

BEAZER HOMES USA INC  
Form 10-Q/A  
May 12, 2008

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

FORM 10-Q/A

Amendment No. 1

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

For the Quarterly Period Ended December 31, 2006  
or

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

Commission File Number 001-12822

BEAZER HOMES USA, INC.  
(Exact name of registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of  
incorporation or organization)

58-2086934  
(I.R.S. employer  
Identification no.)

1000 Abernathy Road, Suite 1200, Atlanta, Georgia 30328  
(Address of principal executive offices)(Zip Code)  
(770) 829-3700

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to the filing requirements for the past 90 days.

YES      o      NO      x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check One):

Large accelerated filer x      Accelerated filer    o      Non-accelerated filer    o      Smaller reporting    o  
company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES      o      NO      x

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Class

Outstanding at April 25,  
2008

Common Stock, \$0.001 par value

39,234,305 shares

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References to “we,” “us,” “our,” “Beazer”, “Beazer Homes” and the “Company” in this quarterly report on Form 10-Q/A refer to Beazer Homes USA, Inc.

## EXPLANATORY NOTE

### Restatement of Consolidated Financial Results

In April 2007, the Audit Committee of the Board of Directors initiated an independent investigation of our mortgage origination business through independent legal counsel and independent forensic accountants. During the course of this investigation, the Audit Committee determined that our mortgage origination practices related to certain loans in prior periods violated certain applicable federal and/or state origination requirements. During the course of the investigation, the Audit Committee also discovered accounting and financial reporting errors and/or irregularities that required restatement resulting primarily from (1) inappropriate accumulation of reserves and/or accrued liabilities associated with land development and house costs (“Inventory Reserves”) and the subsequent improper release of such reserves and accrued liabilities and (2) inaccurate revenue recognition with respect to certain model home sale-leaseback transactions. In conjunction with the restatement of the items above, we also made corresponding capitalized interest, capitalized indirect costs and income tax adjustments to our unaudited condensed consolidated financial statements as these balances were impacted by the aforementioned adjustments. We also made other adjustments to our unaudited condensed consolidated financial statements relating to corrections of accounting and financial reporting errors and/or irregularities, some errors previously identified, but historically not considered to be material to require correction, and some errors and irregularities discovered as part of the restatement process, consisting of (1) reclassifying model home furnishings and sales office leasehold improvements from owned inventory to property, plant and equipment, net in the amounts of \$50.5 million at December 31, 2006 and \$47.0 million at September 30, 2006; (2) reclassifying depreciation and amortization of model home furnishings and sales office leasehold improvements from home construction and land sales expenses to depreciation and amortization in the amount of \$5.0 million and \$6.6 million for the quarters ended December 31, 2006 and 2005, respectively; (3) recognizing total revenue (\$4.5 million) and home construction and land sales expenses (\$3.2 million) for the three months ended December 31, 2005 related to inappropriate revenue recognition timing in the 2005 fiscal year and the fiscal 2006 first and second quarters for certain home closings in California; (4) reclassifying the results of operations from our title services from other income, net (\$1.6 million) to total revenue (\$2.3 million) and selling, general and administrative (“SG&A”) expenses (\$0.7 million) for the quarter ended December 31, 2005; (5) reclassifying \$5.0 million from restricted cash at September 30, 2006 to cash and cash equivalents as such amount was determined not to be restricted; (6) increasing inventory impairment charges by \$20.4 million for the quarter ended December 31, 2006 for the impact on inventory balances as a result of the aforementioned inventory adjustments and the correction of certain capitalized interest and indirect cost inputs into the cash flow models used to assess and calculate the inventory impairments; (7) certain other miscellaneous immaterial adjustments; and (8) the related tax effects of the adjustments described in (1) through (7) above.

As discussed in Note 12 to the accompanying unaudited condensed consolidated financial statements in this Quarterly Report on Form 10-Q/A for the quarter ended December 31, 2006, we have restated our unaudited condensed consolidated financial statements and the related disclosures for the quarters ended December 31, 2006 and 2005 and as of December 31, 2006 and September 30, 2006. Specifically, we have restated our unaudited condensed consolidated balance sheets as of December 31, 2006 and September 30, 2006 and the related unaudited condensed consolidated statements of operations and cash flows, including related disclosures, for the quarters ended December 31, 2006 and 2005. In addition, we have updated the disclosures contained herein to reflect events that occurred after the date of the filing of the original Form 10-Q on January 26, 2007. The accompanying Management’s Discussion and Analysis of Financial Condition and Results of Operations in Part I, Item 2, has been updated to reflect the effects of the restatement. Further, the Management’s Discussion and Analysis of Financial Condition and Results of Operations has been updated to include matters related to investigations and litigation, debt, our outlook and long-term business strategy and recent accounting pronouncements for events subsequent to the date we filed the

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Form 10-Q for the quarter ended December 31, 2006.

We are concurrently filing our Annual Report on Form 10-K for the fiscal year ended September 30, 2007, the Quarterly Report on Form 10-Q/A for the fiscal quarter ended March 31, 2007 and the Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2007 with this December 31, 2006 Form 10-Q/A, all of which contain restated financial statements for the comparative periods of fiscal 2007, 2006 and 2005, as applicable.

For additional discussion of the Audit Committee's investigation, the accounting errors and irregularities identified, and the adjustments made as a result of the restatements, see Notes 8 and 12 to the Unaudited Condensed Consolidated Financial Statements. For a description of the material weaknesses identified by management as a result of the investigation and our internal reviews, and management's plan to remediate those material weaknesses, see Part I, Item 4 – Controls and Procedures.

Pursuant to the rules of the Securities and Exchange Commission ("SEC"), Part II, Item 6 has been amended to contain currently dated certifications for our principal executive officer and principal financial officer, as required by Sections 302 and 906 of the Sarbanes Oxley Act of 2002. The certifications are attached to this Form 10-Q/A as Exhibits 31.1, 31.2, 32.1 and 32.2.

## FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q/A contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements represent our expectations or beliefs concerning future events, and it is possible that the results described in this quarterly report will not be achieved. These forward-looking statements can generally be identified by the use of statements that include words such as “estimate,” “project,” “believe,” “expect,” “anticipate,” “intend,” “plan,” “foresee,” “likely,” “will,” “goal,” “target” or other phrases. All forward-looking statements are based upon information available to us on the date of this quarterly report.

These forward-looking statements are subject to risks, uncertainties and other factors, many of which are outside of our control, that could cause actual results to differ materially from the results discussed in the forward-looking statements, including, among other things, the matters discussed in this quarterly report in the section captioned “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Additional information about factors that could lead to material changes in performance is contained in Part I, Item 1A– Risk Factors of our Annual Report on Form 10-K for the fiscal year ended September 30, 2007 filed concurrently with this report. Such factors may include:

- the timing and final outcome of the United States Attorney investigation, the Securities and Exchange Commission’s (“SEC”) investigation and other state and federal agency investigations, the putative class action lawsuits, the derivative claims, multi-party suits and similar proceedings as well as the results of any other litigation or government proceedings;

- material weaknesses in our internal control over financial reporting;

- additional asset impairment charges or writedowns;

- economic changes nationally or in local markets, including changes in consumer confidence, volatility of mortgage interest rates and inflation;

- continued or increased downturn in the homebuilding industry;

- estimates related to homes to be delivered in the future (backlog) are imprecise as they are subject to various cancellation risks which cannot be fully controlled;

- continued or increased disruption in the availability of mortgage financing;

- our cost of and ability to access capital and otherwise meet our ongoing liquidity needs including the impact of any further downgrades of our credit ratings;

- potential inability to comply with covenants in our debt agreements;

- continued negative publicity;

- increased competition or delays in reacting to changing consumer preference in home design;

- shortages of or increased prices for labor, land or raw materials used in housing production;

- factors affecting margins such as decreased land values underlying land option agreements, increased land development costs on projects under development or delays or difficulties in implementing initiatives to

reduce production and overhead cost structure;

the performance of our joint ventures and our joint venture partners;

the impact of construction defect and home warranty claims and the cost and availability of insurance, including the availability of insurance for the presence of moisture intrusion;

a material failure on the part of our subsidiary Trinity Homes LLC to satisfy the conditions of the class action settlement agreement, including assessment and remediation with respect to moisture intrusion related issues;

delays in land development or home construction resulting from adverse weather conditions;

potential delays or increased costs in obtaining necessary permits as a result of changes to, or complying with, laws, regulations, or governmental policies and possible penalties for failure to comply with such laws, regulations and governmental policies;

effects of changes in accounting policies, standards, guidelines or principles; or

terrorist acts, acts of war and other factors over which the Company has little or no control.

Any forward-looking statement speaks only as of the date on which such statement is made, and, except as required by law, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for management to predict all such factors.

BEAZER HOMES USA, INC.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

BEAZER HOMES USA, INC.  
 UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS  
 (in thousands, except share and per share data)

	December 31, 2006	September 30, 2006
	As Restated, See Note 12	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 150,285	\$ 167,570
Restricted cash	4,699	4,873
Accounts receivable	83,310	338,033
Income tax receivable	8,435	-
Inventory		
Owned inventory	3,062,627	3,137,021
Consolidated inventory not owned	573,828	471,441
Total Inventory	3,636,455	3,608,462
Residential mortgage loans available-for-sale	19,004	92,157
Investments in unconsolidated joint ventures	128,230	124,799
Deferred tax assets	116,183	71,344
Property, plant and equipment, net	78,612	76,454
Goodwill	121,368	121,368
Other assets	115,617	109,611
Total Assets	\$ 4,462,198	\$ 4,714,671
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Trade accounts payable	\$ 86,891	\$ 140,008
Other liabilities	429,100	557,754
Obligations related to consolidated inventory not owned	390,093	330,703
Senior Notes (net of discounts of \$3,457 and \$3,578, respectively)	1,551,543	1,551,422
Junior subordinated notes	103,093	103,093
Warehouse Line	18,332	94,881
Other secured notes payable	111,319	89,264
Model home financing obligations	116,699	117,079
Total Liabilities	2,807,070	2,984,204
Stockholders' Equity:		
Preferred stock (par value \$.01 per share, 5,000,000 shares authorized, no shares issued)	-	-
Common stock (par value \$.001 per share, 80,000,000 shares authorized, 42,585,386 and 42,318,098 issued and 39,154,879 and 38,889,554 outstanding, respectively)	43	42
Paid-in capital	537,878	529,326
Retained earnings	1,306,745	1,390,552
Treasury stock, at cost (3,430,507 and 3,428,544 shares, respectively)	(189,538)	(189,453)
Total Stockholders' Equity	1,655,128	1,730,467
Total Liabilities and Stockholders' Equity	\$ 4,462,198	\$ 4,714,671



See Notes to Unaudited Condensed Consolidated Financial Statements.

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## BEAZER HOMES USA, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended	
	December 31,	
	2006	2005
	As Restated, See Note 12	
Total revenue	\$ 802,535	\$ 1,085,508
Home construction and land sales expenses	665,153	805,775
Inventory impairments and option contract abandonments	140,367	2,927
Gross (loss) profit	(2,985)	276,806
Selling, general and administrative expenses	116,916	131,447
Depreciation and amortization	7,558	9,141
Operating (loss) income	(127,459)	136,218
Equity in (loss) income of unconsolidated joint ventures	(2,360)	352
Other income, net	2,161	2,415
(Loss) income before income taxes	(127,658)	138,985
(Benefit from) provision for income taxes	(47,755)	52,366
Net (loss) income	\$ (79,903)	\$ 86,619
Weighted average number of shares:		
Basic	38,280	40,958
Diluted	38,280	45,607
Earnings per share:		
Basic	\$ (2.09)	\$ 2.11
Diluted	\$ (2.09)	\$ 1.93
Cash dividends per share	\$ 0.10	\$ 0.10

See Notes to Unaudited Condensed Consolidated Financial Statements.

BEAZER HOMES USA, INC.  
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (in thousands)

	Three Months Ended December 31,	
	2006	2005
	As Restated, See Note 12	
Cash flows from operating activities:		
Net (loss) income	\$ (79,903)	\$ 86,619
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation and amortization	7,558	9,141
Stock-based compensation expense	3,728	2,268
Inventory impairments and option contract abandonments	140,367	2,927
Deferred income tax (benefit) provision	(44,839)	6,734
Tax benefit from stock transactions	(1,390)	(6,169)
Equity in loss (income) of unconsolidated joint ventures	2,360	(352)
Cash distributions of income from unconsolidated joint ventures	1,282	-
Changes in operating assets and liabilities:		
Decrease in accounts receivable	254,723	31,466
Increase in income tax receivable	(8,435)	-
Increase in inventory	(79,610)	(293,447)
Decrease in residential mortgage loans available-for-sale	73,153	-
Increase in other assets	(5,936)	(27,165)
Decrease in trade accounts payable	(53,117)	(17,390)
Decrease in other liabilities	(131,350)	(97,139)
Other changes	1,391	140
Net cash provided by (used in) operating activities	79,982	(302,367)
Cash flows from investing activities:		
Capital expenditures	(10,986)	(14,449)
Investments in unconsolidated joint ventures	(8,723)	(19,528)
Changes in restricted cash	174	-
Distributions from unconsolidated joint ventures	886	1,280
Net cash (used in) investing activities	(18,649)	(32,697)
Cash flows from financing activities:		
Borrowings under credit facilities and warehouse line	61,130	164,000
Repayment of credit facilities and warehouse line	(137,679)	(114,000)
Repayment of other secured notes payable	(2,455)	(329)
Borrowings under model home financing obligations	1,444	26,909
Repayment of model home financing obligations	(1,824)	-
Debt issuance costs	(70)	-
Proceeds from stock option exercises	3,435	6,082
Common stock redeemed	(85)	-
Treasury stock purchases	-	(67,005)
Tax benefit from stock transactions	1,390	6,169
Dividends paid	(3,904)	(4,107)
Net change in book overdraft	-	32,396
Net cash (used in) provided by financing activities	(78,618)	50,115
Decrease in cash and cash equivalents	(17,285)	(284,949)

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Cash and cash equivalents at beginning of period	167,570	297,098
Cash and cash equivalents at end of period	\$ 150,285	\$ 12,149

See Notes to Unaudited Condensed Consolidated Financial Statements.

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BEAZER HOMES USA, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements of Beazer Homes USA, Inc. (“Beazer Homes” or “the Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Such financial statements do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In our opinion, all adjustments (consisting solely of normal recurring accruals) necessary for a fair presentation have been included in the accompanying financial statements. For further information and a discussion of our significant accounting policies other than as discussed below, refer to our audited consolidated financial statements appearing in the Beazer Homes’ Annual Report on Form 10-K for the fiscal year ended September 30, 2007 (the “2007 Annual Report”) filed concurrently with this Quarterly Report on Form 10-Q/A.

Reclassifications. Depreciation and amortization in the amounts of \$2.6 million and \$2.4 million for the three months ended December 31, 2006 and 2005, respectively have been reclassified from selling, general and administrative expenses to depreciation and amortization in the accompanying unaudited condensed consolidated statements of operations to conform to the current fiscal 2007 presentation.

Stock-Based Compensation. In the first quarter of fiscal 2006, we adopted Statement of Financial Accounting Standards (“SFAS”) 123R, Share-Based Payment. SFAS 123R applies to new awards and to awards modified, repurchased, or cancelled after October 1, 2005, as well as to the unvested portion of awards outstanding as of October 1, 2005. We use the Black-Scholes model to value stock option grants under SFAS 123R, and applied the “modified prospective method” for existing grants which requires us to value grants made prior to our adoption of SFAS 123R under the fair value method and expense the unvested portion over the remaining vesting period. SFAS 123R also requires us to estimate forfeitures in calculating the expense related to stock-based compensation. In addition, SFAS 123R requires us to reflect the benefits of tax deductions in excess of recognized compensation cost as a financing cash inflow and an operating cash outflow.

Nonvested stock granted to employees is valued based on the market price of the common stock on the date of the grant. Performance based, nonvested stock granted to employees is valued using the Monte Carlo valuation method. No performance-based, nonvested stock was granted during the three months ended December 31, 2006 or 2005.

Compensation cost arising from nonvested stock granted to employees and from non-employee stock awards is recognized as an expense using the straight-line method over the vesting period. Unearned compensation is now included in paid-in capital in accordance with SFAS 123R. As of December 31, 2006, there was \$28.3 million of total unrecognized compensation cost related to nonvested stock. That cost is expected to be recognized over a weighted average period of 3.9 years. For the three months ended December 31, 2006 and 2005, our total stock-based compensation expense, included in selling, general and administrative expenses (“SG&A”), was \$3.7 million (\$2.6 million net of tax) and \$2.3 million (\$1.4 million net of tax), respectively.

Activity relating to nonvested stock awards for the three months ended December 31, 2006 is as follows.

	Weighted Average Grant Date Fair Value
Shares	

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Beginning of period	974,457	\$	50.66
Granted	128,058		44.47
Vested	(19,122)		49.37
Forfeited	(28,655)		42.57
End of period	1,054,738	\$	50.15

In addition, during the quarter ended December 31, 2006, employees surrendered 1,963 shares to us in payment of minimum tax obligations upon the vesting of nonvested stock under our stock incentive plans. We valued the stock at the market price on the date of surrender, for an aggregate value of approximately \$85,000, or approximately \$43.22 per share.

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The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. Expected life of options granted is generally computed using the mid-point between the vesting period and contractual life of the options granted. Expected volatilities are based on the historical volatility of the Beazer Homes' stock and other factors. Expected discrete dividends of \$0.10 per quarter are assumed in lieu of a continuously compounding dividend yield. There were no option grants in the quarter ended December 31, 2006.

The following table summarizes stock options outstanding as of December 31, 2006, as well as activity during the three months then ended:

	Shares	Weighted-Average Exercise Price
Outstanding at beginning of period	2,135,572	\$ 43.82
Granted	-	-
Exercised	(280,107)	12.26
Forfeited	(38,156)	42.85
Outstanding at end of period	1,817,309	\$ 48.71
Exercisable at end of period	431,646	\$ 23.03
Vested or expected to vest in the future	1,676,221	\$ 49.36

At December 31, 2006, the weighted-average remaining contractual life for all options outstanding, currently exercisable, and vested or expected to vest in the future was 5.49 years, 5.37 years and 5.55 years, respectively.

At December 31, 2006, 1,676,221 options were vested or expected to vest in the future with a weighted average exercise price of \$49.36 and a weighted average expected life of 3.59 years. At December 31, 2006, the aggregate intrinsic value of options outstanding, vested and expected to vest in the future and options exercisable was approximately \$15.6 million, \$14.3 million, and \$10.4 million, respectively. The intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the exercise price of the option. The intrinsic value of stock options exercised during the three months ended December 31, 2006 was \$8.6 million.

**Recent Accounting Pronouncements.** In 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109 ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS 109, Accounting for Income Taxes. FIN 48 defines the threshold for recognizing the benefits of tax return positions as well as guidance regarding the measurement of the resulting tax benefits. FIN 48 requires a company to recognize for financial statement purposes the impact of a tax position, if a tax return position is "more likely than not" to prevail (defined as a likelihood of more than fifty percent of being sustained upon audit, based on the technical merits of the tax position). FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective as of the beginning of our fiscal year ending September 30, 2008, with the cumulative effect of the change recorded as an adjustment to retained earnings. We estimate that the cumulative effect upon adoption of FIN 48 will decrease retained earnings by approximately \$10 million.

On November 29, 2006, the FASB ratified EITF Issue No. 06-8, Applicability of the Assessment of a Buyer's Continuing Investment Under FASB Statement No. 66, Accounting for Sales of Real Estate, for Sales of Condominiums. The EITF states that the adequacy of the buyer's continuing investment under SFAS 66 should be assessed in determining whether to recognize profit under the percentage-of-completion method on the sale of individual units in a condominium project. This consensus could require that additional deposits be collected by developers of condominium projects that wish to recognize profit during the construction period under the

percentage-of-completion method. EITF 06-8 is effective for fiscal years beginning after March 15, 2007. The adoption of EITF 06-8 will not have a material impact on our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS 141 (revised 2007), Business Combinations. SFAS 141R amends and clarifies the accounting guidance for the acquirer's recognition and measurement of assets acquired, liabilities assumed and noncontrolling interests of an acquiree in a business combination. SFAS 141R is effective for our fiscal year ended September 30, 2009. We do not expect the adoption of SFAS 141R to have a material impact on our consolidated financial statements.



In September 2006, the FASB issued SFAS 157, Fair Value Measurements, SFAS 157 provides guidance for using fair value to measure assets and liabilities. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value but does not expand the use of fair value in any new circumstances. SFAS 157 includes provisions that require expanded disclosure of the effect on earnings for items measured using unobservable data. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and for interim periods within those fiscal years. In February 2008, the FASB issued FASB Staff Position (“FSP”) 157-2, Effective Date of FASB Statement No. 157, delaying the effective date of certain non-financial assets and liabilities to fiscal periods beginning after November 15, 2008. We are currently evaluating the impact of adopting SFAS 157 on our consolidated financial condition and results of operations; however, it is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115. SFAS 159 permits companies to measure certain financial instruments and other items at fair value. SFAS 159 is effective for our fiscal year beginning October 1, 2008. We are currently evaluating the impact of adopting SFAS 159 on our consolidated financial condition and results of operations; however, it is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements – an Amendment of ARB 51. SFAS 160 requires that a noncontrolling interest (formerly minority interest) in a subsidiary be classified as equity and the amount of consolidated net income specifically attributable to the noncontrolling interest be included in the consolidated financial statements. SFAS 160 is effective for our fiscal year beginning October 1, 2009 and its provisions will be applied retrospectively upon adoption. We are currently evaluating the impact of adopting SFAS 160 on our consolidated financial condition and results of operations.

In December 2007, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin (“SAB”) 110 which expresses the views of the Staff regarding the use of the “simplified” method (the mid-point between the vesting period and contractual life of the option) for “plain vanilla” options in accordance with SFAS 123R. SAB 110 will allow the use of the “simplified” method beyond December 31, 2007 under certain conditions including a company’s inability to rely on historical exercise data. We are currently evaluating the impact of adopting SAB 110 on our consolidated financial condition and results of operations.

**Inventory Valuation – Held for Development.** Our homebuilding inventories that are accounted for as held for development include land and home construction assets grouped together as communities. Homebuilding inventories held for development are stated at cost (including direct construction costs, capitalized indirect costs, capitalized interest and real estate taxes) unless facts and circumstances indicate that the carrying value of the assets may not be recoverable. We assess these assets periodically for recoverability in accordance with the provisions of SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS 144 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets is measured by comparing the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. If the expected undiscounted cash flows generated are expected to be less than its carrying amount, an impairment charge should be recorded to write down the carrying amount of such asset to its estimated fair value based on discounted cash flows.

We conduct a review of the recoverability of our homebuilding inventory held for development at the community level as factors indicate that an impairment may exist. We evaluate, among other things, the following information for each community:

Actual “Net Contribution Margin” (defined as homebuilding revenues less homebuilding costs and direct selling expenses) for homes closed in the current fiscal quarter, fiscal year to date and prior two fiscal

quarters. Homebuilding costs include land and land development costs (based upon an allocation of such costs, including costs to complete the development, or specific lot costs), home construction costs (including an estimate of costs, if any, to complete home construction), previously capitalized indirect costs (principally for construction supervision), capitalized interest and estimated warranty costs;

Projected Net Contribution Margin for homes in backlog;

Actual and trending new orders and cancellation rates;

Actual and trending base home sales prices and sales incentives for home sales that occurred in the prior two fiscal quarters that remain in backlog at the end of the fiscal quarter and expected future homes sales prices and sales incentives and absorption over the expected remaining life of the community;

A comparison of our community to our competition to include, among other things, an analysis of various product offerings including, the size and style of the homes currently offered for sale, community amenity levels, availability of lots in our community and our competition's, desirability and uniqueness of our community and other market factors; and

Other events that may indicate that the carrying value may not be recoverable.

In determining the recoverability of the carrying value of the assets of a community that we have evaluated as requiring a test for impairment, significant quantitative and qualitative assumptions are made relative to the future home sales prices, sales incentives, direct and indirect costs of home construction and land development and the pace of new home orders. In addition, these assumptions are dependent upon the specific market conditions and competitive factors for each specific community and may differ greatly between communities within the same market and communities in different markets. Our estimates are made using information available at the date of the recoverability test, however, as facts and circumstances may change in future reporting periods, our estimates of recoverability are subject to change.

For assets in communities for which the undiscounted future cash flows are less than the carrying value, the carrying value of that community is written down to its then estimated fair value based on discounted cash flows. The carrying value for assets in communities that were previously impaired and continue to be classified as held for development is not written up for future estimates of increases in fair value in future reporting periods.

The fair value of the assets held for development is estimated using the present value of the estimated future cash flows using discount rates commensurate with the risk associated with the underlying community assets. The discount rate used may be different for each community. The factors considered when determining an appropriate discount rate for a community include, among others: (1) community specific factors such as the number of lots in the community, the status of land development in the community, the competitive factors influencing the sales performance of the community and (2) overall market factors such as employment levels, consumer confidence and the existing supply of new and used homes for sale. As of December 31, 2006, we used discount rates of 18% to 22% in our estimated discounted cash flow impairment calculations. We recorded impairments on land held for development and homes under construction of \$115.2 million during the quarter ended December 31, 2006. We did not record any impairments during the quarter ended December 31, 2005.

Due to uncertainties in the estimation process, particularly with respect to projected home sales prices and absorption rate, the timing and amount of the estimated future cash flows and discount rates, it is reasonably possible that actual results could differ from the estimates used in our historical analyses. Our assumptions about future home sales prices and absorption rates require significant judgment because the residential homebuilding industry is cyclical and is highly sensitive to changes in economic conditions. We calculated the estimated fair values of inventory held for development that were evaluated for impairment based on current market conditions and assumptions made by management relative to future results. Because the projected cash flows are significantly impacted by changes in market conditions, it is reasonably possible that actual results could differ materially from our estimates and result in additional impairments.

## (2) Supplemental Cash Flow Information

During the quarters ended December 31, we paid interest of \$53.6 million in fiscal 2007 and \$35.3 million in fiscal 2006. In addition, we paid income taxes of \$13.2 million in fiscal 2007 and \$55.1 million in fiscal 2006. We also had the following non-cash activity (in thousands):

	Quarter ended December 31,	
	2006	2005
Supplemental disclosure of non-cash activity:		
Increase in consolidated inventory not owned	\$ 59,390	\$ 81,628
Land acquired through issuance of notes payable	24,510	7,762



## (3) Inventory

(in thousands)	December 31, 2006	September 30, 2006
Homes under construction	\$ 1,194,547	\$ 1,144,750
Development projects in progress	1,624,257	1,813,720
Unimproved land held for future development	11,294	12,213
Land Held for Sale	88,308	30,074
Model homes	144,221	136,264
Total Owned Inventory	\$ 3,062,627	\$ 3,137,021

Homes under construction includes homes finished and ready for delivery and homes in various stages of construction. We had 1,342 (\$308.8 million) and 1,197 (\$240.8 million) completed homes that were not subject to a sales contract at December 31, 2006 and September 30, 2006, respectively. Development projects in progress consist principally of land and land improvement costs. Certain of the fully developed lots in this category are reserved by a deposit or sales contract.

Total owned inventory, by reportable segment, is set forth in the table below (in thousands):

	December 31, 2006			September 30, 2006		
	Held for Development	Land Held for Sale	Total Owned Inventory	Held for Development	Land Held for Sale	Total Owned Inventory
West Segment	\$ 1,045,843	\$ 53,667	\$ 1,099,510	\$ 1,197,559	\$ 6,411	\$ 1,203,970
Mid-Atlantic Segment	479,483	-	479,483	449,909	-	449,909
Florida Segment Southeast Segment	326,797	-	326,797	337,289	-	337,289
Other	372,766	15,964	388,730	349,598	14,058	363,656
Unallocated	543,410	18,677	562,087	559,124	9,605	568,729
	206,020	-	206,020	213,468	-	213,468