BROOKFIELD HOMES CORP
Form 10-Q
May 10, 2005

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

FORM 10-Q

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

For the quarterly period ended March 31, 2005

Commission File Number: 001 31524

BROOKFIELD HOMES CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**37-1446709**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
12865 Pointe Del Mar **Suite 200** **Del Mar, California**	**92014**
(Address of Principal Executive Offices)	(Zip Code)

(858) 481-8500

(Registrant s Telephone Number, Including Area Code)

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 an accelerated filer (as defined in Exchange Act Rule 12b-2).

Yes þ No o

As of April 30, 2005, the registrant had outstanding 30,852,732 shares of its common stock, $0.01 par value per share.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

BROOKFIELD HOMES CORPORATION

CONSOLIDATED BALANCE SHEETS

(all dollar amounts are in thousands of U.S. dollars)

	Note	*(Unaudited)* March 31, 2005	December 31, 2004
Assets			
Housing and land inventory	2	$ 787,775	$ 679,930
Investments in housing and land joint ventures	3	49,647	59,810
Consolidated land inventory not owned	2	42,131	47,240
Receivables and other assets		29,799	73,986
Cash and cash equivalents	4	124,666	186,731
Deferred income taxes		34,516	33,924
		$ 1,068,534	$ 1,081,621
Liabilities and Equity			
Project specific and other financings		$ 529,898	$ 512,098
Accounts payable and other liabilities		209,128	256,985
Minority interest	2	65,404	66,422
Preferred stock 10,000,000 shares authorized, no shares issued			
Common stock and additional paid-in capital 65,000,000 shares authorized, 30,860,932 shares issued and outstanding with par value of $309, excluding 1,212,849 treasury shares with a cost of $24,508 (December 31, 2004 30,889,632 shares issued and outstanding with par value of $309, excluding 1,184,149 treasury shares with a cost of $23,552)		119,290	120,246
Retained earnings		144,814	125,870
		$ 1,068,534	$ 1,081,621

See accompanying notes to financial statements

BROOKFIELD HOMES CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(all dollar amounts are in thousands of U.S. dollars, except per share amounts)

		(Unaudited) Three Months Ended March 31,	
Revenue	**Note**	**2005**	**2004**
Housing		$ 143,083	$ 138,958
Land and other revenues		9,072	4,231
		152,155	143,189
Direct Cost of Sales	2	(103,978)	(110,051)
		48,177	33,138
Equity in earnings from housing and land joint ventures	3	7,312	851
Selling, general and administrative expense		(21,224)	(16,171)
Minority interest		(3,209)	(2,146)
Net Income Before Taxes		31,056	15,672
Income tax expense		(12,112)	(5,955)
Net Income		$ 18,944	$ 9,717
Earnings Per Share			
Basic	1	$ 0.61	$ 0.31
Diluted	1	$ 0.60	$ 0.31
Weighted Average Common Shares Outstanding *(in thousands)*			
Basic	1	30,865	30,881
Diluted	1	31,517	31,423

See accompanying notes to financial statements

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BROOKFIELD HOMES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(all dollar amounts are in thousands of U.S. dollars)

	Unaudited Three Months Ended March 31, 2005	2004
Cash Flows from Operating Activities		
Net income	$ 18,944	$ 9,717
Adjustments to reconcile net income to net cash used in operating activities:		
Distribution of joint venture earnings in excess of equity income	29	
Minority interest	3,209	2,146
Deferred income taxes	(592)	3,403
Changes in operating assets and liabilities:		
Decrease in receivables and other assets	44,187	16,133
Increase in housing and land inventory	(109,338)	(67,241)
(Decrease)/increase in accounts payable and other	(40,165)	8,011
Net cash used in operating activities	(83,726)	(27,831)
Cash Flows From Investing Activities		
Net recovery from housing and land joint ventures	10,134	3,044
Net cash provided by investing activities	10,134	3,044
Cash Flows From Financing Activities		
Net borrowings under revolving project specific and other financings	17,800	30,263
Net distributions to minority interest	(5,317)	(3,023)
Repurchase of common shares	(956)	
Net cash provided by financing activities	11,527	27,240
(Decrease)/increase in cash and cash equivalents	(62,065)	2,453
Cash and cash equivalents at beginning of period	186,731	218,606
Cash and cash equivalents at end of period	$ 124,666	$ 221,059

Supplemental Cash Flow Information

Interest paid	$	5,771	$	4,420
Income taxes paid	$	39,411	$	7,010
(Decrease)/increase in consolidated land inventory not owned	$	(6,602)	$	6,385

See accompanying notes to financial statements

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BROOKFIELD HOMES CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts in $U.S. thousands except per share amounts)

Note 1. Significant Accounting Policies

(a) Basis of Presentation

Brookfield Homes Corporation (the Company or Brookfield Homes) was incorporated on August 28, 2002 as a wholly-owned subsidiary of Brookfield Properties Corporation (Brookfield Properties) to acquire as of October 1, 2002 all of the California and Washington D.C. area homebuilding and land development operations (the Land and Housing Operations) of Brookfield Properties pursuant to a reorganization of its business (the Spin-off). On January 6, 2003, Brookfield Properties completed the Spin-off by distributing all of the issued and outstanding common stock it owned in the Company to its common stockholders. Brookfield Homes began trading as a separate company on the New York Stock Exchange on January 7, 2003.

The consolidated financial statements include the accounts of Brookfield Homes and its subsidiaries and investments in joint ventures and variable interests in which the Company is the primary beneficiary.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Since they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements, they should be read in conjunction with the Company s consolidated financial statements and footnotes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2004. In the opinion of management, all adjustments necessary for fair presentation of the accompanying consolidated financial statements have been made.

The Company historically has experienced, and expects to continue to experience, variability in quarterly results. The consolidated statements of income for the three months ended March 31, 2005 are not necessarily indicative of the results to be expected for the full year.

The preparation of 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 amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

(b) Earnings Per Share

Earnings per share is computed in accordance with the Statement of Financial Accounting Standards (SFAS) 128. Basic earnings per share is calculated by dividing net income by the average number of common shares outstanding for the period. Diluted earnings per share is calculated by dividing net income by the average number of common shares outstanding including all dilutive potentially issuable shares under various stock option plans.

Basic and diluted earnings per share for the three months ended March 31, 2005 and 2004 were calculated as follows (in thousands except per share amounts):

	Three Months Ended March 31, 2005	2004
Numerator:		
Net income	$ 18,944	$ 9,717
Denominator:		
Basic average shares outstanding	30,865	30,881
Net effect of stock options assumed to be exercised	652	542
Diluted average shares outstanding	31,517	31,423
Basic earnings per share	$ 0.61	$ 0.31
Diluted earnings per share	$ 0.60	$ 0.31

BROOKFIELD HOMES CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts in $U.S. thousands except per share amounts)

(c) Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment.* SFAS No. 123(R) establishes accounting standards for transactions in which a company exchanges its equity instruments for goods or services. In particular, this Statement would require companies to record compensation expense for all share-based payments, such as employee stock options, at fair market value. This Statement is effective as of the beginning of the first interim or annual reporting period of the next fiscal year that begins after June 15, 2005. The Company is currently reviewing the effect of this Statement on its consolidated financial statements.

In December 2003, the FASB issued revised Interpretation 46 (FIN 46R), Consolidation of Variable Interest Entities (VIEs), an Interpretation of Accounting Research Bulletin 51, Consolidated Financial Statements, and replaces the previous version of FASB Interpretation 46 issued in January 2003 (FIN 46). This interpretation applied immediately to variable interest entities created after January 31, 2003. A company that holds a variable interest in a VIE it acquired before February 1, 2003 shall apply the provision of this interpretation no later than the first fiscal year or interim period ending after March 15, 2004 unless those entities are considered to be special purpose entities in which the application is to be no later than the end of the first reporting period that ends after December 15, 2003. This interpretation may be applied prospectively with a cumulative-effect adjustment as of the date on which it is first applied or by restating previously issued financial statements for one or more years with a cumulative-effect adjustment as of the beginning of the first year restated. The Company applied the provision of this new pronouncement effective January 1, 2003 but did not restate any previously issued financial statements. The decision whether to consolidate a VIE begins with establishing that a VIE exists. A VIE exists when either the total equity investment at risk is not sufficient to permit the entity to finance its activities by itself, or the equity investor lack one of three characteristics associated with owning a controlling financial interest. Those characteristics are the direct or indirect ability to make decisions about the entity s activities through voting rights or similar rights, the obligation to absorb the expected losses of an entity, and the right to receive the expected residual returns. The entity with the majority of the expected losses or expected residual return is considered to be the primary beneficiary of the entity and is required to consolidate such entity. The Company has determined they are the primary beneficiary of certain VIEs which are presented in these financial statements under Consolidated land inventory not owned with the interest of others included in Minority interest. See Notes 2 and 3 for further discussion on the consolidation of land option contracts and joint ventures.

(d) Reclassification

Certain prior period amounts in the consolidated financial statements have been reclassified to conform with the March 31, 2005 presentation. In particular, reclassifications have been made to equity in earnings from housing and land joint ventures (now shown as a component of operating income separately from revenue) and to interest expense (now included as a component of Direct Cost of Sales).

Note 2. Housing and Land Inventory

Housing and land inventory includes homes completed and under construction, model homes, developed land and land under and held for development which will be used in the Company s homebuilding operations or sold as building lots to other homebuilders. The following summarizes the components of housing and land inventory:

	March 31, 2005	December 31, 2004
Housing inventory	$ 419,913	$ 244,041
Model homes	27,359	19,179
Land and land under development	340,503	416,710
	$ 787,775	$ 679,930

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(Tabular amounts in $U.S. thousands except per share amounts)

The Company capitalizes interest which is expensed as housing units and building lots are sold. For the three months ended March 31, 2005 and 2004 interest incurred and capitalized by the Company was $5.8 million and $4.4 million, respectively. Capitalized interest expensed for the same periods was $3.1 million and $3.9 million, respectively.

Capitalized costs are expensed as costs of sales on a specific identification basis or on a relative value in proportion to anticipated revenue. Included in direct costs of sales is $101.6 million of costs related to housing revenue (March 31, 2004 $108.2 million) and $2.4 million of costs related to land sales and other revenues (March 31, 2004 $1.8 million).

In the ordinary course of business, the Company has entered into a number of option contracts to acquire lots in the future in accordance with specific terms and conditions of such agreements. Under these option contracts, the Company will fund deposits to secure the right to purchase land or lots at a future point in time. The Company has evaluated its option contracts and determined that for those entities considered to be VIEs, it is the primary beneficiary on options for 354 lots with aggregate exercise prices of $42.1 million (December 31, 2004 375 lots with an exercise price of $47.2 million), which are required to be consolidated. In these cases, the only asset recorded is the Company s exercise price for the option to purchase, with an increase in minority interest of $36.2 million (December 31, 2004 $42.8 million) for the assumed third party investment in the VIE. Where the land sellers are not required to provide the Company with financial information related to the VIE, certain assumptions by the Company were required in its assessment as to whether or not it is the primary beneficiary.

Housing and land inventory includes non-refundable deposits and other costs totaling $49.6 million (December 31, 2004 $36.0 million) in connection with options that are not required to be consolidated under the provisions of FIN 46R. The total exercise price of these options is $649.4 million (December 31, 2004 $627.7 million) including the non-refundable deposits identified above. The number of lots for which the Company has obtained an option to purchase, excluding those already consolidated, and their respective dates of expiry and their exercise price are as follows:

Year of Expiry	Number of Lots	Total Exercise Price
2005	948	$ 81,372
2006	5,204	207,102
2007	3,276	133,503
Thereafter	7,248	227,409
	16,676	$ 649,386

Note 3. Investments in Housing and Land Joint Ventures

The Company participates in a number of joint ventures in which it has less than a controlling interest. Summarized condensed financial information on a combined 100% basis of the joint ventures is as follows:

	March 31, 2005	December 31, 2004
Assets		
Housing and land inventory	$ 331,905	$ 345,939
Other assets	47,017	54,510
	$ 378,922	$ 400,449
Liabilities and Equity		
Accounts payable and other liabilities	$ 18,769	$ 46,313
Project specific financings	266,758	277,568
Investment and advances		
Brookfield Homes	49,647	59,810
Others	43,748	16,758
	$ 378,922	$ 400,449

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BROOKFIELD HOMES CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts in $U.S. thousands except per share amounts)

	Three Months Ended March 31	
	2005	**2004**
Revenue and Expenses		
Revenue	$ 44,349	$ 19,678
Expenses	(28,803)	(17,805)
Net income	$ 15,546	$ 1,873
Company s share of net income	$ 7,312	$ 851

In reporting the Company s share of net income, all inter-company profits or losses from housing and land joint ventures are eliminated on lots purchased by the Company.

Joint ventures in which the Company has a non-controlling interest are accounted for using the equity method. In addition, the Company has performed an evaluation of its existing joint venture relationships by applying the provisions of FIN 46R. The Company has determined that for those entities in which this interpretation applies, none of these joint ventures were considered to be a VIE requiring consolidation pursuant to the requirement of FIN 46R.

The Company and/or its joint venture partners have provided varying levels of guarantees of debt in its joint ventures. At March 31, 2005, the Company had recourse guarantees of $4.1 million and limited maintenance guarantees of $74.8 million with respect to debt in its joint ventures.

Note 4. Commitments, Contingent Liabilities and Other

(a) The Company had demand deposits included in cash and cash equivalents of $75.0 million at March 31, 2005 (December 31, 2004 $125.0 million) with a financial subsidiary of the Company s largest stockholder, Brascan Corporation.

(b) The Company is party to various legal actions arising in the ordinary course of business. Management believes that none of these actions, either individually or in the aggregate, will have a material adverse effect on the financial condition or results of operations of the Company.

(c) When selling a home, the Company s subsidiaries provide customers with a limited warranty. The Company estimates the costs that may be incurred under each limited warranty and records a liability in the amount of such costs at the time the revenue associated with the sale of each home is recognized. In addition, the Company has insurance in place where its subsidiaries are subject to the respective warranty statutes in the State where the Company conducts business which range up to ten years for latent construction defects. Factors that affect the Company s warranty liability include the number of homes sold, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. The following table reflects the changes in the Company s warranty liability for the three months ended March 31, 2005:

	2005
Balance, January 1, 2005	$ 18,202
Payments made during the period	(716)
Warranties issued during the period	1,198
Balance, March 31, 2005	$ 18,684

(d) The Company entered into an interest rate swap contract during the third quarter of 2004 which effectively fixes $60.0 million of the Company s variable rate debt at 5.89% until the contract expires in 2009. At March 31, 2005, the fair market value of the contract was $1.4 million.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This discussion includes forward-looking statements that reflect our current views with respect to future events and financial performance and that involve risks and uncertainties. Our actual results, performance or achievements could differ materially from those anticipated in the forward-looking statements as a result of certain factors including risks discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations Forward-Looking Statements elsewhere in this report and in our Annual Report on Form 10-K for the year ended December 31, 2004.

Overview

We design, construct and market single-family and multi-family homes primarily to move-up and luxury homebuyers and develop land for sale to other homebuilders. Our operations are currently focused primarily in five markets: San Francisco Bay Area; Southland / Los Angeles; San Diego / Riverside; Sacramento; and the Washington D.C. Area. Our goal is to maximize the total return on our common stockholders equity.

The 29,748 lots that we control, 12,718 of which we own directly or through joint ventures, provide a strong foundation for our future homebuilding business and visibility on our future cash flow and earnings. The lots we own directly or through joint ventures represent approximately a seven year lot supply, based on 2005 planned home closings.

Homebuilding is our primary source of revenue and has represented approximately 90% of our total revenue since 2000. We believe our operations are positioned to close between 1,700 and 2,000 homes per year. Operating in markets with higher price points and catering to move-up and luxury buyers, our average sales price as of March 31, 2005 of $645,000 was well in excess of the national average sales price of approximately $273,000. We also sell serviced and unserviced lots to other homebuilders generally on an opportunistic basis where we can redeploy capital to an asset providing higher returns or reduce risk in a market.

In addition to our housing and land inventory and investments in housing and land joint ventures, which together comprised 82% of our total assets as of March 31, 2005, we had $125 million in cash and cash equivalents and $64 million in other assets. Other assets consist of homebuyer receivables of $16 million, deferred taxes of $34 million, and mortgages and other receivables of $14 million. Homebuyer receivables consist primarily of proceeds due from homebuyers on the closing of homes.

Since 2000, our revenues and net income have grown at compounded annual growth rates of 17% and 50%, respectively. Over this period, we generated over $450 million in operating cash flow that was used mainly to return cash to shareholders. At the same time, we believe we have positioned our business for future growth through the selective optioning or acquisition of a significant number of large projects and our overall level of lots controlled. Our recent growth is primarily the result of strong economic fundamentals in the markets in which we operate, our success in acquiring strategic parcels of land and in controlling costs at all levels of our operation.

Critical Accounting Policies and Estimates

There have been no significant changes to our critical accounting policies and estimates during the three months ended March 31, 2005 compared to those disclosed in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations included in the Company s annual report on Form 10-K for the year ended December 31, 2004.

Results of Operations ***Selected Financial Information ($ millions)***	**Three Months Ended March 31, 2005**	**2004**
Revenue:		
Housing	$ 143	$ 139
Land and other revenues	9	4
Total revenues [1]	152	143
Direct cost of sales [1]	(104)	(110)
Gross margin [1]	48	33
Equity in earnings from housing and land joint ventures	7	1
Selling, general and administrative expense	(21)	(16)
Operating income	34	18
Minority interest	(3)	(2)
Net income before taxes	31	16
Income tax expense	(12)	(6)
Net income	$ 19	$ 10

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	Three Months Ended March 31, 2005	2004
Selected Operating Data		
Home closings (units):		
San Francisco Bay Area	34	54
Southland / Los Angeles	24	58
San Diego / Riverside	83	51
Washington D.C. Area	81	81
Total	222	244
Average selling price:		
San Francisco Bay Area	$ 844,000	$ 743,000
Southland / Los Angeles	1,113,000	731,000
San Diego / Riverside	586,000	304,000
Washington D.C. Area	484,000	506,000
Average	$ 645,000	$ 570,000
Net new orders (units): (2)		
San Francisco Bay Area	63	131
Southland / Los Angeles	94	140
San Diego / Riverside	159	161
Washington D.C. Area	201	135
Total	517	567
Backlog (units at end of period): (3)		
San Francisco Bay Area	83	190
Southland / Los Angeles	156	267
San Diego / Riverside	357	224
Washington D.C. Area	315	291