MERITAGE CORP
Form 8-K/A
July 02, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

Amendment No. 3 to

FORM 8-K/A

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

Date of report (Date of earliest event reported): July 12, 2002

MERITAGE CORPORATION

(Exact Name of Registrant as Specified in Charter)

Maryland	I-9977	86-0611231
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

8501 East Princess Drive, Suite 290, Scottsdale, Arizona

(Address of Principal Executive Offices) 85255

(Zip Code)

(480) 609-3330

(Registrant s telephone number, including area code)
Not applicable

(Former Name or Former Address, if Changed Since Last Report)

Item 2. ACQUISITION OR DISPOSITION OF ASSETS

This Amendment No. 3 to Form 8-K/A (Amendment No. 3) amends the Current Report on Form 8-K dated July 12, 2002.

On July 15, 2002, we filed a Form 8-K (the Original Filing) to report the acquisition of substantially all of the homebuilding and related assets of Hammonds Homes, Ltd., a Texas limited partnership and Crystal City Land & Cattle, Ltd., a Texas limited partnership (collectively, Hammonds Homes or Hammonds).

On September 11, 2002, we filed an amendment to the Form 8-K (Amendment No. 1) to include the financial statements of the business acquired, including unaudited pro forma combined financial statements giving effect to the acquisition of Hammonds.

On June 12, 2003, we filed an amendment to the Form 8-K (Amendment No. 2) to provide footnote information which had been inadvertently omitted from the unaudited pro forma combined statement of earnings for the year ended December 31, 2001 and the interim period ended June 30, 2002.

We are filing this Amendment No. 3 to provide:

- The unaudited interim financial statements for Hammonds Homes, Ltd. and Crystal City Land & Cattle, Ltd. for the six months ended June 30, 2002.
- The updated pro forma combined statement of earnings for the twelve months ended December 31, 2002.

No changes have been made to the audited financial statements of the business acquired which are contained in Item 7(a).

FORWARD LOOKING STATEMENTS

Certain matters discussed in this current report are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are based upon the current beliefs and expectations of our management and are subject to significant risks and uncertainties. Actual results may differ from those set forth in the forward-looking statements.

With respect to the Hammonds Homes acquisition, these uncertainties include: the risks that the businesses will not be integrated successfully; that Hammonds may not perform as well in the future as in previous years; that the market and financial synergies anticipated from the acquisition may not be fully realized or may take longer to realize than expected; that the acquisition will not be accretive to earnings within the time period estimated by us, or at all; that unanticipated expenses and liabilities may be incurred; and that the combined companies may lose key employees or suppliers.

In addition, our business is also subject to a number of risks and uncertainties including: the strength and competitive pricing environment of the single-family housing market; changes in the availability and pricing of residential mortgages; changes in the availability and pricing of real estate in the markets in which we operate; our level of indebtedness; demand for and acceptance of our homes; the success of planned marketing and promotional campaigns; the success of our program to integrate existing operations with our planned new operations or those of past or future acquisitions; our ability to raise additional capital; our success in locating and negotiating favorably with other possible acquisition candidates; recent legislative or other initiatives that seek to restrain growth in new housing construction or similar measures; the economic impact of foreign hostilities or military action; general economic slowdowns; and other factors identified in documents filed by us with the Securities and Exchange Commission, including those set forth in Meritage s Form 10-K Report for the year ended December 31, 2002 under the captions Market for the Registrant s Common Stock and Related Stockholder Matters Factors that May Affect Future Stock Performance and Management s Discussion and Analysis of Financial Condition and Results of Operations Factors that May Affect Our Future Results and Financial Condition and in Exhibit 99.4 of Meritage s Form 10-Q for the quarter ended March 31, 2003. As a result of these and other factors, Meritage s stock and note prices may fluctuate dramatically.

Item 7. FINANCIAL STATEMENTS, PRO FORMA FINANCIAL INFORMATION AND EXHIBITS

EXPLANATORY NOTE

The following financial statements of business acquired are being amended and restated in their entirety to provide (i) the unaudited interim financial statements of Hammonds Homes, Ltd. for the six months ended June 30, 2002 and (ii) the unaudited financial statements of Crystal City Land & Cattle, Ltd. for the six months ended June 30, 2002.

No changes have been made to the audited financial statements contained herein.

(a) Financial Statements of Business Acquired.

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Independent Auditors Report

To the Partners
Hammonds Homes, Ltd.

We have audited the consolidated balance sheets of Hammonds Homes, Ltd. and Subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of income and partners capital and cash flows for each of the years in the three year period ended December 31, 2001. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hammonds Homes, Ltd. and Subsidiaries as of December 31, 2001 and 2000, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America.

/s/ Kolkhorst & Kolkhorst

Houston, Texas
March 25, 2002

HAMMONDS HOMES, LTD. AND SUBSIDIARIES

Consolidated Balance Sheets

	December 31	
	2001	2000
Assets		
Inventory	$53,542,220	$59,327,921
Cash and cash equivalents	14,269,666	5,511,149
Property and equipment	1,791,843	1,682,158
Land	989,720	7,102,380
Receivable from title and mortgage companies	2,119,405	3,456,798
Receivable from employees	18,778	14,774
Receivable from affiliates	883,555	
Prepaid expenses and other assets	2,114,850	1,289,821
Investments in joint ventures	735,122	576,886
	$76,465,159	$78,961,887
Liabilities and partners capital		
Liabilities:		
Construction loans payable	$44,545,580	$46,861,779
Development loans	440,000	4,716,828
Accounts payable and accrued liabilities	10,904,288	12,018,368
Accounts payable to related party	636,409	1,593,176

Total liabilities	56,526,277	65,190,151
Commitments and contingencies		
Partners capital	19,938,882	13,771,736
	$76,465,159	$78,961,887

See independent auditor s report and accompanying notes to the financial statements.

HAMMONDS HOMES, LTD. AND SUBSIDIARIES

Consolidated Statements of Income and Partners Capital

	Year ended December 31		
	2001	2000	1999
Revenue			
Sale of houses	$179,808,377	$136,022,574	$108,068,747
Sale of land and lots	445,179	745,115	2,161,200
	180,253,556	136,767,689	110,229,947
Cost of houses sold	(149,574,800)	(115,711,708)	(93,542,095)
Cost of land and lots sold	(47,777)	(704,930)	(2,046,751)
	(149,622,577)	(116,416,638)	(95,588,846)
Sale of houses gross profit	30,233,577	20,310,866	14,526,652
Sale of land and lots gross profit	397,402	40,185	114,449
Gross profit	30,630,979	20,351,051	14,641,101
Other income	1,283,738	917,020	543,068

	31,914,717	21,268,071	15,184,169
Operating expenses			
Sales and marketing	5,745,211	4,054,577	2,837,876
General and administrative	7,513,102	5,849,351	4,248,190
Interest	1,420,138	1,360,868	582,425
	14,678,451	11,264,796	7,668,491
Net income before state income taxes	17,236,266	10,003,275	7,515,678
Provision for state income taxes			201,000
Net Income	17,236,266	10,003,275	7,314,678
Retained earnings-subsidiaries-beginning			4,831

Partners Capital-beginning	13,771,736	9,647,692	7,038,670
Distributions	(11,069,120)	(5,879,231)	(4,710,484)
Partners capital	$19,938,882	$13,771,736	$9,647,692

See independent auditor s report and accompanying notes to the financial statements.

HAMMONDS HOMES, LTD. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

	Year ended December 31	
2001	2000	1999

Operating activities

Net income
$17,236,266 $10,003,275 $7,314,678

Adjustments to reconcile net income to net cash used in operating activities:

Depreciation and amortization
1,014,885 735,285 507,309

Changes in operating assets and liabilities:

Inventory of houses and land
7,789,517 (18,248,199) (11,222,350)

Receivables from title and mortgage companies
804,629 (2,607,153) 175,895

Receivables from employees
(4,004) 31,377 17,834

Receivables from affiliates
886,699

Prepaid expenses and other assets
(840,029) (114,680) (68,627)

Investments in joint venture
(158,236) (576,886)

Accounts payable and accrued liabilities
(161,616) 5,598,715 (1,187)

Accounts payable to related party
(956,767) 995,000 (44,921)

State income taxes payable
(231,446) (50,715)

Net cash provided by (used in) operating activities
25,611,344 (4,414,712) (3,372,084)

Investing activities

Purchase of property and equipment	(1,124,571)	(1,363,979)	(767,803)
Net cash used in investing activities	(1,124,571)	(1,363,979)	(767,803)
Financing activities			
Proceeds from advances on construction and development loans	41,265,783	108,650,655	81,955,153
Principal payments on construction and development loans	(45,924,919)	(93,671,646)	(72,844,392)
Partners distributions	(11,069,120)	(5,879,231)	(4,710,487)
Net cash provided by (used in) financing activities	(15,728,256)	9,099,778	4,400,274
Net increase in cash and cash equivalents	8,758,517	3,321,087	260,387
Cash and cash equivalents at beginning of year	5,511,149	2,190,062	1,929,675

Cash and cash equivalents at end of year	$14,269,666	$ 5,511,149	$2,190,062
Supplemental disclosure of cash flow information			
Cash paid for:			
Interest	$4,691,343	$4,970,843	$3,266,347
Income taxes	$	$	$251,714

See independent auditor s report and accompanying notes to the financial statements.

HAMMONDS HOMES, LTD. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation The consolidated financial statements include the accounts of Hammonds Homes, Ltd. (the Company), and its wholly-owned subsidiaries, R. H. Development Company, Inc., and R. H. Development/Park West CC, Inc. for the year ended December 31, 2000. All intercompany accounts and transactions have been eliminated in consolidation. R.H. Development Company, Inc. was incorporated in the State of Texas in 1997. R.H. Development/Park West CC, Inc., was incorporated in the State of Texas in 1999.

In August 2001, R.H. Development Company, Inc. and R.H. Development/Park West CC, Inc. were converted to limited partnerships. The net assets of these subsidiaries were distributed and contributed to the new partnerships. The new partnerships are controlled by the majority partner of Hammonds Homes, Ltd.

The 2001 financial statements of the company include the activity of its subsidiaries for the eight months through August 31, 2001. At December 31, 2001 the balance sheet of the company does not include any of the accounts of its former subsidiaries.

Organization Hammonds Homes, Inc., incorporated in Texas in 1987, was wholly-owned by a single stockholder. During 1999, Hammonds Homes, Inc., converted to a Texas limited partnership, Hammonds Homes, Ltd. Hammonds Homes Ltd., continues to be engaged in the construction and sale of single family homes in Houston, Dallas, and Austin, Texas.

Critical Accounting Policies and Estimates The preparation of the consolidated financial statements required management to make a number of estimates and assumptions that affect the reported amounts and disclosures in the consolidated financial statements. On an ongoing basis, management evaluates these estimates and assumptions based upon historical experience and various other factors and circumstances. Management believes that these estimates and assumptions are reasonable in the circumstances; however, actual results may differ from these estimates and assumptions under different future conditions.

The accounting policies that management deems most critical and involve the most difficult, subjective or complex judgments, include estimates of costs to complete individual developments, the ultimate recoverability (or impairment) of these costs, the likelihood of closing lots held under option or contract and the ability to estimate expenses and accruals, including legal and warranty reserves. Should management under or over estimate costs to complete individual projects, gross margins in a particular period could be misstated and the ultimate recoverability of costs related to a project from individual home sales may be uncertain. Furthermore, non-refundable deposits paid for land options or contracts may have no economic value to us if the land is not ultimately purchased. Finally, the inability to accurately estimate expenses or accruals could result in charges or income in the future results of operations related to activities or transactions in a preceding period.

HAMMONDS HOMES, LTD. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue Recognition Revenue from sales of houses is recognized at the time of closing, when sufficient down payment has been received, any financing has been arranged, title, possession, and other attributes of ownership have been transferred to the buyer, and the Company is not obligated to perform additional significant activities related to the sale.

Estimated future warranty costs are charged to cost of sales in the period when the revenues from related home closings are recognized. These estimated warranty costs are approximately $500 per home.

Inventory Real estate inventories include land acquisition costs, construction costs, and related indirect costs and expenditures. Interest on indebtedness and real estate taxes are capitalized until substantial completion of construction. Cost of sales is determined by lot with specific identification of land, direct construction and closing costs, and an allocation of indirect construction costs.

Property and Equipment Property and equipment, consisting principally of model home furnishings, sales office fixtures, and computer equipment, are carried at cost and depreciated using the straight-line method over estimated useful lives ranging from two to five years.

Receivables From Title and Mortgage Companies Receivables from title and mortgage companies consist of sales proceeds due from houses sold and closed but not yet funded.

Cash Equivalents The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Use of Estimates The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities at the balance sheet dates and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

HAMMONDS HOMES, LTD. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B INVENTORY

Inventory at December 31, 2001 and 2000 consists of the following:

	2001		2000	
	# of Units	Amount	# of Units	Amount
Lots	159	$5,875,995	170	$5,252,796
Houses completed:				
Under contract for sale	23	3,211,314	28	3,648,690
Unsold	42	6,217,475	39	5,313,819
Model homes	36	5,059,353	41	6,315,023
Houses under construction:				
Under contract for sale	222	20,994,942	350	26,618,482
Unsold	131	12,183,141	167	12,179,111
Total	613	$53,542,220	795	$59,327,921

A summary of interest for the years ended December 31, 2001 and 2000 is as follows:

	2001	2000
Interest capitalized at beginning of year	$1,518,213	$1,036,714
Interest incurred	4,691,343	4,970,843
Interest expensed	(1,420,138)	(1,360,868)
Interest included in cost of houses sold	(3,685,215)	(3,128,476)
Interest capitalized at end of year	$1,104,203	$1,518,213

NOTE C PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2001 and 2000 consist of the following:

	2001	2000
Model home furnishings	$4,065,719	$3,261,375
Sales office fixtures	1,132,514	933,462
Computer equipment	720,880	511,344
Office furniture and other	399,152	498,094
Construction trailers	70,202	70,202
Leasehold improvements	96,755	86,173
	6,485,222	5,360,650
Less accumulated depreciation and amortization	(4,693,379)	(3,678,492)

$1,791,843	$1,682,158

HAMMONDS HOMES, LTD. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE D CONSTRUCTION AND DEVELOPMENT LOANS PAYABLE

Construction loans payable to financial institutions at December 31, 2001 and 2000 are collateralized by inventory. The construction loans are payable by Hammonds Homes, Ltd. R.H. Development Company, Inc. and R.H Development/Park West CC. Inc. have no liability for these loans. The interest on all loans is payable monthly and bears interest as follows:.

Interest rate	2001	2000
Prime rate	$19,720,778	$15,101,784
Prime rate plus .25%	14,548,974	27,609,195
Prime rate plus .75%	2,258,529	3,885,222
30-day Libor plus 2.90%	7,871,799	265,578
	$44,400,080	$46,861,779
Unsecured note, prime plus .50%	145,500	
	$44,545,580	$46,861,779

The Company believes carrying amounts of its construction loans payable approximate their fair value.

Development loans payable to financial institutions at December 31, 2001 and 2000 are collateralized by land held for future development by the Company. The loans bear interest at prime at December 31, 2001 and prime to prime plus 3% at December 31, 2000. The loans will be repaid as lots are developed and sold. The development loans are payable by Hammonds Homes, Ltd., at December 31, 2001 and by R.H. Development Company, Inc. and R.H. Development/Park West CC, Inc. at December 31, 2000.

At December 31, 2001 and 2000, the Company had unused lines of credit, subject to the terms of the related loan documents, aggregating $65,678,957 and $16,939,598, respectively. These lines of credit are generally available for one year.

At the time of the initial loan draw for a house, the Company usually pays a loan fee for the individual loan amount. Construction loans are generally repaid as individual units are sold and closed. Construction loans mature within 6 to 12 months or, at the discretion of the lender, are extended.

Certain of the Company s loan agreements require, among other things, that the Company maintain minimum net worth, limit distributions, and retain certain percentages of net income.

HAMMONDS HOMES, LTD. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE E FEDERAL AND STATE INCOME TAXES

The stockholder of the Company had elected under Subchapter S of the Internal Revenue Code to include the Company s income in his own income for federal income tax purposes through 1998. As a result of the conversion of the Company to a limited partnership as described in Note A, the Partnership has elected, under Internal Revenue Service Regulations, to continue under Subchapter S of the Internal Revenue Code to include the Company s income in the partners federal income tax return. As a result, the Company is not generally subject to federal income taxes.

The Company was subject to Texas state franchise taxes through August 1999. As a result of the conversion of the Company to a limited partnership, the Company will no longer be subject to a Texas franchise tax.

There are no significant temporary differences between income for financial reporting purposes and income calculated for income tax purposes.

NOTE F COMMITMENTS AND CONTINGENCIES

The Company s contingent liabilities include warranty obligations and disputes arising in the ordinary course of business, which management believes will not have a material adverse effect on the Company s financial position.

In the ordinary course of business, the Company enters into lot option contracts. At December 31, 2001, the Company had nonrefundable deposits aggregating $1,836,462 for the purchase of lots relating to these contracts. The Company s liability for nonperformance under these lot option contracts is limited to forfeiture of the deposits.

At December 31, 2001, future minimum payments under noncancelable operating leases are as follows:

December 31	
2002	$219,694
2003	70,133
Thereafter	-0-
	$289,827

Rental expense for the years ended December 31, 2001, 2000, and 1999 aggregated $264,731, $248,416, and $176,962, respectively.

HAMMONDS HOMES, LTD. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE G RELATED PARTY TRANSACTIONS

During the year ending December 31, 2001, the Company purchased approximately $540,429 of lots from a company in which the majority partner of Hammonds Homes, Ltd. has a 50% interest.

Receivables from affiliates consist of amounts due to the Company from limited partnerships, described in Note A, that are controlled by the sole owner of the Company. Receivables for 2001 are $883,555 and are advances made to the Partnership for land development.

Accounts payable to related party consist of amounts due the partner of the Company. Related party payables for 2001 and 2000 are $636,409 and $1,593,176 respectively.

NOTE H 401(k) PLAN

The Company has a 401(k) plan that covers all qualified employees. Contributions to the plan are at the discretion of the Board of Directors. There were no contributions made for 2001, 2000, or 1999.

NOTE I JOINT VENTURES

The Company has invested in several joint ventures, which are accounted for using the equity method of accounting, that are in the business of land development, homebuilding and originating and selling residential mortgage loans. Income from these joint ventures for the years ended December 31, 2001, 2000, and 1999 aggregated $615,079, $330,034, and $242,176, respectively and is included in other income.

Independent Auditors Report

To the Partners
Crystal City Land & Cattle, Ltd.

We have audited the consolidated balance sheet of Crystal City Land & Cattle, Ltd. and Subsidiaries as of December 31, 2001, and the related consolidated statements of income and partners capital and cash flows from August 23, 2001 (date of inception) to December 31, 2001. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Crystal City Land & Cattle, Ltd. and Subsidiaries as of December 31, 2001, and the results of its operations and its cash flows from August 23, 2001 (date of inception) to December 31, 2001 in conformity with accounting principles generally accepted in the United States of America.

/s/ Kolkhorst & Kolkhorst

Houston, Texas
March 25, 2002

CRYSTAL CITY LAND AND CATTLE, LTD. AND SUBSIDIARIES

Consolidated Balance Sheet

December 31, 2001

Assets	
Inventory	$3,172,550
Cash and cash equivalents	1,134,279
Deposits	227,611
Land and land development costs	1,584,825
Reimbursable costs	350,000
Other assets	7,146
	$6,476,411
Liabilities and partners capital	
Liabilities	
Development loans	$1,958,720
Accounts payable and accrued liabilities	735,480
Due to affiliates	883,555
Total liabilities	3,577,755
Commitments and contingencies	
Partners capital	

2,898,656
$6,476,411

See independent auditor s report and accompanying notes to the financial statements.

CRYSTAL CITY LAND & CATTLE, LTD. AND SUBSIDIARIES

Consolidated Statement of Income and Partners Capital

From August 23, 2001 (date of inception) to December 31, 2001

Revenue	
Sale of land and lots	$829,426
Cost of land and lots sold	(645,849)
Gross profit	183,577
Other income	512
	184,089
Operating expenses	
Interest	53,449
General and administrative	133,954
	187,403
Net income (loss)	(3,314)
Partners Capital-contributed	2,901,970
Distributions	

Partners capital	$2,898,656

See independent auditor s report and accompanying notes to the financial statements.

CRYSTAL CITY LAND & CATTLE, LTD. AND SUBSIDIARIES

Consolidated Statement of Cash Flows

From August 23, 2001 (date of inception) to December 31, 2001

Operating activities	
Net income (loss)	$(3,314)
Adjustments to reconcile net income to net cash used in operating activities:	
Changes in operating assets and liabilities	
Inventory and land and development costs	(4,757,375)
Deposits	(227,611)
Reimbursable costs	(350,000)
Other assets	(7,146)
Accounts payable and accrued liabilities	1,619,035
Net cash used in operating activities	(3,726,411)
Financing activities	
Proceeds from advances on construction and development loans	1,958,720
Partners contributions	2,901,970
Net cash provided by financing activities	4,860,690

Net increase in cash and cash equivalents	1,134,279
Cash and cash equivalents at beginning of year	
Cash and cash equivalents at end of year	$1,134,279
Supplemental disclosure of cash flow information	
Cash paid for	
Interest	$338,902

See independent auditor s report and accompanying notes to the financial statements.

CRYSTAL CITY LAND & CATTLE, LTD. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation The consolidated financial statements include the accounts of Crystal City Land & Cattle, Ltd. (the Company), and its subsidiaries, CCLC Development, LLC, R.H. Development/Park West CC, Ltd., R.H. Development Company, Ltd., Avery R. Development Ltd., Gleannloch Lot, Ltd., and Ashford Lot Development, Ltd. All intercompany accounts and transactions have been eliminated in consolidation. CCLC Development, LLC became a limited liability company in the State of Texas in 2001. R.H. Development Company, Ltd. became a partnership in the state of Texas September 1, 2001. R.H. Development/Park West CC Company, Ltd. became a partnership in the State of Texas September 1, 2001. Gleannloch Lot, Ltd. became a partnership in the State of Texas in 2001. Avery R. Development Ltd. became a partnership in the State of Texas in 2001. Ashford Lot Development, Ltd. became a partnership in the State of Texas in 2001.

Organization Crystal City Land & Cattle, Ltd. became a limited partnership in Texas in 2001. The company is engaged in the business of real estate development in Houston, Dallas, and Austin, Texas.

Revenue Recognition Revenue from sales of lots is recognized at the time of closing, when sufficient down payment has been received, any financing has been arranged, title, possession, and other attributes of ownership have been transferred to the buyer, and the Company is not obligated to perform additional significant activities related to the sale.

Inventory Real estate inventories include land acquisition costs, construction costs, and related indirect costs and expenditures. Interest on indebtedness and real estate taxes are capitalized until substantial completion of development. Cost of sales is determined by lot with specific identification of land and closing costs.

Reimbursable Costs Reimbursable costs consist of funds due the company for development costs incurred.

Cash Equivalents The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Use of Estimates The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities at the balance sheet dates and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

CRYSTAL CITY LAND & CATTLE, LTD. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B INVENTORY AND LAND AND LAND DEVELOPMENT COSTS

Inventory at December 31, 2001 consists of fully developed lots ready for sale. Land and land development costs at December 31, 2001 consists of land being developed and land being held for future development.

A summary of interest for the period ended December 31, 2001 is as follows:

Interest incurred	$338,902
Interest expensed	(53,449)
Interest included in cost of land and lots sold	(281,506)
Interest capitalized at end of year	$3,947

NOTE C DEVELOPMENT LOANS PAYABLE

Development loans payable to financial institutions at December 31, 2001 are collateralized by land held for future development by the Company. The loans bear interest at 8%, prime plus .75%, and at prime plus 3% and is payable monthly. The loans will be repaid as lots are developed and sold. The development loans are payable by R.H. Development Company, Ltd., R.H Development/Park West CC, Ltd. and Ashford Lot Development, Ltd.

At December 31, 2001, the Company had unused lines of credit, subject to the terms of the related loan documents, aggregating $1,783,804. These lines of credit are generally available for one year.

Certain of the Company s loan agreements require, among other things, that the Company maintain minimum net worth, limit distributions, and retain certain percentages of net income.

The Company believes carrying amounts of its development loans payable approximate their fair value.

NOTE D FEDERAL AND STATE INCOME TAXES

Federal income taxes are not payable by, or provided for, the Partnership. All tax effects of the Partnership s income or loss are passed through to the partners.

The Company is not subject to a Texas franchise tax.

There are no significant temporary differences between income for financial reporting purposes and income calculated for income tax purposes.

CRYSTAL CITY LAND & CATTLE, LTD. AND SUBSIDIARIES

Notes To Consolidated Financial Statements

NOTE E   COMMITMENTS AND CONTINGENCIES

The Company s contingent liabilities include obligations and disputes arising in the ordinary course of business which management believes will not have a material adverse effect on the Company s financial position.

In the ordinary course of business, the Company enters into option contracts. At December 31, 2001, the Company had nonrefundable deposits aggregating $227,611 for the purchase of land relating to these contracts. The Company s liability for nonperformance under these option contracts is limited to forfeiture of the deposits.

NOTE F   RELATED PARTY TRANSACTIONS

During the period ending December 31, 2001, $341,065 of lots were sold to an affiliated company, which is included in sales of land and lots.

In addition, the Company owes its affiliate company $883,555 for advances made to the Company for expenses relating to land development.

HAMMONDS HOMES, LTD. AND SUBSIDIARIES
AND CRYSTAL CITY LAND & CATTLE, LTD. AND SUBSIDIARIES

Combined Balance Sheets
(dollars in thousands)

	At June 30, 2002				At December 31, 2001			
	Hammonds	Crystal City	Intercompany Eliminations	Combined Hammonds & Crystal City	Hammonds	Crystal City	Intercompany Eliminations	Combined Hammonds & Crystal City
	(Unaudited)							
Assets								
Inventory	$59,897	$2,917	$	$62,814	$54,532	$4,757	$	$59,289
Cash and cash equivalents	10,053	2,070		12,123	14,270	1,134		15,404
Deposits on real estate	2,941	228		3,169		228		228
Other receivables	5,178	1,043	(1,373)	4,848	3,021	350	(884)	2,487
Property and Equipment	2,420			2,420	1,792			1,792
Other assets	702			702	2,850	7		2,857
	$81,191	$6,258	$(1,373)	$86,076	$76,465	$6,476	$(884)	$82,057

Liabilities								
Accounts payable and accrued expenses	$9,330	$1,905	$(1,373)	$9,862	$10,904	$1,619	$(884)	$11,639
Home sale deposits	2,011			2,011				
Revolving credit facilities	49,960	1,061		51,021	44,986	1,959		46,945
Other liabilities					636			636
Total liabilities	61,301	2,966	(1,373)	62,894	56,526	3,578	(884)	59,220
Partners capital	19,890	3,292		23,182	19,939	2,898		22,837

$81,191	$6,258	$(1,373)	$86,076	$76,465	$6,476	$(884)	$82,057

See accompanying notes to financial statements.

HAMMONDS HOMES, LTD. AND SUBSIDIARIES
AND CRYSTAL CITY LAND & CATTLE, LTD. AND SUBSIDIARIES

Unaudited Combined Statements of Income
Six Month Period Ended June 30, 2002 and 2001

	Six Months Ended June 30,				
	2002				2001(1)
	Hammonds	Crystal City	Intercompany Eliminations	Combined Hammonds & Crystal City	Combined Hammonds & Crystal City
Revenue					
Home and land sales revenue	$79,015	$3,043	$(2,887)	$79,171	$84,959
Cost of home and land sales	62,708	2,115	(2,376)	62,447	68,461
Gross profit	16,307	928	(511)	16,724	16,498
Selling, general and administrative	11,425	534		11,959	8,733
Net income	$4,882	$394	$(511)	$4,765	$7,765

(1) Crystal City was consolidated with Hammonds until August 2001.

See accompanying notes to financial statements.

HAMMONDS HOMES LTD. AND SUBSIDIARIES AND
CRYSTAL CITY LAND & CATTLE, LTD. AND SUBSIDIARIES

Unaudited Combined Statements of Cash Flows
Six Months Ended June 30, 2002 and 2001

(Dollars in thousands)

	Six Months Ended June 30,				
	2002				2001(1)
	Hammonds	Crystal City	Intercompany Eliminations	Combined Hammonds & Crystal City	
Cash flows from operating activities:					
Net Income	$4,892	$ 394	$ (511)	$ 4,765	$7,794
Adjustment to reconcile net income to net cash provided by (used in) operating activities:					