

TECHNICAL OLYMPIC USA INC

Form 10-Q

May 11, 2004

Table of Contents

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 March 31, 2004

OR

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

For the transition period from to

Commission File Number: 000-23677

Technical Olympic USA, Inc.

(Exact name of Registrant as specified in its charter)

Delaware

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

76-0460831

*(I.R.S. Employer
Identification No.)*

**4000 Hollywood Blvd., Suite 500 N
Hollywood, Florida**

(Address of principal executive offices)

33021

(ZIP code)

(954) 364-4000

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 29,898,837 shares of common stock as of May 7, 2004.

TECHNICAL OLYMPIC USA, INC.

INDEX

	<u>Page</u>
<u>PART I.</u> <u>Financial Information</u>	1
<u>ITEM 1.</u> <u>Financial Statements (Unaudited)</u>	1
<u>Consolidated Statements of Financial Condition</u>	1
<u>Consolidated Statements of Income</u>	2
<u>Consolidated Statements of Cash Flows</u>	3
<u>Notes to the Consolidated Financial Statements</u>	4
<u>ITEM 2.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	10
<u>ITEM 3.</u> <u>Quantitative and Qualitative Disclosures about Market Risk</u>	20
<u>ITEM 4.</u> <u>Controls and Procedures</u>	21
<u>PART II.</u> <u>Other Information</u>	22
<u>ITEM 6.</u> <u>Exhibits and Reports on Form 8-K</u>	22
<u>Signatures</u>	23
<u>Certificate of Amendment</u>	
<u>Employment Agreement w/ Harry Engelstein</u>	
<u>Amended & Restated Credit Agreement</u>	
<u>Sec 302 Chief Executive Officer Certification</u>	
<u>Sec 302 Chief Financial Officer Certification</u>	
<u>Sec 906 Chief Executive Officer Certification</u>	
<u>Sec 906 Chief Financial Officer Certification</u>	

Table of Contents**PART I****FINANCIAL INFORMATION****Item 1. Financial Statements****TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(IN THOUSANDS, EXCEPT PAR VALUE)**

	December 31, 2003	March 31, 2004
		(unaudited)
ASSETS		
HOMEBUILDING:		
Cash and cash equivalents:		
Unrestricted	\$ 73,703	\$ 103,419
Restricted	21,222	28,339
Inventory	1,183,423	1,197,839
Property and equipment, net	23,727	25,524
Other assets	43,653	75,825
Goodwill	100,103	106,425
	<u>1,445,831</u>	<u>1,537,371</u>
FINANCIAL SERVICES:		
Cash and cash equivalents:		
Unrestricted	3,148	4,352
Restricted	73,358	177,682
Mortgage loans held for sale	75,241	61,971
Other assets	3,544	3,976
Goodwill	3,907	3,907
	<u>159,198</u>	<u>251,888</u>
Total assets	<u>\$ 1,605,029</u>	<u>\$ 1,789,259</u>
LIABILITIES AND STOCKHOLDERS EQUITY		
HOMEBUILDING:		
Accounts payable	\$ 50,228	\$ 41,422
Accrued expenses and other liabilities	98,711	85,879
Customer deposits	35,506	45,101
Consolidated obligations for inventory not owned	242,740	245,852
Homebuilding borrowings	497,919	614,587
	<u>925,104</u>	<u>1,032,841</u>
FINANCIAL SERVICES:		
Accounts payable and other liabilities	74,893	178,134
Financial services borrowings	63,243	20,063
	<u>138,136</u>	<u>198,197</u>

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Total liabilities	1,063,240	1,231,038
Minority interest	5,379	3,671
Commitments and contingencies		
Stockholders' equity:		
Preferred stock \$0.01 par value; 3,000 shares authorized; none issued or outstanding		
Common stock \$0.01 par value; 67,000 shares authorized and 29,889 and 29,896 shares issued and outstanding at December 31, 2003 and March 31, 2004, respectively	299	299
Additional paid-in capital	370,926	370,985
Retained earnings	165,185	183,266
Total stockholders' equity	536,410	554,550
Total liabilities and stockholders' equity	\$ 1,605,029	\$ 1,789,259

See accompanying notes to consolidated financial statements.

Table of Contents**TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)**
(unaudited)

	Three Months Ended March 31,	
	2003	2004
HOMEBUILDING:		
Revenues:		
Home sales	\$ 313,820	\$ 406,738
Land sales	1,403	18,175
	<u>315,223</u>	<u>424,913</u>
Cost of sales:		
Home sales	247,048	331,607
Land sales	1,196	12,675
	<u>248,244</u>	<u>344,282</u>
Gross profit	66,979	80,631
Selling, general and administrative expenses	41,789	52,031
Variable stock-based compensation expense		992
Depreciation and amortization expense	1,646	3,285
Other income, net	(922)	(1,147)
	<u>24,466</u>	<u>25,470</u>
Homebuilding pretax income	24,466	25,470
FINANCIAL SERVICES:		
Revenues	9,521	10,326
Expenses	6,160	7,141
	<u>3,361</u>	<u>3,185</u>
Financial Services pretax income	3,361	3,185
Income before income taxes	27,827	28,655
Provision for income taxes	10,171	10,574
	<u>17,656</u>	<u>18,081</u>
Net income	\$ 17,656	\$ 18,081
EARNINGS PER COMMON SHARE:		
Basic and Diluted	\$ 0.63	\$ 0.60
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:		
Basic	27,882	29,891
	<u>27,882</u>	<u>29,891</u>
Diluted	27,882	30,353
	<u>27,882</u>	<u>30,353</u>

See accompanying notes to consolidated financial statements.

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(DOLLARS IN THOUSANDS)
(unaudited)

	Three Months Ended March 31,	
	2003	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 17,656	\$ 18,081
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,646	3,285
Non-cash compensation expense	160	1,192
Changes in operating assets and liabilities:		
Restricted cash	8,660	(111,441)
Inventory	(44,610)	(9,969)
Other assets	(6,761)	(30,941)
Accounts payable and accrued and other liabilities	9,423	80,611
Customer deposits	676	9,595
Mortgage loans held for sale	14,775	13,270
Net cash provided by (used in) operating activities	1,625	(26,317)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Amounts paid for acquisitions, net of cash acquired	(58,968)	
Additional consideration paid for acquisitions	(11,594)	(6,322)
Net additions to property and equipment	(4,068)	(5,082)
Net cash used in investing activities	(74,630)	(11,404)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes offering	94,836	125,000
Payments for deferred financing costs	(2,597)	(1,663)
Net repayments on revolving credit facilities	(2,420)	(10,000)
Proceeds from Homebuilding borrowings		1,480
Net repayments on Financial Services borrowings	(13,705)	(43,180)
Minority interest in consolidated subsidiaries	146	(1,708)
Net payments on consolidated obligations for inventory not owned	(3,387)	(1,147)
Other		(141)
Net cash provided by financing activities	72,873	68,641
(Decrease) increase in cash and cash equivalents	(132)	30,920
Cash and cash equivalents at beginning of period	49,211	76,851
Cash and cash equivalents at end of period	\$ 49,079	\$ 107,771

SUPPLEMENTAL DISCLOSURE OF NON-CASH
FINANCING ACTIVITY

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Increase in consolidated land bank obligations for inventory not owned and corresponding increase in inventory	\$	\$ 4,259
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See accompanying notes to consolidated financial statements.

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2004**

1. Business and Organization

Business

Technical Olympic USA, Inc. is a Delaware corporation. We are a homebuilder with a geographically diversified national presence. We operate in 14 metropolitan markets located in four major geographic regions: Florida, the Mid-Atlantic, Texas and the West. We design, build, and market detached single-family residences, town homes and condominiums. We also provide title and mortgage brokerage services to our homebuyers and others. Generally, we do not retain or service the mortgages that we originate but, rather, sell the mortgages and related servicing rights to investors.

Organization

Technical Olympic S.A. owns 73.95% of our outstanding common stock. Technical Olympic S.A. is a publicly-traded Greek company whose shares are traded on the Athens Stock Exchange.

2. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include our accounts and those of our subsidiaries. Our accounting and reporting policies conform to accounting principles generally accepted in the United States and general practices within the homebuilding industry. All significant intercompany balances and transactions have been eliminated in the consolidated financial statements.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Due to our normal operating cycle being in excess of one year, we present unclassified consolidated statements of financial condition.

Interim Presentation

The accompanying consolidated financial statements have been prepared by us and are unaudited. Certain information and footnote disclosures normally included in financial statements presented in accordance with accounting principles generally accepted in the United States have been omitted from the accompanying financial statements. Management believes that the disclosures made are adequate to make the information presented not misleading. However, the financial statements included as part of this Form 10-Q should be read in conjunction with the financial statements and notes thereto included in our December 31, 2003 Annual Report on Form 10-K. The accompanying unaudited consolidated financial statements reflect all adjustments, consisting primarily of normal recurring items that, in the opinion of management, are considered necessary for a fair presentation of the financial position, results from operations, and cash flows for the periods presented. Results of operations achieved through March 31, 2004 are not necessarily indicative of those that may be achieved for the year ending December 31, 2004.

Segment Reporting

In accordance with Statement of Financial Accounting Standards (SFAS) No. 131, Disclosures about Segments of an Enterprise and Related Information, we have concluded that our operating segments consist of homebuilding and financial services. These two segments are segregated

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in the accompanying consolidated financial statements under Homebuilding and Financial Services.

Table of Contents**TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

For the three months ended March 31, 2003 and 2004, we have eliminated inter-segment Financial Services revenues of \$1.1 million and \$1.8 million, respectively.

Earnings Per Share

We present earnings per share in accordance with the provisions of SFAS No. 128, Earnings Per Share. Basic earnings per share is computed by dividing earnings attributable to common stockholders by the weighted average number of common shares outstanding for the period.

Diluted earnings per share is computed based on the weighted average number of shares of common stock and dilutive securities outstanding during the period. Dilutive securities are not included in the weighted average number of shares when inclusion would increase the earnings per share. For the three months ended March 31, 2003, we had no dilutive securities outstanding as all of the vested options granted were anti-dilutive because their exercise prices were above market. For the three months ended March 31, 2004, we had stock options that were dilutive as the exercise prices of the options were below market value. Other than stock options, we had no other dilutive securities.

The following table represents a reconciliation of weighted average shares outstanding:

	Three Months Ended March 31,	
	2003	2004
Basic average shares outstanding	27,882,090	29,891,152
Net effect of stock options assumed to be exercised		462,259
Diluted average shares outstanding	27,882,090	30,353,411

Stock-Based Compensation

We account for our stock option plan in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Refer to Note 7 for the required pro forma disclosures.

Reclassifications

Certain prior period amounts have been reclassified to conform with the current period's presentation.

New Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities (Interpretation No. 46). Interpretation No. 46 addresses consolidation by business enterprises of variable interest entities (VIEs) which have one or both of the following characteristics: (1) the equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated support from other parties, which is provided through other interests that will absorb some or all of the expected losses of the entity; or (2) the equity investors lack one or more of the following essential characteristics of a controlling financial interest: (a) the direct or indirect ability to make decisions about the entity's activities through voting rights or similar rights; or (b) the obligation to absorb the expected losses of the entity if they occur, which makes it possible for the entity to finance its activities; or (c) the right to receive the

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expected residual returns of the entity if they occur, which is the compensation for the risk of absorbing the expected losses.

Generally, in the homebuilding industry, homebuilders enter into option contracts for the purchase of land or homesites with land sellers and third-party financial entities, some of which may qualify as VIEs, as a

Table of Contents**TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

method of acquiring developed homesites. We believe that Interpretation No. 46 must be evaluated as it relates to these and similar types of arrangements. In applying Interpretation No. 46 to our homesite option contracts and other transactions with VIEs, we need to make estimates regarding cash flows and other assumptions. We believe that our critical assumptions underlying these estimates are reasonable based on historical evidence and industry practice. Based on our analysis of transactions entered into with VIEs, we determined that we are the primary beneficiary of certain of these homesite option contracts. Consequently, Interpretation No. 46 requires us to consolidate the assets (homesites) at their fair value, although (1) we have no legal title to the assets, (2) our maximum exposure to loss is limited to the deposits or letters of credits placed with these entities, and (3) creditors, if any, of these entities have no recourse against us. The effect of this consolidation at March 31, 2004 was to increase inventory by \$94.3 million, excluding deposits of \$7.6 million, which had been previously recorded, with a corresponding increase to consolidated obligations for inventory not owned in the accompanying consolidated statements of financial condition. Additionally, we have entered into arrangements with VIEs to acquire homesites whereby our variable interest is insignificant and, therefore, we have determined that we are not the primary beneficiary and are not required to consolidate the assets of such VIEs.

3. Inventory

Inventory consists of (dollars in thousands):

	December 31, 2003	March 31, 2004
Homesites and land under development	\$ 453,893	\$ 327,664
Deposits	78,725	88,468
Residences completed and under construction	404,581	532,371
Consolidated inventory not owned	246,224	249,336
	<u>\$ 1,183,423</u>	<u>\$ 1,197,839</u>

A summary of Homebuilding interest capitalized in inventory is (dollars in thousands):

	Three Months Ended March 31,	
	2003	2004
Interest capitalized, beginning of period	\$ 11,578	\$ 29,696
Interest incurred	11,045	14,959
Less interest included in:		
Cost of sales	(7,382)	(10,693)
Other	(1,983)	(1,983)
Interest capitalized, end of period	<u>\$ 15,241</u>	<u>\$ 31,979</u>

In the ordinary course of business we enter into contracts to purchase homesites and land held for development. At December 31, 2003 and March 31, 2004, we had refundable and nonrefundable deposits aggregating \$78.7 million and \$88.5 million, respectively, included in inventory in the accompanying consolidated statements of financial condition. Our liability for nonperformance under such contracts is generally limited to forfeiture of the related deposits.

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During the three months ended March 31, 2004, we sold certain parcels of land for net proceeds of \$33.7 million. In connection with these transactions, we entered into options with the purchasers to acquire fully developed homesites. As we have retained a continuing involvement in these properties, in accordance with SFAS No. 66, Accounting for the Sales of Real Estate, we have accounted for these transactions as

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

financing arrangements. As a result, we have included the corresponding liability of \$33.7 million in consolidated obligations for inventory not owned in the accompanying consolidated statement of financial condition as of March 31, 2004. As of March 31, 2004, \$141.0 million of consolidated inventory not owned relates to sales with continuing involvement.

4. Acquisitions

On February 28, 2003, we acquired the net assets of The James Construction Company (James), a homebuilder operating in the greater Denver, Colorado area, for approximately \$22.0 million in cash. In addition, we are obligated to pay an additional \$1.4 million to the sellers over a two-year period, of which \$0.7 million has been paid as of March 31, 2004. This acquisition resulted in no goodwill being recorded.

On February 6, 2003, we acquired the net assets of Trophy Homes, Inc. (Trophy), a homebuilder operating in Las Vegas, Nevada, and certain homesites for approximately \$36.2 million in cash. In addition, if certain targets are met regarding home deliveries during 2003 and 2004, we will be obligated to pay up to an additional \$2.5 million over a two-year period. Of this amount, \$1.9 million has been paid as of March 31, 2004. This acquisition resulted in approximately \$9.2 million of goodwill.

On November 18, 2002, we acquired the net assets of Masonry Homes, Inc., a homebuilder operating in the northwestern suburbs of Baltimore, for approximately \$17.1 million in cash. In addition, if certain targets are met regarding home deliveries, the development and/or subdivision of certain homesites and earnings for the 2003 and 2004 fiscal years, we will be obligated to pay up to an additional \$21.3 million in cash to the sellers over a two-year period. Of this amount (i) we paid \$11.3 million during the year ended December 31, 2003, and (ii) we accrued additional consideration of \$6.0 million during the three months ended March 31, 2004, which was paid in April 2004. This acquisition resulted in approximately \$17.2 million of goodwill.