TECHNICAL OLYMPIC USA INC
Form 10-Q
August 08, 2006

Table of Contents

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

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2006

OR

o **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: 001-32322

TECHNICAL OLYMPIC USA, INC.
(Exact name of registrant as specified in its charter)

Delaware	**76-0460831**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
4000 Hollywood Blvd., Suite 500 N Hollywood, Florida	**33021**
(Address of principal executive offices)	*(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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (check one):
Large Accelerated Filer o Accelerated Filer þ Non-Accelerated Filer o

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

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: 59,590,519 shares of common stock as of August 2, 2006.

TECHNICAL OLYMPIC USA, INC.

INDEX

		Page
PART I.	Financial Information	2
ITEM 1.	Financial Statements (Unaudited)	2
	Consolidated Statements of Financial Condition	2
	Consolidated Statements of Income	3
	Consolidated Statements of Cash Flows	4
	Notes to Unaudited Consolidated Financial Statements	5
ITEM 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	21
ITEM 3.	Quantitative and Qualitative Disclosures about Market Risk	36
ITEM 4.	Controls and Procedures	36
PART II.	Other Information	37
ITEM 1A.	Risk Factors	37
ITEM 4.	Submission of Matters to a Vote of Security Holders	37
ITEM 5.	Other Information	38
ITEM 6.	Exhibits	38
	Signatures	39

Ex-10.32(a) Amendment to Employment Agreement
Ex-10.33(a) Amendment to Employment Agreement
Ex-31.1 Section 302 Certification of CEO
Ex-31.2 Section 302 Cetification of CFO
Ex-32.1 Section 906 Cetification of CEO
Ex-32.2 Section 906 Cetification of CFO

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. *FINANCIAL STATEMENTS*

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	June 30, 2006 (Unaudited)	December 31, 2005
	(Dollars in millions, except par value)	
ASSETS		
HOMEBUILDING:		
Cash and cash equivalents:		
Unrestricted	$ 39.6	$ 26.2
Restricted	2.9	3.1
Inventory:		
Deposits	215.3	218.5
Homesites and land under development	807.4	650.3
Residences completed and under construction	855.4	747.4
Inventory not owned	218.5	124.6
	2,096.6	1,740.8
Property and equipment, net	30.6	27.1
Investments in unconsolidated joint ventures	249.9	254.5
Receivables from unconsolidated joint ventures	83.0	60.5
Other assets	104.2	133.2
Goodwill	108.8	108.8
	2,715.6	2,354.2
FINANCIAL SERVICES:		
Cash and cash equivalents:		
Unrestricted	7.7	8.7
Restricted	3.2	3.1
Mortgage loans held for sale	45.1	43.9
Other assets	11.8	12.8
	67.8	68.5
Total assets	$ 2,783.4	$ 2,422.7

LIABILITIES AND STOCKHOLDERS EQUITY

HOMEBUILDING:		
Accounts payable and other liabilities	$ 285.2	$ 329.4
Customer deposits	76.0	79.3
Obligations for inventory not owned	218.5	124.6
Notes payable	1,060.5	811.6
Bank borrowings		65.0
	1,640.2	1,409.9
FINANCIAL SERVICES:		
Accounts payable and other liabilities	6.4	6.4
Bank borrowings	38.2	35.1
	44.6	41.5
Total liabilities	1,684.8	1,451.4
Stockholders equity:		
Preferred stock $0.01 par value; 3,000,000 shares authorized; none issued or outstanding		
Common stock $0.01 par value; 97,000,000 shares authorized and 59,590,519 and 59,554,977 shares issued and outstanding at June 30, 2006, and December 31, 2005, respectively	0.6	0.6
Additional paid-in capital	479.4	480.5
Unearned compensation		(7.7)
Retained earnings	618.6	497.9
Total stockholders equity	1,098.6	971.3
Total liabilities and stockholders equity	$ 2,783.4	$ 2,422.7

See accompanying notes to consolidated financial statements.

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(Unaudited) (Dollars in millions, except per share amounts)			
HOMEBUILDING:				
Revenues:				
Home sales	$ 641.6	$ 582.1	$ 1,227.9	$ 1,094.5
Land sales	18.0	33.7	46.0	54.9
	659.6	615.8	1,273.9	1,149.4
Cost of sales:				
Home sales	482.2	448.2	921.2	849.2
Land sales	12.8	29.9	37.7	46.7
	495.0	478.1	958.9	895.9
Gross profit	164.6	137.7	315.0	253.5
Selling, general and administrative expenses	104.4	77.1	201.8	156.5
(Income) from joint ventures, net	(37.9)	(8.1)	(65.7)	(10.7)
Other (income), net	(2.4)	(2.3)	(4.4)	(4.2)
Homebuilding pretax income	100.5	71.0	183.3	111.9
FINANCIAL SERVICES:				
Revenues	17.4	11.4	32.6	21.4
Expenses	11.0	9.0	21.7	17.7
Financial Services pretax income	6.4	2.4	10.9	3.7
Income before provision for income taxes	106.9	73.4	194.2	115.6
Provision for income taxes	39.3	27.7	71.6	43.5
Net income	$ 67.6	$ 45.7	$ 122.6	$ 72.1
EARNINGS PER COMMON SHARE:				
Basic	$ 1.13	$ 0.82	$ 2.06	$ 1.29
Diluted	$ 1.10	$ 0.79	$ 1.99	$ 1.24
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:				
Basic	59,572,856	56,083,450	59,580,962	56,078,578
Diluted	61,405,216	58,189,548	61,539,678	58,157,052

CASH DIVIDENDS PER SHARE	$	0.015	$	0.015	$	0.030	$	0.027

See accompanying notes to consolidated financial statements.

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30,	
	2006	2005
	(Unaudited) (Dollars in millions)	
Cash flows from operating activities:		
Net income	$ 122.6	$ 72.1
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	6.9	6.3
Non-cash compensation	6.9	4.8
Loss on impairment of inventory	5.4	0.6
Deferred income taxes	(2.1)	
Undistributed equity in earnings from unconsolidated joint ventures	(22.6)	(3.8)
Distributions of earnings from unconsolidated joint ventures	19.2	
Changes in operating assets and liabilities:		
Restricted cash	0.1	4.9
Inventory	(274.3)	(270.2)
Receivables from unconsolidated joint ventures	(15.0)	
Other assets	35.5	(33.3)
Mortgage loans held for sale	(1.2)	14.9
Accounts payable and other liabilities	(47.1)	10.2
Customer deposits	(3.3)	21.6
Net cash used in operating activities	(169.0)	(171.9)
Cash flows from investing activities:		
Net additions to property and equipment	(10.3)	(6.0)
Loans to unconsolidated joint ventures	(7.5)	
Investments in unconsolidated joint ventures	(8.2)	(21.5)
Capital distributions from unconsolidated joint ventures	25.2	9.6
Net cash (used in) provided by investing activities	(0.8)	(17.9)
Cash flows from financing activities:		
Net repayments on revolving credit facility	(65.0)	
Net proceeds from notes offering	248.8	
Net proceeds from Financial Services bank borrowings	3.1	0.4
Payments for deferred financing costs	(3.2)	(0.3)
Excess income tax benefit from exercise of stock options	0.1	
Proceeds from stock option exercises	0.2	0.2
Dividends paid	(1.8)	(1.5)
Net cash provided by (used in) financing activities	182.2	(1.2)
Increase (decrease) in cash and cash equivalents	12.4	(191.0)

Cash and cash equivalents at beginning of period		34.9		268.5
Cash and cash equivalents at end of period	$	47.3	$	77.5
Supplemental disclosure of non-cash financing activity:				
Increase (decrease) in obligations for inventory not owned and corresponding increase (decrease) in inventory not owned	$	93.9	$	(32.6)

See accompanying notes to consolidated financial statements.

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2006

1. Business and Organization

Business

Technical Olympic USA, Inc. is a homebuilder with a geographically diversified national presence. We operate in various metropolitan markets in ten states, 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 insurance 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.

Organization

Technical Olympic S.A. owns approximately 67% 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 United States generally accepted accounting principles and general practices within the homebuilding industry. These accounting principles require 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.

All significant intercompany balances and transactions have been eliminated in the consolidated financial statements.

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

We have two reportable segments which are segregated in the accompanying consolidated financial statements under Homebuilding and Financial Services.

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

Interim Presentation

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 June 30, 2006 are not necessarily indicative of those that may be achieved for the year ending December 31, 2006. Certain information and footnote disclosures normally included in financial statements presented in accordance with United States generally accepted accounting principles have been omitted from the accompanying financial statements. 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 Annual Report on Form 10-K for the year ended December 31, 2005.

For the three months ended June 30, 2006 and 2005, we have eliminated inter-segment Financial Services revenues of $1.2 million and $2.1 million, respectively. For the six months ended June 30, 2006 and 2005, we have eliminated inter-segment Financial Services revenues of $2.2 million and $3.8 million, respectively.

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Earnings Per Share

Basic earnings per share is computed by dividing income available 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 gives effect to all potential shares that were dilutive and outstanding during the period. Potential common shares are securities, such as stock options or other common stock equivalents, that may entitle the holder to obtain common stock during the reporting period or after the end of the reporting period. Dilutive securities are not included in the weighted average number of shares when inclusion would increase the earnings per share or decrease the loss per share.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Basic weighted average shares outstanding	59,572,856	56,083,450	59,580,962	56,078,578
Net effect of common stock equivalents assumed to be exercised	1,832,360	2,106,098	1,958,716	2,078,474
Diluted weighted average shares outstanding	61,405,216	58,189,548	61,539,678	58,157,052

Revenue Recognition

In accordance with Statement of Financial Accounting Standards (SFAS) No. 66, *Accounting for the Sales of Real Estate* (SFAS No. 66), we deferred approximately $1.5 million in gross profit related to certain homes that were delivered for which our mortgage subsidiary originated interest-only loans or loans with high loan to value ratios which did not meet the initial and continuing investment requirements under SFAS No. 66, and the loans were still held for sale at June 30, 2006. This profit will be recognized upon the sale of the loans to a third party, with non-recourse provisions, which generally occurs within 45 days from the date the loan is originated.

Stock-Based Compensation

Prior to January 1, 2006, we accounted for stock option awards granted under our share-based payment plan in accordance with the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB 25) and related Interpretations, as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*, (SFAS 123). Share-based employee compensation expense was not recognized in our consolidated statement of income prior to January 1, 2006, except for certain options with performance-based accelerated vesting criteria and certain outstanding common stock purchase rights, as all other stock option awards granted under the plan had an exercise price equal to or greater than the market value of the common stock on the date of the grant. Effective January 1, 2006, we adopted the provisions of SFAS 123 (revised

2004), *Share-Based Payment*, (SFAS 123R) using the modified-prospective-transition method. Under this transition method, compensation expense recognized during the six months ended June 30, 2006 included: (a) compensation expense for all share-based awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation expense for all share-based awards granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. In accordance with the modified-prospective-transition method, results for prior periods have not been restated. Additionally, in connection with the adoption of SFAS 123R, we recognized a cumulative

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

change in accounting principle of $2.0 million, net of tax, related to certain common stock purchase rights that were accounted for under the variable accounting method. The cumulative effect of the change in accounting principle of $3.2 million, gross of tax, was not material and therefore was included in selling, general and administrative expenses with the related tax effect of $1.2 million included in the provision for income taxes rather than displayed separately as a cumulative change in accounting principle in the consolidated statements of income. The adoption of SFAS 123R resulted in a charge of $7.4 million and $4.7 million to income before provision for income taxes and net income, respectively, for the six months ended June 30, 2006. The impact of adopting SFAS 123R on both basic and diluted earnings was $0.08 per share. See Note 7 for more information on the impact of SFAS 123R on our consolidated financial statements.

3. Inventory

A summary of homebuilding interest capitalized in inventory is as follows (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Interest capitalized, beginning of period	$ 52.5	$ 40.2	$ 47.7	$ 36.8
Interest incurred	25.5	19.6	48.3	38.7
Less interest included in:				
Cost of sales	(18.9)	(17.7)	(36.6)	(32.4)
Other	0.2	1.0	(0.1)	
Interest capitalized, end of period	$ 59.3	$ 43.1	$ 59.3	$ 43.1

In the ordinary course of business, we enter into contracts to purchase homesites and land held for development. At June 30, 2006 and December 31, 2005, we had refundable and non-refundable deposits aggregating $215.3 million and $218.5 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.

Homebuilders may enter into option contracts for the purchase of land or homesites with land sellers and third-party financial entities, some of which qualify as Variable Interest Entities (VIEs) under Financial Accounting Standards Board (FASB) Interpretation No. 46 (Revised), *Consolidation of Variable Interest Entities* (FIN 46(R)). FIN 46(R) addresses consolidation by business enterprises of VIEs in which an entity absorbs a majority of the expected losses, receives a majority of the entity s expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity. Obligations for inventory not owned in our consolidated statements of financial condition represent liabilities associated with our land banking and similar activities, including obligations in VIEs which have been consolidated by us and in which we have a less than 50% ownership interest, and the creditors have no recourse against us. As a result, the obligations have been specifically excluded from the calculation of leverage ratios pursuant to the terms of our revolving credit facility.

In applying FIN 46(R) to our homesite option contracts and other transactions with VIEs, we 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, FIN 46(R) 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 generally 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 FIN 46(R) at June 30, 2006 was to increase inventory by $85.7 million, excluding deposits of $13.0 million, which had been previously recorded, with a corresponding

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

increase to obligations for inventory not owned in the accompanying consolidated statement of financial condition. Additionally, we have entered into arrangements with VIEs to acquire homesites in which 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.

From time to time, we transfer title to certain parcels of land to unrelated third parties and enter 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, we have accounted for these transactions as financing arrangements. At June 30, 2006, $132.8 million of inventory not owned and obligations for inventory not owned related to sales where we have retained a continuing involvement.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we carry long-lived assets at the lower of the carrying amount or fair value. Impairment is evaluated by estimating future undiscounted cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected undiscounted future cash flows is less than the carrying amount of the assets, an impairment loss is recognized. Fair value, for purposes of calculating impairment, is measured based on estimated future cash flows, discounted at a market rate of interest. During the six months ended June 30, 2006, we recorded an impairment loss of $5.4 million, which is included in cost of sales home sales in the accompanying consolidated statement of income. Additionally, during the six months ended June 30, 2006, we wrote-off $2.2 million in deposits and pre-acquisition costs, which are included in cost of sales land sales in the accompanying consolidated statement of income, related to land that we no longer intend to purchase.

4. Investments in Unconsolidated Joint Ventures

Summarized condensed combined financial information of unconsolidated entities in which we have investments that are accounted for under the equity method is (dollars in millions):

	June 30, 2006		
	Land Development	Home Construction	Total
Assets:			
Cash and cash equivalents	$ 9.3	$ 115.8	$ 125.1
Inventories	369.8	1,091.7	1,461.5
Other assets	6.2	222.0	228.2
Total assets	$ 385.3	$ 1,429.5	$ 1,814.8
Liabilities and partners equity:			
Accounts payable and other liabilities	$ 70.8	$ 268.9	$ 339.7
Notes payable	145.4	821.4	966.8
Equity of:			

Technical Olympic USA, Inc.	70.6	180.2	250.8
Others	98.5	159.0	257.5
Total equity	169.1	339.2	508.3
Total liabilities and partners equity	$ 385.3	$ 1,429.5	$ 1,814.8

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2005		
	Land Development	Home Construction	Total
Assets:			
Cash and cash equivalents	$ 13.4	$ 60.5	$ 73.9
Inventories	306.1	1,023.6	1,329.7
Other assets	3.3	227.5	230.8
Total assets	$ 322.8	$ 1,311.6	$ 1,634.4
Liabilities and partners equity:			
Accounts payable and other liabilities	$ 6.6	$ 211.2	$ 217.8
Notes payable	142.0	781.5	923.5
Equity of:			
Technical Olympic USA, Inc.	86.1	167.1	253.2
Others	88.1	151.8	239.9
Total equity	174.2	318.9	493.1
Total liabilities and partners equity	$ 322.8	$ 1,311.6	$ 1,634.4

	Three Months Ended June 30, 2006			Three Months Ended June 30, 2005		
	Land Development	Home Construction	Total	Land Development	Home Construction	Total
Revenues	$ 7.8	$ 387.6	$ 395.4	$ 3.5	$ 65.1	$ 68.6
Cost and expenses	9.2	347.7	356.9	4.2	57.9	62.1
Net earnings (losses) of unconsolidated entities	$ (1.4)	$ 39.9	$ 38.5	$ (0.7)	$ 7.2	$ 6.5
Our share of net earnings (losses)	$ (1.0)	$ 28.1	$ 27.1	$ (0.5)	$ 3.0	$ 2.5
Management fees earned	0.8	10.0	10.8	0.8	4.8	5.6
Income (loss) from joint ventures	$ (0.2)	$ 38.1	$ 37.9	$ 0.3	$ 7.8	$ 8.1

Six Months Ended	Six Months Ended

	June 30, 2006			June 30, 2005		
	Land Development	**Home Construction**	**Total**	**Land Development**	**Home Construction**	**Total**
Revenues	$ 13.8	$ 701.1	$ 714.9	$ 10.2	$ 103.4	$ 113.6
Cost and expenses	15.8	625.0	640.8	11.8	92.9	104.7
Net earnings (losses) of unconsolidated entities	$ (2.0)	$ 76.1	$ 74.1	$ (1.6)	$ 10.5	$ 8.9
Our share of net earnings (losses)	$ (1.3)	$ 45.2	$ 43.9	$ (0.8)	$ 4.6	$ 3.8
Management fees earned	1.5	20.3	21.8	1.6	5.3	6.9
Income from joint ventures	$ 0.2	$ 65.5	$ 65.7	$ 0.8	$ 9.9	$ 10.7

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

We enter into strategic joint ventures to acquire, develop and sell land and/or homesites, as well as to construct and sell homes, in which we have a voting ownership interest of 50% or less and do not have a controlling interest. Our partners generally are unrelated homebuilders, land sellers, financial partners or other real estate entities. At June 30, 2006, we had receivables of $83.0 million from these joint ventures, of which $43.9 million represented notes receivable.

In many instances, we are appointed as the day-to-day manager of the unconsolidated entities and receive management fees for performing this function. We received management fees from these unconsolidated entities of $10.8 million and $21.8 million for the three and six months ended June 30, 2006, respectively. We received management fees from these unconsolidated entities of $5.6 million and $6.9 million for the three and six months ended June 30, 2005, respectively. These fees are included in income from joint ventures in the accompanying consolidated statements of income. In the aggregate, these joint ventures delivered 2,085 and 344 homes for the six months ended June 30, 2006 and 2005, respectively.

In March 2006, we assigned to our Sunbelt joint venture our rights under a contract to purchase approximately 539 acres of raw land. We received $18.7 million for the assignment of the purchase contract. In connection with this assignment, we realized a gain of $15.8 million, of which $2.3 million is included in cost of sales-land sales in the accompanying consolidated statements of income. Due to our continuing involvement with this contract through our investment in the joint venture, we deferred $13.5 million of this gain which is included in accounts payable and other liabilities in the accompanying consolidated statements of financial condition. This deferral will be recognized in income as homes are delivered by the joint venture.

During the six months ended June 30, 2006, we purchased several parcels of land for an aggregate purchase price of $39.4 million from our Transeastern joint venture (the Transeastern JV). In connection with these transactions, the Transeastern JV realized a gain of $14.1 million. We deferred our share of that gain, $7.1 million, and have recorded it as a reduction in the basis of the underlying property.

Under the limited liability company agreement that governs the operations of the Transeastern JV, the Transeastern JV is required to make a preferred payment to our joint venture partner. The preferred payment is to be made quarterly and to the extent allowable under the covenants and restrictions imposed by the joint venture s bank borrowings. To the extent the joint venture is not allowed to make these payments, we are required, under the joint venture agreement, to advance funds to the Transeastern JV in the form of a member loan sufficient to make the payment. Such member loans bear interest at 18% per annum and are payable once certain conditions and covenants under the JV agreement and the joint venture s bank borrowings are met. Based on our joint venture partner s current equity investment, the quarterly preferred payment is $3.8 million. As of June 30, 2006, we have advanced funds totaling $11.3 million to the joint venture in connection with this provision, which is included in receivables from unconsolidated joint ventures in the accompanying consolidated statement of financial condition.

5. Borrowings

Our revolving credit facility permits us to borrow up to the lesser of (i) $800.0 million or (ii) our borrowing base (calculated in accordance with the revolving credit facility agreement) minus our outstanding senior debt. The facility has a letter of credit subfacility of $400.0 million. In addition, we have the right to increase the size of the facility to

provide up to an additional $150.0 million of revolving loans, provided we satisfy certain conditions. Loans outstanding under the facility may be base rate loans or Eurodollar loans, at our election. Our obligations under the revolving credit facility are guaranteed by our material domestic subsidiaries, other than our mortgage and title subsidiaries. The revolving credit facility expires on March 9, 2010. As of June 30, 2006, we had no borrowings under the revolving credit facility and had issued letters of credit totaling $281.0 million. As of June 30, 2006, we had $420.0 million in availability, all of which we could have borrowed without violating any of our debt covenants.

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Our mortgage subsidiary has the ability to borrow up to $200.0 million under two warehouse lines of credit to fund the origination of residential mortgage loans. The primary revolving warehouse line of credit (the Primary Warehouse Line of Credit) provides for revolving loans of up to $150.0 million. Our mortgage subsidiary s other warehouse line of credit (the Secondary Warehouse Line of Credit), which was amended on February 11, 2006, is comprised of (1) a credit facility providing for revolving loans of up to $30.0 million, subject to meeting borrowing base requirements based on the value of collateral provided, and (2) a mortgage loan purchase and sale agreement which provides for the purchase by the lender of up to $20.0 million in mortgage loans generated by our mortgage subsidiary. The Primary Warehouse Line of Credit bears interest at the 30 day LIBOR rate plus a margin of 1.125% to 3.0%, except for certain specialty mortgage loans, determined based upon the type of mortgage loans being financed. The Secondary Warehouse Line of Credit bears interest at the 30 day LIBOR rate plus a margin of 1.125%. The Primary Warehouse Line of Credit expires on December 8, 2006 and the Secondary Warehouse Line of Credit expires on February 11, 2007. Both warehouse lines of credit are secured by funded mortgages, which are pledged as collateral, and require our mortgage subsidiary to maintain certain financial ratios and minimums. At June 30, 2006, we had $38.2 million in borrowings under our mortgage subsidiary s warehouse lines of credit.

On April 12, 2006, we issued $250.0 million of 81/4% Senior Notes due 2011. The net proceeds of $248.8 million were used to repay amounts outstanding under our revolving credit facility. These notes are guaranteed, on a joint and several basis, by the Guarantor Subsidiaries, which are all of our material domestic subsidiaries, other than our mortgage and title subsidiaries (the Non-guarantor Subsidiaries). The senior notes rank *pari passu* in right of payment with all of our existing and future unsecured senior debt and senior in right of payment to our senior subordinated notes and any future subordinated debt. The indenture governing the senior notes requires us to maintain a minimum consolidated net worth and places certain restrictions on our ability, among other things, to incur additional debt, pay or declare dividends or other restricted payments, sell assets, enter into transactions with affiliates, and merge or consolidate with other entities. Interest on these notes is payable semi-annually.

6. Commitments and Contingencies

We are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters is not expected to have a material adverse effect on our consolidated financial position or results of operations.

We provide homebuyers with a limited warranty of workmanship and materials from the date of sale for up to two years. We generally have recourse against our subcontractors for claims relating to workmanship and materials. We also provide up to a ten-year homeowner s warranty which covers major structural defects. We also have a homebuilder protective policy which covers warranty claims for structure and design defects related to homes sold by us during the policy period, subject to a significant self-insured retention per occurrence. Estimated warranty costs are recorded at the time of sale based on historical experience and current factors.

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the six months ended June 30, 2006 and 2005, changes in our warranty accrual consisted of (dollars in millions):

	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Accrued warranty costs at January 1	$ 7.0	$ 6.5
Liability recorded for warranties issued during the period	6.5	6.0
Warranty work performed	(4.6)	(4.1)
Liability recorded for pre-existing warranties	(0.1)	(0.7)
Accrued warranty costs at June 30	$ 8.8	$ 7.7

During the three and six months ended June 30, 2006, we recorded $6.4 million and $7.5 million, respectively, of one-time termination benefits and contract termination costs which are included in selling, general and administrative expenses in the accompanying consolidated statements of income. The termination benefits related to employees that were involuntarily terminated and are no longer providing services. The contract termination costs related to costs that will continue to be incurred under consulting contracts for their remaining terms for which we are not receiving economic benefit.

On June 1, 2006, we entered into employment agreements with two members of our board of directors, who also serve as officers and directors of Technical Olympic, S.A. Each of these members will serve as an Executive Vice President of Technical Olympic USA, Inc. and receive an annual salary of $300,000. The agreements are for one year employment terms and renew automatically for successive one year periods unless either party provides at least 30 days notice of an intent not to renew. The agreements were amended on August 4, 2006 to provide for certain change of control provisions.

7. Stockholders Equity and Stock-Based Compensation

Under the Technical Olympic USA, Inc. Annual and Long-Term Incentive Plan (the Plan) employees, consultants and directors of ours, our subsidiaries and affiliated entities, (as defined in the Plan), are eligible to receive options to purchase shares of common stock. Each stock option expires on a date determined when the options are granted, but not more than ten years after the date of grant. Stock options granted have a vesting period ranging from immediate vesting to a graded vesting over five years. Under the Plan, subject to adjustment as defined, the maximum number of shares with respect to which awards may be granted is 8,250,000. At June 30, 2006, there were 250,686 shares available for grant.

Prior to January 1, 2006, we accounted for stock option awards granted under our share-based payment plan in accordance with the recognition and measurement provisions of APB 25 and related Interpretations, as permitted by SFAS 123. Share-based employee compensation expense was not recognized in our consolidated statement of income

prior to January 1, 2006, except for certain options with performance-based accelerated vesting criteria and certain outstanding common stock purchase rights, as all other stock option awards granted under the plan had an exercise price equal to or greater than the market value of the common stock on the date of the grant. Effective January 1, 2006, we adopted the provisions of SFAS 123R using the modified-prospective-transition method. Under this transition method, compensation expense recognized during the six months ended June 30, 2006 included:
(a) compensation expense for all share-based awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation expense for all share-based awards granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. In accordance with the modified-prospective-transition method, results for prior periods have not been restated. Additionally, in connection with the adoption of SFAS 123R we recognized a cumulative change in accounting principle of $2.0 million, net of tax, related to certain common stock purchase rights that were

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

accounted for under the variable accounting method. The cumulative effect of the change in accounting principle of $3.2 million, gross of tax, was not material and therefore was included in selling, general and administrative expenses with the related tax effect of $1.2 million included in the provision for income taxes rather than displayed separately as a cumulative change in accounting principle in the consolidated statement of income. The adoption of SFAS 123R resulted in a charge of $7.4 million and $4.7 million to income before provision for income taxes and net income, respectively, for the six months ended June 30, 2006. The impact of adopting SFAS 123R on both basic and diluted earnings was $0.08 per share.

Under the provisions of SFAS 123R, the unearned compensation caption in our consolidated statement of financial condition, a contra-equity caption representing the amount of unrecognized share-based compensation costs, is no longer presented. The amount that had been previously shown as unearned compensation was reversed through the additional paid-in capital caption in our consolidated statement of financial condition.

In accordance with SFAS 123R, we present the tax benefits resulting from the exercise of share-based awards as financing cash flows. Prior to the adoption of SFAS 123R, we reported the tax benefits resulting from the exercise of share-based awards as operating cash flows. The effect of this change was not material to our consolidated statement of cash flows.

We estimate that we will record an additional $1.9 million of pre-tax expense in accordance with SFAS 123R for the remainder of the year ending December 31, 2006.

If the methodologies of SFAS 123R were applied to determine compensation expense for our stock options based on the fair value of our common stock at the grant dates for awards under our option plan, our net income and earnings per share for the six months ended June 30, 2005 would have been adjusted to the pro forma amounts indicated below (dollars in millions, except per share amounts):

	Six Months Ended June 30, 2005	
Net income as reported	$	72.1
Add: Stock-based employee compensation included in reported net income, net of tax		2.8
Deduct: Stock-based employee compensation expense determined under the fair value method, net of tax		(1.9)
Pro forma net income	$	73.0
Reported basic earnings per share	$	1.29
Pro forma basic earnings per share	$	1.30
Reported diluted earnings per share	$	1.24
Pro forma diluted earnings per share	$	1.26

The fair values of options granted were estimated on the date of their grant using the Black-Scholes option pricing model based on the following assumptions for all of the years presented:

Expected volatility	0.33%-0.42%
Expected dividend yield	0%
Risk-free interest rate	1.47%-4.85%
Expected life	3-10 years

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Activity under the Plan for the six months ended June 30, 2006 was as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in millions)
Options outstanding at beginning of year	6,606,611	$ 11.06		
Granted	1,339,708	$ 23.58		
Exercised	(23,750)	$ 10.84		
Forfeited	(133,125)	$ 19.37		
Options outstanding at end of period	7,789,444	$ 13.07	6.06	$ 24.4
Vested and expected to vest in the future at end of period	7,789,444	$ 13.07	6.06	$ 24.4
Options exercisable at end of period	5,025,632	$ 10.89	6.55	$ 18.2
Weighted average fair market value per share of options granted during the period	$ 7.90			

As of June 30, 2006, there was $5.5 million of total unrecognized compensation expense related to unvested stock option awards. This expense is expected to be recognized over a weighted average period of 2.0 years.

The aggregate fair market value of options vested during the six months ended June 30, 2006 was $1.1 million.

Our chief executive officer had the right to purchase 1% of our outstanding common stock on January 1, 2007 for $16.23 per share and an additional 1% on January 1, 2008 for $17.85 per share. On January 13, 2006, our chief executive officer s employment agreement was amended primarily to grant him 1,323,940 options at an exercise price of $23.62 per share and provide for a special bonus award of $8.7 million in lieu of the common stock purchase rights.

8. Summarized Financial Information

Our outstanding senior notes and senior subordinated notes are fully and unconditionally guaranteed, on a joint and several basis, by the Guarantor Subsidiaries, which are all of our material domestic subsidiaries, other than our mortgage and title subsidiaries (the Non-guarantor Subsidiaries). Each of the Guarantor Subsidiaries is directly or indirectly 100% owned by us. In lieu of providing separate audited financial statements for the Guarantor Subsidiaries, consolidated condensed financial statements are presented below. Separate financial statements and

other disclosures concerning the Guarantor Subsidiaries are not presented because management has determined that they are not material to investors.

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Consolidating Statement of Financial Condition
June 30, 2006

	Technical Olympic USA, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Intercompany Eliminations	Total
			(Dollars in millions)		
ASSETS					
HOMEBUILDING:					
Cash and cash equivalents	$ 20.5	$ 22.0	$	$	$ 42.5
Inventory		2,096.6			2,096.6
Property and equipment, net	7.3	23.3			30.6
Investments in unconsolidated joint ventures		249.9			249.9
Receivables from unconsolidated joint ventures		83.0			83.0
Investments in/advances to consolidated subsidiaries	2,161.2	(319.0)	4.9	(1,847.1)	
Other assets	48.9	55.3			104.2
Goodwill		108.8			108.8
	2,237.9	2,319.9	4.9	(1,847.1)	2,715.6
FINANCIAL SERVICES:					
Cash and cash equivalents			10.9		10.9
Mortgage loans held for sale			45.1		45.1
Other assets			11.8		11.8
			67.8		67.8
Total assets	$ 2,237.9	$ 2,319.9	$ 72.7	$ (1,847.1)	$ 2,783.4
LIABILITIES AND STOCKHOLDERS EQUITY					
HOMEBUILDING:					
Accounts payable and other liabilities	$ 78.8	$ 206.4	$	$	$ 285.2
Customer deposits		76.0			76.0
Obligations for inventory not owned		218.5			218.5
Notes payable	1,060.5				1,060.5
	1,139.3	500.9			1,640.2

FINANCIAL SERVICES:					
Accounts payable and other liabilities			6.4		6.4
Bank borrowings			38.2		38.2
			44.6		44.6
Total liabilities	1,139.3	500.9	44.6		1,684.8
Total stockholders equity	1,098.6	1,819.0	28.1	(1,847.1)	1,098.6
Total liabilities and stockholders equity	$ 2,237.9	$ 2,319.9	$ 72.7	$ (1,847.1)	$ 2,783.4

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Consolidating Statement of Financial Condition
December 31, 2005

	Technical Olympic USA, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Intercompany Eliminations	Total
			(Dollars in millions)		
ASSETS					
HOMEBUILDING:					
Cash and cash equivalents	$ 21.9	$ 7.4	$	$	$ 29.3
Inventory		1,740.8			1,740.8
Property and equipment, net	7.3	19.8			27.1
Investments in unconsolidated joint ventures		254.5			254.5
Receivables from unconsolidated joint ventures		60.5			60.5
Investments in/advances to consolidated subsidiaries	1,946.8	(427.7)	(3.7)	(1,515.4)	
Other assets	26.3	106.9			133.2
Goodwill		108.8			108.8
	2,002.3	1,871.0	(3.7)	(1,515.4)	2,354.2
FINANCIAL SERVICES:					
Cash and cash equivalents			11.8		11.8
Mortgage loans held for sale			43.9		43.9
Other assets			12.8		12.8
			68.5		68.5
Total assets	$ 2,002.3	$ 1,871.0	$ 64.8	$ (1,515.4)	$ 2,422.7
LIABILITIES AND STOCKHOLDERS EQUITY					
HOMEBUILDING:					
Accounts payable and other liabilities	$ 154.4	$ 175.0	$	$	$ 329.4
Customer deposits		79.3			79.3
Obligations for inventory not owned		124.6			124.6

Notes payable	811.6				811.6
Bank borrowings	65.0				65.0
	1,031.0	378.9			1,409.9
FINANCIAL SERVICES:					
Accounts payable and other liabilities			6.4		6.4
Bank borrowings			35.1		35.1
			41.5		41.5
Total liabilities	1,031.0	378.9	41.5		1,451.4
Total stockholders equity	971.3	1,492.1	23.3	(1,515.4)	971.3
Total liabilities and stockholders equity	$ 2,002.3	$ 1,871.0	$ 64.8	$ (1,515.4)	$ 2,422.7

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Consolidating Statement of Income
Three Months Ended June 30, 2006

	Technical Olympic USA, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Intercompany Eliminations	Total
	(Dollars in millions)				
HOMEBUILDING:					
Revenues	$	$ 659.6	$	$	$ 659.6
Cost of sales		495.0			495.0
Gross profit		164.6			164.6
Selling, general and administrative expenses	27.0	78.6		(1.2)	104.4
(Income) from joint ventures, net		(37.9)			(37.9)
Other (income) expense, net	(91.1)	14.0		74.7	(2.4)
Homebuilding pretax income	64.1	109.9		(73.5)	100.5
FINANCIAL SERVICES:					
Revenues			18.6	(1.2)	17.4
Expenses			13.6	(2.6)	11.0
Financial Services pretax income			5.0	1.4	6.4
Income before provision (benefit) for income taxes	64.1	109.9	5.0	(72.1)	106.9
Provision (benefit) for income taxes	(3.5)	40.4	2.4		39.3
Net income	$ 67.6	$ 69.5	$ 2.6	$ (72.1)	$ 67.6

Consolidating Statement of Income
Three Months Ended June 30, 2005

	Technical Olympic USA, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Intercompany Eliminations	Total
	(Dollars in millions)				

HOMEBUILDING:										
Revenues	$		$	615.8	$		$		$	615.8
Cost of sales				478.1						478.1
Gross profit				137.7						137.7
Selling, general and administrative expenses		15.0		64.2				(2.1)		77.1
(Income) from joint ventures, net				(8.1)						(8.1)
Other (income) expense, net		(60.1)		1.5				56.3		(2.3)
Homebuilding pretax income		45.1		80.1				(54.2)		71.0
FINANCIAL SERVICES:										
Revenues						13.5		(2.1)		11.4
Expenses						10.5		(1.5)		9.0
Financial Services pretax income						3.0		(0.6)		2.4
Income before provision (benefit) for income taxes		45.1		80.1		3.0		(54.8)		73.4
Provision (benefit) for income taxes		(0.6)		27.2		1.1				27.7
Net income	$	45.7	$	52.9	$	1.9	$	(54.8)	$	45.7

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Consolidating Statement of Income
Six Months Ended June 30, 2006

	Technical Olympic USA, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Intercompany Eliminations	Total
		(Dollars in millions)			
HOMEBUILDING:					
Revenues	$	$ 1,273.9	$	$	$ 1,273.9
Cost of sales		958.9			958.9
Gross profit		315.0			315.0
Selling, general and administrative expenses	46.3	157.7		(2.2)	201.8
(Income) from joint ventures, net		(65.7)			(65.7)
Other (income) expense, net	(162.7)	22.1		136.2	(4.4)
Homebuilding pretax income	116.4	200.9		(134.0)	183.3
FINANCIAL SERVICES:					
Revenues			34.8	(2.2)	32.6
Expenses			26.2	(4.5)	21.7
Financial Services pretax income			8.6	2.3	10.9
Income before provision (benefit) for income taxes	116.4	200.9	8.6	(131.7)	194.2
Provision (benefit) for income taxes	(6.2)	74.1	3.7		71.6
Net income	$ 122.6	$ 126.8	$ 4.9	$ (131.7)	$ 122.6

Consolidating Statement of Income
Six Months Ended June 30, 2005

	Technical Olympic USA, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Intercompany Eliminations	Total
		(Dollars in millions)			

HOMEBUILDING:					
Revenues	$	$ 1,149.4	$	$	$ 1,149.4
Cost of sales		895.9			895.9
Gross profit		253.5			253.5
Selling, general and administrative expenses	36.5	123.8		(3.8)	156.5
(Income) from joint ventures, net		(10.7)			(10.7)
Other (income) expense, net	(107.4)	17.2		86.0	(4.2)
Homebuilding pretax income	70.9	123.2		(82.2)	111.9
FINANCIAL SERVICES:					
Revenues			25.2	(3.8)	21.4
Expenses			20.1	(2.4)	17.7
Financial Services pretax income			5.1	(1.4)	3.7
Income before provision (benefit) for income taxes	70.9	123.2	5.1	(83.6)	115.6
Provision (benefit) for income taxes	(1.2)	43.4	1.3		43.5
Net income	$ 72.1	$ 79.8	$ 3.8	$ (83.6)	$ 72.1

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Consolidating Statement of Cash Flows
Six Months Ended June 30, 2006

	Technical Olympic USA, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Intercompany Eliminations	Total
	(Dollars in millions)				
Cash flows from operating activities:					
Net income	$ 122.6	$ 126.8	$ 4.9	$ (131.7)	$ 122.6
Adjustments to reconcile net income to net cash (used in) provided by operating activities:					
Depreciation and amortization	1.7	4.5	0.7		6.9
Non-cash compensation	6.9				6.9
Loss on impairment of inventory		5.4			5.4
Deferred income taxes	(2.1)				(2.1)
Undistributed equity in earnings from unconsolidated joint ventures		(22.6)			(22.6)
Distributions of earnings from unconsolidated joint ventures		19.2			19.2
Changes in operating assets and liabilities:					
Restricted cash	(0.9)	1.1	(0.1)		0.1
Inventory	0.1	(274.4)			(274.3)
Receivables from unconsolidated joint ventures		(15.0)			(15.0)
Other assets	(17.5)	51.6	1.4		35.5
Mortgage loans held for sale			(1.2)		(1.2)
Accounts payable and other liabilities	(76.2)	29.0	0.1		(47.1)
Customer deposits		(3.3)			(3.3)
Net cash (used in) provided by operating activities	34.6	(77.7)	5.8	(131.7)	(169.0)
Cash flows from investing activities:					
Net additions to property and equipment	(1.6)	(7.6)	(1.1)		(10.3)
Loans to unconsolidated joint ventures		(7.5)			(7.5)
Investments in unconsolidated joint ventures		(8.2)			(8.2)
Capital distributions from unconsolidated joint ventures		25.2			25.2
Net cash (used in) provided by investing activities	(1.6)	1.9	(1.1)		(0.8)
Cash flows from financing activities:					

Net repayments on revolving credit facility	(65.0)				(65.0)
Net proceeds from notes offering	248.8				248.8
Net proceeds from Financial Services bank borrowings			3.1		3.1
Payments for deferred financing costs	(3.2)				(3.2)
Excess income tax benefit from exercise of stock options	0.1				0.1
Proceeds from stock option exercises	0.2				0.2
Dividends paid	(1.8)				(1.8)
Increase (decrease) in intercompany transactions	(214.4)	91.5	(8.8)	131.7	
Net cash provided by (used in) financing activities	(35.3)	91.5	(5.7)	131.7	182.2
Increase (decrease) in cash and cash equivalents	(2.3)	15.7	(1.0)		12.4
Cash and cash equivalents at beginning of period	20.2	6.0	8.7		34.9
Cash and cash equivalents at end of period	$ 17.9	$ 21.7	$ 7.7	$	$ 47.3

Table of Contents

TECHNICAL OLYMPIC USA, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Consolidating Statement of Cash Flows
Six Months Ended June 30, 2005

	Technical Olympic USA, Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Intercompany Eliminations	Total
			(Dollars in millions)		
Cash flows from operating activities:					
Net income	$ 72.1	$ 79.8	$ 3.8	$ (83.6)	$ 72.1
Adjustments to reconcile net income to net cash (used in) provided by operating activities:					
Depreciation and amortization	1.8	4.0	0.5		6.3
Non-cash compensation	4.8				4.8
Loss on impairment of inventory		0.6			0.6
Undistributed equity in earnings from unconsolidated joint ventures		(3.8)			(3.8)
Changes in operating assets and liabilities:					
Restricted cash	(1.2)	6.3	(0.2)		4.9
Inventory		(270.2)			(270.2)
Other assets	(30.6)	(0.5)	(2.2)		(33.3)
Mortgage loans held for sale			14.9		14.9
Accounts payable and other liabilities	(5.6)	14.9	0.9		10.2
Customer deposits		21.6			21.6
Net cash (used in) provided by operating activities	41.3	(147.3)	17.7	(83.6)	(171.9)
Cash flows from investing activities:					
Net additions to property and equipment	(2.1)	(2.9)	(1.0)		(6.0)
Investments in unconsolidated joint ventures		(21.5)			(21.5)
Capital distributions from unconsolidated joint ventures		9.6			9.6
Net cash used in investing activities	(2.1)	(14.8)	(1.0)		(17.9)
Cash flows from financing activities:					
Net proceeds from Financial Services bank borrowings			0.4		0.4
Payments for deferred financing costs	(0.3)				(0.3)
Proceeds from stock option exercises	0.2				0.2
Dividends paid	(1.5)		(8.0)	8.0	(1.5)

Increase (decrease) in intercompany transactions	(166.6)	146.8	(55.8)	75.6	
Net cash (used in) provided by financing activities	(168.2)	146.8	(63.4)	83.6	(1.2)
Decrease in cash and cash equivalents	(129.0)	(15.3)	(46.7)		(191.0)
Cash and cash equivalents at beginning of period	159.3	58.3	50.9		268.5
Cash and cash equivalents at end of period	$ 30.3	$ 43.0	$ 4.2	$	$ 77.5

Table of Contents

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

Executive Summary

We generate revenues from our homebuilding operations (Homebuilding) and financial services operations (Financial Services), which comprise our reportable segments. Through our Homebuilding operations we design, build and market high quality detached single-family residences, town homes and condominiums in various metropolitan markets in ten states located in four major geographic regions: Florida, the Mid-Atlantic, Texas and the West.

Florida	**Mid-Atlantic**	**Texas**	**West**
Jacksonville	Baltimore/Southern Pennsylvania	Austin	Colorado
Orlando	Delaware	Dallas/Ft. Worth	Las Vegas
Southeast Florida	Nashville	Houston	Phoenix
Southwest Florida	Northern Virginia	San Antonio	
Tampa/St. Petersburg			

We conduct our Homebuilding operations through our consolidated subsidiaries and through various unconsolidated joint ventures that acquire and develop land for our Homebuilding operations and/or joint ventures that additionally build and market homes. As used in this Form 10-Q, consolidated information refers only to information relating to our operations which are consolidated in our financial statements; combined information includes consolidated information and information relating to our unconsolidated joint ventures. At June 30, 2006, our investment in these unconsolidated joint ventures was $249.9 million. Additionally, we had receivables of $83.0 million from these joint ventures.

We also seek to use option contracts to acquire land whenever feasible. Option contracts allow us to control significant homesite positions with minimal capital investment and substantially reduce the risks associated with land ownership and development. At June 30, 2006, we controlled approximately 106,000 combined homesites. Of this amount, we owned approximately 24,900 homesites, had option contracts on approximately 55,300 homesites and our unconsolidated joint ventures controlled approximately 25,800 homesites. Based on current housing market conditions, we have curtailed approving new land acquisitions in most of our markets, except Texas.

As part of our land acquisition strategy, from time to time we use our capital to control, acquire and develop larger land parcels that could yield homesites exceeding the requirements of our homebuilding activities. These additional homesites are typically sold to other homebuilders. We confine these activities to selected land-constrained markets where we believe land supplies will remain constrained and opportunities for land sale profits are likely to continue for a period of time. At June 30, 2006, of the 24,900 owned homesites, 8,200 homesites are part of this strategy. Of the 55,300 homesites controlled through option contracts, 19,800 homesites are also part of this strategy. At June 30, 2006, deposits supporting this strategy aggregated $16.6 million. The table below summarizes our controlled homesite supply as of June 30, 2006 and December 31, 2005.

	June 30, 2006			**December 31, 2005**		
	Owned	**Optioned**	**Total Controlled**	**Owned**	**Optioned**	**Total Controlled**

Consolidated	24,900	55,300	80,200	27,300	41,600	68,900
Unconsolidated joint ventures	7,800	18,000	25,800	6,300	19,100	25,400
Combined total	32,700	73,300	106,000	33,600	60,700	94,300

For the three months ended June 30, 2006, total consolidated revenues increased 8%, consolidated net income increased 48%, combined net sales orders decreased 34% and combined home deliveries increased 46% as compared to the three months ended June 30, 2005. For the six months ended June 30, 2006, total consolidated revenues increased 12%, consolidated net income increased 70%, combined net sales orders decreased 20% and combined home deliveries increased 42% as compared to the six months ended June 30,

2005. Consolidated sales value in backlog at June 30, 2006 as compared to June 30, 2005 decreased by 13% to $1.8 billion. Our joint ventures had an additional $1.1 billion in sales backlog at June 30, 2006. Our combined home cancellation rate was approximately 35% for the three months ended June 30, 2006 as compared to 24% for the three months ended March 31, 2006, and 14% for the three months ended June 30, 2005. The increase in the combined home cancellation rate is a result of the challenging housing market which we discuss in further detail below.

Homebuilding Operations. We build homes for inventory (speculative homes) and on a pre-sold basis. At June 30, 2006, we had 8,151 homes completed or under construction on a combined basis compared to 7,467 homes at December 31, 2005. Approximately 24% of these homes were unsold at June 30, 2006 compared to 19% at December 31, 2005. At June 30, 2006, we had 156 completed unsold homes in our inventory on a combined basis, an increase of 9% from 143 homes at December 31, 2005. Approximately 34% of our completed, unsold homes at both June 30, 2006 and December 31, 2005 had been completed for more than 90 days. We actively work to control our finished speculative home inventory to reduce carrying costs, increase our available capital and improve our gross margins.

Once a sales contract with a buyer has been approved, we classify the transaction as a new sales order and include the home in backlog. Such sales orders are usually subject to certain contingencies such as the buyer s ability to qualify for financing. At closing, title passes to the buyer and a home is considered to be delivered and is removed from backlog. Revenue and cost of sales are recognized upon the delivery of the home, land or homesite when title is transferred to the buyer and all conditions necessary for profit recognition have been met. We estimate that the average period between the execution of a sales contract for a home and delivery ranges from approximately four months to over a year for presold homes; however, this varies by market. The principal expenses of our Homebuilding operations are (i) cost of sales and (ii) selling, general and administrative (SG&A) expenses. Costs of home sales include land and land development costs, home construction costs, previously capitalized indirect costs and interest, and estimated warranty costs. SG&A expenses for our Homebuilding operations include administrative costs, advertising expenses, on-site marketing expenses, sales commission costs, and closing costs. Sales commissions are included in selling, general and administrative costs when the related revenue is recognized. As used herein, Homebuilding includes results of home and land sales. Home sales includes results related only to the sale of homes.

Outlook. Our Homebuilding operations have been and continue to be impacted by a more challenging housing market for which the duration is unknown, characterized by weakening demand, an oversupply of homes available for sale, increased competition and lack of buyer urgency. We believe the weakening demand is due to concerns from prospective homebuyers over rising interest rates and home prices. In addition, speculative investors are canceling existing contracts and reducing prices on homes previously purchased contributing to the oversupply of homes available for sale.

The slowdown in the housing market has led to increased sales incentives, increased pressure on margins, higher cancellation rates, increased advertising expenditures and broker commissions, and increased inventories. We expect our gross margin on home sales to be negatively impacted due to increased sales incentives and a product mix shift to markets with lower margins. We also continue to be impacted by labor and supply shortages and increases in the cost of materials caused by the recent active hurricane seasons and the high costs of petroleum. We are responding to these situations by (1) analyzing each community to determine our profit and sales pace goals; (2) renegotiating our takedown schedules and prices for homesites and land under option contracts; (3) curtailing land acquisition in most of our markets; (4) working with our suppliers to reduce supply and labor costs; and (5) actively managing our general and administrative costs to increase efficiencies and streamline our operations.

Financial Services Operations. To provide homebuyers with a seamless home purchasing experience, we have a complementary financial services business which provides mortgage financing and closing services and offers title, homeowners and other insurance products to our homebuyers and others. Our mortgage financing operation derives

most of its revenues from buyers of our homes, although it also offers its services to existing homeowners refinancing their mortgages. Our title and closing services and our insurance agency operations are used by our homebuyers and a broad range of other clients purchasing or refinancing residential

or commercial real estate. Our mortgage financing operations revenues consist primarily of origination and premium fee income, gain on the sale of the mortgages and interest income net of interest expense on our warehouse lines of credit. Our title operations revenues consist primarily of fees and premiums from title insurance and closing services. The principal expenses of our Financial Services operations are SG&A expenses, which consist primarily of compensation.

Critical Accounting Policies

Prior to January 1, 2006, we accounted for stock option awards granted under our share-based payment plan in accordance with the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB 25) and related Interpretations, as permitted by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, (SFAS 123). Share-based employee compensation expense was not recognized in our consolidated statement of income prior to January 1, 2006, except for certain options with performance-based accelerated vesting criteria and certain outstanding common stock purchase rights, as all other stock option awards granted under the plan had an exercise price equal to or greater than the market value of the common stock on the date of the grant. Effective January 1, 2006, we adopted the provisions of SFAS 123 (revised 2004), *Share-Based Payment*, (SFAS 123R) using the modified-prospective-transition method. Under this transition method, compensation expense recognized during the six months ended June 30, 2006 included: (a) compensation expense for all share-based awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation expense for all share-based awards granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. In accordance with the modified-prospective-transition method, results for prior periods have not been restated. Additionally, in connection with the adoption of SFAS 123R we recognized a cumulative change in accounting principle of $2.0 million, net of tax, related to certain common stock purchase rights that were accounted for under the variable accounting method. The cumulative effect of the change in accounting principle of $3.2 million, gross of tax, was not material and therefore was included in selling, general and administrative expenses with the related tax effect of $1.2 million included in the provision for income taxes rather than displayed separately as a cumulative change in accounting principle in the consolidated statement of income. The adoption of SFAS 123R resulted in a charge of $7.4 million and $4.7 million to income before provision for income taxes and net income, respectively, for the six months ended June 30, 2006. The impact of adopting SFAS 123R on both basic and diluted earnings was $0.08 per share. See Note 7 for more information on the impact of SFAS 123R to our consolidated financial statements.

The calculation of share-based employee compensation expense involves estimates that require management s judgment. These estimates include the fair value of each of our stock option awards, which is estimated on the date of grant using a Black-Scholes option-pricing model. The fair value of our stock option awards, which are subject to graded vesting, is expensed separately for each vesting tranche over the vesting life of the options. Expected volatility is based on the historical volatility of our stock. The risk-free rate for periods within the contractual life of the option is based on the yield curve of a zero-coupon U.S. Treasury bond with a maturity equal to the expected term of the option granted. We use historical data to estimate stock option exercises and forfeitures within our valuation model. The expected term of stock option awards granted is derived from historical exercise experience under our share-based payment plan and represents the period of time that stock option awards granted are expected to be outstanding.

We believe that there have been no other significant changes to our critical accounting policies during the six months ended June 30, 2006 as compared to those we disclosed in Management s Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2005.

Recent Developments

On April 12, 2006, we issued $250.0 million of 81/4% Senior Notes due 2011. The net proceeds of $248.8 million were used to repay amounts outstanding under our revolving credit facility. These notes are

guaranteed, on a joint and several basis, by the Guarantor Subsidiaries, which are all of our material domestic subsidiaries, other than our mortgage and title subsidiaries (the Non-guarantor Subsidiaries). The senior notes rank *pari passu* in right of payment with all of our existing and future unsecured senior debt and senior in right of payment to our senior subordinated notes and any future subordinated debt. The indenture governing the senior notes requires us to maintain a minimum consolidated net worth and places certain restrictions on our ability, among other things, to incur additional debt, pay or declare dividends or other restricted payments, sell assets, enter into transactions with affiliates, and merge or consolidate with other entities. Interest on these notes is payable semi-annually.

Results of Operations Consolidated

Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005

Total revenues increased 8% to $677.0 million for the three months ended June 30, 2006, from $627.2 million for the three months ended June 30, 2005. This increase is attributable to an increase in Homebuilding revenues of 7%, and an increase in Financial Services revenues of 52%.

Income before provision for income taxes increased by 45% to $106.9 million for the three months ended June 30, 2006, from $73.4 million for the comparable period in 2005. This increase is primarily attributable to an increase in Homebuilding pretax income to $100.5 million for the three months ended June 30, 2006, from $71.0 million for the three months ended June 30, 2005.

Our effective tax rate was 36.8% and 37.8% for the three months ended June 30, 2006 and 2005, respectively. This change primarily is due to the impact of the American Jobs Creation Act of 2004 and a decrease in state income taxes resulting from a shift in income to states with lower tax rates.

As a result of the above, net income increased to $67.6 million (or $1.10 per diluted share) for the three months ended June 30, 2006 from $45.7 million (or $0.79 per diluted share) for the three months ended June 30, 2005.

Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005

Total revenues increased 12% to $1,306.5 million for the six months ended June 30, 2006, from $1,170.8 million for the six months ended June 30, 2005. This increase is attributable to an increase in Homebuilding revenues of 11%, and an increase in Financial Services revenues of 52%.

Income before provision for income taxes increased by 68% to $194.2 million for the six months ended June 30, 2006, from $115.6 million for the comparable period in 2005. This increase is primarily attributable to an increase in Homebuilding pretax income to $183.3 million for the six months ended June 30, 2006, from $111.9 million for the six months ended June 30, 2005.

Our effective tax rate was 36.9% and 37.7% for the six months ended June 30, 2006 and 2005, respectively. This change primarily is due to the impact of the American Jobs Creation Act of 2004 and a decrease in state income taxes resulting from a shift in income to states with lower tax rates.

As a result of the above, net income increased to $122.6 million (or $1.99 per diluted share) for the six months ended June 30, 2006 from $72.1 million (or $1.24 per diluted share) for the six months ended June 30, 2005.

Table of Contents

Selected Homebuilding Operations and Financial Data

The following tables set forth certain operating and financial data for our homebuilding operations in our four major geographic regions, Florida, the Mid-Atlantic, Texas, and the West (dollars in millions, except average price in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2006		2005		2006		2005	
Deliveries:	**Homes**	**$**	**Homes**	**$**	**Homes**	**$**	**Homes**	**$**
Consolidated:								
Florida	753	$ 278.9	760	$ 223.3	1,499	$ 544.9	1,517	$ 436.2
Mid-Atlantic	171	64.7	155	64.3	333	134.7	277	111.3
Texas	768	186.7	454	110.2	1,413	344.8	847	204.3
West	342	111.3	643	184.3	663	203.5	1,238	342.7
Consolidated total	2,034	641.6	2,012	582.1	3,908	1,227.9	3,879	1,094.5
Unconsolidated joint ventures:								
Florida	689	204.9			1,061	321.1		
Mid-Atlantic	28	8.3	32	9.6	88	25.8	47	13.8
West	473	175.2	171	55.5	936	343.7	297	89.6
Total unconsolidated joint ventures	1,190	388.4	203	65.1	2,085	690.6	344	103.4
Combined total	3,224	$ 1,030.0	2,215	$ 647.2	5,993	$ 1,918.5	4,223	$ 1,197.9

	Three Months Ended June 30,				Six Months Ended June 30,			
	2006		2005		2006		2005	
Net Sales Orders[1]:	**Homes**	**$**	**Homes**	**$**	**Homes**	**$**	**Homes**	**$**
Consolidated:								
Florida	624	$ 237.1	776	$ 261.3	1,250	$ 491.9	1,482	$ 514.9
Mid-Atlantic	175	70.2	205	89.5	334	137.4	396	173.4
Texas	825	208.7	735	190.7	1,643	411.9	1,424	356.5
West	222	78.8	983	310.0	776	270.7	1,818	584.6
Consolidated total	1,846	594.8	2,699	851.5	4,003	1,311.9	5,120	1,629.4
Unconsolidated joint ventures:								
Florida	86	46.4			120	68.4		
Mid-Atlantic	15	3.2	67	24.3	58	14.8	100	34.3
West	170	44.0	419	155.1	584	185.3	700	247.8
	271	93.6	486	179.4	762	268.5	800	282.1

Total unconsolidated joint ventures								
Combined total	2,117	$ 688.4	3,185	$ 1,030.9	4,765	$ 1,580.4	5,920	$ 1,911.5

(1) Net of cancellations

Sales Backlog:	June 30, 2006 Homes	$	Avg Price	June 30, 2005 Homes	$	Avg Price
Consolidated:						
Florida	2,688	$ 983.7	$ 366	2,861	$ 977.5	$ 342
Mid-Atlantic	247	97.3	$ 394	465	204.0	$ 439
Texas	1,468	386.6	$ 263	1,120	289.6	$ 259
West	964	371.0	$ 385	1,889	630.8	$ 334
Consolidated total	5,367	1,838.6	$ 343	6,335	2,101.9	$ 332
Unconsolidated joint ventures:						
Florida	2,173	642.9	$ 296	32	7.7	$ 242
Mid-Atlantic	62	20.3	$ 328	189	60.1	$ 318
West	1,191	427.1	$ 359	904	321.3	$ 355
Total unconsolidated joint ventures	3,426	1,090.3	$ 318	1,125	389.1	$ 346
Combined total	8,793	$ 2,928.9	$ 333	7,460	$ 2,491.0	$ 334

	Three Months Ended June 30,				Six Months Ended June 30,			
	2006		2005		2006		2005	
Average Price:	Deliveries	Sales Orders	Deliveries	Sales Orders	Deliveries	Sales Orders	Deliveries	Sales Orders
Consolidated:								
Florida	$ 370	$ 380	$ 294	$ 337	$ 364	$ 394	$ 288	$ 347
Mid-Atlantic	$ 378	$ 401	$ 415	$ 437	$ 405	$ 411	$ 402	$ 438
Texas	$ 243	$ 253	$ 243	$ 259	$ 244	$ 251	$ 241	$ 250
West	$ 325	$ 355	$ 287	$ 315	$ 307	$ 349	$ 277	$ 322
Consolidated total	$ 315	$ 322	$ 289	$ 316	$ 314	$ 328	$ 282	$ 318
Unconsolidated joint ventures:								
Florida	$ 297	$ 539			$ 303	$ 570		
Mid-Atlantic	$ 297	$ 218	$ 301	$ 362	$ 293	$ 255	$ 293	$ 344
West	$ 370	$ 259	$ 324	$ 370	$ 367	$ 317	$ 302	$ 354
Total unconsolidated joint ventures	$ 326	$ 345	$ 321	$ 369	$ 331	$ 352	$ 301	$ 353
Combined total	$ 319	$ 325	$ 292	$ 324	$ 320	$ 332	$ 284	$ 323

Table of Contents

The following table shows our approximate homesite inventory by region and in total for the periods indicated:

Land Supply	**June 30, 2006**	**December 31, 2005**
Consolidated:		
Florida	20,300	20,100