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CAPITAL PACIFIC HOLDINGS INC

Form 10-Q

July 16, 2001

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MAY 31, 2001

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

COMMISSION FILE NUMBER: 001-09911

CAPITAL PACIFIC HOLDINGS, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)

95-2956559
(I.R.S. EMPLOYER IDENTIFICATION NUMBER)

4100 MACARTHUR BLVD., SUITE 200, NEWPORT BEACH, CA 92660
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

(949) 622-8400
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

Indicate by check mark whether the Registrant (1) 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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

CLASS AND TITLE OF
CAPITAL STOCK

SHARES OUTSTANDING AS OF
JUNE 30, 2001

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Common Stock, \$.10 Par Value

14,932,111

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CAPITAL PACIFIC HOLDINGS, INC.

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PART 1 -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS)

ASSETS

| | MAY 31, 2001 ----- | FEBRUARY 28, 2001 ----- |
|--|--------------------------|-------------------------------|
| | (UNAUDITED) | |
| Cash and cash equivalents..... | \$ 6,494 | \$ 7,552 |
| Restricted cash..... | 757 | 781 |
| Accounts and notes receivable..... | 12,297 | 25,082 |
| Real estate projects..... | 262,599 | 259,873 |
| Property, plant and equipment..... | -- | -- |
| Investment in and advances to unconsolidated joint ventures..... | 3,824 | 5,273 |

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| | | |
|--|------------|------------|
| Prepaid expenses and other assets..... | 11,129 | 10,851 |
| | ----- | ----- |
| Total assets..... | \$ 297,100 | \$ 309,412 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Accounts payable and accrued liabilities..... | \$ 41,779 | \$ 43,150 |
| Notes payable..... | 100,848 | 110,223 |
| Senior unsecured notes payable..... | 55,592 | 55,592 |
| | ----- | ----- |
| Total liabilities..... | 198,219 | 208,965 |
| | ----- | ----- |
| Negative goodwill..... | 9,821 | 9,924 |
| | ----- | ----- |
| Minority interest..... | -- | 7,743 |
| | ----- | ----- |
| Stockholders' equity: | | |
| Common stock, par value \$.10 per share, 30,000,000 shares authorized; 16,230,000 and 14,995,000 shares issued; 14,932,111 and 13,767,311 shares outstanding, respectively..... | 1,623 | 1,500 |
| Additional paid-in capital..... | 216,853 | 211,888 |
| Accumulated deficit..... | (125,624) | (127,054) |
| Treasury stock..... | (3,792) | (3,554) |
| | ----- | ----- |
| Total stockholders' equity..... | 89,060 | 82,780 |
| | ----- | ----- |
| Total liabilities and stockholders' equity..... | \$ 297,100 | \$ 309,412 |
| | ===== | ===== |

See accompanying notes to financial statements.

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
(IN THOUSANDS EXCEPT PER SHARE DATA)
(UNAUDITED)

| | THREE MONTHS ENDED MAY 31, | |
|---|-------------------------------|----------|
| | 2001 | 2000 |
| | ----- | ----- |
| Sales of homes and land..... | \$77,494 | \$65,034 |
| Cost of sales..... | 57,882 | 50,560 |
| | ----- | ----- |
| Gross margin..... | 19,612 | 14,474 |
| Income from unconsolidated joint ventures..... | 4 | 11 |
| Selling, general and administrative expenses..... | (9,963) | (7,743) |
| Interest expense..... | (7,668) | (4,783) |
| Interest and other income, net..... | 619 | 445 |
| | ----- | ----- |
| Income from operations..... | 2,604 | 2,404 |

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| | | |
|---|----------|----------|
| Minority interest..... | (159) | (724) |
| | ----- | ----- |
| Income before income taxes and extraordinary item..... | 2,445 | 1,680 |
| Provision for income taxes..... | 1,015 | 336 |
| | ----- | ----- |
| Income before extraordinary item..... | 1,430 | 1,344 |
| Extraordinary gain for debt retired at less than face value, net of minority interest and taxes..... | -- | 945 |
| | ----- | ----- |
| Net income..... | \$ 1,430 | \$ 2,289 |
| | ===== | ===== |
| Net income per share -- basic and diluted: | | |
| Income per share before extraordinary item..... | \$ 0.10 | \$ 0.10 |
| Extraordinary gain for debt retired at less than face value, net of minority interest and taxes..... | -- | 0.07 |
| | ----- | ----- |
| Net income per share..... | \$ 0.10 | \$ 0.17 |
| | ===== | ===== |
| Weighted average number of common shares -- basic..... | 13,735 | 13,787 |
| | ===== | ===== |
| Weighted average number of common shares -- diluted..... | 13,917 | 13,884 |
| | ===== | ===== |

See accompanying notes to financial statements.

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CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

| | FOR THE THREE MONTHS ENDED MAY 31, | |
|--|---------------------------------------|----------|
| | 2001 | 2000 |
| | ----- | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income..... | \$1,430 | \$ 2,289 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Gain on retirement of senior unsecured notes payable..... | -- | (945) |
| Depreciation and amortization..... | 12 | 366 |
| Accretion of negative goodwill..... | (496) | -- |
| Change in restricted cash..... | 24 | 384 |
| Increase in real estate projects..... | (2,726) | (238) |
| (Increase) decrease in receivables, prepaid expenses and other assets..... | 12,507 | 3,870 |
| (Increase) decrease in accounts payable and accrued liabilities..... | (3,432) | (10,896) |
| Minority interest..... | 159 | 724 |
| | ----- | ----- |
| Net cash provided by (used in) operating activities..... | 7,478 | (4,446) |
| | ----- | ----- |

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| | | |
|--|---------|----------|
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment, net..... | (372) | (303) |
| Distributions to minority interest..... | -- | (32) |
| Decrease (increase) in investment in and advances to unconsolidated joint ventures..... | 1,449 | (781) |
| | ----- | ----- |
| Net cash provided by (used in) investing activities..... | 1,077 | (1,116) |
| | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Borrowings (payments) on notes payable, net..... | (9,375) | 8,482 |
| Retirement of senior unsecured notes payable..... | -- | (15,676) |
| Repurchase of common stock..... | (238) | (120) |
| | ----- | ----- |
| Net cash provided by (used in) financing activities..... | (9,613) | (7,314) |
| | ----- | ----- |
| NET DECREASE IN CASH AND CASH EQUIVALENTS..... | (1,058) | (12,876) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD..... | 7,552 | 19,389 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD..... | \$6,494 | \$ 6,513 |
| | ===== | ===== |

NON-CASH ACTIVITIES:

During the three month period ended May 31, 2001, the Company issued 1,235,000 shares of non-voting common stock to CHF in return for CHF's remaining 7% interest in CPH LLC in connection with the Exchange Transaction described in Note 3 to the financial statements. Below is a summary of amounts recorded as a result of this transaction:

| | | |
|---|----------|--|
| Minority interest acquired..... | \$ 7,902 | |
| Issuance of non-voting common stock..... | (5,088) | |
| Deferred income taxes and accrued expenses recorded..... | (2,061) | |
| Adjustment of remaining property and equipment to zero..... | (360) | |
| Negative goodwill recorded..... | (393) | |
| | ----- | |
| | \$ -- | |
| | ===== | |

See accompanying notes to financial statements.

CAPITAL PACIFIC HOLDINGS, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

The unaudited financial statements presented herein have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by generally accepted accounting principles. These statements should be read in conjunction with the consolidated financial statements, and notes thereto, included in the Form 10-K for the

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fiscal year ended February 28, 2001, of Capital Pacific Holdings, Inc. (the "Company"). In the opinion of management, the financial statements presented herein include all adjustments (which are solely of a normal recurring nature) necessary to present fairly the Company's financial position and results of operations. The results of operations for the three month period ended May 31, 2001, are not necessarily indicative of the results that may be expected for the year ending February 28, 2002. The consolidated financial statements include the accounts of the Company, wholly owned subsidiaries and certain majority owned joint ventures, as well as the accounts of Capital Pacific Holdings, LLC ("CPH LLC"). All other investments are accounted for on the equity method. All significant intercompany balances and transactions have been eliminated in consolidation.

2. RECLASSIFICATIONS

Certain items in prior period financial statements have been reclassified in order to conform with current year presentation.

3. COMPANY ORGANIZATION AND OPERATIONS

The Company is a regional builder and developer with operations throughout selected metropolitan areas of Southern California, Nevada, Texas, Arizona and Colorado. The Company's principal business activities are to build and sell single-family homes and to develop and build commercial and mixed-use projects. The Company's single-family homes are targeted to entry-level, move-up and luxury buyers.

In fiscal year 1998, the Company consummated an equity and restructuring transaction whereby the Company and certain of its subsidiaries transferred to Capital Pacific Holdings, LLC ("CPH LLC") substantially all of their respective assets and CPH LLC assumed all the liabilities of the Company and its subsidiaries. An unaffiliated investment company, California Housing Finance, L.P. ("CHF") then acquired a 32.07% minority interest in CPH LLC as a result of a cash investment in CPH LLC. From fiscal 1998 through fiscal 2001, the Company expanded its operating strategy to encompass the acquisition and development of commercial and mixed-use projects, as well as ownership of existing commercial properties, primarily through non-majority investments in limited liability companies, with approximately 99% of the capital for these projects being provided by CHF.

Effective February 23, 2001, the Company and CHF consummated an interest exchange transaction (the "Exchange Transaction"), whereby the Company exchanged its interests in the majority of the joint ventures capitalized by CHF, including certain entities which were previously consolidated, (the "Divested Joint Ventures") for approximately 78% of CHF's interest in CPH LLC and all of CHF's interests in certain residential joint ventures. At February 28, 2001, and during the three month period ended May 31, 2001, the Company had a 93% interest in CPH LLC and CHF held a 7% minority interest. The Company and CHF both had an option to convert CHF's remaining 7% interest in CPH LLC into 1,235,000 shares of non-voting Common Stock of the Company for the period extending from 90 to 180 days following the closing of the Exchange Transaction. This option was exercised by the Company on May 31, 2001, thus, as of this date, the Company owned 100% of CPH LLC. In addition, Capital Pacific Homes, Inc., a subsidiary of the Company, has entered or expects to enter into construction, management and marketing agreements relating to certain of the Divested Joint Ventures with residential components, (the "Managed Projects"), whereby the Company is compensated for performing such services through a management fee arrangement.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (UNAUDITED)

The Exchange Transaction has been accounted for as the simultaneous acquisition of CHF's minority interest in CPH LLC and certain other residential joint ventures and the disposition of the Company's interest in the Divested Joint Ventures. As a result, no gain has been recognized, the remaining balance of the Company's property and equipment was adjusted to zero at February 28, 2001, and again at May 31, 2001, and the balance of the transaction was recorded as negative goodwill. Negative goodwill is being accreted over five years, which accretion is included in selling, general and administrative expenses.

Assets under management, including assets owned by unconsolidated joint ventures and Managed Projects, totaled \$465 million at May 31, 2001 in 52 residential properties. At May 31, 2001, CPH LLC had \$240 million in assets and a net worth of \$109 million. The Company maintains certain licenses and other assets as is necessary to fulfill its obligations as managing member and under management agreements. The Company and its subsidiaries perform their respective management functions for CPH LLC and the Managed Projects, pursuant to management agreements, which include provisions for the reimbursement of Company and subsidiary costs and a management fee. CPH LLC, the Managed Projects and certain other project-specific entities indemnify the Company against liabilities arising from the projects owned by such entities.

References to the Company are, unless the context indicates otherwise, also references to CPH LLC and the project-specific entities in which the Company has an equity ownership interest. At the current time, all material financing transactions and arrangements are incurred either by CPH LLC or by the project-specific entities.

4. INVESTMENTS IN AND ADVANCES TO UNCONSOLIDATED ENTITIES

The Company is a general partner or a direct or indirect managing member and has a 50 percent or less ownership in 6 unconsolidated entities at May 31, 2001. The Company's net investment in and advances to unconsolidated entities are as follows at May 31, 2001 and February 28, 2001 (in thousands):

| | MAY 31, 2001 ----- | FEBRUARY 28, 2001 ----- |
|----------------------------------|--------------------------|-------------------------------|
| Unconsolidated Joint Ventures: | | |
| JMP Canyon Estates, L.P..... | \$ 161 | \$ 162 |
| JMP Harbor View, L.P..... | 611 | 609 |
| Grand Coto Estates, L.P..... | 344 | 231 |
| M.P.E. Partners, L.P..... | 982 | 983 |
| LB/L -- CPH Providence, LLC..... | 785 | 715 |
| LB/L -- CPH Longmont, LLC..... | 896 | 1,087 |
| | ----- | ----- |
| | 3,779 | 3,787 |
| | ----- | ----- |
| Divested Joint Ventures..... | 45 | 1,486 |
| | ----- | ----- |
| | \$3,824 | \$5,273 |
| | ===== | ===== |

The Company's ownership interest in the unconsolidated joint ventures varies. Generally, the Company receives a portion of any earnings, although a preferred return on invested capital is provided. Typically, the majority of

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capital is provided by capital partners. The Company is typically a general partner or managing member in each of the above entities and is the managing entity pursuant to terms in each venture's agreement. In the case of Divested Joint Ventures which are also Managed Projects, the Company or its subsidiaries manage the development of the project under a management contract. The Company's carrying amount in each of the unconsolidated joint ventures (and the Divested Joint Ventures prior to the Exchange Transaction) equals the underlying equity in the joint venture, and there are generally no significant amounts of undistributed earnings. The Company provides for income taxes currently on its share of distributed and undistributed earnings and losses from the investments.

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CAPITAL PACIFIC HOLDINGS, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (UNAUDITED)

The Company uses the equity method of accounting for its investments in the unconsolidated 50 percent or less owned entities. The accounting policies of the entities are substantially the same as those of the Company.

Following is summarized, combined financial information for the unconsolidated entities at May 31, 2001 and February 28, 2001 and for the three month periods ended May 31, 2001 and May 31, 2000 (in thousands). The balance sheet information at both dates and the income statement information for the period ended May 31, 2001 does not include the Divested Joint Ventures, but the income statement information for the period ended May 31, 2000 does reflect the results of the Divested Joint Ventures because the Company held an ownership interest in those entities during that period:

ASSETS

| | MAY 31, 2001 | FEBRUARY 28, 2001 |
|---------------------------|-----------------|----------------------|
| | ----- | ----- |
| Cash..... | \$ 321 | \$ 512 |
| Real estate projects..... | 15,234 | 14,620 |
| Other assets..... | 622 | 611 |
| | ----- | ----- |
| | \$16,177 | \$15,743 |
| | ===== | ===== |

LIABILITIES AND EQUITY

| | MAY 31, 2001 | FEBRUARY 28, 2001 |
|---|-----------------|----------------------|
| | ----- | ----- |
| Accounts payable and other liabilities..... | \$ 4,068 | \$ 4,167 |
| Notes payable..... | 2,286 | 1,878 |
| | ----- | ----- |
| | 6,354 | 6,045 |
| | ----- | ----- |
| Equity..... | 9,823 | 9,698 |
| | ----- | ----- |

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\$16,177 \$15,743
 =====

INCOME STATEMENT

| | THREE MONTHS ENDED | |
|-------------------------------------|--------------------|-----------------|
| | MAY 31, 2001 | MAY 31, 2000 |
| | ----- | ----- |
| Sales of homes and land..... | \$ 1,109 | \$20,095 |
| Interest and other income, net..... | 3 | 2,835 |
| | ----- | ----- |
| | 1,112 | 22,930 |
| Costs and expenses..... | 1,049 | 21,786 |
| | ----- | ----- |
| Net income..... | \$ 63 | \$ 1,144 |
| | ===== | ===== |

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CAPITAL PACIFIC HOLDINGS, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 (UNAUDITED)

5. NOTES PAYABLE

Notes payable at May 31, 2001 and February 28, 2001, are summarized as follows (in thousands):

| | MAY 31, 2001 | FEBRUARY 28, 2001 |
|---|-----------------|----------------------|
| | ----- | ----- |
| Notes payable to banks, including interest varying from LIBOR plus two percent to thirteen percent, maturing between July 31, 2001 and February 3, 2003, secured by certain real estate projects on a non-recourse basis..... | \$ 83,928 | \$ 88,272 |
| Notes payable to banks, including interest at prime with the terms of the commitment reducing commencing August 1, 2001, secured by certain real estate projects on a recourse basis..... | 14,269 | 16,158 |
| Other..... | 2,651 | 5,793 |
| | ----- | ----- |
| | \$100,848 | \$110,223 |
| | ===== | ===== |

6. NET INCOME PER COMMON SHARE

The Company follows SFAS No. 128. This statement requires the presentation of both basic and diluted net income per share for financial statement purposes. Basic net income per share is computed by dividing income available to common

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stockholders by the weighted average number of common shares outstanding. Diluted net income per share includes the effect of the potential shares outstanding, including dilutive securities using the treasury stock method. The table below reconciles the components of the basic net income per share calculation to diluted net income per share (in thousands, except per share data):

| | THREE MONTHS ENDED | | | | | |
|--|--------------------|--------|--------|--------------|--------|--------|
| | MAY 31, 2001 | | | MAY 31, 2000 | | |
| | INCOME | SHARES | EPS | INCOME | SHARES | EPS |
| Basic net income per share: | | | | | | |
| Income available to common stockholders before extraordinary item..... | \$1,430 | 13,735 | \$0.10 | \$1,344 | 13,787 | \$0.10 |
| Effect of dilutive securities: | | | | | | |
| Warrants..... | -- | 8 | -- | -- | -- | -- |
| Stock options..... | -- | 174 | -- | -- | 97 | -- |
| Diluted net income per share before extraordinary item.... | \$1,430 | 13,917 | \$0.10 | \$1,344 | 13,884 | \$0.10 |
| | ===== | ===== | ===== | ===== | ===== | ===== |

7. COMMON STOCK REPURCHASE PROGRAM

The Company has announced a stock repurchase program whereby up to 1,000,000 shares of the Company's outstanding common stock may be repurchased by CPH LLC. As of May 31, 2001, 608,400 shares have been repurchased under this program. In addition, the Company has repurchased 244,363 of the warrants originally issued in connection with the issuance of the Senior Notes.

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

FORWARD-LOOKING INFORMATION IS SUBJECT TO RISK AND UNCERTAINTY

Certain statements in the financial discussion and analysis by management contain "forward-looking" information (as defined in the Private Securities Litigation Reform Act of 1995 and within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended) that involves risk and uncertainty, including projections and assumptions regarding the business environment in which the Company operates. Actual future results and trends may differ materially depending on a variety of factors, including the Company's successful execution of internal performance strategies; changes in general national and regional economic conditions, such as levels of employment, consumer confidence and income, availability to homebuilders of financing for acquisitions, development and construction, availability to homebuyers of permanent mortgages, interest rate levels, the demand for housing and office space and commercial lease rates; supply levels of land, labor and materials; difficulties in obtaining permits or approvals from governmental authorities; difficulties in marketing homes; regulatory changes and weather and other environmental uncertainties; competitive influences; and the outcome of pending and future legal claims and proceedings.

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RESULTS OF OPERATIONS -- GENERAL

As is noted in footnote 1 to the financial statements presented herein, the Company is reporting its results on a consolidated basis with the results of CPH LLC. References to the Company in this Item 2 are, unless the context indicates otherwise, also references to CPH LLC. At the current time, all material financing transactions and arrangements are incurred either by CPH LLC or by project-specific entities.

The following table illustrates the actual and pro forma results of the Company's operations for the three months ended May 31, 2001 and 2000. The pro forma results reflect the inclusion of the operating results of the Company's unconsolidated joint ventures, including the portion attributable to the Company's joint venture partners, and are used throughout this discussion for comparative purposes wherever the phrase "pro forma" is utilized.

RESULTS OF OPERATIONS (AMOUNTS IN THOUSANDS)

| | THREE MONTHS ENDED | | | |
|------------------------------|--------------------|----------------------------------|--------------|----------------------------------|
| | MAY 31, 2001 | | MAY 31, 2000 | |
| | CONSOLIDATED | PRO FORMA WITH JOINT VENTURES | CONSOLIDATED | PRO FORMA WITH JOINT VENTURES |
| Sales of homes and land..... | \$77,494 | \$78,603 | \$65,034 | \$85,129 |
| Cost of sales..... | 57,882 | 58,830 | 50,560 | 68,700 |
| | ----- | ----- | ----- | ----- |
| Gross margin..... | \$19,612 | \$19,773 | \$14,474 | \$16,429 |
| | ===== | ===== | ===== | ===== |

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OPERATING DATA

Both of the tables shown below include data for the Divested Joint Ventures at May 31, 2000 and exclude such data as of May 31, 2001, due to the change in the Company's ownership in such entities.

The following table shows new home deliveries, lot deliveries, net new orders and average sales prices for each of the Company's operations, including unconsolidated joint ventures:

| | THREE MONTHS ENDED | |
|----------------------|--------------------|-----------------|
| | MAY 31, 2001 | MAY 31, 2000 |
| New homes delivered: | | |
| California..... | 24 | 4 |
| Texas..... | 87 | 127 |
| Nevada..... | 46 | 63 |

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| | | |
|---|-------------|-------------|
| Arizona..... | 48 | 64 |
| Colorado..... | 44 | 50 |
| | ----- | ----- |
| Subtotal..... | 249 | 308 |
| Unconsolidated Joint Ventures (California)..... | 4 | 18 |
| | ----- | ----- |
| Total homes delivered..... | 253 | 326 |
| Lot deliveries..... | 11 | 29 |
| | ----- | ----- |
| Total homes and lots delivered..... | 264 | 355 |
| | ===== | ===== |
| Net new orders..... | 209 | 375 |
| | ===== | ===== |
| Average home sales price: | | |
| California..... | \$1,061,000 | \$1,309,000 |
| Texas..... | 244,000 | 182,000 |
| Nevada..... | 203,000 | 200,000 |
| Arizona..... | 153,000 | 147,000 |
| Colorado..... | 224,000 | 190,000 |
| Combined..... | \$ 306,000 | \$ 256,000 |

The following table shows backlog in units and dollars at May 31, 2001 and 2000 for each of the Company's operations, including unconsolidated joint ventures:

| | ENDING BACKLOG | | | |
|-----------------|----------------|-----------|--------------|-----------|
| | MAY 31, 2001 | | MAY 31, 2000 | |
| | UNITS | (\$000S) | UNITS | (\$000S) |
| California..... | 71 | \$ 62,499 | 74 | \$118,800 |
| Texas..... | 234 | 60,094 | 280 | 61,300 |
| Nevada..... | 23 | 6,924 | 85 | 17,400 |
| Arizona..... | 48 | 7,319 | 85 | 14,100 |
| Colorado..... | 63 | 9,684 | 123 | 23,700 |
| | --- | ----- | --- | ----- |
| Total..... | 439 | \$146,520 | 647 | \$235,300 |
| | === | ===== | === | ===== |

FIRST THREE MONTHS OF FISCAL 2002 (ENDED MAY 31, 2001) COMPARED TO FIRST THREE MONTHS OF FISCAL 2001 (ENDED MAY 31, 2000)

The Company reported net income of \$1.4 million or \$0.10 per share, in the first quarter of fiscal 2002, as compared to net income of \$2.3 million or \$0.17 per share, in the first quarter of fiscal 2001. Income for the quarter ended May 31, 2000 included an extraordinary gain of \$945,000, or \$0.07 per share, as a result of the retirement of debt at less than face value. Excluding the extraordinary gain, operating net income increased from \$1.3 million in the first quarter of fiscal 2001 to \$1.4 million in the corresponding quarter of fiscal 2002.

On a consolidated basis, sales of homes and land increased to \$77.5 million from \$65.0 million for the respective quarters. This increase is due to an

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increase in Company's average sales price per home to \$306,000 in the first quarter of fiscal 2002 (which, in turn, is due primarily to a higher number of home closings in the California market) from \$256,000 in the first quarter of fiscal 2001, offset by a decrease in total home closings. Sales of homes and land including unconsolidated joint ventures were \$78.6 million for the first quarter of fiscal 2002 compared to \$85.1 million for the first quarter of fiscal 2001. Total home closings decreased from 326 in the first quarter of fiscal 2001 to 253 in the first quarter of fiscal 2002, including 18 and 4 homes, respectively, closed in unconsolidated joint ventures. The decrease in the Company's backlog is primarily due to the exclusion of backlog in the Divested Joint Ventures at May 31, 2001, as well as the reduction in backlog units in Nevada in connection with the buildout of that market and a decrease in demand in certain of the Company's other markets. In addition, the number of actively selling projects has decreased from 37 at May 31, 2001 to 24 at May 31, 2002, which affected both backlog and net new orders.

The Company's actual gross margin on home and lot closings increased to 25.3% for the first quarter of fiscal 2002 as compared to 22.3% for the first quarter of fiscal 2001. The Company's pro forma gross margin on home and lot closings also increased to 25.2% during the first quarter of fiscal 2002 as compared to 19.3% for the first quarter of fiscal 2001. These substantial increases are due in part to stronger demand experienced in the Company's markets for homes which closed in the current year.

As a percentage of revenue, selling, general and administrative expense increased from 11.9% for the first quarter of fiscal 2001 to 12.9% for the first quarter of fiscal 2002. Selling, general and administrative expense of \$10.0 million for the first quarter of fiscal 2002 increased \$2.2 million or 28.7% as compared to the first quarter of fiscal 2001, primarily due to a higher level of sales activity and certain additional compensation expense recorded in connection with the Exchange Transaction.

Income from unconsolidated joint ventures decreased from \$11,000 in the first quarter of fiscal 2001 to \$4,000 in the first quarter of fiscal 2002, due to a minimal level of profit participation in the active joint ventures in both periods.

Interest and other income increased from \$445,000 in the first quarter of fiscal 2001 to \$619,000 in the first quarter of fiscal 2002.

Minority interest of \$159,000 for the first quarter of fiscal 2002 and \$724,000 for the first quarter of fiscal 2001 primarily represents the share of CPH LLC's income attributable to CHF. The decrease between years is due to the lower percentage ownership in CPH LLC held by CHF during fiscal 2002 as compared to fiscal 2001.

Interest incurred was \$5.1 million in the first quarter of fiscal 2002, as compared to \$6.2 million in the first quarter of fiscal 2001, while interest expensed was \$7.7 million during the first quarter of fiscal 2002, as compared to \$4.8 million in the first quarter of fiscal 2001.

The Company recorded a provision for income taxes of \$1.0 million in the first quarter of fiscal 2002, utilizing an effective tax rate of 41.5 percent, as compared to \$336,000 in the first quarter of fiscal 2001, with an effective tax rate of 20 percent. The increase in the effective tax rate was due primarily to the utilization of the remaining net operating loss carryforwards during fiscal 2001.

LIQUIDITY AND CAPITAL RESOURCES

At the current time, all material financing transactions and arrangements are incurred either by CPH LLC or by certain project specific entities. As of

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May 31, 2001, the Company has in place several credit facilities totaling \$255 million (the "Facilities") with various bank lenders (the "Banks"), of which \$98 million was outstanding. The Facilities are secured by liens on various completed or under construction homes and lots held by CPH LLC, CPH Newport Coast, LLC and CPH Yucaipa I, LLC, which are consolidated subsidiaries. Pursuant to the Facilities, the Company is subject to certain covenants, which require, among other things, the maintenance of a consolidated liabilities to net worth ratio, minimum liquidity, minimum net worth and loss limitations, all as defined in the documents that evidence the Facilities. At May 31, 2001, the Company was in compliance with these covenants. The Facilities also define certain

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events that constitute events of default. As of May 31, 2001, no such event had occurred. Commitment fees are payable annually on some of the Facilities.

Homebuilding activity is being financed out of CPH LLC cash, bank financing, and the existing joint ventures, including joint ventures with institutional investors. In addition, development work undertaken in certain of the Company's joint ventures is financed through various non-recourse lending arrangements. The Company anticipates that it will continue to utilize both third party financing and joint ventures to cover financing needs in excess of internally generated cash flow.

In May, 1994 the Company completed the sale of \$100 million of 12 3/4% Senior Notes ("Senior Notes") including 790,000 warrants to purchase common stock. The proceeds from the offering were used to repay certain debt of the Company, acquire certain properties and for general working capital and construction purposes. The obligations associated with the Senior Notes have been transferred from the Company to CPH LLC. The Senior Notes mature in May, 2002 and are callable at the option of CPH LLC at par. As of May 31, 2001, Senior Notes with a face value of \$44.4 million have been repurchased by the Company.

The indenture to which the Senior Notes are subject (the "Indenture") contains restrictions on CPH LLC on the incurring of indebtedness, which affect the availability of the Facilities based on various measures of the financial performance of CPH LLC. Subject to such restrictions, the Facilities are available to augment cash flow from operations and joint venture financing to fund CPH LLC's operations.

Management expects that cash flow generated from operations and from additional financing permitted by the terms of the Indenture will be sufficient to cover the debt service and to fund CPH LLC's current development and homebuilding activities for the reasonably foreseeable future, and expects that capital commitments from its joint venture partners and other bank facilities will provide sufficient financing for the operation of its joint ventures.

MARKET RISK EXPOSURE

The "Market Risk Exposure" paragraphs are presented to provide an update about material changes to the "Quantitative and Qualitative Disclosures about Market Risk" paragraphs included in the Company's 2001 Annual Report on Form 10-K filed with the Securities and Exchange Commission and should be read in conjunction with those paragraphs.

The Company is exposed to market risks related to fluctuations in interest rates on its debt. The Company does not use interest rate swaps, forward or option contracts on foreign currencies or commodities, or other types of derivative financial instruments.

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The Company uses debt financing primarily for the purpose of acquiring and developing land and constructing and selling homes. Historically, the Company has made short-term borrowings under its revolving credit facilities to fund those expenditures. In addition, the Company has previously issued \$100 million in fixed-rate Senior Notes to provide longer-term financing. At May 31, 2001, \$55.6 million of the Senior Notes remain outstanding.

For fixed rate debt, changes in interest rates generally affect the fair market value, but not the Company's earnings or cash flows. Conversely, for variable rate debt, changes in interest rates generally do not impact fair market value, but do affect the Company's future earnings and cash flows. The Company does not have an obligation to prepay fixed rate debt prior to maturity, and as a result, interest rate risk and changes in fair market value should not have a significant impact on such debt until the Company would be required to refinance such debt. Based upon the amount of variable rate debt outstanding at the end of the first quarter, and holding the variable rate debt balance constant, each one percentage point increase in interest rates occurring on the first day of an annual period would result in an increase in interest incurred for the coming year of approximately \$950,000.

The Company does not believe that future market interest rate risks related to its debt obligations will have a material impact on the Company's financial position, results of operations or liquidity.

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PART II -- OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None Filed

(b) Reports on Form 8-K

A report on Form 8-K was filed on March 9, 2001, regarding the Interest Exchange Agreement between the Company and California Housing Finance, L.P.

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SIGNATURES

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

Date: July 16, 2001

By: /s/ HADI MAKARECHIAN

Hadi Makarechian
Chairman of the Board,
Chief Executive Officer and
President
(Principal Executive Officer)

Date: July 16, 2001

By: /s/ STEVEN O. SPELMAN, JR.

Steven O. Spelman, Jr.
Chief Financial Officer and
Corporate Secretary
(Principal Financial Officer)