

HOVNANIAN ENTERPRISES INC
Form 10-Q
June 11, 2007
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For quarterly period ended APRIL 30, 2007 or

Transition report pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Commission file number 1-8551

Hovnanian Enterprises, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	22-1851059
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

110 West Front Street, P.O. Box 500, Red Bank, NJ 07701

(Address of Principal Executive Offices) (Zip Code)

732-747-7800

(Registrant's Telephone Number, Including Area Code)

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Same (Former Name, Former Address and Former Fiscal Year, if Changed

Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer Accelerated Filer

Non-Accelerated Filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 47,548,429 shares of Class A Common Stock and 14,649,568 shares of Class B Common Stock were outstanding as of June 1, 2007.

HOVNIANIAN ENTERPRISES, INC.

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HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands Except Share Amounts)

	April 30, 2007 (unaudited)	October 31, 2006
ASSETS		
Homebuilding:		
Cash and cash equivalents	\$10,144	\$43,635
Restricted cash	11,332	9,479
Inventories - at the lower of cost or fair value:		
Sold and unsold homes and lots under development	3,428,811	3,297,766
Land and land options held for future development or sale	392,274	362,760
Consolidated inventory not owned:		
Specific performance options	14,996	20,340
Variable interest entities	185,443	208,167
Other options	216,006	181,808
Total consolidated inventory not owned	416,445	410,315
Total inventories	4,237,530	4,070,841
Investments in and advances to unconsolidated joint ventures	215,962	212,581
Receivables, deposits, and notes	82,904	94,750
Property, plant, and equipment net	113,098	110,704
Prepaid expenses and other assets	182,324	175,603
Goodwill	32,658	32,658
Definite life intangibles	71,814	165,053
Total homebuilding	4,957,766	4,915,304
Financial services:		
Cash and cash equivalents	9,387	10,688
Restricted cash	8,777	1,585
Mortgage loans held for sale	133,326	281,958
Other assets	6,637	10,686
Total financial services	158,127	304,917
Income taxes receivable including deferred tax benefits	293,139	259,814
Total assets	\$5,409,032	\$5,480,035

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See notes to condensed consolidated financial statements (unaudited).

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HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In Thousands Except Share Amounts)

	April 30, 2007 (unaudited)	October 31, 2006
LIABILITIES AND STOCKHOLDERS EQUITY		
Homebuilding:		
Nonrecourse land mortgages	\$10,190	\$26,088
Accounts payable and other liabilities	381,252	582,393
Customers deposits	127,232	184,943
Nonrecourse mortgages secured by operating properties	23,341	23,684
Liabilities from inventory not owned	261,438	205,067
Total homebuilding	803,453	1,022,175
Financial services:		
Accounts payable and other liabilities	15,284	12,158
Mortgage warehouse line of credit	121,837	270,171
Total financial services	137,121	282,329
Notes payable:		
Revolving credit agreement	412,300	
Senior notes	1,650,336	1,649,778
Senior subordinated notes	400,000	400,000
Accrued interest	49,812	51,105
Total notes payable	2,512,448	2,100,883
Total liabilities	3,453,022	3,405,387
Minority interest from inventory not owned	94,533	130,221
Minority interest from consolidated joint ventures	1,599	2,264
Stockholders equity:		
Preferred stock, \$.01 par value-authorized 100,000 shares; issued 5,600 shares at April 30, 2007 and at October 31, 2006 with a liquidation preference of \$140,000	135,299	135,299
Common stock, Class A, \$.01 par value-authorized 200,000,000 shares; issued 59,232,205 shares at April 30, 2007 and 58,653,723 shares at October 31, 2006 (including 11,694,720 shares at April 30, 2007 and 11,494,720 shares at October 31, 2006 held in Treasury)	592	587
Common stock, Class B, \$.01 par value (convertible to Class A at time of sale) authorized 30,000,000 shares; issued 15,341,316 shares at April 30, 2007 and 15,343,410 shares at October 31, 2006 (including 691,748 shares at April 30, 2007 and October 31, 2006 held in Treasury)	153	153
Paid in capital common stock	265,286	253,262
Retained earnings	1,573,805	1,661,810
Treasury stock - at cost	(115,257)	(108,948)

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Total stockholders' equity	1,859,878	1,942,163
Total liabilities and stockholders' equity	\$5,409,032	\$5,480,035

See notes to condensed consolidated financial statements (unaudited).

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HOVNIANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In Thousands Except Per Share Data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	April 30, 2007	2006	April 30, 2007	2006
Revenues:				
Homebuilding:				
Sale of homes	\$1,058,014	\$1,479,548	\$2,193,930	\$2,725,745
Land sales and other revenues	34,761	73,382	43,098	85,915
Total homebuilding	1,092,775	1,552,930	2,237,028	2,811,660
Financial services	17,883	21,191	39,431	40,453
Total revenues	1,110,658	1,574,121	2,276,459	2,852,113
Expenses:				
Homebuilding:				
Cost of sales, excluding interest	903,810	1,180,299	1,837,785	2,114,986
Cost of sales interest	28,756	20,283	55,628	36,852
Inventory impairment loss and land option write-offs	34,353	5,595	75,827	8,704
Total cost of sales	966,919	1,206,177	1,969,240	2,160,542
Selling, general and administrative	137,637	151,853	269,779	287,087
Total homebuilding	1,104,556	1,358,030	2,239,019	2,447,629
Financial services	11,628	14,517	24,698	28,047
Corporate general and administrative	19,558	25,911	42,191	53,633
Other interest	6,666	700	7,886	1,520
Other operations	805	8,521	2,258	15,522
Intangible amortization	6,718	13,391	68,274	25,060
Total expenses	1,149,931	1,421,070	2,384,326	2,571,411
(Loss) income from unconsolidated joint ventures	(2,160)	9,497	(195)	17,072
(Loss) income before income taxes	(41,433)	162,548	(108,062)	297,774
State and federal income tax (benefit)/provision:				
State	1,094	6,235	(1,252)	11,109
Federal	(14,468)	52,664	(24,143)	98,920

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Total taxes	(13,374)	58,899	(25,395)	110,029
Net (loss) income	(28,059)	103,649	(82,667)	187,745
Less: preferred stock dividends	2,669	2,669	5,338	5,338
Net (loss) income available to common stockholders	\$(30,728)	\$100,980	\$(88,005)	\$182,407
Per share data:				
Basic:				
(Loss) income per common share	\$(0.49)	\$1.60	\$(1.40)	\$2.90
Weighted average number of common shares outstanding	63,004	62,919	62,953	62,864
Assuming dilution:				
(Loss) income per common share	\$(0.49)	\$1.55	\$(1.40)	\$2.80
Weighted average number of common shares outstanding	63,004	65,106	62,953	65,254
See notes to condensed consolidated financial statements (unaudited).				

HOVNIANIAN ENTERPRISES, INC. AND
SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF
STOCKHOLDERS' EQUITY

(In Thousands Except Share Amounts)

(Unaudited)

	A Common Stock		B Common Stock		Preferred Stock		Paid-In Capital	Retained Earnings	Treasury Stock	Total
	Shares Issued and Outstanding	Amount	Shares Issued and Outstanding	Amount	Shares Issued and Outstanding	Amount				
Balance, October 31, 2006	47,159,003	\$587	14,651,662	\$153	5,600	\$135,299	\$253,262	\$1,661,810	\$(108,948)	\$1,942,163
Preferred dividends declared (\$953.21 per share)								(5,338)		(5,338)
Stock options amortization and issuances, net of tax	398,817	4					11,670			11,674
Restricted stock amortization, issuances and forfeitures, net of tax	177,571	1					354			355
Conversion of Class B to Class A common stock	2,094		(2,094)							-
Treasury stock purchases	(200,000)								(6,309)	(6,309)
Net loss								(82,667)		(82,667)
Balance, April 30, 2007	47,537,485	\$592	14,649,568	\$153	5,600	\$135,299	\$265,286	\$1,573,805	\$(115,257)	\$1,859,878

See notes to condensed consolidated financial statements (unaudited).

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands - Unaudited)

	Six Months Ended	
	April 30,	
	2007	2006
Cash flows from operating activities:		
Net (loss) income	\$(82,667)	\$187,745
Adjustments to reconcile net (loss)/income to net cash used in operating activities:		
Depreciation	8,972	6,319
Intangible amortization	68,274	25,060
Compensation from stock options and awards	12,455	16,955
Amortization of bond discounts	558	508
Excess tax benefits from share-based payment	(2,467)	(3,802)
Loss (gain) on sale and retirement of property and assets	(2)	145
(Loss)/income from unconsolidated joint ventures	195	(17,072)
Distributions from unconsolidated joint ventures	464	9,829
Deferred income taxes	(17,148)	(40,761)
Impairment and land option deposit write-offs	75,827	8,704
Decrease (increase) in assets:		
Mortgage notes receivable	148,646	(2,940)
Restricted cash, receivables, prepaids and other assets	27,745	44,128
Inventories	(214,732)	(805,208)
(Decrease) increase in liabilities:		
State and federal income taxes	(16,177)	(45,986)
Customers deposits	(52,706)	(20,977)
Interest and other accrued liabilities	(143,377)	5,349
Accounts payable	(49,594)	(10,705)
Net cash used in operating activities	(235,734)	(642,709)
Cash flows from investing activities:		
Net proceeds from sale of property and assets	557	166
Purchase of property, equipment and other fixed assets and acquisitions	(33,246)	(44,454)
Investments in and advances to unconsolidated joint ventures	(27,008)	(17,343)
Distributions from unconsolidated joint ventures	22,878	271
Net cash used in investing activities	(36,819)	(61,360)
Cash flows from financing activities:		
Proceeds from mortgages and notes	35,075	47,736
Net proceeds (payments) related to revolving credit agreement	412,300	275,000
Net proceeds (payments) related to mortgage warehouse line of credit	(148,334)	(3,668)
Proceeds from senior debt		300,000
Payments of issuance costs		(90)
Principal payments on mortgages and notes	(54,960)	(58,529)
Excess tax benefits from share-based payment	2,467	3,802
Preferred dividends paid	(5,338)	(5,338)
Purchase of treasury stock	(6,309)	(14,153)
Proceeds from sale of stock and employee stock plan	2,860	714

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Net cash provided by financing activities	237,761	545,474
Net (decrease) in cash	(34,792)	(158,595)
Cash and cash equivalents balance, beginning of period	54,323	211,273
Cash and cash equivalents balance, end of period	\$19,531	\$52,678

HOVNANIAN ENTERPRISES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands - Unaudited)

(Continued)

	Six Months Ended	
	April 30,	
	2007	2006
Supplemental disclosures of cash flow:		
Cash paid during the period for:		
Interest	\$68,371	\$37,296
Income taxes	\$5,316	\$165,446
Supplemental disclosures of noncash operating activities:		
Consolidated inventory not owned:		
Specific performance options	\$13,631	\$9,385
Variable interest entities	168,548	363,888
Other options	213,491	134,015
Total inventory not owned	\$395,670	\$507,288

See notes to condensed consolidated financial statements (unaudited).

HOVNIANIAN ENTERPRISES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

1. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments for interim periods presented have been made, which include only normal recurring accruals and deferrals necessary for a fair presentation of our consolidated financial position, results of operations, and changes in cash flows. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and these differences could have a significant impact on the financial statements. Results for interim periods are not necessarily indicative of the results which might be expected for a full year. The balance sheet at October 31, 2006 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

The Company's reportable segments consist of six Homebuilding segments (Northeast, Mid-Atlantic, Midwest, Southeast, Southwest and West) and the Financial Services segment (see Note 13).

2. For the three and six months ended April 30, 2007, the Company's total stock-based compensation expense was \$6.0 million (\$4.1 million net of tax) and \$12.5 million (\$9.5 million net of tax), respectively. Included in this total stock-based compensation expense was expense for stock options of \$3.1 million (\$2.1 million net of tax) and \$6.4 million (\$4.9 million net of tax) for the three and six months ended April 30, 2007, respectively.

3. Interest costs incurred, expensed and capitalized were:

	Three Months Ended April 30, 2007		Six Months Ended April 30, 2007	
	2006		2006	
	(Dollars in Thousands)			
Interest capitalized at beginning of period (1)	\$120,054	\$61,781	\$102,849	\$48,366
Plus interest incurred (2)	53,501	36,250	98,798	67,054
Less cost of sales interest expensed (3)	28,756	20,283	55,628	36,852
Less other interest expensed	6,666	700	7,886	1,520
Interest capitalized at end of period	\$138,133	\$77,048	\$138,133	\$77,048

(1) Beginning balance for 2006 does not include interest incurred of \$2.3 million which is capitalized in property, plant, and equipment.

(2) Data does not include interest incurred by our mortgage and finance subsidiaries.

(3) Represents interest on borrowings for construction, land and development costs, which are charged to

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interest expense when homes are delivered.

4. Accumulated depreciation at April 30, 2007 and October 31, 2006 amounted to \$51.2 million and \$43.7 million, respectively, for our homebuilding assets.

5. In accordance with Financial Accounting Standards No. 144 (SFAS 144), Accounting for the Impairment of or Disposal of Long Lived Assets , we record impairment losses on inventories related to communities under development when events and circumstances indicate that they may be impaired and the undiscounted cash flows estimated to be generated by those assets are less than their carrying amounts. For land held for sale we recorded impairment losses if the fair value less cost to sell is below the carrying amount. For the

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three months ended April 30, 2007 and 2006, we recorded impairment losses of \$29.8 million and zero, respectively, and \$76.3 million and \$1.6 million during the six months ended April 30, 2007 and 2006, respectively. Of the fiscal 2007 amount, \$49.4 million (\$41.9 million in the first quarter and \$7.5 million in the second quarter) was for our Fort Myers - Cape Coral (Fort Myers) operations in the Southeast, as a result of a continued decline in sales pace and general market conditions, as well as increased cancellation rates during the year. The remaining inventory impairments recorded during the second quarter were \$4.4 million in the Northeast, \$2.9 million in the Midwest, \$0.3 million in the Southwest, and \$14.7 million in the West. For the six months ended April 30, 2007, in addition to the impairment in Fort Myers, inventory impairments recorded were \$5.8 million in the Northeast, \$6.1 million in the Midwest, \$0.3 million in the Southwest, and \$14.7 million in the West.

In addition, from time to time, we write off certain residential land options, including approval and engineering costs for land we decided not to purchase, at the earlier of the option expiration or the decision to terminate the option. We wrote off such costs in the amount of \$4.5 million and \$5.6 million during the three months ended April 30, 2007 and 2006, respectively, and \$7.5 million and \$7.1 million during the six months ended April 30, 2007 and 2006, respectively. These write-offs in the six months ended April 30, 2007 were offset by \$8.0 million in recovered deposits that had been written off in the prior year as walk-away costs because, in certain instances where we walked away from option contracts in the fourth quarter of fiscal 2006, we took legal action to recover our deposits. In two of these cases we were successful and received a portion of our deposit back in the first quarter of fiscal 2007. Residential inventory impairment losses and option write-offs are reported in the Condensed Consolidated Statements of Operations as Homebuilding-inventory impairment loss and land option write-offs .

6. We provide a warranty accrual for repair costs over \$1,000 that are not covered by our general liability insurance to homes, community amenities, and land development infrastructure. We accrue for warranty costs as part of cost of sales at the time each home is closed and title and possession have been transferred to the homebuyer. In addition, we accrue for warranty costs under our general liability insurance deductible as part of selling, general and administrative costs. For homes delivered in fiscal 2007, our deductible under our general liability insurance is \$20 million per occurrence with an aggregate \$20 million for premise liability claims and an aggregate \$21.5 million for construction defect claims. Additions and charges incurred in the warranty accrual and general liability accrual for the three and six months ended April 30, 2007 and 2006 are as follows:

	Three Months Ended		Six Months Ended	
	April 30, 2007	2006	April 30, 2007	2006
Balance, beginning of period	\$91,670	\$87,631	\$93,516	\$86,706
Additions	10,445	5,066	18,871	12,330
Company acquisitions during period		186		186
Charges incurred	(11,384)	(2,650)	(21,656)	(8,989)
Balance, end of period	\$90,731	\$90,233	\$90,731	\$90,233

Warranty accruals are based upon historical experience. We engage a third party actuary that uses our historical warranty data to estimate our unpaid claims, claim adjustment expenses and incurred but not reported claims reserves for the risks that we are assuming under the general liability and workers compensation programs. The estimates include provisions for inflation, claims handling and legal fees.

Insurance claims paid by our insurance carriers were \$0.8 million and \$4.8 million for the six months ended April 30, 2007 and 2006, respectively, for prior year deliveries.

7. We are involved in litigation arising in the ordinary course of business, none of which is expected to have a material adverse effect on our financial position or results of operations and we are subject to extensive and complex regulations that affect the development and home building, sales and customer financing processes, including zoning, density, building standards and mortgage financing. These regulations often

provide broad discretion to the administering governmental authorities. This can delay or increase the cost of development or homebuilding.

We also are subject to a variety of local, state, federal and foreign laws and regulations concerning protection of health and the environment. The particular environmental laws which apply to any given community vary greatly according to the community site, the site's environmental conditions and the present and former uses of the site. These environmental laws may result in delays, may cause us to incur substantial compliance, remediation, and/or other costs, and can prohibit or severely restrict development and homebuilding activity in certain environmentally sensitive regions or areas.

In March 2005, we received two requests for information pursuant to Section 308 of the Clean Water Act from Region 3 of the Environmental Protection Agency (the "EPA"). These requests sought information concerning storm water discharge practices in connection with completed, ongoing and planned homebuilding projects by subsidiaries in the states and district that comprise EPA Region 3. We also received a notice of violations for one project in Pennsylvania and requests for sampling plan implementation in two projects in Pennsylvania. The amount requested by the EPA to settle the asserted violations at the one project was less than \$100,000. We provided the EPA with information in response to its requests. We have since been advised by the Department of Justice ("DOJ") that it will be involved in the review of our storm water discharge practices. We cannot predict the outcome of the review of these practices or estimate the costs that may be involved in resolving the matter. To the extent that the EPA or the DOJ asserts violations of regulatory requirements and requests injunctive relief or penalties, we will defend and attempt to resolve such asserted violations.

In addition, in November 2005, we received two notices from the California Regional Water Quality Control Board alleging violations in Riverside County, California and El Dorado County, California of certain storm water discharge rules. The Riverside County notice assessed an administrative civil liability of \$236,895 and in March 2006, we agreed to make a donation of \$118,447 to Riverside County, California and paid a fine of \$118,448 to the State of California. In October 2006, we agreed to pay a fine of \$300,000 to the County of El Dorado, California and have tentatively agreed to a pay a fine of \$300,000 to the State of California with respect to the El Dorado notice.

It can be anticipated that increasingly stringent requirements will be imposed on developers and homebuilders in the future. Although we cannot predict the effect of these requirements, they could result in time-consuming and expensive compliance programs and in substantial expenditures, which could cause delays and increase our cost of operations. In addition, the continued effectiveness of permits already granted or approvals already obtained is dependent upon many factors, some of which are beyond our control, such as changes in policies, rules and regulations and their interpretations and application.

Our sales and customer financing processes are subject to the jurisdiction of the U. S. Department of Housing and Urban Development ("HUD"). In connection with the Real Estate Settlement Procedures Act, HUD has inquired about our process of referring business to our affiliated mortgage company and has separately requested documents related to customer financing. We have responded to HUD's inquiries. After an audit inspection, HUD has recommended that the Company indemnify HUD against any losses that it may sustain with respect to five loans that it alleges were improperly underwritten. The Company has agreed to such indemnification and does not anticipate that any losses with respect to such loans will be material. HUD also recommended that the Company refund a total of \$5,190 in connection with seventeen loans; the Company has agreed to provide this refund. The Company has requested that HUD reconsider its request that the Company refund an additional \$24,833 with respect to sixty-five loans. The Company has also agreed to certain changes recommended by HUD in its quality control plans.

On September 26, 2006, a stockholder derivative action was filed in the Superior Court of New Jersey, Monmouth County, against certain of our current and former officers and directors, captioned as *Michael Crady v. Ara K. Hovnanian et al.*, Civil Action No. L-4380-06. The complaint alleges, among other things, breach of fiduciary duty in connection with certain of our historical stock option grants. An amended complaint, containing similar allegations, was filed on January 11, 2007. The amended complaint seeks an award of damages, disgorgement of certain stock options and any proceeds of certain stock options, equitable relief and an award of fees and expenses. The parties have agreed to extend the time we have to respond to the amended complaint. We have engaged counsel with respect to the claims.

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The Company has been named as a defendant in a purported class action suit filed May 30, 2007 in the United States District Court for the Eastern District of Pennsylvania, *Mark W. Mellar et al v. Hovnanian Enterprises, Inc. et al*, asserting that the Company's sales of homes along with the financing of home purchases and

the provision of title insurance by affiliated companies violated the Real Estate Settlement Procedures Act. The Company has not yet been served and is reviewing the matter.

A subsidiary of the Company has been named as defendant in a purported class action suit filed May 30, 2007 in the United States District Court for the Middle District of Florida, *Randolph Sewell et al v. D. Alessandro & Woodyard et al*, alleging violations of the federal securities acts, among other allegations, in connection with the sale of some of the Company's subsidiary's homes in Fort Myers, Florida. The Company has not yet been served and is reviewing the matter.

8. As of April 30, 2007 and October 31, 2006, respectively, we are obligated under various performance letters of credit amounting to \$386.1 million and \$453.4 million.

9. Our amended and restated unsecured Revolving Credit Agreement ("Agreement") with a group of lenders provides a revolving credit line and letter of credit line of \$1.5 billion through May 2011. The facility contains an accordion feature under which the aggregate commitment can be increased to \$2.0 billion subject to the availability of additional commitments. Loans under the Agreement bear interest at various rates based on (1) a base rate determined by reference to the higher of (a) PNC Bank, National Association's prime rate and (b) the federal funds rate plus $\frac{1}{2}\%$ or (2) a margin ranging from 0.65% to 1.50% per annum, depending on our Leverage Ratio, as defined in the Agreement, and our debt ratings plus a LIBOR-based rate for a one, two, three, or six month interest period as selected by us. In addition, we pay a fee ranging from 0.15% to 0.25% per annum on the unused portion of the revolving credit line depending on our Leverage Ratio and our debt ratings and the average percentage unused portion of the revolving credit line. As of April 30, 2007 and October 31, 2006, the outstanding balance under the Agreement was \$412.3 million and zero, excluding letters of credit of \$136.1 million and \$329.8 million, respectively. The Agreement has covenants that restrict, among other things, the ability of Hovnanian and certain of its subsidiaries, including K. Hovnanian Enterprises, Inc. ("K. Hovnanian"), the borrower, to incur additional indebtedness, pay dividends on common and preferred stock and repurchase capital stock, make other restricted payments, make investments, sell certain assets, incur lines, consolidate, merge, sell or otherwise dispose of all or substantially all of its assets and enter into certain transactions with affiliates. The Agreement also requires the Company to stay within specified financial ratios. The Agreement contains events of default which would permit the lenders to accelerate the loans if not cured within applicable grace periods, including the failure to make timely payments under the Agreement or other material indebtedness, the failure to satisfy covenants and specified events of bankruptcy and insolvency. As of April 30, 2007, we were in compliance with the covenants under the Agreement.

On October 11, 2006, (a) we, K. Hovnanian and certain of our subsidiaries as guarantors entered into a Credit Agreement (the "Credit Agreement") with Citicorp USA, Inc., as administrative agent and issuing bank, the lenders from time to time party thereto, and The Bank of New York, as paying agent, and (b) K. Hovnanian entered into an Agreement for Letter of Credit (the "LC Agreement") with Citibank, N.A. ("Citibank"). Under the Credit Agreement, K. Hovnanian has the right to borrow and to obtain the issuance, renewal, extension and increase of a letter of credit (the "Security Letter of Credit") up to an aggregate availability of \$125 million. On November 14, 2006, per the accordion feature provided for in the Credit Agreement, the aggregate commitments under the Credit Agreement were increased to \$250 million. The Security Letter of Credit will serve as security for any letters of credit that may be issued under the LC Agreement. Under the LC Agreement, K. Hovnanian may request Citibank to issue letters of credit up to the aggregate maximum amount of the Security Letter of Credit. Loans under the Credit Agreement will bear interest at various rates based on (1) an alternate base rate determined by reference to the higher of (a) Citibank's base rate and (b) the federal funds rate plus $\frac{1}{2}\%$ or (2) a LIBOR-based rate for a one day, one or two week, or one, two, three or six month interest period as selected by K. Hovnanian.

The Credit Agreement has covenants that restrict Hovnanian and certain of its subsidiaries', including K. Hovnanian's, ability to grant liens and enter into consolidations, mergers and transfers of all or substantially all of their respective assets. The Credit Agreement contains events of default which would permit the lenders to accelerate the loans if not cured within applicable grace periods, including the failure to make timely payments under the Credit Agreement or other material indebtedness, the failure to satisfy covenants and specified events of bankruptcy and insolvency. Borrowings under the Credit Agreement may be used for general corporate purposes. As of April 30, 2007 and October 31, 2006, the outstanding balance under the Credit Agreement was zero, excluding letters of credit of \$250.0 million and \$123.6 million, respectively. As of April 30, 2007, we were in compliance with our loan covenants.

Our amended secured mortgage loan warehouse agreement with a group of banks, which is a short-term borrowing facility, provides up to \$150 million through March 13, 2008. Interest is payable monthly at the LIBOR Rate plus 0.9%. The loan is repaid when we sell the underlying mortgage loans to permanent investors. We also have a commercial paper facility in the amount of \$150 million. The facility expires on April 18, 2008 and interest is payable monthly at the LIBOR Rate plus 0.40%. We believe that we will be able to extend the facilities beyond their current expiration dates or negotiate replacement facilities, but there can be no assurance of such extension or replacement facilities. As of April 30, 2007 and October 31, 2006, borrowings under both agreements were \$121.8 million and \$270.2 million, respectively. The agreements require K. Hovnanian American Mortgage, LLC to satisfy and maintain specified financial ratios and other financial condition tests. As of April 30, 2007, we were in compliance with the covenants of these agreements.

10. At April 30, 2007, we had \$1,655.3 million of outstanding senior notes (\$1,650.3 million, net of discount), comprised of \$140.3 million 10 1/2% Senior Notes due 2007, \$100 million 8% Senior Notes due 2012, \$215 million 6 1/2% Senior Notes due 2014, \$150 million 6 3/8% Senior Notes due 2014, \$200 million 6 1/4% Senior Notes due 2015, \$300 million 6 1/4% Senior Notes due 2016, \$300 million 7 1/2% Senior Notes due 2016, and \$250 million 8 5/8% Senior Notes due 2017. At April 30, 2007, we had \$400.0 million of outstanding senior subordinated notes, comprised of \$150 million 8 7/8% Senior Subordinated Notes due 2012, \$150 million 7 3/4% Senior Subordinated Notes due 2013, and \$100 million 6% Senior Subordinated Notes due 2010.

Under the terms of the indentures governing our debt securities, we have the right to make certain redemptions and depending on market conditions and covenant restrictions, may do so from time to time. The indentures governing the senior notes and senior subordinated notes contain restrictive covenants that limit, among other things, the ability of Hovnanian and certain of its subsidiaries, including K. Hovnanian, the issuer of the senior notes and senior subordinated notes, to incur additional indebtedness, pay dividends on common and preferred stock and repurchase capital stock, make other restricted payments, make investments, sell certain assets, incur liens, consolidate, merge, sell or otherwise dispose of all or substantially all of its assets and enter into certain transactions with affiliates. The indentures contain events of default which would permit the holders of the senior notes and senior subordinated notes to declare those notes to be immediately due and payable if not cured within applicable grace periods, including the failure to make timely payments on the notes or other material indebtedness, the failure to satisfy covenants and specified events of bankruptcy and insolvency. As of April 30, 2007, we were in compliance with the covenants of these indentures.

11. Per Share Calculations - Basic earnings per common share is computed using the weighted average number of shares outstanding. Diluted earnings per common share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to non-vested stock and outstanding options to purchase common stock, of 2.2 million and 2.4 million for the three and six months ended April 30, 2006, respectively. For the three and six months ended April 30, 2007 there were no incremental shares attributed to non-vested stock and outstanding options to purchase common stock because we had a net loss for the period, and any incremental shares would not be dilutive.

12. On July 12, 2005, we issued 5,600 shares of 7.625% Series A Preferred Stock, with a liquidation preference of \$25,000 per share for net proceeds of \$135 million. Dividends on the Series A Preferred Stock are not cumulative and are paid at an annual rate of 7.625%. The Series A Preferred Stock is not convertible into the Company's common stock and is redeemable in whole or in part at our option at the liquidation preference of the shares beginning on the fifth anniversary of their issuance. The Series A Preferred Stock is traded as depositary shares, with each depositary share representing 1/1000th of a share of Series A Preferred Stock. The depositary shares are listed on the Nasdaq Global Market under the symbol HOVNP. The net proceeds from the offering, reflected in Preferred Stock in the Condensed Consolidated Balance Sheets, were used for the partial repayment of the outstanding balance under our revolving credit facility as of July 12, 2005. In each of the first and second quarters of 2007 and 2006, we paid \$2.7 million of dividends on the Series A Preferred Stock.

13. Operating and Reporting Segments - SFAS 131, *Disclosures About Segments of an Enterprise and Related Information* ("SFAS 131") defines operating segments as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions. The Company has identified

its chief operating decision-maker as the Chief Executive Officer. Under the definition, we have more than 70 homebuilding operating

segments, and therefore, in accordance with paragraph 24 of SFAS 131, it is impractical to provide segment disclosures for this many segments. As such, we have aggregated the homebuilding operating segments into six reportable segments.

The Company's operating segments are aggregated into reportable segments in accordance with SFAS 131, based primarily upon geographic proximity, similar regulatory environments, land acquisition characteristics and similar methods used to construct and sell homes. The Company's reportable segments consist of:

Homebuilding:

- (1) Northeast (New Jersey, New York, Pennsylvania)
- (2) Mid-Atlantic (Delaware, Maryland, Virginia, West Virginia, Washington D.C.)
- (3) Midwest (Illinois, Kentucky, Michigan, Minnesota, Ohio)
- (4) Southeast (Florida, Georgia, North Carolina, South Carolina)
- (5) Southwest (Arizona, Texas)
- (6) West (California)

Financial Services

Operations of the Company's Homebuilding segments primarily include the sale and construction of single-family attached and detached homes, attached townhomes and condominiums, mid-rise and high-rise condominiums, urban infill and active adult homes in planned residential developments. Operations of the Company's Financial Services segment include mortgage banking and title services to the homebuilding operations' customers. We do not retain or service mortgages that we originate but rather sell the mortgages and related servicing rights to investors.

Evaluation of segment performance is based primarily on operating earnings from continuing operations before provision for income taxes. Operating earnings for the Homebuilding segments consist of revenues generated from sales of homes and land, equity in earnings from unconsolidated entities and management fees and other income, net, less the cost of homes and land sold, selling, general and administrative expenses and minority interest expense, net. Operating earnings for the Financial Services segment consist of revenues generated from mortgage banking and title services, less the cost of such services and certain selling, general and administrative expenses incurred by the Financial Services segment.

Operational results of each segment are not necessarily indicative of the results that would have occurred had the segment been an independent, stand-alone entity during the periods presented.

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Financial information relating to the Company's operations was as follows:

	Three Months Ended		Six Months Ended	
	April 30,		April 30,	
(In thousands)	2007	2006	2007	2006
Revenues:				
Northeast				