----	2005 ----	2006 ----	2007 ----	2008 ----	Th --
Unsecured debt:						
Revolving credit facility	\$ 10,168	\$ -	\$ -	\$ -	\$ -	\$
5.46% dissenter notes	-	-	-	-	-	
Secured debt	230	490	530	573	620	
Non-cancelable operating lease payments	79	210	210	210	210	
Total contractual obligations	\$ 10,477 =====	\$ 700 =====	\$ 740 =====	\$ 783 =====	\$ 830 =====	\$ =

In order to continue to expand and develop its portfolio of properties and other investments, the Company intends to finance future acquisitions and growth through the most advantageous sources of capital available at the time. Such capital sources may include proceeds from public or private offerings of the Company's debt or equity securities, secured or unsecured borrowings from banks or other lenders, acquisitions of the Company's affiliated entities or other unrelated companies, or the disposition of assets, as well as undistributed funds from operations.

In August 2003, the Company commenced the class C common share offering. This offering is being exclusively made through the NASD independent financial planning community. It was a \$44 million offering, of which \$4 million has been reserved for the dividend reinvestment plan. As of June 30, 2004, 4.04 million shares had been issued, including shares issued through the dividend reinvestment program, resulting in approximately \$40.4 million in gross proceeds. The proceeds are being and will be used to finance the acquisition and development of retail real estate projects, pay down the revolving credit facility and provide working capital for the on going operation of the company

Edgar Filing: AMREIT - Form 10QSB

and its properties.

For the quarters ended June 30, 2004 and 2003, the Company paid dividends to its shareholders of \$1.489 million, and \$749 thousand respectively. The class A and class C shareholders receive monthly dividends and the class B shareholders receive quarterly dividends. All dividends are declared on a quarterly basis. The dividends by class follow (in thousands):

F-17

		Class A	Class B	Class C
2004	Second quarter	\$383	\$429	\$677
	First quarter	\$345	\$434	\$379
2003	Fourth quarter	\$320	\$437	\$156
	Third quarter	\$308	\$443	\$15
	Second quarter	\$310	\$439	N/A

Until properties are acquired by the Company, the Company's funds are held in short-term, highly liquid investments which the Company believes to have appropriate safety of principal. This investment strategy has allowed, and continues to allow, high liquidity to facilitate the Company's use of these funds to acquire properties at such time as properties suitable for acquisition are located. At June 30, 2004, the Company's cash and cash equivalents totaled \$846 thousand.

Cash flows from operating activities, investing activities, and financing activities for the three and six months ended June 30, are presented below in thousands:

	QUARTER		YEAR TO DATE	
	2004	2003	2004	2003
Operating activities	\$1,635	\$(4,343)	\$1,940	\$(4,091)
Investing activities	(6,182)	(40)	(7,910)	(3,096)
Financing activities	3,214	4,294	4,784	5,417

INFLATION

Inflation has had very little effect on income from operations. Management expects that increases in store sales volumes due to inflation as well as increases in the Consumer Price Index (C.P.I.), may contribute to capital appreciation of the Company properties. These factors, however, also may have an adverse impact on the operating margins of the tenants of the properties.

FUNDS FROM OPERATIONS

AmREIT considers FFO to be an appropriate measure of the operating performance of an equity REIT. The National Association of Real Estate Investment Trusts (NAREIT) defines FFO as net income or loss computed in accordance with generally accepted accounting principles (GAAP), excluding gains from sales of property, plus real estate related depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. In addition, NAREIT recommends that extraordinary items not be considered in arriving at FFO. AmREIT calculates its FFO in accordance with this definition. Most industry analysts and equity REITs, including AmREIT, consider FFO to be an appropriate

Edgar Filing: AMREIT - Form 10QSB

supplemental measure of operating performance because, by excluding gains or losses on dispositions and excluding depreciation, FFO is a helpful tool that can assist in the comparison of the operating performance of a company's real estate between periods, or as compared to different companies. There can be no assurance that FFO presented by AmREIT is comparable to similarly titled measures of other REITs. FFO should not be considered as an alternative to net income or other measurements under GAAP

F-18

as an indicator of our operating performance or to cash flows from operating, investing or financing activities as a measure of liquidity.

Below is the calculation of FFO and the reconciliation to net income, which the Company believes is the most comparable GAAP financial measure to FFO, in thousands for the three months ended June 30:

	QUARTER		
	2004	2003	
Income (loss) before discontinued operations	\$ 308	\$ 13	\$
Income from discontinued operations	(211)	636	
Plus depreciation of real estate assets - from operations	257	170	
Plus depreciation of real estate assets - from discontinued operations	26	38	
Less class B and class C distributions	(1,106)	(439)	
Total Funds From Operations available to class A shareholders *	\$(726)	418	
Cash dividends paid to class A shareholders	\$ 383	\$ 310	\$
Dividends (in excess of) less than FFO *	\$(1,109)	\$ 108	\$

* Based on the adherence to the NAREIT definition of FFO, we have not added back the \$362 thousand or \$1.7 million charge to earnings for the three and six months ended June 30, 2004, respectively, resulting from shares issued to Mr. Taylor. Additionally, we have not added back the \$1.1 million charge to earnings for the three and six months ended June 30, 2004, resulting from an asset impairment and corresponding write-down of value. Adding these charges back to earnings would result in adjusted funds from operations available to class A shareholders of \$739 thousand for the three months ended June 30, 2004 and \$1.1 million for the six months ended June 30, 2004. Adding the charge to earnings would also result in dividends paid being less than adjusted FFO of \$356 thousand for the three months ended June 30, 2004 and \$397 thousand for the six months ended June 30, 2004.

RESULTS OF OPERATIONS

COMPARISON OF THE THREE MONTHS ENDED JUNE 30, 2004 TO JUNE 30, 2003:

Rental revenue and earned income from direct financing leases increased by 42%, or \$619 thousand, for the three months ended June 30, 2004 when compared to the three months ended June 30, 2003. Of this increase, \$597 thousand is related to acquisitions made after the second quarter of 2003.

Securities commission income increased by \$1.2 million for the three months ended June 30, 2004 when compared to 2003. This increase in securities commission income is due to increased capital being raised through our broker

Edgar Filing: AMREIT - Form 10QSB

dealer company, AmREIT Securities Company (ASC). As ASC raises capital for either AmREIT or its affiliated retail partnerships, ASC earns a securities commission of between 8% and 10.5% of the money raised. During the second quarter of 2004, AmREIT and its affiliated retail partnerships raised approximately \$15.3 million, as compared to approximately \$4.3 million during the second quarter of 2003. This increase in commission income is somewhat mitigated by a corresponding increase in commission expense paid to other third party broker dealer firms. Commission expense increased by \$1.0 million for the three months ended June 30, 2004 compared to the three months ended June 30, 2003. Interest and other income increased approximately \$313 thousand primarily due to the negotiated claim on the lease of the Footstar location in Baton Rouge.

General and operating expense for the three months ended June 30, 2004 increased \$804 thousand when compared to 2003. The increase in general and operating expense is primarily due to additional personnel and the associated

F-19

salary and benefits costs related to these individuals. Since the second quarter of 2003, the Company added members to each of the operating teams, two on the real estate team (property management, legal, acquisitions and leasing), four on the securities team and three clerical and administrative support positions. By building our various teams, we have not only been able to grow revenue and Funds from Operations, but believe that we will be able to sustain and further enhance our growth. Compensation expense increased \$424 thousand in the three months ended June 30, 2004 as compared to the three months ended June 30, 2003. In addition, property expense increased \$126 thousand.

Deferred merger costs increased from \$0 in 2003 to \$362 thousand in 2004. The deferred merger cost is related to deferred consideration payable to Mr. Taylor as a result of the acquisition of our advisor, which was owned by Mr. Taylor in 1998. In connection with the acquisition, Mr. Taylor agreed to payment for this advisory company in the form of common shares, paid as the Company increases its outstanding equity. To date, Mr. Taylor has received 900 thousand class A common shares, which fulfills the shares that he is owed under the deferred consideration agreement.

COMPARISON OF THE SIX MONTHS ENDED JUNE 30, 2004 TO JUNE 30, 2003:

Rental revenue and earned income from direct financing leases increased by 43%, or \$1.3 million for the six months ended June 30, 2004 when compared to the six months ended June 30, 2003. Of this increase, \$1.2 million is related to acquisitions made after the second quarter of 2003.

Securities commission income increased by \$3.0 million, from \$527 thousand in 2003 to \$3.6 million in 2004. This increase in securities commission income is due to increased capital being raised through our broker dealer company, AmREIT Securities Company (ASC). As ASC raises capital for either AmREIT or its affiliated retail partnerships, ASC earns a securities commission of between 8% and 10.5% of the money raised. During the six months ended June 30, 2004, AmREIT and its affiliated retail partnerships raised approximately \$33.3 million, as compared to approximately \$5.2 million during the six months ended June 30, 2003. This increase in commission income is somewhat mitigated by a corresponding increase in commission expense paid to other third party broker dealer firms. Commission expense increased by \$2.4 million, from \$396 thousand in 2003 to \$2.8 million in 2004.

General and operating expense increased \$1.5 million, from \$1.5 million in 2003 to \$3.0 million in 2004. The increase in general and operating expense is primarily due to additional personnel and the associated salary and benefits

Edgar Filing: AMREIT - Form 10QSB

costs related to these individuals. Since the second quarter of 2003, the Company added members to each of the operating teams, two on the real estate team (property management, legal, acquisitions and leasing), four on the securities team and three clerical and administrative support positions. By building our various teams, we have not only been able to grow revenue and Funds from Operations, but believe that we will be able to sustain and further enhance our growth. Compensation expense increased \$882 thousand in the six months ended June 30, 2004 as compared to the six months ended June 30, 2003. In addition, property expense increased \$261 thousand.

Deferred merger costs increased from \$0 in 2003 to \$1.7 million in the six months ended June 30, 2004. The deferred merger cost is related to deferred consideration payable to Mr. Taylor as a result of the acquisition of our advisor, which was owned by Mr. Taylor in 1998. In connection with the acquisition, Mr. Taylor agreed to payment for this advisory company in the form of common shares, paid as the Company increases its outstanding equity. To date, Mr. Taylor has received 900 thousand class A common shares, which fulfills the shares that he is owed under the deferred consideration agreement.

F-20

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

NONE

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

NONE

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

NONE

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

NONE

ITEM 5. OTHER INFORMATION

NONE

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

- 31.1 Chief Executive Officer Section 302 Certification
- 31.2 Chief Financial Officer Section 302 Certification
- 32.1 Chief Executive Officer certification pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Chief Financial Officer certification pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

Edgar Filing: AMREIT - Form 10QSB

Current report on Form 8-K dated and filed with the Commission on May 6, 2004 contained information under Item 7 (Financial Statements, Pro Forma Financial Information and Exhibits) and Item 9 (Regulation FD Disclosure).

F-21

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the issuer has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AmREIT

(Issuer)

August 13, 2004

Date

/s/ H. Kerr Taylor

H. Kerr Taylor, President

August 13, 2004

Date

/s/ Chad C. Braun

Chad C. Braun
(Principal Accounting Officer)

F-22