

**Hovnanian Enterprises, Inc.**

*Annual Report 2001*



*Growing Strong*



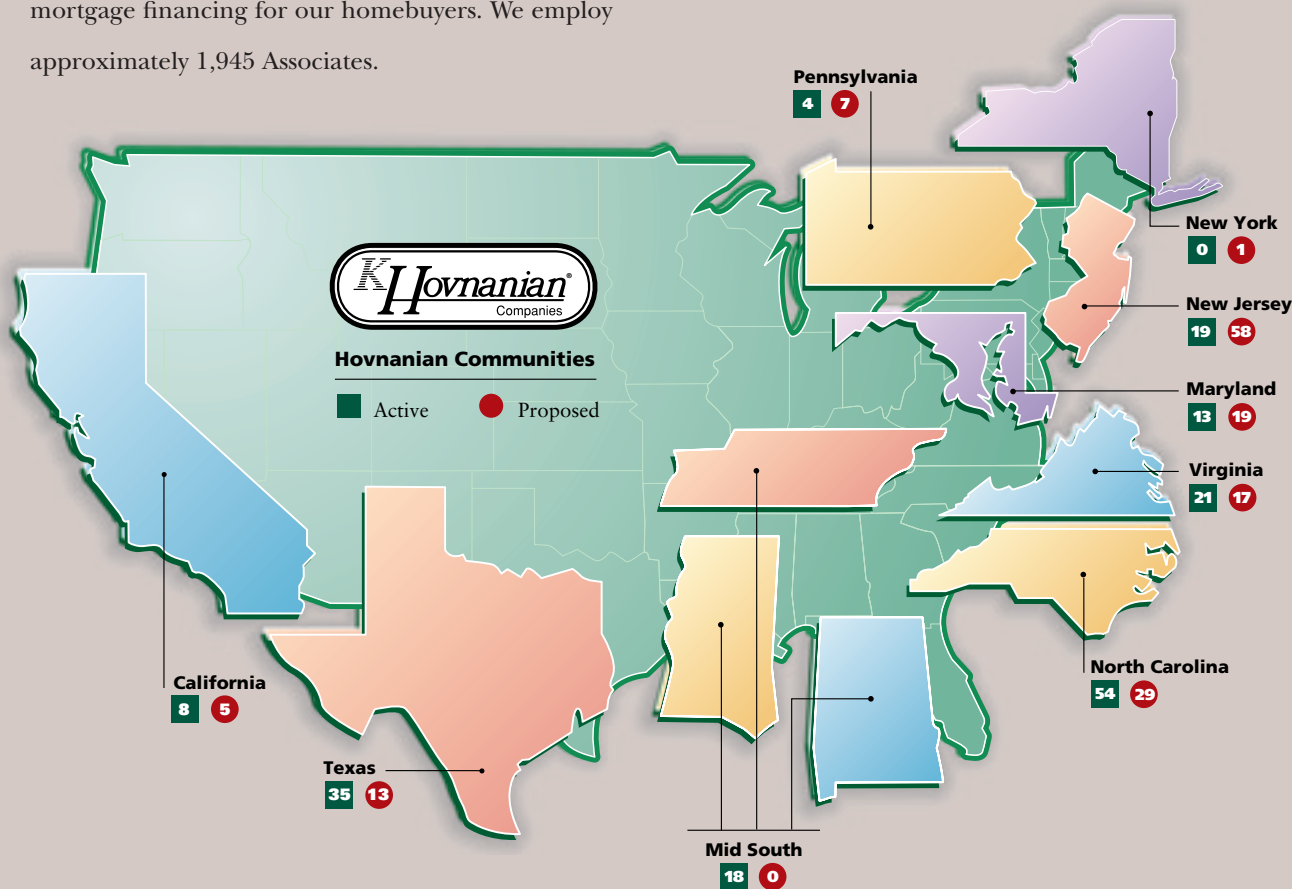
# Hovnanian Enterprises, Inc.

## Company Profile

As one of America's leading homebuilders, we design, build and sell a wide variety of home designs, from entry-level condominiums to luxury single family homes in planned communities in Alabama, California, Maryland, Mississippi, New Jersey, New York, North Carolina, Pennsylvania, Tennessee, Texas and Virginia. We are proud of our reputation for building homes of superior quality and value. We also provide mortgage financing for our homebuyers. We employ approximately 1,945 Associates.

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## Common Stock\*

	Fiscal 2001		Fiscal 2000	
	High	Low	High	Low
First Quarter	\$ 9.99	\$ 7.19	\$6.88	\$5.25
Second Quarter	\$18.75	\$ 8.75	\$6.62	\$5.44
Third Quarter	\$19.34	\$13.00	\$6.38	\$5.44
Fourth Quarter	\$15.00	\$ 9.71	\$7.94	\$5.88

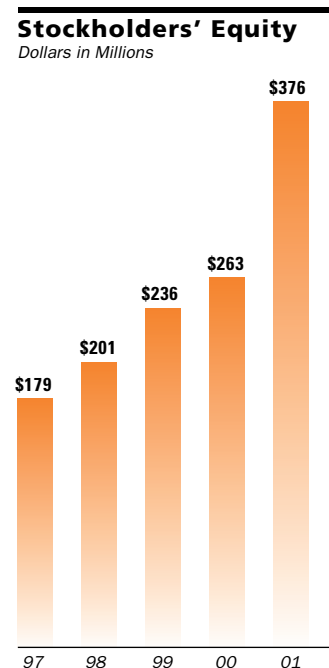
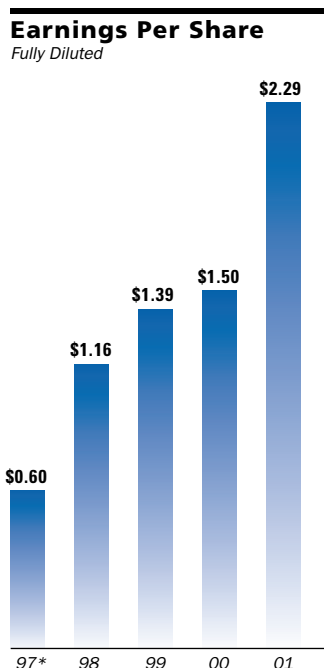
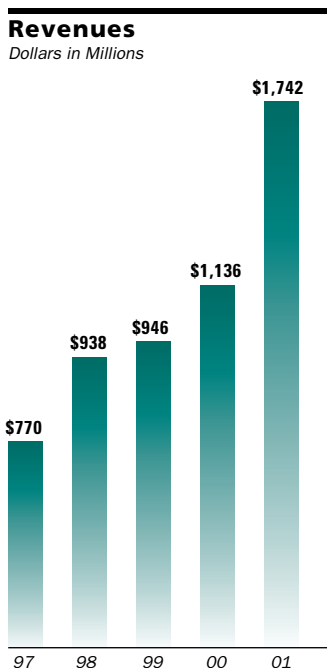
\*At October 31, 2001 our Class A Common Stock was held by approximately 607 shareholders of record and our Class B Common Stock was held by approximately 439 shareholders of record.

For additional information, visit our website at [khov.com](http://khov.com)

# Financial Highlights

Hovnanian Enterprises, Inc.

	For the Year Ended October 31,				
	2001	2000	1999	1998	1997
<b>Contracts, Deliveries and Backlog</b> (Dollars in Millions)					
Net Sales Contracts	<b>\$1,619.4</b>	\$1,102.1	\$796.5	\$806.2	\$762.8
Deliveries	<b>\$1,693.7</b>	\$1,105.5	\$908.6	\$895.6	\$731.8
Contract Backlog at Year-End	<b>\$ 773.1</b>	\$ 538.5	\$460.7	\$381.8	\$374.3
<b>Revenues and Income</b> (Dollars in Millions)					
Total Revenues	<b>\$1,742.0</b>	\$1,135.6	\$946.4	\$937.7	\$770.4
Pre-tax Earnings (Loss)	<b>\$ 106.4</b>	\$ 51.8	\$ 50.6	\$ 41.3	\$ (12.1)
Net Income (Loss)	<b>\$ 63.7</b>	\$ 33.2	\$ 30.1	\$ 25.4	\$ (7.0)
EBITDA	<b>\$ 175.1</b>	\$ 98.2	\$ 91.3	\$ 90.3	\$ 59.3
Return on Average Stockholders' Equity	<b>19.3%</b>	13.5%	14.0%	13.4%	(3.8)%
<b>Assets, Debt and Equity</b> (Dollars in Millions)					
Total Assets	<b>\$1,064.3</b>	\$ 873.5	\$712.9	\$589.1	\$637.1
Total Recourse Debt	<b>\$ 396.5</b>	\$ 396.4	\$320.1	\$213.4	\$285.0
Stockholders' Equity	<b>\$ 375.6</b>	\$ 263.4	\$236.4	\$201.4	\$178.8
<b>Earnings and Book Value Per Share</b> (Shares in Thousands)					
Fully Diluted Earnings (Loss) Per Share	<b>\$ 2.29</b>	\$ 1.50	\$ 1.39	\$ 1.16	\$ (0.31)
Fully Diluted Weighted Average Shares Outstanding	<b>27,792</b>	22,043	21,612	22,016	22,506
Book Value Per Outstanding Share at Year-End	<b>\$ 13.48</b>	\$ 12.42	\$10.67	\$ 9.34	\$ 8.18



\*Excluding the impact of writedowns and interest policy refinement

## To Our Shareholders and Associates

We are pleased to report that 2001 was another in a series of record-breaking years, by virtually every measure. Revenues soared to an all-time high of \$1.7 billion, an increase of 53% over \$1.1 billion in 2000. The Company delivered a record 6,791 homes. More important, net income nearly doubled from last year, to \$63.7 million, or \$2.29 per fully diluted share, up from \$1.50 last year and nearly a four-fold increase from 1997.

A solid year of sales in all our markets allowed us to post a record 6,722 contracts with a sales value of \$1.6 billion, up 47% from last year. Our contract backlog going into fiscal year 2002 is a very healthy 3,033 homes with a sales value of \$773 million, equivalent to nearly half of our projected deliveries for fiscal 2002.

*“Net income nearly doubled from last year, to \$63.7 million, or \$2.29 per fully diluted share, up from \$1.50 last year and nearly a four-fold increase from 1997.”*

### THE IMPACT OF WASHINGTON HOMES

An important factor contributing to the improved performance was our merger with Washington Homes earlier this year. Our expanded and improved operations in the Washington, D.C. and North Carolina markets made an immediate and significant

contribution to our profits for the year. Just as important, we have been able to very quickly integrate this large acquisition into our Company's core practices and culture, while learning much from their focus on operational efficiency and cost containment. With strong leadership and a great team, Washington Homes has proven to be an outstanding acquisition.

### ECONOMIC OUTLOOK

Despite the recent economic climate, which has impacted many industries across the country, we remain optimistic about the near-term and long-term prospects for housing, and for our Company in particular. The demand for new homes continues to outstrip available supply in many of our markets, due in large part to increased regulatory restrictions on development. This scarcity of available lots has kept prices firm and rising, and has allowed us to maintain strong absorptions at active communities.

A dominant presence in our core markets is also helping us to continue meeting our sales projections. In fact, sales have remained strong, and have even risen slightly since the terrorist attacks on September 11th.

Additionally, mortgage rates remain near 30-year lows, improving affordability and bringing more families into the home-buying mix. Our long-term view is also bullish, with 11.7 million

household formations projected in the next decade. Add to that our expertise and strong position developing active adult communities, which target the fastest growing segment of the population, and we have a great formula for success and growth.

### **GROWING STRONG**

Throughout much of the 1990's, we focused not on growth, but on improving our Company's operations and margins, while strengthening our balance sheet and preparing for growth with a solid foundation. As our performance in fiscal 2001 indicates, we have achieved the operational

improvements needed to enable and sustain growth. A notable indicator of our improved operational efficiency is a decline in total SG&A expenses from 12.2% in 2000 to 10.6% this year. And our pretax margin rose to 6.1% from 4.6% in 2000. We expect these important performance measures to continue to improve in the years ahead.

In recent years, we began to grow in earnest, building on our strong financial base, with the acquisitions of Matzel and Mumford in New Jersey, Goodman Family of Builders in Texas, the land portfolio of Westminster Homes in New Jersey, and Washington Homes. We've been able to quickly and efficiently integrate these operations, and they have brought immediate profitability to our bottom line.

Our announcement in December of the acquisition of Forecast Homes in California is the latest example of our growth strategy. This outstanding acquisition is expected to be \$0.50 accretive to earnings per share in 2002, and again reflects our strategy to leverage acquisitions to achieve marketplace dominance. With Forecast Homes, we will be the second largest builder in both the "Inland Empire" market of southern California and the combined Sacramento and Central Valley market in northern California.

Our plan is to continue to grow in the years ahead, based on a solid capital structure and with a continued focus on maximizing shareholder returns. We plan to continue to increase our rank among the nation's top builders, while continuing to improve our record financial performance.

Thanks to our solid financial performance, we are poised for additional growth, both internally and through acquisition. At year's end, we controlled nearly 37,000 prime building lots (45,000 including the Forecast Homes acquisition), enough to meet our needs for nearly 5 years. As a result, the substantial majority of home deliveries in the Company's growth plan for the next few years will come from communities that we currently own or control under an option contract.

*“As our performance in fiscal 2001 indicates, we have achieved the operational improvements needed to enable and sustain growth.”*



This reduces our exposure to rising lot prices, and gives us a high degree of confidence in our growth plan. Yet, only about 30% of these lots are owned, with the balance held under option contracts, which reduces our risk and allows us to maintain balance sheet flexibility and liquidity.

Indeed, our balance sheet and financial performance has improved in almost every category. Pre-tax profit for the year totaled \$106.4 million, up 105% from last year, including a one-time pre-tax restructuring charge of \$3.25 million resulting from the Washington Homes merger. Our return on beginning equity for 2001 was 24%, and our return on average equity was nearly 20%, a very strong performance. Our return on capital, a critical performance measure for us, was 13% for the year.

Our earnings continued to grow impressively, with compounded annual growth of 47% over the past five years. This is compared to a growth in revenues of 22% over the same period,

reflecting our commitment to grow our bottom line results more quickly than our top line performance.

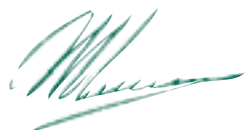
This very solid earnings growth is allowing us to grow without reliance on debt. Our debt to equity ratio at year-end stood at only 1.06 to 1.0, and we had very strong interest coverage for the year, at 3.7 to 1.0.

***“This very solid earnings growth is allowing us to grow without reliance on debt. Our debt to equity ratio at year-end stood at only 1.06 to 1.0.”***

Again, this is reflective of one of our core strategies, to grow on the strength of our earnings.

Finally, we are very pleased to report that our Financial Services segment, comprised of our Mortgage and Title operations, contributed to our solid performance as well. Our Financial Services operations reported pre-tax earnings for the year of \$10.0 million, compared with a small loss in the prior year, resulting in part from a successful restructuring of our Mortgage operations. We expect continued improvement from this sector in the years ahead.

As you can see, 2001 was a very good year for our Company. As important, we are very optimistic about 2002 and beyond, and are confident that we'll continue to improve, to grow and to prosper as a Company. We are deeply indebted to all of our Associates and our business partners who worked so hard all year to achieve this outstanding performance.



Kevork S. Hovnanian  
Founder and Chairman



Ara K. Hovnanian  
President and  
Chief Executive Officer

## **Growing Strong**

**I**n order to achieve the best possible returns for our shareholders, a core strategy for the future of our Company is growth. We consider growth to be a competitive requirement as well. The nation's top homebuilders are becoming ever-larger and more dominant, and mergers and acquisitions of all sizes dominate our industry's landscape. We are in a great position to continue growing profitably without undue risk. We're financially strong, we're in great markets, we have a strong management team, and we have well-designed and nimble operations.

Our growth strategies are comprised of five related elements: 1) achieving marketplace dominance; 2) achieving "internal growth" in our current markets; 3) maintaining and expanding a broad product array; 4) increasing our commitment to active adult community development in our markets outside the Northeast; and 5) acquiring companies that fit our strategic plan to accelerate our growth.

*"We're in a great position to continue growing profitably without undue risk."*

### **DOMINATING THE MARKETPLACE**

As the largest homebuilder in New Jersey and North Carolina and the second largest builder in the Metro-Washington, D.C. market, we have substantially achieved one of our core growth strategies – dominating our local marketplaces. We have proven that market dominance provides important competitive advantages – powers and economies of scale that allow us to get the "first look" at the best land opportunities, to recruit the best people, purchase materials and labor less expensively, leverage our marketing efforts and achieve valuable name recognition. We plan to maintain this advantage where we have it, and to achieve it where we don't.

### **GROWING INTERNALLY**

We plan to grow our business in our current strong markets by increasing the number of residential communities in which we are selling homes. This will require us to maintain our proactive approach toward land and to increase our commitment of available capital to control more lots, while also maintaining our conservative strategy of controlling these lots primarily through options. Our dominant market positions and expertise in land acquisition and development will facilitate this growth. We'll also look to the geographic boundaries of our markets, with an eye toward expanding into current voids. Our markets remain strong and vibrant, and thus we also see more room to grow by increasing absorption at our current communities.

## **EXPLORING NEW MARKET NICHES**

There are opportunities in our current markets to expand our already diversified product offerings. We intend to look beyond our traditional product lines in each of our markets, and to look for new opportunities to attract a broader segment of the home-buying population. Our creation of a national Product Development Team will increase our nimbleness and ability to share a broad array of product offerings and great designs across our different regions.

Another important growth opportunity that we will continue to exploit is urban redevelopment. Regulators and planners are driving such redevelopment as a goal and thus the relative returns and risks are highly attractive. We have expertise in this area of homebuilding, with successful communities in northern New Jersey urban areas dating back to the mid 1980's. Opportunities abound in northern New Jersey, Philadelphia, Washington D.C., Baltimore, and Los Angeles. We intend to take advantage of them, and currently have several communities in development and selling successfully.

*“We intend to look beyond our traditional product lines in each of our markets, and to look for new opportunities to attract a broader segment of the home-buying population.”*

## **OUR GROWING COMMITMENT TO THE ACTIVE ADULT MARKET**

The huge baby boomer generation was the driving force behind our shift in product offerings from entry level, attached housing in the 1980's to move-up and luxury housing in the 1990's. In the same way, we are following the boomers into late middle age by shifting our focus to meet their changing housing needs in the form of age-restricted “active adult” communities, with our “K. Hovnanian's Four Seasons” brand.

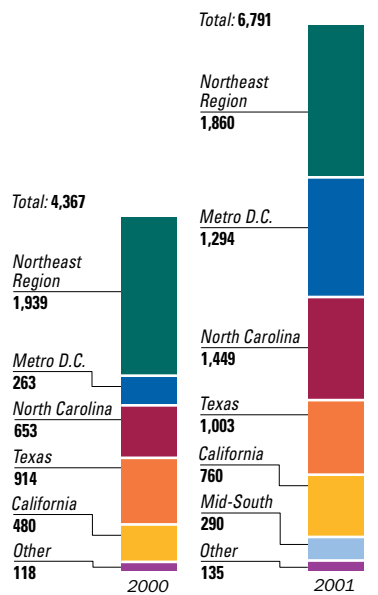
Already in our Northeast Region, active adult communities account for close to 30% of our deliveries. We opened our first K. Hovnanian's Four Seasons community in southern California in January of 2001, with outstanding sales performance, and we have one successful community in North Carolina, with more in the planning stages. Plans are also underway to open additional K. Hovnanian's Four Seasons communities in Maryland, Virginia and Texas. The demographics speak for themselves in describing the enormous potential of the active adult market in the coming decades. We are already exploiting our expertise and success in catering to this unique market, and we plan to have our K. Hovnanian's Four Seasons brand account for approximately 30% of our business in each of our markets going forward.





**Because of our expertise in developing a wide variety of amenitized active adult lifestyle communities, our "K. Hovnanian's Four Seasons" brand is quickly establishing a national reputation for excellence. Our commitment to this important market is growing, with new communities opening this year in several of our markets.**

### Homes Delivered



## **GROWING THROUGH ACQUISITION**

Growing by acquiring other companies is a potent strategy for achieving rapid growth, as our industry has shown in recent years. It can also be very challenging, as combining different cultures, management staffs and operating practices is no small feat. Unlike some national builders, whose acquisition strategies do not include the desire for such cultural and operating integration, it is our intention to achieve a “one company” model, with standardized processes and practices to the greatest extent possible. We do not want to be merely “a collection of homebuilding companies,” growing bigger without gaining competitive advantages.

With our recent acquisitions of Matzel & Mumford in New Jersey, Goodman Family of Builders in Dallas and Washington Homes, we have proven our ability to quickly and successfully integrate newly acquired companies into our culture and operating practices, while learning and adopting better methodologies from each of the acquired operations. We believe this ability is crucial to successfully achieving growth through acquisition.

*“We have proven our ability to quickly and successfully integrate newly acquired companies into our culture and operating practices”*

Our acquisition of Washington Homes is also evidence of our strategy to achieve dominance in markets where we lack it. With the joining of Washington Homes, we catapulted into the position of the largest builder in North Carolina and the second-largest builder in the Washington, D.C. market, where we were previously a much smaller player. Our strategic acquisition of the land position of Westminster Homes in New Jersey this year, consisting of 14 communities and over 1,200 lots, is another example of this strategy in action. Future acquisitions will be made with the same strategic goal of achieving a dominant position in each of our current or new markets.

## **OPERATIONAL STRATEGIES TO SUPPORT GROWTH**

We are creating a “one company” model, with a shared culture and with standardized processes and products, in several ways.

### ***Standardizing Our Processes***

We recognize that certain “local” practices and methods dictate necessary differences in the way we run our business, but our goal is to identify best practices wherever they exist, and to institutionalize them in all our operations, with a constant eye toward cost efficiency and enhanced productivity. Using a careful, phased approach, we are implementing our new



*North Carolina's Builder of Choice.*



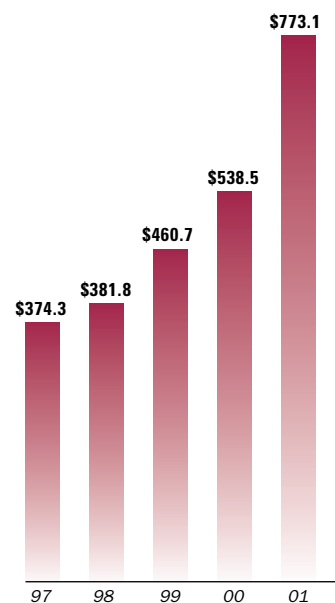
Matzel & Mumford



***Our recent experience of growth through acquisition, with the addition of Matzel & Mumford, Goodman Family Homes, and Washington Homes, Inc., has proven to be an excellent strategy, as each new acquisition has been an outstanding contributor to our overall performance.***

**Contract Backlog**

*Backlog value in millions of dollars*



enterprise-wide software system featuring one-time data entry, universal access to information, and countless productivity enhancements. We intend to implement this system company-wide, over a period of several years, enabling us to further standardize our processes, reduce our costs and support our continued growth.

### ***Standardizing Our Product Portfolio***

Of course, we recognize that a brick-front colonial home is not likely to be well received in San Diego. But that design does sell in North Carolina, Virginia, Maryland, New Jersey, and Pennsylvania. To the extent that our products can achieve marketplace acceptance, we are standardizing our product portfolio to be used in multiple markets. Our new national Product Development Team will create and manage our broad product array. A standardized product portfolio gives us the ability to perfect efficient building methods, standardize materials to support national contracting and reduce architectural design costs. We had no contracts with national material suppliers just a few short years ago, where we now have over 20 cost saving national contracts, and we're working on more.

*“With a solid financial footing, a strong management team, and excellent markets in which we maintain dominant positions, we are poised for continued strong growth and outstanding profit performance.”*

### ***Developing Our Associates***

Our commitment to the training and development of our Associates is unmatched in our industry. Through our Leadership Development Program, our Career Path program, Corporate Training Department, and numerous other initiatives, we're nurturing the future leaders we'll need to support our growth. We recognize that our successful growth is completely dependent upon the skill, talent and commitment of our Associates. We have the programs in place to ensure that we'll be ready for growth with the best people in the industry.

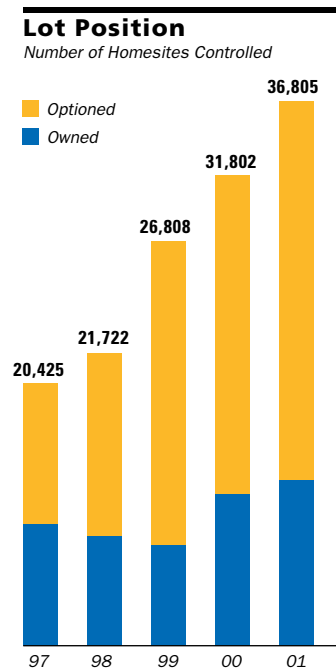
### **GROWING STRONG**

In closing, we are bullish on the future. With a solid financial footing, a strong management team, and excellent markets in which we maintain dominant positions, we are poised for continued strong growth and outstanding profit performance. We're very optimistic about the long-term prospects for housing markets, and we're confident that we'll secure our place among America's top builders. We're well on our way to becoming *THE BEST* homebuilder in the nation.





*Our plan is to create a "one company" model, where best practices are standardized across all Regions. That operating model is being created with valuable input from our Associates, who understand our processes and practices, and are helping to identify the "best methods" to institutionalize.*



## Board of Directors

KEVORK S. HOVNIANIAN (78) is the founder of the Company and has served as Chairman of the Board since its



original incorporation in 1967. He served as Chief Executive Officer from 1967 through 1997. In 1996, the New Jersey Institute of Technology awarded

Mr. Hovnianian a President's Medal for "Distinguished Achievement to an Outstanding Entrepreneur". In 1992, Mr. Hovnianian was granted one of five nationwide Harvard Dively Awards for Leadership in Corporate Public Initiatives.

ARA K. HOVNIANIAN (44) has been Chief Executive Officer since 1997 after being appointed President in



1988 and Executive Vice President in 1983; joining the Company in 1979. In 1985, Governor Kean appointed Mr. Hovnianian to The

Council on Affordable Housing and he was reappointed to the Council in 1990 by Governor Florio. In 1994, Governor Whitman appointed him as member of the Governor's Economic Master Plan Commission. Mr. Hovnianian serves as a Member of the Advisory Council of PNC Bank, The Monmouth Real Estate Investment Corporation and is on the Boards of a variety of charitable organizations.

ARTHUR M. GREENBAUM, ESQ. (76) has been a senior partner of Greenbaum, Rowe, Smith, Ravin, Davis & Himmel, a law firm since 1950.



DESMOND P. McDONALD\* (74) was a Director of Midlantic Bank, N.A. from 1976 to December 1995,



Executive Committee Chairman of Midlantic Bank, N.A. from August 1992 to December 1995 and was President of Midlantic Bank, N.A. from 1976 to June 1992.

He was also a Director of Midlantic Corporation to December 1995 and was Vice Chairman of Midlantic Corporation from June 1990 to July 1992.

JOHN J. ROBBINS\* (62) was a managing partner of the New York office of Kenneth Leventhal & Company



and executive committee partner, retiring from the firm in 1992. Mr. Robbins has been a Trustee of Keene Creditors Trust since 1996. Mr. Robbins

was elected as a Director of the Company in January 2001.

STEPHEN D. WEINROTH\* (63) is Chairman of the Board of Core Laboratories N.V. He is also a senior



partner in Andersen, Weinroth & Co. L.P., a merchant banking firm. He has held such positions since 1994 and the beginning of 1996 respectively.

From November 1993 until December 1995 he was Co-Chairman and Co-Chief Executive Officer of VETTA Sports, Inc. From 1989 to the present, Mr. Weinroth has been Co-Chairman of the Board of Directors and Chairman of the Investment Committee of First Britannia N.V.

PAUL W. BUCHANAN (51) has been Senior Vice President and Corporate Controller since May 1990.



Mr. Buchanan was elected a Director of the Company in March 1982. Mr. Buchanan is a CPA and prior to joining the Company, he was

employed by Deloitte, Haskins & Sells.

GEATON A. DECESARIS, JR. (46) has been President of Homebuilding



Operations and Chief Operating Officer since January 2001. Mr. DeCesaris served as President and Chief Executive Officer of

Washington Homes, Inc. prior to joining the Company in 2001. Mr. DeCesaris was honored as the Washington, D.C. area's Entrepreneur of the Year in the real estate category in 1994, sponsored by Inc. magazine and Ernst and Young. Mr. DeCesaris was elected as a Director of the Company in January 2001.

PETER S. REINHART (51) has been Senior Vice President and



General Counsel since April 1985 and was elected Secretary of the Company in February 1997.

Mr. Reinhart was elected a Director of the Company in December 1981.

J. LARRY SORSBY (46) has been Chief Financial Officer of the



Company since 1996 and Executive Vice President since November 2000. He became a member of the Board in 1997.

From March 1991 to November 2000, he was Senior Vice President, and from March 1991 to July 2000, he was Treasurer.

*\*Member of the Audit Committee*



## Communities Under Development

Net Sales Contracts	For the Year Ended					
	Homes			Dollars (In thousands)		
	October 31, 2001	October 31, 2000	Percent Change	October 31, 2001	October 31, 2000	Percent Change
Northeast Region .....	1,871	1,963	(4.7%)	\$ 509,784	\$ 519,994	(2.0%)
North Carolina .....	1,466	661	121.8%	266,048	122,527	117.1%
Metro D. C. ....	1,253	329	280.9%	323,603	82,406	292.7%
California .....	781	502	55.6%	259,311	160,854	61.2%
Texas .....	984	935	5.2%	210,459	192,460	9.4%
Mid South .....	313	—	N/A	48,300	—	N/A
Other .....	54	152	(64.5%)	1,865	23,861	(92.2%)
Total .....	6,722	4,542	48.0%	\$1,619,370	\$1,102,102	46.9%

Contract Backlog	For the Year Ended					
	Homes			Dollars (In thousands)		
	October 31, 2001	October 31, 2000	Percent Change	October 31, 2001	October 31, 2000	Percent Change
Northeast Region .....	1,160	1,149	1.0%	\$322,100	\$311,539	3.4%
North Carolina .....	534	215	148.4%	103,616	40,635	155.0%
Metro D.C. ....	779	215	262.3%	208,888	52,339	299.1%
California .....	172	151	13.9%	53,338	58,089	(8.2%)
Texas .....	263	282	(6.7%)	64,961	61,703	5.3%
Mid South .....	122	—	N/A	19,734	—	N/A
Other .....	3	84	(96.4%)	437	14,241	(96.9%)
Total .....	3,033	2,096	44.7%	\$773,074	\$538,546	43.5%

Deliveries	For the Year Ended					
	Homes			Dollars (In thousands)		
	October 31, 2001	October 31, 2000	Percent Change	October 31, 2001	October 31, 2000	Percent Change
Northeast Region .....	1,860	1,939	(4.1%)	\$ 570,647	\$ 561,422	1.6%
North Carolina .....	1,449	653	121.9%	255,390	126,596	101.7%
Metro D.C. ....	1,294	263	392.0%	310,815	66,137	370.0%
California .....	760	480	58.3%	280,582	143,729	95.2%
Texas .....	1,003	914	9.7%	215,045	186,294	15.4%
Mid South .....	290	—	N/A	44,372	—	N/A
Other .....	135	118	14.4%	16,866	21,288	(20.8%)
Total .....	6,791	4,367	55.5%	\$1,693,717	\$1,105,466	53.2%

All statements in this Annual Report that are not historical facts should be considered "forward-looking statements" within the meaning of the Private Securities Litigation Act of 1995. Such statements involve known and unknown risks, uncertainties and other factors that may cause actual results to differ materially. Such risks, uncertainties and other factors include, but are not limited to, changes in general economic conditions, fluctuations in interest rates, increases in raw materials and labor costs, levels of competition and other factors described in detail in the Company's Form 10K for the year ended October 31, 2001.

**Ten Year Financial Review**

(In Thousands Except Number of Homes and Per Share Data)	Years Ended October 31,			
	2001	2000	1999	1998
<b>Statement of Operations Data:</b>				
Total Revenue .....	\$1,741,963	\$1,135,559	\$946,414	\$937,729
Writedown of Inventory and Investment Properties .....	\$ 4,368	\$ 1,791	\$ 2,091	\$ 5,032
Pre-Tax Income.....	\$ 106,354	\$ 51,818	\$ 50,617	\$ 41,292
Net Income .....	\$ 63,686	\$ 33,163	\$ 30,075	\$ 25,403
Net Income per common share				
Diluted .....	\$ 2.29	\$ 1.50	\$ 1.39	\$ 1.16
Weighted Average Shares Outstanding <sup>(2)</sup> .....	27,792	22,043	21,612	22,016
<b>Balance Sheet Data:</b>				
Cash .....	\$ 16,149	\$ 43,253	\$ 19,365	\$ 14,792
Inventory.....	\$ 740,114	\$ 614,983	\$527,230	\$375,733
Total Assets.....	\$1,064,258	\$ 873,541	\$712,861	\$589,102
Total Recourse Debt.....	\$ 396,544	\$ 396,430	\$320,125	\$213,449
Total Non-Recourse Debt.....	\$ 13,490	\$ 21,720	\$ 10,069	\$ 15,616
Stockholders' Equity.....	\$ 375,646	\$ 263,359	\$236,426	\$201,392
<b>Supplemental Financial Data:</b>				
EBIT <sup>(4)</sup> .....	\$ 157,800	\$ 86,968	\$ 80,851	\$ 79,493
EBITDA .....	\$ 175,072	\$ 98,172	\$ 91,277	\$ 90,268
Cash Flow From Operating Activities.....	\$ 37,069	\$ (60,645)	\$ 35,479	\$ 65,054
Interest Incurred .....	\$ 47,272	\$ 38,878	\$ 24,594	\$ 28,947
EBIT/Interest Incurred .....	3.3X	2.2X	3.3X	2.7X
EBITDA/Interest Incurred.....	3.7X	2.5X	3.7X	3.1X
<b>Financial Statistics:</b>				
Average Recourse Debt/Average Equity.....	1.40:1	1.54:1	1.17:1	1.43:1
Homebuilding Inventory Turnover <sup>(3)</sup> .....	2.3X	1.9X	2.2X	2.2X
Homebuilding Gross Margin.....	20.6%	20.7%	21.0%	17.3%
EBIT Margin .....	9.1%	7.8%	8.8%	8.5%
Return on Average Equity.....	19.3%	13.5%	14.0%	13.4%
<b>Operating Statistics:</b>				
Net Sales Contracts – Homes.....	6,722	4,542	3,535	3,877
Net Sales Contracts – Dollars.....	\$1,619,370	\$1,102,102	\$796,453	\$806,247
Deliveries – Homes.....	6,791	4,367	3,768	4,138
Deliveries – Dollars.....	\$1,693,717	\$1,105,466	\$908,553	\$895,644
Backlog – Homes.....	3,033	2,096	1,921	1,681
Backlog – Dollars.....	\$773,074	\$ 538,546	\$460,660	\$381,816

<sup>(1)</sup> The summary consolidated income data for the 12 month period ended October 31, 1994 is unaudited, but in management's opinion includes all accruals and other adjustments necessary for a fair representation.

<sup>(2)</sup> Prior to the fiscal year ended October 31, 1996, represents basic shares outstanding.

<sup>(3)</sup> Derived by dividing total home and land sales by average homebuilding inventory.

<sup>(4)</sup> EBIT for the fiscal year ended October 31, 1997 includes writedowns on investment properties that were sold.

Years Ended October 31,				Years Ended February 28,	
1997	1996	1995	1994 <sup>(1)</sup>	1994	1993
\$770,379	\$796,248	\$777,745	\$704,443	\$587,010	\$429,315
\$ 28,465	\$ 1,608	\$ 2,780	\$ 6,357	0	\$ 3,100
\$ (12,124)	\$ 25,006	\$ 21,654	\$ 16,531	\$ 29,151	\$ 14,525
\$ (6,970)	\$ 17,287	\$ 14,128	\$ 11,477	\$ 18,645	\$ 9,790
\$ (0.31)	\$ 0.75	\$ 0.61	\$ 0.50	\$ 0.82	\$ 0.43
22,506	23,120	23,032	22,906	22,821	22,775
\$ 10,550	\$ 20,731	\$ 15,453	\$ 17,437	\$ 28,094	\$ 17,065
\$410,393	\$376,307	\$404,413	\$386,540	\$278,738	\$243,391
\$637,082	\$614,111	\$645,378	\$612,925	\$539,602	\$465,029
\$285,000	\$230,000	\$280,650	\$299,200	\$200,000	\$167,157
\$ 24,455	\$ 29,069	\$ 29,049	\$ 29,884	\$ 28,941	\$ 35,008
\$178,762	\$193,622	\$176,335	\$162,130	\$171,001	\$151,937
\$ 40,301	\$ 58,771	\$ 55,178	\$ 48,247	\$ 51,681	\$ 39,894
\$ 59,312	\$ 64,017	\$ 59,273	\$ 51,906	\$ 54,716	\$ 42,818
\$ (30,708)	\$ 45,797	\$ (3,358)	\$ (50,109)	\$ (13,293)	\$ (29,934)
\$ 34,777	\$ 35,551	\$ 37,828	\$ 28,353	\$ 25,968	\$ 22,155
1.2X	1.7X	1.5X	1.7X	2.0X	1.8X
1.7X	1.8X	1.6X	1.8X	2.1X	1.9X
1.66:1	1.71:1	2.02:1	1.62:1	1.34:1	1.21:1
1.8X	1.8X	1.7X	2.0X	1.9X	1.7X
15.6%	16.4%	21.1%	20.7%	22.0%	22.8%
5.2%	7.3%	7.1%	6.8%	8.8%	9.3%
(3.8%)	9.5%	8.5%	6.9%	11.8%	6.8%
4,073	4,175	3,910	3,546	4,305	3,331
\$762,750	\$738,331	\$660,033	\$546,185	\$606,601	\$436,848
3,717	4,134	4,244	4,352	3,828	2,999
\$731,807	\$764,682	\$740,481	\$670,870	\$557,489	\$397,306
1,872	1,516	1,476	1,810	1,926	1,449
\$374,314	\$292,376	\$275,701	\$310,455	\$278,127	\$199,751

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Capital Resources and Liquidity**

Our cash uses during the twelve months ended October 31, 2001 were for operating expenses, seasonal increases in housing inventories, construction, income taxes, interest, the repurchase of common stock, and the merger with Washington Homes, Inc. We provided for our cash requirements from housing and land sales, the revolving credit facility, financial service revenues, and other revenues. We believe that these sources of cash are sufficient to finance our working capital requirements and other needs.

Our net income historically does not approximate cash flow from operating activities. The difference between net income and cash flow from operating activities is primarily caused by changes in inventory levels, mortgage loans and liabilities, and non-cash charges relating to depreciation, impairment losses and goodwill amortization. When we are expanding our operations, which was the case in fiscal 2001 and 2000, inventory levels increase causing cash flow from operating activities to decrease. Liabilities also increase as inventory levels increase. The increase in liabilities partially offsets the negative effect on cash flow from operations caused by the increase in inventory levels. As our mortgage warehouse loan asset increases, cash flow from operations decreases. Conversely, as such loans decrease, cash flow from operations increases. Depreciation and impairment losses always increase cash flow from operating activities since they are non-cash charges to operations. We expect to be in an expansion mode in fiscal 2002. As a result, we expect cash flow from operations to be less than net income in fiscal 2002.

On December 31, 2000, our stock repurchase program to purchase up to 4 million shares of Class A Common Stock expired. As of December 31, 2000, 3,391,047 shares had been purchased under this program. On July 3, 2001, our Board of Directors authorized a revision to our stock repurchase program to purchase up to 2 million shares of Class A Common Stock. As of October 31, 2001, 458,700 have been purchased under this program.

Our homebuilding bank borrowings are made pursuant to a revolving credit agreement (the "Agreement") that provides a revolving credit line and letter of credit line of up to \$440,000,000 through July 2004. Interest is payable monthly and at various rates of either the prime rate plus .40% or Libor plus 1.85%. We believe that we will be able either to extend the Agreement beyond July 2004 or negotiate a replacement facility, but there can be no assurance of such extension or replacement facility. We currently are in compliance and intend to maintain compliance with the covenants under the Agreement. As of October 31, 2001, borrowings under the Agreement were zero.

The subordinated indebtedness issued by us and outstanding as of October 31, 2001 was \$99,747,000 9 3/4% Subordinated Notes due June 2005. In April 2001, we retired \$253,000 of these Subordinated Notes. On October 2, 2000, we issued \$150,000,000 10 1/2% Senior Notes due October 2007. The proceeds were used to repay outstanding debt under our "Revolving Credit Facility". On May 4, 1999, we issued \$150,000,000 9 1/8% Senior Notes due April 2009. We believe that we will be able either to repay the subordinated indebtedness and senior notes at their respective maturity dates through cash flows generated from operations or through subsequent debt issuances.

Our mortgage banking subsidiary borrows under a \$110,000,000 bank warehousing arrangement which expires in July 2002. Interest is payable monthly at the Federal Funds Rate plus 1.125%. We believe that we will be able either to extend this agreement beyond July 2002 or negotiate a replacement facility, but there can be no assurance of such extension or replacement facility. Other finance subsidiaries formerly borrowed from a multi-builder owned financial corporation and a builder owned financial corporation to finance mortgage backed securities but in fiscal 1988 decided to cease further borrowing from multi-builder and builder owned financial corporations. These non-recourse borrowings have been generally secured by mortgage loans originated by one of our subsidiaries. As of October 31, 2001, the aggregate outstanding principal amount of such borrowings was \$100,704,000.

Total inventory increased \$125,131,000 from October 31, 2000 to October 31, 2001. This increase was primarily due to the merger with Washington Homes, Inc. and significant land purchases in the Northeast Region. In addition, inventory increased in most of our other markets except in California where inventory decreased due to strong home deliveries. Substantially, all homes under construction or completed and included in inventory at October 31, 2001 are expected to be closed during the next twelve months. Most inventory completed or under development is financed through our revolving credit facility, senior notes, and subordinated indebtedness.

We usually option property for development prior to acquisition. By optioning property, we are only subject to the loss of a small option fee and predevelopment costs if we choose not to exercise the option. As a result, our commitment for major land acquisitions is reduced.

The following table summarizes housing lots included in our total residential real estate:

	Total Home Lots	Contracted Not Delivered	Remaining Lots Available
<b>October 31, 2001:</b>			
Northeast Region.....	15,875	1,136	14,739
North Carolina.....	6,576	534	6,042
Metro D. C.....	7,568	779	6,789
California.....	1,670	172	1,498
Texas.....	2,828	263	2,565
Mid South.....	1,279	122	1,157
Other.....	1,009	3	1,006
Total.....	36,805	3,009	33,796
Owned.....	10,970	2,525	8,445
Optioned.....	25,835	484	25,351
Total.....	36,805	3,009	33,796
<b>October 31, 2000:</b>			
Northeast Region.....	15,957	1,149	14,808
North Carolina.....	2,731	215	2,516
Metro D. C.....	5,583	215	5,368
California.....	2,591	151	2,440
Texas.....	2,380	282	2,098
Other.....	2,560	84	2,476
Total.....	31,802	2,096	29,706
Owned.....	10,012	1,963	8,049
Optioned.....	21,790	133	21,657
Total.....	31,802	2,096	29,706

We expect to fund future acquisitions of home lots contracted not delivered and remaining lots available principally through cash flows from operations and through our revolving credit agreement.

The following table summarizes our started or completed unsold homes in active, substantially completed and suspended communities:

	October 31, 2001			October 31, 2000		
	Unsold Homes	Models	Total	Unsold Homes	Models	Total
Northeast Region .....	69	48	117	133	48	181
North Carolina .....	205	41	246	102	31	133
Metro D.C. ....	27	27	54	6	7	13
California .....	60	11	71	136	32	168
Texas.....	215	15	230	238	8	246
Mid South .....	54	22	76	—	—	—
Other .....	7	—	7	58	—	58
<b>Total .....</b>	<b>637</b>	<b>164</b>	<b>801</b>	<b>673</b>	<b>126</b>	<b>799</b>

Financial Services - mortgage loans held for sale consist of residential mortgages receivable of which \$105,174,000 and \$61,549,000 at October 31, 2001 and October 31, 2000, respectively, are being temporarily warehoused and awaiting sale in the secondary mortgage market. The balance of mortgage loans held for sale are being held as an investment. We may incur risk with respect to mortgages that are delinquent, but only to the extent the losses are not covered by mortgage insurance or resale value of the house. Historically, we have incurred minimal credit losses.

**Results of Operations**

Our operations consist primarily of residential housing development and sales in our Northeast Region (New Jersey, southern New York state, and eastern Pennsylvania), North Carolina, Metro D. C. (northern Virginia and Maryland), southern California, Texas, and the Mid South (Tennessee, Alabama, and Mississippi). In addition, we provide financial services to our homebuilding customers.

**Total Revenues**

Compared to the same prior period, revenues increased (decreased) as follows:

<i>(Dollars in Thousands)</i>	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
Homebuilding:			
Sale of homes.....	\$588,251	\$196,913	\$12,909
Land sales and other revenues.....	6,049	(6,334)	1,692
Financial services .....	12,104	(1,434)	977
Other Operations .....			(6,893)
Total change .....	<b>\$606,404</b>	\$189,145	\$ 8,685
Percent change.....	<b>53.4%</b>	20.0%	1.0%



**Homebuilding**

Compared to the same prior period, housing revenues increased \$588.3 million or 53.2% for the year ended October 31, 2001, increased \$196.9 million or 21.7% for the year ended October 31, 2000, and increased \$12.9 million or 1.4% for the year ended October 31, 1999. Housing revenues are recorded at the time each home is delivered and title and possession have been transferred to the buyer.

Information on homes delivered by market area is set forth below:

<i>(Dollars in Thousands)</i>	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
<b>Northeast Region:</b>			
Housing Revenues.....	\$ 570,647	\$ 561,422	\$560,586
Homes Delivered.....	1,860	1,939	2,063
<b>North Carolina:</b>			
Housing Revenues.....	\$ 255,390	\$ 126,596	\$145,153
Homes Delivered.....	1,449	653	756
<b>Metro D.C.:</b>			
Housing Revenues.....	\$ 310,815	\$ 66,137	\$ 45,493
Homes Delivered.....	1,294	263	198
<b>California:</b>			
Housing Revenues.....	\$ 280,582	\$ 143,729	\$105,941
Homes Delivered.....	760	480	514
<b>Texas:</b>			
Housing Revenues.....	\$ 215,045	\$ 186,294	\$ 13,184
Homes Delivered.....	1,003	914	66
<b>Mid South:</b>			
Housing Revenues.....	\$ 44,372	—	—
Homes Delivered.....	290	—	—
<b>Other:</b>			
Housing Revenues.....	\$ 16,866	\$ 21,288	\$ 38,196
Homes Delivered.....	135	118	171
<b>Totals:</b>			
Housing Revenues.....	\$1,693,717	\$1,105,466	\$908,553
Homes Delivered.....	6,791	4,367	3,768

The increase in housing revenues was primarily due to the merger with Washington Homes, Inc. (comprising a portion of the North Carolina and Metro D. C. markets and all of the Mid South market), increased deliveries in California and Texas, and an increase in average sales prices in the Northeast Region, California, and Texas markets. Continued strong housing demand in our major markets enables us to increase home prices and home sales.

Unaudited quarterly housing revenues and net sales contracts using base sales prices by market area for the years ending October 31, 2001, 2000, and 1999 are set forth below:

<i>(In Thousands)</i>	Quarter Ended			
	October 31, 2001	July 31, 2001	April 30, 2001	January 31, 2001
<b>Housing Revenues:</b>				
Northeast Region .....	\$163,955	\$156,366	\$126,700	\$123,626
North Carolina.....	77,248	85,887	60,457	31,798
Metro D.C.....	89,472	109,535	74,263	36,691
California.....	109,099	61,830	65,339	44,314
Texas .....	68,441	62,360	46,434	37,810
Mid South.....	10,675	18,774	11,846	3,077
Other .....	830	2,539	8,262	6,089
Total.....	\$519,720	\$497,291	\$393,301	\$283,405
<b>Sales Contracts (Net of Cancellations):</b>				
Northeast Region .....	\$109,585	\$119,073	\$155,693	\$125,433
North Carolina.....	55,041	59,873	109,483	41,651
Metro D. C.....	75,384	77,253	138,957	32,009
California.....	38,350	66,794	88,620	65,547
Texas .....	45,299	63,640	64,343	37,177
Mid South.....	11,801	12,394	20,299	3,806
Other .....	287	279	442	857
Total.....	\$335,747	\$399,306	\$577,837	\$306,480

<i>(In Thousands)</i>	Quarter Ended			
	October 31, 2000	July 31, 2000	April 30, 2000	January 31, 2000
<b>Housing Revenues:</b>				
Northeast Region .....	\$188,770	\$131,668	\$113,732	\$127,252
North Carolina.....	35,016	33,319	30,891	27,370
Metro D.C.....	18,932	13,901	17,459	15,845
California.....	39,725	48,055	30,313	25,636
Texas .....	52,188	47,318	37,573	49,215
Other .....	7,658	3,743	5,087	4,800
Total.....	\$342,289	\$278,004	\$235,055	\$250,118
<b>Sales Contracts (Net of Cancellations):</b>				
Northeast Region .....	\$121,179	\$115,649	\$174,126	\$109,040
North Carolina.....	29,317	32,338	33,980	26,892
Metro D. C.....	20,354	23,459	25,144	13,449
California.....	43,551	41,350	52,114	23,839
Texas .....	51,251	54,708	46,671	39,830
Other .....	4,571	4,412	10,685	4,193
Total.....	\$270,223	\$271,916	\$342,720	\$217,243

(In Thousands)	Quarter Ended			
	October 31, 1999	July 31, 1999	April 30, 1999	January 31, 1999
<b>Housing Revenues:</b>				
Northeast Region <sup>(1)</sup> .....	\$164,899	\$142,503	\$126,501	\$126,683
North Carolina.....	47,251	38,269	30,553	29,080
Metro D.C.....	15,541	11,400	6,005	12,547
California.....	37,290	24,792	26,548	17,311
Texas.....	13,184	—	—	—
Other .....	9,294	10,107	9,531	9,264
Total.....	<b>\$287,459</b>	<b>\$227,071</b>	<b>\$199,138</b>	<b>\$194,885</b>
<b>Sales Contracts (Net of Cancellations):</b>				
Northeast Region <sup>(1)</sup> .....	\$135,514	\$111,083	\$114,924	\$ 90,163
North Carolina.....	25,757	33,078	50,673	31,111
Metro D.C.....	12,246	14,338	16,201	11,077
California.....	36,197	37,788	24,135	17,817
Texas.....	5,416	—	—	—
Other .....	3,230	4,643	9,050	12,012
Total.....	<b>\$218,360</b>	<b>\$200,930</b>	<b>\$214,983</b>	<b>\$162,180</b>

<sup>(1)</sup> Includes \$31,961,000 housing revenues and \$12,922,000 sales contracts in the quarter ended October 31, 1999 from a New Jersey homebuilder acquired on August 7, 1999.

Our contract backlog using base sales prices by market area is set forth below:

(Dollars in Thousands)	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
<b>Northeast Region:</b>			
Total Contract Backlog .....	<b>\$322,100</b>	\$311,539	\$286,149
Number of Homes .....	<b>1,160</b>	1,149	1,125
<b>North Carolina:</b>			
Total Contract Backlog .....	<b>\$103,616</b>	\$ 40,635	\$ 44,534
Number of Homes .....	<b>534</b>	215	207
<b>Metro D.C.:</b>			
Total Contract Backlog .....	<b>\$208,888</b>	\$ 52,339	\$ 34,484
Number of Homes .....	<b>779</b>	215	149
<b>California:</b>			
Total Contract Backlog .....	<b>\$ 53,338</b>	\$ 58,089	\$ 34,313
Number of Homes .....	<b>172</b>	151	129
<b>Texas:</b>			
Total Contract Backlog .....	<b>\$ 64,961</b>	\$ 61,703	\$ 51,610
Number of Homes .....	<b>263</b>	282	261
<b>Mid South:</b>			
Total Contract Backlog .....	<b>\$ 19,734</b>	—	—
Number of Homes .....	<b>122</b>	—	—
<b>Other:</b>			
Total Contract Backlog .....	<b>\$ 437</b>	\$ 14,241	\$ 9,570
Number of Homes .....	<b>3</b>	84	50
<b>Totals:</b>			
Total Contract Backlog .....	<b>\$773,074</b>	\$538,546	\$460,660
Number of Homes .....	<b>3,033</b>	2,096	1,921

We have written down or written off certain inventories totaling \$4.4, \$1.8, and \$2.1 million during the years ended October 31, 2001, 2000, and 1999, respectively, to their estimated fair value. See "Notes to Consolidated Financial Statements - Note 11" for additional explanation. These writedowns and write-offs were incurred primarily because of lower property values, a change in the marketing strategy to liquidate a particular property, or the decision not to exercise an option to purchase land.

During the years ended October 31, 2001 and 2000, we wrote off residential land options including approval and engineering costs amounting to \$1.9 and \$1.8 million, respectively. We did not exercise those options because the communities' proforma profitability did not produce adequate returns on investment commensurate with the risk. Those communities were located in New Jersey, New York, Metro D. C., North Carolina, and California.

During the year ended October 31, 2001, we wrote down two residential communities in the Northeast Region, one community in North Carolina, and two land parcels in Florida. The writedown in the Northeast Region was attributed to two communities that were part of a large land acquisition, which resulted in a loss. The writedowns in North Carolina and Florida were based upon changes in market conditions. The result of the above decisions was a reduction in inventory carrying amounts to fair value, resulting in a \$2.5 million impairment loss.

During the year ended October 31, 1999 we wrote off one residential land option including approval and engineering costs amounting to \$0.3 million. We did not exercise this option because the community's proforma profitability did not produce an adequate return on investment commensurate with the risk. In addition, we wrote down one land parcel in Florida, one residential community in New York and two residential communities in North Carolina. The Florida land parcel was written down based on recent purchase offers. The communities were written down based on our decision to discontinue selling homes and offer the remaining lots for sale. The result of the above decisions was a reduction in inventory carrying amounts to fair value, resulting in a \$1.8 million impairment loss.

Cost of sales includes expenses for housing and land and lot sales. A breakout of such expenses for housing sales and housing gross margin is set forth below:

<i>(Dollars in Thousands)</i>	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
Sale of homes .....	<b>\$1,693,717</b>	\$1,105,466	\$908,553
Cost of sales .....	<b>1,344,708</b>	876,492	717,953
Housing gross margin .....	<b>\$ 349,009</b>	\$ 228,974	\$190,600
Gross margin percentage .....	<b>20.6%</b>	20.7%	21.0%

Cost of sales expenses as a percentage of home sales revenues are presented below:

	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
Sale of homes .....	<b>100.0%</b>	100.0%	100.0%
Cost of sales:			
Housing, land and development costs.....	<b>71.5</b>	71.1	71.0
Commissions .....	<b>2.3</b>	2.2	2.0
Financing concessions.....	<b>1.0</b>	0.9	0.8
Overheads.....	<b>4.6</b>	5.1	5.2
Total cost of sales .....	<b>79.4</b>	79.3	79.0
Gross margin percentage .....	<b>20.6%</b>	20.7%	21.0%

We sell a variety of home types in various local communities, each yielding a different gross margin. As a result, depending on the mix of both the communities and of home types delivered, consolidated gross margin will fluctuate up or down. During the year ended October 31, 2001, our gross margin percentage decreased 0.1% from the previous year. This decrease was due to the Washington Homes, Inc. merger, which significantly increased our activity in Metro Washington D. C. and North Carolina and added markets in the Mid South region that collectively have a lower average sales price and gross margin than the averages for our other markets. On an individual market basis all of our markets showed an increase in gross margin primarily resulting from increased sales prices. During the year ended October 31, 2000, our gross margin percentage decreased 0.3% from the previous year. This decrease was primarily attributed to a full year of operations from our Texas division where they report lower margins (acquired in October 1999). During the year ended October 31, 1999, our gross margin percentage increased 3.6% from the previous year. This can be attributed to higher gross margins being achieved in each of our markets. The dollar increases for each of the three years ended October 31, 2001, 2000, and 1999 was attributed to increased sales, primarily resulting from the acquisition of Washington Homes in 2001 and the Texas division at the end of 1999.

Selling and general administrative expenses as a percentage of homebuilding revenues decreased to 8.2% for the year ended October 31, 2001 and increased to 9.4% for the year ended October 31, 2000 from 8.8% for the year ended October 31, 1999. The dollar amount of selling and general expenses has increased the last two years to \$140.1 million for the year ended October 31, 2001 from \$104.8 million for the year ended October 31, 2000 which increased from \$81.4 million for the previous year. The percentage decrease during the year ended October 31, 2001 was due to increased deliveries and the in market merger with Washington Homes, Inc., which resulted in administrative efficiencies. The percentage increase in 2000 was primarily attributable to a full year of operations from our Texas division and increases in the number of active selling communities in California. The percentage increase in 1999 was attributable to increases in all our markets but primarily due to fewer deliveries in our Northeast Region and due to Northeast Region and California administrative cost increases.

**Land Sales and Other Revenues**

Land sales and other revenues consist primarily of land and lot sales, interest income, contract deposit forfeitures, cash discounts, and corporate owned life insurance benefits.

A breakout of land and lot sales is set forth below:

<i>(In Thousands)</i>	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
Land and lot sales .....	\$11,356	\$6,549	\$12,077
Cost of sales .....	10,646	3,971	11,766
Land and lot sales gross margin .....	\$ 710	\$2,578	\$ 311

Land and lot sales are incidental to our residential housing operations and are expected to continue in the future but may significantly fluctuate up or down.

Year ended October 2000 land and lot sales gross margin includes a legal settlement in California amounting to \$1,924,000.

### Financial Services

Financial services consists primarily of originating mortgages from our homebuyers, selling such mortgages in the secondary market, and title insurance activities. During the year ended October 31, 2001, financial services provided a \$10.0 million pretax profit. During the years ended 2000 and 1999, financial services resulted in \$0.5 million loss and a \$1.0 million profit, respectively, before income taxes. The increase from 2000 to 2001 was primarily due to a change in management, reduced costs, increased mortgage loan amounts, and the addition of a mortgage operation from the merger with Washington Homes. In the market areas served by our wholly-owned mortgage banking subsidiaries, approximately 57%, 54%, and 57% of our non-cash homebuyers obtained mortgages originated by these subsidiaries during the years ended October 31, 2001, 2000, and 1999, respectively. Our mortgage banking goals are to improve profitability by increasing the capture rate of our homebuyers to 70%. Most servicing rights on new mortgages originated by us will be sold as the loans are closed.

### Corporate General and Administrative

Corporate general and administrative expenses includes the operations at our headquarters in Red Bank, New Jersey. Such expenses include our executive offices, information services, human resources, corporate accounting, training, treasury, process redesign, internal audit, and administration of insurance, quality, and safety. As a percentage of total revenues, such expenses were 2.5%, 2.9%, and 3.0% for the years ended October 31, 2001, 2000, and 1999, respectively. The percentage decrease during the year ended October 31, 2001 was due to increased housing revenues. The decrease in fiscal year 2000 was due to increased housing revenues and the adoption of SOP 98-1, "Accounting For the Cost of Computer Software Development For or Obtained For Internal Use." See "Notes to Consolidated Financial Statements – Note 2" for additional explanation. Our long term improvement initiatives include total quality, process redesign (net of capitalized expenses), and training. Such initiatives resulted in additional expenses for the years ended October 31, 2001, 2000, and 1999 which were not capitalized amounting to \$7.2 million, \$6.9 million, and \$7.5 million, respectively.

### Interest

Interest expense includes housing, and land and lot interest. Interest expense is broken down as follows:

	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
<i>(In Thousands)</i>			
Sale of homes .....	\$51,046	\$34,541	\$29,261
Land and lot sales .....	400	415	1,082
Total .....	\$51,446	\$34,956	\$30,343

Housing interest as a percentage of sale of home revenues amounted to 3.0%, 3.1%, and 3.2% for the years ended October 31, 2001, 2000, and 1999, respectively.

### Other Operations

Other operations consist primarily of miscellaneous senior residential rental operations, amortization of senior and subordinated note issuance expenses, amortization of goodwill, earnout payments from homebuilding company acquisitions, corporate owned life insurance loan interest, reserves for bad debts, and contributions to a foundation for victims of the September 11, 2001 World Trade Center attack.



### **Restructuring Charges**

Restructuring charges are estimated expenses associated with the integration of our operations with those of Washington Homes, Inc. These expenses are salaries, severance and outplacement costs for the termination of associates and costs to close and relocate existing administrative offices, and lost rent and leasehold improvements. At October 31, 2001, \$1.5 million has been charged against the \$2.0 million accrual for termination and related costs while \$0.5 million has been charged against the \$1.2 million accrual established for closing and relocation costs.

### **Total Taxes**

Total taxes as a percentage of income before income taxes amounted to 40.1%, 36.0%, and 38.9% for the years ended October 31, 2001, 2000, and 1999, respectively. The increased percentage is due primarily to higher amounts of expenses in 2001 not deductible for federal taxes and a reduced effect of our senior rental tax credits. Although the credits are the same in 2001 and 2000, they reduce our effective tax rate less when pretax profits are higher. Deferred federal and state income tax assets primarily represent the deferred tax benefits arising from temporary differences between book and tax income which will be recognized in future years as an offset against future taxable income. If for some reason the combination of future years income (or loss) combined with the reversal of the timing differences results in a loss, such losses can be carried back to prior years to recover the deferred tax assets. As a result, management is confident such deferred tax assets are recoverable regardless of future income. (See "Notes to Consolidated Financial Statements - Note 10" for an additional explanation of taxes.)

### **Extraordinary Loss**

On June 7, 1999, we redeemed \$45,449,000 of our outstanding 11 1/4% Subordinated Notes due 2002 at an average price of 101.875% of par which resulted in an extraordinary loss of \$868,000 net of income taxes of \$468,000.

### **Recent Accounting Pronouncements**

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method is no longer permitted. SFAS No. 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination that is completed after June 30, 2001. We adopted SFAS No. 141 for all future acquisitions.

SFAS No. 142 no longer permits the amortization of goodwill and indefinite-lived intangible assets. Instead, these assets must be reviewed annually (or more frequently under certain conditions) for impairment in accordance with this statement. This impairment test uses a fair value approach rather than the undiscounted cash flows approach previously required by SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." The amortization of goodwill included in other expenses will also no longer be recorded upon adoption of the new rules. Intangible assets that do not have indefinite lives will continue to be amortized over their useful lives and reviewed for impairment in accordance with SFAS No. 121. We adopted SFAS 142 on November 1, 2001. Upon adoption of SFAS No. 142, goodwill amortization of \$3,764,000, which was incurred in 2001, will no longer be incurred in the future. We do not anticipate that the adoption of the new statement will have a material effect on the financial position or results of operations of our Company.

In October 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards (SFAS) No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 provides accounting guidance for financial accounting and reporting for impairment or disposal of long-lived assets. SFAS 144 supersedes SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." It also supersedes the accounting and reporting of APB Opinion No. 50 "Reporting the Results of Operations – Reporting the Events and Transactions" related to the disposal of a segment of a business. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. We do not anticipate that the adoption of the new statement will have a material effect on the financial position or results of operations of our Company.

### **Inflation**

Inflation has a long-term effect on us because increasing costs of land, materials and labor result in increasing sales prices of our homes. In general, these price increases have been commensurate with the general rate of inflation in our housing markets and have not had a significant adverse effect on the sale of our homes. A significant inflationary risk faced by the housing industry generally is that rising housing costs, including land and interest costs, will substantially outpace increases in the income of potential purchasers. In recent years, in the price ranges in which we sell homes, we have not found this risk to be a significant problem.

Inflation has a lesser short-term effect on us because we generally negotiate fixed price contracts with our subcontractors and material suppliers for the construction of our homes. These prices usually are applicable for a specified number of residential buildings or for a time period of between four to twelve months. Construction costs for residential buildings represent approximately 58% of our homebuilding cost of sales.

### **Merger with Washington Homes, Inc.**

On January 23, 2001 we merged with Washington Homes, Inc. for a total purchase price of \$87.4 million, of which \$38.5 was paid in cash and 6,352,900 shares of our Class A common stock valued at \$44.9 million were issued and options issued to Washington Homes, Inc. employees with an intrinsic value of \$3.4 million were converted to 738,785 of our options. (See "Notes To Consolidated Financial Statements – Note 15" for an additional explanation of our merger with Washington Homes, Inc.). The merger with Washington Homes, Inc. did not result in a new segment.

### **Acquisition of a California Homebuilder**

On January 10, 2002 we acquired certain homebuilding assets and assumed related liabilities from The Forecast Group, L.P. ("TFG") for an estimated purchase price of \$176.0 million plus the assumption of debt net of cash acquired. The final purchase price is subject to adjustment based on financial performance through January 31, 2002. Under the terms of the agreement the partners in TFG received \$45.5 million of Hovnanian restricted Class A Common Stock and the balance in cash. To fund the acquisition we are planning to raise \$150 million through a five year term loan. We believe our line of credit is adequate to provide working capital for our new TFG operations. The addition of the TFG operations for almost 10 months of fiscal 2002 is expected to add approximately \$0.50 per share to our net earnings. We expect total revenues to increase more than 30% in fiscal 2002 from 2001 levels, largely as a result of the purchase of the TFG operations.

**Safe Harbor Statement**

Certain statements contained in this Annual Report that are not historical facts should be considered as “Forward-Looking Statements” within the meaning of the Private Securities Litigation Act of 1995. Such statements involve known and unknown risks, uncertainties and other factors that may cause actual results to differ materially. Such risks, uncertainties and other factors include, but are not limited to:

- . Changes in general economic and market conditions
- . Changes in interest rates and the availability of mortgage financing
- . Changes in costs and availability of material, supplies and labor
- . General competitive conditions
- . The availability of capital
- . The ability to successfully effect acquisitions

These risks, uncertainties, and other factors are described in detail in Item 1 and 2 Business and Properties in the Form 10-K for the year ended October 31, 2001.

**Quantitative and Qualitative Disclosures About Market Risk**

The primary market risk facing us is interest rate risk on our long term debt. In connection with our mortgage operations, mortgage loans held for sale and the associated mortgage warehouse line of credit are subject to interest rate risk; however, such obligations reprice frequently and are short-term in duration. In addition, we hedge the interest rate risk on mortgage loans by obtaining forward commitments from FNMA, FHLMC, GNMA securities and private investors. Accordingly the risk from mortgage loans is not material. We do not hedge interest rate risk other than on mortgage loans using financial instruments. We are also subject to foreign currency risk but this risk is not material. The following tables set forth as of October 31, 2001 and 2000, our long term debt obligations, principal cash flows by scheduled maturity, weighted average interest rates and estimated fair market value (“FMV”). There have been no significant changes in our market risk from October 31, 2000 to October 31, 2001.

(Dollars in Thousands)	As of October 31, 2001 for the Year Ended October 31,						Total	FMV @ 10/31/01
	2002	2003	2004	2005	2006	Thereafter		
<b>Long Term Debt<sup>(1)</sup>:</b>								
Fixed Rate	<b>\$8,919</b>	<b>\$ 2,577</b>	<b>\$ 75</b>	<b>\$ 81</b>	<b>\$ 88</b>	<b>\$400,193</b>	<b>\$411,933</b>	<b>\$406,192</b>
Average interest rate	<b>6.65%</b>	<b>7.04%</b>	<b>8.38%</b>	<b>8.38%</b>	<b>8.38%</b>	<b>9.80%</b>	<b>9.71%</b>	—

(Dollars in Thousands)	As of October 31, 2000 for the Year Ended October 31,					Total	FMV @ 10/31/00	
	2001	2002	2003	2004	2005			
<b>Long Term Debt<sup>(1)</sup>:</b>								
Fixed Rate	\$11,797	\$ 138	\$ 2,594	\$ 74	\$ 81	\$400,534	\$415,218	\$379,629
Average interest rate	4.63%	7.63%	7.04%	8.38%	8.38%	9.79%	9.63%	—

<sup>(1)</sup> Does not include bonds collateralized by mortgages receivable.

**Consolidated Balance Sheets**

<i>(In Thousands)</i>	<b>October 31, 2001</b>	October 31, 2000
<b>ASSETS</b>		
Homebuilding:		
Cash and cash equivalents (Note 5) .....	<b>\$ 10,173</b>	\$ 40,131
Inventories – At the lower of cost or fair value (Notes 7, 11 and 12):		
Sold and unsold homes and lots under development.....	<b>593,149</b>	525,116
Land and land options held for future development or sale .....	<b>146,965</b>	89,867
Total Inventories.....	<b>740,114</b>	614,983
Receivables, deposits, and notes (Note 12) .....	<b>75,802</b>	36,190
Property, plant, and equipment – net (Note 4) .....	<b>30,756</b>	35,594
Senior residential rental properties – net (Notes 4 and 7) .....	<b>9,890</b>	10,276
Prepaid expenses and other assets (Note 15) .....	<b>78,796</b>	64,897
Total Homebuilding .....	<b>945,531</b>	802,071
Financial Services:		
Cash.....	<b>5,976</b>	3,122
Mortgage loans held for sale (Notes 6 and 7) .....	<b>105,567</b>	61,860
Other assets.....	<b>6,465</b>	6,488
Total Financial Services.....	<b>118,008</b>	71,470
Income Taxes Receivable – Including deferred tax benefits (Note 10) .....	<b>719</b>	
<b>Total Assets</b> .....	<b>\$1,064,258</b>	\$873,541

*See notes to consolidated financial statements.*

<i>(In Thousands)</i>	October 31, 2001	October 31, 2000
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Homebuilding:		
Nonrecourse land mortgages (Note 7) .....	\$ 10,086	\$ 18,166
Accounts payable and other liabilities (Note 16) .....	124,125	82,205
Customers' deposits (Note 5) .....	39,114	31,475
Nonrecourse mortgages secured by operating properties (Note 7) .....	3,404	3,554
Total Homebuilding .....	<u>176,729</u>	<u>135,400</u>
Financial Services:		
Accounts payable and other liabilities .....	5,264	5,085
Mortgage warehouse line of credit (Notes 6 and 7) .....	98,305	56,486
Total Financial Services .....	<u>103,569</u>	<u>61,571</u>
Notes Payable:		
Revolving credit agreement (Note 7) .....		
Senior notes (Note 8) .....	296,797	296,430
Subordinated notes (Note 8) .....	99,747	100,000
Accrued interest (Notes 7 and 8) .....	11,770	12,709
Total Notes Payable .....	<u>408,314</u>	<u>409,139</u>
Income Taxes Payable - Net of deferred tax benefits (Note 10) .....		4,072
Total Liabilities .....	<u>688,612</u>	<u>610,182</u>
Commitments and Contingent Liabilities (Notes 5, 9, 12, 14 and 15)		
Stockholders' Equity (Notes 13 and 15):		
Preferred Stock, \$.01 par value-authorized 100,000 shares; none issued .....		
Common Stock, Class A, \$.01 par value-authorized 87,000,000 shares; issued 24,599,379 shares in 2001 and 17,309,369 shares in 2000 (including 4,195,621 shares in 2001 and 3,736,921 shares in 2000 held in Treasury) .....	246	173
Common Stock, Class B, \$.01 par value (convertible to Class A at time of sale) - authorized 13,000,000 shares; issued 7,818,927 shares in 2001 and 7,978,903 shares in 2000 (both years include 345,874 shares held in Treasury) .....	78	79
Paid in Capital .....	100,957	46,086
Retained Earnings (Note 8) .....	310,106	246,420
Deferred Compensation .....	(127)	
Treasury Stock - at cost .....	(35,614)	(29,399)
Total Stockholders' Equity .....	<u>375,646</u>	<u>263,359</u>
Total Liabilities and Stockholders' Equity .....	<u>\$1,064,258</u>	<u>\$873,541</u>

See notes to consolidated financial statements.

**Consolidated Statements of Income**

	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
<i>(In Thousands Except Per Share Data)</i>			
Revenues:			
Homebuilding:			
Sale of homes .....	\$1,693,717	\$1,105,466	\$908,553
Land sales and other revenues (Notes 12 and 14) .....	16,818	10,769	17,103
Total Homebuilding .....	1,710,535	1,116,235	925,656
Financial Services.....	31,428	19,324	20,758
Total Revenues .....	1,741,963	1,135,559	946,414
Expenses:			
Homebuilding:			
Cost of sales .....	1,355,354	880,463	729,719
Selling, general and administrative .....	140,126	104,771	81,396
Inventory impairment loss (Note 11) .....	4,368	1,791	2,091
Total Homebuilding .....	1,499,848	987,025	813,206
Financial Services.....	21,443	19,750	19,699
Corporate General and Administrative (Note 3) .....	44,278	33,309	28,652
Interest (Notes 7 and 8) .....	51,446	34,956	30,343
Other operations (Note 15) .....	15,347	8,701	3,897
Restructuring charges (Note 16) .....	3,247		
Total Expenses.....	1,635,609	1,083,741	895,797
Income Before Income Taxes and Extraordinary Loss .....	106,354	51,818	50,617
State and Federal Income Taxes:			
State (Note 10).....	4,024	2,495	5,093
Federal (Note 10) .....	38,644	16,160	14,581
Total Taxes.....	42,668	18,655	19,674
Extraordinary Loss From Extinguishment of Debt, Net of Income Taxes (Note 8) .....			(868)
Net Income.....	\$ 63,686	\$ 33,163	\$ 30,075
Per Share Data:			
Basic:			
Income Per Common Share Before Extraordinary Loss .....	\$ 2.38	\$ 1.51	\$ 1.45
Extraordinary Loss.....			(.04)
Income .....	\$ 2.38	\$ 1.51	\$ 1.41
Weighted Average Number of Common Shares Outstanding.....	26,810	21,933	21,404
Assuming Dilution:			
Income Per Common Share Before Extraordinary Loss .....	\$ 2.29	\$ 1.50	\$ 1.43
Extraordinary Loss.....			(.04)
Income .....	\$ 2.29	\$ 1.50	\$ 1.39
Weighted Average Number of Common Shares Outstanding.....	27,792	22,043	21,612

See notes to consolidated financial statements.

**Consolidated Statements of Stockholders' Equity**

(Dollars in Thousands)	A Common Stock		B Common Stock		Paid-In Capital	Retained Earnings	Deferred Comp	Treasury Stock	Total
	Shares		Shares						
	Issued and Outstanding	Amount	Issued and Outstanding	Amount					
Balance,									
October 31, 1998.....	13,865,923	\$157	7,694,297	\$80	\$ 34,561	\$183,182	\$	\$(16,588)	\$201,392
Acquisitions.....	1,362,057	13			11,237				11,250
Sale of common stock under employee stock option plan.....	10,000	1			58				59
Conversion of Class B to Class A common stock .....	43,088	1	(43,088)	(1)					
Treasury stock purchases .....	(772,900)							(6,350)	(6,350)
Net Income .....						30,075			30,075
Balance,									
October 31, 1999.....	14,508,168	172	7,651,209	79	45,856	213,257		(22,938)	236,426
Acquisitions.....	47,619	1			(270)				(269)
Sale of common stock under employee stock option plan .....					346				346
Stock bonus plan .....	25,128				154				154
Conversion of Class B to Class A common stock .....	18,180		(18,180)						
Treasury stock purchases .....	(1,026,647)							(6,461)	(6,461)
Net Income .....						33,163			33,163
Balance,									
October 31, 2000.....	13,572,448	173	7,633,029	79	46,086	246,420		(29,399)	263,359
Acquisitions.....	6,546,932	66			51,361				51,427
Sale of common stock under employee stock option plan .....	519,673	5			2,885				2,890
Stock bonus plan .....	63,429	1			625				626
Conversion of Class B to Class A .....	159,976	1	(159,976)	(1)					
Deferred compensation .....							(127)		(127)
Treasury stock purchases .....	(458,700)							(6,215)	(6,215)
Net Income .....						63,686			63,686
<b>Balance,</b>									
<b>October 31, 2001 .....</b>	<b>20,403,758</b>	<b>\$246</b>	<b>7,473,053</b>	<b>\$78</b>	<b>\$100,957</b>	<b>\$310,106</b>	<b>\$(127)</b>	<b>\$(35,614)</b>	<b>\$375,646</b>

See notes to consolidated financial statements.



**Consolidated Statements of Cash Flows**

(In Thousands)	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
<b>Cash Flows From Operating Activities:</b>			
Net Income.....	<b>\$63,686</b>	\$33,163	\$30,075
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation.....	<b>8,164</b>	6,423	6,314
Amortization of Goodwill.....	<b>3,764</b>	2,513	261
Loss (gain) on sale and retirement of property and assets.....	<b>641</b>	(728)	283
Extraordinary loss from extinguishment of Debt net of income taxes.....			868
Deferred income taxes.....	<b>(6,265)</b>	2,551	3,056
Impairment losses.....	<b>4,368</b>	1,791	2,091
Decrease (increase) in assets:			
Mortgage notes receivable.....	<b>(42,573)</b>	(27,703)	46,012
Receivables, prepaids and other assets.....	<b>(35,805)</b>	(13,256)	(9,736)
Inventories.....	<b>12,540</b>	(89,544)	(53,592)
Increase (decrease) in liabilities:			
State and Federal income taxes.....	<b>7,004</b>	3,244	3,020
Tax effect from exercise of stock options.....	<b>(566)</b>		
Customers' deposits.....	<b>4,543</b>	6,240	(1,269)
Interest and other accrued liabilities.....	<b>15,466</b>	8,222	9,203
Post development completion costs.....	<b>5,120</b>	(2,555)	3,293
Accounts payable.....	<b>(3,018)</b>	8,994	(4,400)
Net cash provided by (used in) operating activities.....	<b>37,069</b>	(60,645)	35,479
<b>Cash Flows From Investing Activities:</b>			
Net proceeds from sale of property and assets.....	<b>5,325</b>	1,517	18,251
Purchase of property, equipment, and other fixed assets.....	<b>(6,777)</b>	(15,607)	(13,381)
Acquisition of homebuilding companies.....	<b>(37,905)</b>	(3,845)	(12,249)
Investment in and advances to unconsolidated affiliates.....	<b>(372)</b>		249
Net cash (used in) investing activities.....	<b>(39,729)</b>	(17,935)	(7,130)
<b>Cash Flows From Financing Activities:</b>			
Proceeds from mortgages and notes.....	<b>1,472,789</b>	1,433,150	850,320
Proceeds from senior debt.....		146,430	150,000
Principal payments on mortgages and notes.....	<b>(1,494,528)</b>	(1,470,805)	(972,265)
Principal payments on subordinated debt.....			(46,302)
Purchase of treasury stock.....	<b>(6,215)</b>	(6,461)	(6,350)
Proceeds from sale of stock and employee stock plan.....	<b>3,510</b>	154	59
Net cash (used in) provided by financing activities.....	<b>(24,444)</b>	102,468	(24,538)
Net (Decrease) Increase In Cash.....	<b>(27,104)</b>	23,888	3,811
Cash and Cash Equivalents Balance, Beginning Of Year.....	<b>43,253</b>	19,365	15,554
Cash and Cash Equivalents Balance, End Of Year.....	<b>\$16,149</b>	\$43,253	\$19,365
<b>Supplemental Disclosures Of Cash Flow:</b>			
Cash paid during the year for:			
Interest.....	<b>\$53,100</b>	\$33,814	\$23,731
Income Taxes.....	<b>\$45,498</b>	\$12,858	\$16,395
Stock issued for acquisitions/extension of options granted.....	<b>\$50,530</b>	\$ 721	\$11,250

See notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

For the Years Ended October 31, 2001, 2000, and 1999

### 1. Basis of Presentation and Segment Information

*Basis of Presentation* – The accompanying consolidated financial statements include our accounts and all wholly-owned subsidiaries after elimination of all significant intercompany balances and transactions.

*Segment Information* – Statement of Financial Accounting Standards (SFAS) No. 131 “Disclosures About Segments of an Enterprise and Related Information” established new standards for segment reporting based on the way management organizes segments within a company for making operating decisions and assessing performance. Our financial reporting segments consist of homebuilding, financial services, and corporate. Our homebuilding operations comprise the most substantial part of our business, with approximately 97% of consolidated revenues in years ended October 31, 2001 and 2000 and approximately 96% in the year ended October 31, 1999 contributed by the homebuilding operations. We are a Delaware corporation, currently building and selling homes in more than 172 new home communities in New Jersey, Pennsylvania, New York, Virginia, Maryland, North Carolina, Tennessee, Alabama, Mississippi, Texas, and California. We offer a wide variety of homes that are designed to appeal to first time buyers, first and second time move up buyers, luxury buyers, active adult buyers and empty nesters. Our financial services operations provide mortgage banking and title services to the homebuilding operations’ customers. We do not retain or service the mortgages that we originate but rather, sell the mortgages and related servicing rights to investors. Corporate primarily includes the operations of our corporate office whose primary purpose is to provide executive services, information services, human resources, management reporting, training, cash management, internal audit, risk management, and administration of process redesign, quality and safety. Assets, liabilities, revenues and expenses of our reportable segments are separately included in the consolidated balance sheets and consolidated statements of income.

### 2. Significant Accounting Policies

*Use of Estimates* - 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.

*Business Combinations* – When we make an acquisition of another company, we use the purchase method of accounting in accordance with Accounting Principal Board Opinion 16 (“APB 16”) “Business Combinations”. Under APB 16 we record as our cost the acquired assets less liabilities assumed. Any difference between the cost of an acquired company and the sum of the fair values of tangible and identified intangible assets less liabilities is recorded as goodwill. The reported income of an acquired company includes the operations of the acquired company after acquisition, based on the acquisition costs. See “Accounting Pronouncements Not Yet Adopted.”

*Income Recognition* - Income from home sales is recorded when title is conveyed to the buyer, subject to the buyer's financial commitment being sufficient to provide economic substance to the transaction.

*Cash and Cash Equivalents* - Cash and cash equivalents include cash deposited in checking accounts, overnight repurchase agreements, certificates of deposit, Treasury bills and government money market funds with original maturities of 90 days or less when purchased.

*Fair Value of Financial Instruments* - The fair value of financial instruments is determined by

reference to various market data and other valuation techniques as appropriate. Our financial instruments consist of cash equivalents, mortgages and notes receivable, mortgages and notes payable, and the senior and subordinated notes payable. Unless otherwise disclosed, the fair value of financial instruments approximates their recorded values.

*Inventories* - For inventories of communities under development, a loss is recorded when events and circumstances indicate impairment and the undiscounted future cash flows generated are less than the related carrying amounts. The impairment loss is based on expected revenue, cost to complete including interest, and selling costs. Inventories and long-lived assets held for sale are recorded at the lower of cost or fair value less selling costs. Fair value is defined in Statement of Financial Accounting Standard (SFAS) No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" as the amount at which an asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. See "Accounting Pronouncements Not Yet Adopted." Construction costs are accumulated during the period of construction and charged to cost of sales under specific identification methods. Land, land development, and common facility costs are allocated based on buildable acres to product types within each community, then amortized equally based upon the number of homes to be constructed in the community.

Interest costs related to properties under development are capitalized during the land development and home construction period and expensed along with the associated cost of sales as the related inventories are sold (see Note 7).

The cost of land options is capitalized when incurred and either included as part of the purchase price when the land is acquired or charged to operations when we determine we will not exercise the option.

*Intangible Assets* - Any intangible assets acquired by us are amortized on a straight line basis over their useful life. Goodwill resulting from company acquisitions during the years ended October 31, 2001 and October 31, 1999 is being amortized over 5 to 10 years and reported in the consolidated statements of income as "Other Operations". During the years ended October 31, 2001, 2000, and 1999, goodwill amortization amounted to \$3,764,000, \$2,513,000, and \$261,000, respectively. The carrying amount of goodwill is reviewed if facts and circumstances suggest that it may be impaired. If this review indicates that goodwill will not be recoverable, as determined based on the estimated undiscounted cash flows of the company acquired over the remaining amortization period, the carrying amount of the goodwill is reduced by the estimated shortfall of cash flows. In addition, we assess long-lived assets for impairment under SFAS 121. Under those rules, goodwill associated with assets acquired in a purchase business combination is included in impairment evaluations when events or circumstances exist that indicate the carrying amount of those assets may not be recoverable. Total accumulated amortization at October 31, 2001 and 2000 was \$7,579,000 and \$3,815,000, respectively. See "Accounting Pronouncements Not Yet Adopted."

*Deferred Bond Issuance Costs* - Costs associated with the issuance of our Senior and Subordinated Notes are capitalized and amortized over the associated term of each note issuance into other operations on the consolidated statements of income.

*Debt Issued At a Discount* - Debt issued at a discount to the face amount is accreted back up to its face amount utilizing the effective interest method over the term of the note and recorded as a component of Interest on the consolidated statements of income.

*Post Development Completion Costs* - In those instances where a development is substantially completed and sold and we have additional construction work to be incurred, an estimated liability is provided to cover the cost of such work.

*Advertising Costs* – Advertising costs are treated as period costs and expensed as incurred. During the years ended October 31, 2001, 2000, and 1999, advertising costs expensed amounted to \$18,536,000, \$14,418,000, and \$11,995,000, respectively.

*Deferred Income Tax* - Deferred income taxes or income tax benefits are provided for temporary differences between amounts recorded for financial reporting and for income tax purposes.

*Common Stock* - Each share of Class A Common Stock entitles its holder to one vote per share and each share of Class B Common Stock entitles its holder to ten votes per share. The amount of any regular cash dividend payable on a share of Class A Common Stock will be an amount equal to 110% of the corresponding regular cash dividend payable on a share of Class B Common Stock. If a shareholder desires to sell shares of Class B Common Stock, such stock must be converted into shares of Class A Common Stock.

On December 31, 2000, our stock repurchase program to purchase up to 4 million shares of Class A Common Stock expired. As of December 31, 2000 3,391,047 shares had been purchased under this program. On July 3, 2001, our Board of Directors authorized a revision to our stock repurchase program to purchase up to 2 million shares of Class A Common Stock. As of October 31, 2001, 458,700 have been purchased under this program.

*Depreciation* - The straight-line method is used for financial reporting purposes and MACRS is used for tax reporting purposes.

*Prepaid Expenses* - Prepaid expenses which relate to specific housing communities (model setup, architectural fees, homeowner warranty, etc.) are amortized to costs of sales as the applicable inventories are sold. All other prepaid expenses are amortized over a specific time period or as used and charged to overhead expense.

*Stock Options* - Statement of Financial Accounting Standards (SFAS) No. 123 “Accounting for Stock-Based Compensation” establishes a fair value-based method of accounting for stock-based compensation plans, including stock options. Registrants may elect to continue accounting for stock option plans under Accounting Principles Board Opinion No. 25 (APB 25), “Accounting for Stock Issued to Employees,” but are required to provide pro forma net income and earnings per share information “as if” the new fair value approach had been adopted. We intend to continue accounting for our stock option plan under APB 25. Under APB 25, no compensation expense is recognized when the exercise price of our employee stock options equals the market price of the underlying stock on the date of grant (see Note 13).

*Per Share Calculations* - Statement of Financial Accounting Standards (SFAS) No. 128 “Earnings Per Share” requires the presentation of basic earnings per share and diluted earnings per share. Basic earnings per common share is computed using the weighted average number of shares outstanding and is the same calculation as reported in prior years. Basic weighted average shares outstanding at October 31, 2001, 2000, and 1999 amounted to 26,809,668 shares, 21,933,022 shares, and 21,404,473 shares, respectively. Diluted earnings per common share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to

outstanding options to purchase common stock shares of 982,000, 110,000, and 208,000 for the years ended October 31, 2001, 2000, and 1999, respectively.

*Computer Software Development* – On November 1, 1999 we adopted SOP-98-1, Accounting For the Costs of Computer Software Developed For or Obtained For Internal Use. The SOP-98-1 requires the capitalization of certain costs incurred in connection with developing or obtaining software for internal use. Prior to the adoption of SOP-98-1, we expensed such internal use software related costs as incurred. The effect of adopting SOP-98-1 was to increase net income for the year ended October 31, 2000 by \$2,570,000 or \$0.12 per share. Upon entering the application and development phase, the capitalized costs are amortized over the systems estimated useful life. For the year ended October 31, 2001 we recorded amortization expense in the amount of approximately \$2.0 million based on an estimated useful life of 10 years.

*Accounting for Derivative Instruments and Hedging Activities* – On November 1, 2000, we adopted Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by Statement of Financial Accounting Standards (SFAS) No. 138, which addresses the accounting for and disclosure of derivative instruments, including derivative instruments imbedded in other contracts, and hedging activities. The statement requires us to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change is recognized in earnings.

We manage our interest rate risk on mortgage loans held for sale and our estimated future commitments to originate and close mortgage loans at fixed prices through the use of best-efforts whole loan delivery commitments. These instruments are classified as derivatives and generally have maturities of three months or less. Accordingly, gains and losses are recognized in current earnings during the period of change. The impact of the adoption of the new statement as of November 1, 2000 did not have a significant impact on our earnings or financial position. The effect of SFAS 133 is immaterial to our financial statements.

*Accounting Pronouncements Not Yet Adopted* – In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method is no longer permitted. SFAS No. 141 also includes guidance on the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination that is completed after June 30, 2001. We adopted SFAS No. 141 for all acquisitions subsequent to June 30, 2001.

SFAS No. 142 no longer permits the amortization of goodwill and indefinite-lived intangible assets. Instead, these assets must be reviewed annually (or more frequently under certain conditions) for impairment in accordance with this statement. This impairment test uses a fair value approach rather than the undiscounted cash flows approach previously required by SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." The amortization of goodwill included in other expenses will also no longer be recorded upon adoption of the new rules. Intangible assets that do not have indefinite lives will continue to be amortized over their useful lives and reviewed for impairment in accordance with SFAS No. 121. We adopted SFAS 142 on November 1, 2001. Upon adoption of SFAS No. 142, goodwill amortization of \$3,764,000, which was incurred in 2001, will no longer be incurred in the future. We do not anticipate that the adoption of the new statement will have a material effect on the financial position or results of operations of our Company.

In October 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards (SFAS) No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 provides accounting guidance for financial accounting and reporting for impairment or disposal of long-lived assets. SFAS 144 supersedes SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." It also supersedes the accounting and reporting of APB Opinion No. 50 "Reporting the Results of Operations – Reporting the Events and Transactions" related to the disposal of a segment of a business. We will adopt SFAS No. 144 effective for our fiscal year beginning November 1, 2002. We do not anticipate that the adoption of the new statement will have a material effect on the financial position or results of operations of our Company.

*Reclassifications* – Certain amounts in the 2000 and 1999 consolidated financial statements have been reclassified to conform to the 2001 presentation.

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**3. Corporate Initiatives**

We have embarked on long term improvement initiatives of total quality, process redesign, and training. Included in Corporate General and Administrative is \$7,200,000, \$6,902,000, and \$7,502,000 for the years ended October 31, 2001, 2000, and 1999, respectively, related to such initiatives. These amounts are in addition to software development costs capitalized in those years.

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**4. Property**

Homebuilding property, plant, and equipment consists of land, land improvements, buildings, building improvements, furniture and equipment used to conduct day to day business. Homebuilding accumulated depreciation related to these assets at October 31, 2001 and October 31, 2000 amounted to \$18,367,000 and \$22,164,000, respectively. In addition we have two senior citizen residential rental communities recorded as senior residential rental properties on the balance sheets. Accumulated depreciation on senior residential rental properties at October 31, 2001 and October 31, 2000 amounted to \$2,688,000 and \$2,294,000, respectively.

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**5. Escrow Cash**

We hold escrow cash amounting to \$4,420,000 and \$3,424,000 at October 31, 2001 and October 31, 2000, respectively, which primarily represents customers' deposits which are restricted from use by us. We are able to release other escrow cash by pledging letters of credit and surety bonds. Escrow cash accounts are substantially invested in short-term certificates of deposit, time deposits, or money market accounts.

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**6. Mortgage Loans Held for Sale**

Our wholly-owned mortgage banking subsidiary originates mortgage loans, primarily from the sale of our homes. Such mortgage loans are sold in the secondary mortgage market with servicing released. At October 31, 2001 and 2000, respectively, \$105,174,000 and \$61,549,000 of such mortgages were pledged against our mortgage warehouse line (see Note 7). We may incur risk with respect to mortgages that are delinquent, but only to the extent the losses are not covered by mortgage insurance or resale value of the home. Historically, we have incurred minimal credit losses. The mortgage loans held for sale are carried at the lower of cost or market value, determined on an aggregate basis. There was no valuation adjustment at October 31, 2001 or 2000.

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**7. Mortgages and Notes Payable**

Substantially all of the nonrecourse land mortgages are short-term borrowings. Nonrecourse mortgages secured by operating properties are installment obligations having annual principal maturities in the following years ending October 31, of approximately \$138,000 in 2002, \$2,577,000 in 2003, \$75,000 in 2004, \$81,000 in 2005, \$88,000 in 2006 and \$445,000 after 2006. The interest rates on these obligations range from 6.0% to 10.0%.



We have an unsecured Revolving Credit Agreement (“Agreement”) with a group of banks which provides up to \$440,000,000 through July 2004. Interest is payable monthly and at various rates of either the prime rate plus .40% or LIBOR plus 1.85%. In addition, we pay a fee equal to .375% per annum on the weighted average unused portion of the line. As of October 31, 2001 and 2000, there was no outstanding balance under the Agreement.

Interest costs incurred, expensed and capitalized were:

<i>(Dollars in Thousands)</i>	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
Interest capitalized at beginning of year .....	\$25,694	\$21,966	\$25,545
Plus acquired entity interest .....	3,604	—	3,397
Plus interest incurred <sup>(1)(2)</sup> .....	47,272	38,878	24,594
Less interest expensed <sup>(2)</sup> .....	51,446	34,956	30,343
Less impairment write-off .....	—	194	—
Less sale of assets .....	—	—	1,227
Interest capitalized at end of year <sup>(2)</sup> .....	\$25,124	\$25,694	\$21,966

<sup>(1)</sup> Data does not include interest incurred by our mortgage and finance subsidiaries.

<sup>(2)</sup> Represents acquisition interest for construction, land and development costs which is charged to interest expense when homes are delivered or when land is not under active development.

Average interest rates and average balances outstanding for short-term debt are as follows:

<i>(Dollars in Thousands)</i>	October 31, 2001	October 31, 2000	October 31, 1999
Average monthly outstanding borrowings.....	\$ 74,543	\$128,788	\$ 55,495
Average interest rate during period.....	7.1%	10.0%	9.2%
Average interest rate at end of period <sup>(1)</sup> .....	4.1%	8.4%	7.2%
Maximum outstanding at any month end .....	\$120,600	\$170,800	\$117,085

<sup>(1)</sup> Average interest rate at the end of the period excludes any charges on unused loan balances.

In addition, we have a secured mortgage loan warehouse agreement with a group of banks, which is a short-term borrowing, that provides up to \$110,000,000 through July 26, 2002. Interest is payable monthly at the Federal Funds Rate plus 1.125% (approximately 3.81% at October 31, 2001) plus fees equal to .625% of the outstanding loan balance. The loan is repaid when the underlying mortgage loans are sold to permanent investors by the Company.

## 8. Senior and Subordinated Notes

On April 29, 1992, we issued \$100,000,000 principal amount of 11 1/4% Subordinated Notes due April 15, 2002. Prior to 1999, we redeemed \$44,551,000 principal amount. The funds were provided by the revolving credit agreement. In June 1999, we redeemed the remaining \$45,449,000 principal amount at an average price of 101.875% of par. The funds for this redemption were provided by the issuance of Senior Notes and resulted in an extraordinary loss of \$868,000 net of an income tax benefit of \$468,000.

On June 7, 1993, we issued \$100,000,000 principal amount of 9 3/4% Subordinated Notes due June 1, 2005. In April 2001, we retired \$253,000 of these notes. Interest is payable semi-annually. The notes are redeemable in whole or in part at our option, initially at 104.875% of their principal amount on or after June 1, 1999 and reducing to 100% of their principal amount on or after June 1, 2002.

On May 4, 1999, we issued \$150,000,000 principal amount of 9 1/8% Senior Notes due May 1, 2009. Interest is payable semi-annually. The notes are redeemable in whole or in part at our option, initially at 104.563% of their principal amount on or after May 1, 2004 and reducing to 100% of their principal amount on or after May 1, 2007.

On October 2, 2000, we issued \$150,000,000 principal amount of 10 1/2% Senior Notes due October 1, 2007. The 10 1/2% Senior Notes were issued at a discount to yield 11% and have been reflected net of the unamortized discount in the accompanying consolidated balance sheet. Interest is payable semi-annually. The notes are redeemable in whole or in part at our option at 100% of their principal amount upon payment of a make-whole price.

The indentures relating to the Senior and Subordinated Notes and the Revolving Credit Agreement contain restrictions on the payment of cash dividends. At October 31, 2001, \$66,013,000 of retained earnings were free of such restrictions.

The fair value of both the Senior Notes and Subordinated Notes is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to us for debt of the same remaining maturities. The fair value of the Senior Notes and Subordinated Notes is estimated at \$297,750,000 and \$96,256,000, respectively, as of October 31, 2001.

### 9. Retirement Plan

In December 1982, we established a defined contribution savings and investment retirement plan. Under such plan there are no prior service costs. All associates are eligible to participate in the retirement plan and employer contributions are based on a percentage of associate contributions. Plan costs charged to operations amount to \$3,675,000, \$2,948,000, and \$2,760,000 for the years ended October 31, 2001, 2000, and 1999, respectively.

### 10. Income Taxes

Income Taxes payable (receivable) including deferred benefits, consists of the following:

<i>(In Thousands)</i>	Year Ended	
	October 31, 2001	October 31, 2000
State income taxes:		
Current.....	\$3,393	\$1,552
Deferred.....	(2,262)	163
Federal income taxes:		
Current.....	6,623	5,519
Deferred.....	(8,473)	(3,162)
Total.....	<b>\$ (719)</b>	<b>\$4,072</b>

The provision for income taxes is composed of the following charges (benefits):

<i>(In Thousands)</i>	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
Current income tax expense:			
Federal <sup>(1)</sup> .....	\$48,478	\$13,609	\$13,253
State <sup>(2)</sup> .....	6,461	1,574	4,954
	<b>54,939</b>	<b>15,183</b>	<b>18,207</b>
Deferred income tax expense:			
Federal.....	(9,834)	2,551	860
State.....	(2,437)	921	139
	<b>(12,271)</b>	<b>3,472</b>	<b>999</b>
Total.....	<b>\$42,668</b>	<b>\$18,655</b>	<b>\$19,206</b>

<sup>(1)</sup> The current federal income tax expense includes a tax benefit of \$468,000 and in the year ended October 31, 1999 relating to the loss on the redemption of Subordinated Notes that was reported as an extraordinary item in the "Statements of Income."

<sup>(2)</sup> The current state income tax expense is net of the use of state loss carryforwards amounting to \$26,830,000, \$21,330,000, and \$5,860,000, for the years ended October 31, 2001, 2000, and 1999.

The deferred tax liabilities or assets have been recognized in the consolidated balance sheets due to temporary differences as follows:

<i>(In Thousands)</i>	<b>October 31, 2001</b>	October 31, 2000
Deferred tax assets:		
Maintenance guarantee reserves .....	<b>\$ 658</b>	\$ 740
Inventory impairment loss .....	<b>2,206</b>	1,785
Uniform capitalization of overhead.....	<b>6,726</b>	6,008
Post development completion costs.....	<b>5,319</b>	3,194
State net operating loss carryforwards .....	<b>27,846</b>	30,916
Other.....	<b>7,067</b>	2,970
Total .....	<b>49,822</b>	45,613
Valuation allowance <sup>(3)</sup> .....	<b>(27,846)</b>	(30,916)
Total deferred tax assets .....	<b>21,976</b>	14,697
Deferred tax liabilities:		
Deferred interest.....	<b>31</b>	31
Installment sales .....	<b>76</b>	96
Accelerated depreciation .....	<b>2,113</b>	3,965
Acquisition goodwill.....	<b>3,124</b>	2,279
Software development expenses .....	<b>5,897</b>	5,327
Total deferred tax liabilities .....	<b>11,241</b>	11,698
Net deferred tax assets <sup>(4)</sup> .....	<b>\$10,735</b>	\$ 2,999

<sup>(3)</sup> The net change in the valuation allowance of \$(3,070,000) results from a decrease in the separate company state net operating losses that may not be fully utilized.

<sup>(4)</sup> In connection with the merger with Washington Homes, Inc. we recorded a deferred tax liability of \$4,534,000.

The effective tax rates varied from the expected rate. The sources of these differences were as follows:

	Year Ended		
	<b>October 31, 2001</b>	October 31, 2000	October 31, 1999
Computed "expected" tax rate .....	<b>35.0%</b>	35.0%	35.0%
State income taxes, net of Federal income tax benefit .....	<b>3.2</b>	3.1	6.5
Permanent timing differences.....	<b>1.6</b>	1.0	.2
Low income housing tax credit .....	<b>(1.3)</b>	(2.6)	(2.8)
Other .....	<b>1.6</b>	(1.5)	.1
Effective tax rate .....	<b>40.1%</b>	36.0%	39.0%

We have state net operating loss carryforwards for financial reporting and tax purposes of \$358,000,000 due to expire between the years October 31, 2002 and October 31, 2016.

#### **11. Reduction of Inventory to Fair Value**

In accordance with Financial Accounting Standards (SFAS) No. 121 "Accounting for the Impairment of Long Lived Assets and for Long Lived Assets to Be Disposed Of", 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 related carrying amounts. During the year ended October 31, 2001, inventory with a carrying amount of \$12,084,000 was written down by \$2,088,000 to its fair value. This was based on our evaluation of the expected revenue, cost to complete including interest and selling cost. The writedown during the year ended October 31, 2001 was attributed to two communities in the Northeast Region that were part of a large land acquisition, which resulted in a loss.

Also in accordance with SFAS 121, we record impairment losses on inventories and long-lived assets held for sale when the related carrying amount exceeds the fair value less the selling cost. As of October 31, 2001, inventory with a carrying amount of \$1,391,000 was written down by \$424,000 to its fair value. No inventory was written down during the year ended October 31, 2000. As of October 31, 1999, inventory with a carrying amount of \$4,539,000 was written down by \$1,801,000 to its fair value. The writedowns during the year ended October 31, 2001 were attributed to two land parcels in Florida and one community in North Carolina. The writedowns in Florida and North Carolina were based upon changes in market conditions. The writedowns during the year ended October 31, 1999 were attributed to one land parcel in Florida and two residential communities in North Carolina. The Florida land parcel was written down based on purchase offers. The communities in North Carolina were written down based on our decision to discontinue selling homes and offer the remaining lots for sale.

The total aggregate impairment losses, which are presented in the consolidated statements of income, in inventory held for future development or sale were \$2,512,000, zero, and \$1,801,000 for the years ended October 31, 2001, 2000, and 1999, respectively.

On the statement of income the line entitled "Homebuilding – Inventory impairment loss" also includes write-offs of options including approval, engineering, and capitalized interest costs. During the years ended October 31, 2001, 2000, and 1999 write-offs amounted to \$1,856,000, \$1,791,000 and \$290,000, respectively. During the years ended October 31, 2001, 2000, and 1999 we did not exercise options in various locations because the communities pro forma profitability did not produce adequate returns on investment commensurate with the risk. Those communities were located in New Jersey, New York, Metro D. C., North Carolina, and California.

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**12. Transactions with  
Related Parties**

Our Board of Directors has adopted a general policy providing that it will not make loans to our officers or directors or their relatives at an interest rate less than the interest rate at the date of the loan on six month U.S. Treasury Bills, that the aggregate of such loans will not exceed \$3,000,000 at any one time, and that such loans will be made only with the approval of the members of our Board of Directors who have no interest in the transaction. At October 31, 2001 and 2000 included in receivables, deposits and notes are related party receivables from officers and directors amounted to \$1,119,000 and \$3,127,000, respectively. Due to an oversight the loan balances exceeded \$3,000,000 at October 31, 2000. On November 9, 2000 a \$250,000 payment was received which reduced the loans to within authorized limits. Interest income from these loans for October 31, 2001, 2000, and 1999 amounted to \$84,000, \$167,000 and \$108,000, respectively.

We provide property management services to various limited partnerships including one partnership in which Mr. A. Hovnanian, our Chief Executive Officer, President and a Director, is a general partner, and members of his family and certain officers and directors are limited partners. During the years ended October 31, 2001, 2000, and 1999 we received \$76,000, \$85,000, and \$80,000, respectively, in fees for such management services. At October 31, 2000 and 1999, no amounts were due us by these partnerships.

During the year ended October 31, 2001 we entered into an agreement to purchase land from an entity that is a family relative of our Chairman of the Board and our Chief Executive Officer. As of October 31, 2001, land aggregating \$2,384,000 has been purchased. The Company remains obligated under a land purchase agreement to purchase an additional \$26.9 million of land from this entity over the next three years. Neither the Company nor the Chairman of the Board and Chief Executive Officer has a financial interest in the relative's company from whom the land was purchased.

**13. Stock Plans**

We have a stock option plan for certain officers and key employees. Options are granted by a Committee appointed by the Board of Directors. The exercise price of all stock options must be at least equal to the fair market value of the underlying shares on the date of the grant. Options granted prior to May 14, 1998 vest in three equal installments on the first, second and third anniversaries of the date of the grant. Options granted on or after May 14, 1998 vest in four equal installments on the third, fourth, fifth and sixth anniversaries of the date of the grant. Certain Washington Homes associates were granted and held options to purchase Washington Homes stock prior to the January 23, 2001 merger. These options vest in three installments: 25% on the first and second anniversary, and 50% on the third anniversary of the date of the grant. In connection with the merger (See Note 15) the options were exchanged for options to purchase the Company's Class A Common Stock. In 2000 we extended the life of options that expired on May 4, 2000 five years which resulted in additional compensation expense of \$346,000 net of taxes. All options expire ten years after the date of the grant. In addition, during the years ended October 31, 2000 and 1999 each of the three outside directors of the Company were granted options to purchase 10,000 shares at the same price and terms as those granted to officers and key employees. Stock option transactions are summarized as follows:

	Weighted Average Fair Value <sup>(1)</sup> And Exercise Price		Weighted Average Fair Value <sup>(1)</sup> And Exercise Price		Weighted Average Fair Value <sup>(1)</sup> And Exercise Price	
	October 31, 2001		October 31, 2000		October 31, 1999	
Options outstanding at						
beginning of period .....	<b>1,980,500</b>	<b>\$7.55</b>	1,656,000	\$8.02	1,415,000	\$8.13
Granted .....	<b>1,048,785</b>	<b>\$5.81</b>	444,500	\$6.10	251,000	\$7.87
Exercised .....	<b>519,673</b>	<b>\$4.29</b>			10,000	\$5.81
Forfeited .....	<b>238,955</b>	<b>\$7.67</b>	120,000	\$8.60		
Options outstanding at						
end of period .....	<b>2,270,657</b>	<b>\$7.44</b>	1,980,500	\$9.44	1,656,000	\$8.29
Options exercisable at						
end of period .....	<b>1,451,718</b>		1,276,708		1,106,666	
Price range of options .....	<b>\$ 2.66-</b>		\$ 5.13-		\$ 5.13-	
outstanding .....	<b>\$15.08</b>		\$11.50		\$11.50	
Weighted-average remaining						
contractual life .....	<b>6.0 yrs.</b>		7.0 yrs.		5.0 yrs.	

<sup>(1)</sup> Fair value of options at grant date approximate exercise price.

Pro forma information regarding net income and earnings per share is required under the fair value method of Financial Accounting Standards (SFAS) No. 123 "Accounting for Stock-Based Compensation" and is to be calculated as if we had accounted for our stock options under the fair value method of SFAS 123. The fair value for these options is established at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for 2001, 2000, and 1999: risk-free interest rate of 4.4%, 5.9%, and 6.4%, respectively; dividend yield of zero; volatility factor of the expected market price of our common stock of 0.38, 0.41, and 0.46, respectively; and a weighted-average expected life of the option of 5.1, 7.0, and 7.7 years, respectively.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options and are not likely to be representative of the effects on reported net income for future years, if applicable.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. Our pro forma information follows (*in thousands except for earnings per share information*):

	Year Ended		
	October 31, 2001	October 31, 2000	October 31, 1999
Pro forma net income.....	\$ 63,491	\$ 32,322	\$ 29,851
Pro forma basic earnings per share .....	\$ 2.37	\$ 1.47	\$ 1.39
Pro forma diluted earnings per share .....	\$ 2.28	\$ 1.47	\$ 1.38

During the year ended October 31, 1999, we modified our bonus plan for certain associates. A portion of their bonus will be paid by issuing a deferred right to receive our Class A Common Stock. The number of shares will be calculated by dividing the portion of the bonus subject to the deferred right award by our stock price on the date the bonus is earned. 25% of the deferred right award will vest and shares will be issued one year after the year end and then 25% a year for the next three years. During the years ended October 31, 2001 and 2000, we issued 84,962 and 25,000 shares under the plan. During the years ended October 31, 2001 and 2000 41,550 and 26,000 shares were forfeited under this plan, respectively. For the years ended October 31, 2001, 2000, and 1999, approximately 319,000, 281,000, and 200,000 deferred rights were awarded in lieu of \$3,857,000, \$1,923,000, and \$1,534,000 of bonus payments, respectively.

#### 14. Commitments and Contingent Liabilities

We are involved from time to time in litigation arising in the ordinary course of business, none of which is expected to have a material adverse effect on us. We were involved in an action resulting from the non-performance by a land owner (the "Defendant") to sell real property to us. In 1999, we entered into a Settlement Agreement and Mutual Release ("SAMR") relating to this action. Pursuant to the terms of the SAMR, the Defendant stipulated to a judgement in our favor in the amount of \$3,535,349. In 2000 the judgement was upheld in bankruptcy proceedings. As a result of the bankruptcy proceeding and evaluation of the collateral underlying our claim, we recorded a net gain on settlement of \$1.8 million which is included in land sales and other revenues in the consolidated statements of income at October 31, 2000.

As of October 31, 2001 and 2000, respectively, we are obligated under various performance letters of credit amounting to \$10,223,000 and \$4,284,000. (See Note 5)

#### 15. Acquisitions

On August 7, 1999 we acquired The Matzel and Mumford Organization, Inc. ("M & M"), a New Jersey homebuilder and its related entities. On October 1, 1999 we acquired the Goodman Family of Builders, L.P. ("Goodman"), a Texas homebuilder and its related entities. The combined purchase price for both acquisitions was approximately \$24,400,000 in cash and 1,845,359 shares of our Class A Common Stock at a weighted average share price of \$7.18, of which 483,302 shares were held in escrow (and thus not reported as issued and outstanding) for pre-acquisition contingencies. As of October 31, 2001, 241,651 of those shares held in escrow were released. At the dates of the acquisition we loaned the acquired entities approximately \$85,000,000 to pay off their third party debt. In addition, both the M & M and Goodman acquisitions provide for other payments to be made generally dependent upon the achievement of certain future operating and return objectives.

Both acquisitions were accounted for as a purchase with the results of operations of the acquired entities included in our consolidated financial statements as of the dates of acquisitions. The purchase prices were allocated based on estimated fair values at the dates of the acquisitions. An intangible asset equal to the excess purchase prices over the fair values of net assets acquired of \$19,998,000 has been recorded in prepaid expenses and other assets on the consolidated balance sheet; this amount is being amortized on a straight-line basis over a period of ten years.



On January 23, 2001 we merged with Washington Homes, Inc. for a total purchase price of \$87.4 million, of which \$38.5 million was paid in cash and 6,352,900 shares of our Class A Common Stock valued at \$44.9 million were issued and options issued to Washington Homes, Inc. employees with an intrinsic value of \$3.4 million were converted to 738,785 of our options. At the date of acquisition we loaned Washington Homes, Inc. approximately \$57,000,000 to pay off their third party debt.

The merger with Washington Homes, Inc. was accounted for as a purchase with the results of operations of the merged entity included in our consolidated financial statements as of the date of the merger. The purchase price was allocated based on estimated fair value at the date of the merger. An intangible asset equal to the excess purchase price over the fair value of the net assets of \$16,689,000 is recorded in prepaid expenses and other assets on the consolidated balance sheet. This amount is being amortized on a straight line basis over a period of ten years.

The following unaudited pro forma financial data presents a summary of our consolidated results of operations as if the merger with Washington Homes, Inc. on January 23, 2001 had occurred on November 1, 1999. Unaudited pro forma financial data is presented for information purposes only and may not be indicative of the actual amounts of the Company had the events occurred on the dates listed above, nor does it purport to represent future periods.

<i>(In Thousands Except Per Share)</i>	Year Ended October 31,	
	2001	2000
Revenues.....	<b>\$1,811,701</b>	\$1,617,161
Expenses.....	<b>1,704,844</b>	1,544,083
Income Taxes.....	<b>42,126</b>	27,556
Net Income.....	<b>\$ 64,731</b>	\$ 45,522
Diluted Net Income Per Common Share.....	<b>\$ 2.22</b>	\$ 1.59

These pro forma results have been prepared for comparative purposes only and include certain adjustments including additional amortization expense as a result of goodwill, additional compensation and increased interest expense on acquisition debt. This pro forma does not purport to be indicative of the results of operations which actually would have resulted had the combination been in effect on November 1, 1999 or of future results of operations of the consolidated entities.

#### **16. Restructuring Charges**

Restructuring charges are estimated expenses associated with the merger of our operations with those of Washington Homes, Inc. on January 23, 2001. Under our merger plan, administration offices in Maryland, Virginia, and North Carolina will be either closed, relocated, or combined. The merger of administration offices was completed by July 31, 2001. Expenses were accrued for salaries, severance and outplacement costs for the involuntary termination of associates, costs to close and/or relocate existing administrative offices, and lost rent and leasehold improvements. We estimated that approximately 58 associates would be terminated. We have accrued approximately \$2.0 million to cover termination and related costs. Associates being terminated are primarily administrative. In addition, we accrued approximately \$1.2 million to cover closing and/or relocating various administrative offices in these three states. At October 31, 2001 \$1.5 million has been charged against termination costs relating to the termination of 55 associates and \$0.5 million has been charged against closing and relocation costs.

**17. Unaudited Summarized Consolidated Quarterly Information**

Summarized quarterly financial information for the years ended October 31, 2001 and 2000 is as follows:

<i>(In Thousands Except Per Share Data)</i>	Three Months Ended			
	October 31, 2001	July 31, 2001	April 30, 2001	January 31, 2001 <sup>(1)</sup>
Revenues.....	\$537,185	\$509,250	\$402,340	\$293,188
Expenses.....	\$500,243	\$473,965	\$379,773	\$281,628
Income before income taxes.....	\$ 36,942	\$ 35,285	\$ 22,567	\$ 11,560
State and Federal income tax.....	\$ 15,251	\$ 14,273	\$ 8,507	\$ 4,637
Net Income.....	\$ 21,691	\$ 21,012	\$ 14,060	\$ 6,923
Per Share Data:				
Basic:				
Net Income.....	\$ 0.77	\$ 0.74	\$ 0.50	\$ 0.31
Weighted average number of common shares outstanding.....	28,288	28,375	28,176	22,286
Assuming Dilution:				
Net Income.....	\$ 0.74	\$ 0.71	\$ 0.48	\$ 0.30
Weighted average number of common shares outstanding.....	29,227	29,623	29,472	22,732

<sup>(1)</sup> On January 23, 2001, we merged with Washington Homes, Inc.

<i>(In Thousands Except Per Share Data)</i>	Three Months Ended			
	October 31, 2000	July 31, 2000	April 30, 2000	January 31, 2000
Revenues.....	\$352,483	\$284,620	\$241,487	\$256,969
Expenses.....	\$323,151	\$272,362	\$236,035	\$252,193
Income before income taxes.....	\$ 29,332	\$ 12,258	\$ 5,452	\$ 4,776
State and Federal income tax.....	\$ 11,170	\$ 4,167	\$ 1,994	\$ 1,324
Net Income.....	\$ 18,162	\$ 8,091	\$ 3,458	\$ 3,452
Per Share Data:				
Basic:				
Net Income.....	\$ 0.85	\$ 0.37	\$ 0.16	\$ 0.15
Weighted average number of common shares outstanding.....	21,463	21,904	22,054	22,327
Assuming Dilution:				
Net Income.....	\$ 0.84	\$ 0.37	\$ 0.16	\$ 0.15
Weighted average number of common shares outstanding.....	21,704	21,949	22,111	22,413

**18. Financial Information of Subsidiary Issuer and Subsidiary Guarantors**

Hovnanian Enterprises, Inc., the parent company (the "Parent") is the issuer of publicly traded common stock. One of its wholly owned subsidiaries, K. Hovnanian Enterprises, Inc., (the "Subsidiary Issuer") was the issuer of certain Senior Notes on May 4, 1999 and October 2, 2000.

The Subsidiary Issuer acts as a finance and management entity that as of October 31, 2001 had issued and outstanding approximately \$97,747,000 subordinated notes, \$300,000,000 senior notes and a revolving credit agreement with an outstanding balance of zero. The subordinated notes, senior notes and the revolving credit agreement are fully and unconditionally guaranteed by the Parent.

Each of the wholly owned subsidiaries of the Parent (collectively the "Guarantor Subsidiaries"), with the exception of various subsidiaries formerly engaged in the issuance of collateralized mortgage obligations, a mortgage lending subsidiary, a subsidiary holding and licensing the "K. Hovnanian" trade name, a subsidiary engaged in homebuilding activity in Poland, our Title subsidiaries, and a joint venture (collectively the "Non-guarantor Subsidiaries"), have guaranteed fully and unconditionally, on a joint and several basis, the obligation to pay principal and interest under the senior notes and revolving credit agreement of the Subsidiary Issuer.

In lieu of providing separate audited financial statements for the Guarantor Subsidiaries we have included the accompanying consolidated condensed financial statements. Management does not believe that separate financial statements of the Guarantor Subsidiaries are material to investors. Therefore, separate financial statements and other disclosures concerning the Guarantor Subsidiaries are not presented.

The following consolidating condensed financial information presents the results of operations, financial position and cash flows of (i) the Parent (ii) the Subsidiary Issuer (iii) the Guarantor Subsidiaries of the Parent (iv) the Non-guarantor Subsidiaries of the Parent and (v) the eliminations to arrive at the information for Hovnanian Enterprises, Inc. on a consolidated basis.

**Consolidating Condensed Balance Sheet**

October 31, 2001

<i>(Thousands of Dollars)</i>	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>Assets:</b>						
Homebuilding.....	\$ 2,022	\$ 50,565	\$882,715	\$ 10,229	\$	\$ 945,531
Financial Services .....			205	117,803		118,008
Income Taxes (Payables)Receivables .....	(5,067)	(3,658)	11,893	(2,449)		719
Investments in and amounts due to and from consolidated subsidiaries.....	378,691	375,514	(668,285)	14,513	(100,433)	
<b>Total Assets.....</b>	<b>\$375,646</b>	<b>\$422,421</b>	<b>\$226,528</b>	<b>\$140,096</b>	<b>\$(100,433)</b>	<b>\$1,064,258</b>
<b>Liabilities:</b>						
Homebuilding.....	\$	\$ 14,679	\$161,759	\$ 291	\$	\$ 176,729
Financial Services .....				103,569		103,569
Notes Payable .....		408,206	108			408,314
Income Taxes Payable .....						
Stockholders' Equity.....	375,646	(464)	64,661	36,236	(100,433)	375,646
<b>Total Liabilities and Stockholders' Equity .....</b>	<b>\$375,646</b>	<b>\$422,421</b>	<b>\$226,528</b>	<b>\$140,096</b>	<b>\$(100,433)</b>	<b>\$1,064,258</b>

**Consolidating Condensed Balance Sheet**

October 31, 2000

<i>(Thousands of Dollars)</i>	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>Assets:</b>						
Homebuilding.....	\$ (63)	\$ 76,648	\$717,484	\$ 8,002	\$	\$802,071
Financial Services .....			994	70,476		71,470
Income Taxes (Payables)Receivables .....	(4,585)	(5,873)	12,567	(2,109)		
Investments in and amounts due to and from consolidated subsidiaries .....	268,007	353,115	(473,872)	577	(147,827)	
<b>Total Assets.....</b>	<b>\$263,359</b>	<b>\$423,890</b>	<b>\$257,173</b>	<b>\$76,946</b>	<b>\$(147,827)</b>	<b>\$873,541</b>
<b>Liabilities:</b>						
Homebuilding.....	\$	\$ 11,533	\$122,807	\$ 1,060	\$	\$135,400
Financial Services .....			457	61,114		61,571
Notes Payable.....		409,041	98			409,139
Income Taxes Payable .....			4,072			4,072
Stockholders' Equity.....	263,359	3,316	129,739	14,772	(147,827)	263,359
<b>Total Liabilities and Stockholders' Equity .....</b>	<b>\$263,359</b>	<b>\$423,890</b>	<b>\$257,173</b>	<b>\$76,946</b>	<b>\$(147,827)</b>	<b>\$873,541</b>

**Consolidating Condensed Statement of Income**

Twelve Months Ended October 31, 2001

<i>(Thousands of Dollars)</i>	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>Revenues:</b>						
Homebuilding .....	\$	\$ 431	\$1,701,394	\$46,190	\$(37,480)	\$1,710,535
Financial Services.....			10,391	21,037		31,428
Intercompany Charges .....		96,368	30,480		(126,848)	
Equity In Pretax Income of Consolidated Subsidiaries .....	106,354				(106,354)	
<b>Total Revenues .....</b>	<b>106,354</b>	<b>96,799</b>	<b>1,742,265</b>	<b>67,227</b>	<b>(270,682)</b>	<b>1,741,963</b>
<b>Expenses:</b>						
Homebuilding .....		96,799	1,637,238	8,935	(128,806)	1,614,166
Financial Services.....			5,748	15,821	(126)	21,443
<b>Total Expenses .....</b>		<b>96,799</b>	<b>1,642,986</b>	<b>24,756</b>	<b>(128,932)</b>	<b>1,635,609</b>
<b>Income (Loss) Before Income Taxes .....</b>	<b>106,354</b>		<b>99,279</b>	<b>42,471</b>	<b>(141,750)</b>	<b>106,354</b>
<b>State and Federal Income Taxes .....</b>	<b>42,668</b>	<b>109</b>	<b>39,278</b>	<b>16,448</b>	<b>(55,835)</b>	<b>42,668</b>
<b>Net Income (Loss) .....</b>	<b>\$ 63,686</b>	<b>\$ (109)</b>	<b>\$ 60,001</b>	<b>\$26,023</b>	<b>\$(85,915)</b>	<b>\$ 63,686</b>

**Consolidating Condensed Statement of Income**

Twelve Months Ended October 31, 2000

<i>(Thousands of Dollars)</i>	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>Revenues:</b>						
Homebuilding .....	\$	\$ 391	\$1,112,173	\$21,397	\$ (17,726)	\$1,116,235
Financial Services .....			6,028	13,296		19,324
Intercompany Charges.....		82,051	34,505		(116,556)	
Equity In Pretax Income of Consolidated Subsidiaries.....	51,818				(51,818)	
<b>Total Revenues .....</b>	<b>51,818</b>	<b>82,442</b>	<b>1,152,706</b>	<b>34,693</b>	<b>(186,100)</b>	<b>1,135,559</b>
<b>Expenses:</b>						
Homebuilding .....		66,232	1,094,207	2,831	(99,279)	1,063,991
Financial Services .....			4,591	15,426	(267)	19,750
<b>Total Expenses.....</b>		<b>66,232</b>	<b>1,098,798</b>	<b>18,257</b>	<b>(99,546)</b>	<b>1,083,741</b>
Income (Loss) Before Income Taxes. ....	51,818	16,210	53,908	16,436	(86,554)	51,818
State and Federal Income Taxes.... ..	18,655	6,616	18,438	5,757	(30,811)	18,655
<b>Net Income (Loss) .....</b>	<b>\$33,163</b>	<b>\$ 9,594</b>	<b>\$ 35,470</b>	<b>\$10,679</b>	<b>\$ (55,743)</b>	<b>\$ 33,163</b>



**Consolidating Condensed Statement of Income**

Twelve Months Ended October 31, 1999

<i>(Thousands of Dollars)</i>	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>Revenues:</b>						
Homebuilding .....	\$ (159)	\$ 1,120	\$ 922,333	\$ 22,767	\$ (20,405)	\$ 925,656
Financial Services .....			3,561	17,197		20,758
Intercompany Charges.....		91,695	72		(91,767)	
Equity In Pretax Income of Consolidated Subsidiaries.....	50,776				(50,776)	
<b>Total Revenues .....</b>	<b>50,617</b>	<b>92,815</b>	<b>925,966</b>	<b>39,964</b>	<b>(162,948)</b>	<b>946,414</b>
<b>Expenses:</b>						
Homebuilding .....		90,111	865,736	2,248	(81,997)	876,098
Financial Services .....			2,757	17,370	(428)	19,699
<b>Total Expenses.....</b>		<b>90,111</b>	<b>868,493</b>	<b>19,618</b>	<b>(82,425)</b>	<b>895,797</b>
Income (Loss) Before Income Taxes.....	50,617	2,704	57,473	20,346	(80,523)	50,617
State and Federal Income Taxes .....	19,674	917	21,453	7,771	(30,141)	19,674
Extraordinary Loss .....	(868)	(868)			868	(868)
<b>Net Income (Loss) .....</b>	<b>\$30,075</b>	<b>\$ 919</b>	<b>\$ 36,020</b>	<b>\$ 12,575</b>	<b>\$ (49,514)</b>	<b>\$ 30,075</b>

**Consolidating Condensed Statement of Cash Flows**

Twelve Months Ended October 31, 2001

<i>(Thousands of Dollars)</i>	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>Cash Flows From Operating Activities:</b>						
Net Income .....	<b>\$63,686</b>	<b>\$ (109)</b>	<b>\$60,001</b>	<b>\$26,023</b>	<b>\$(85,915)</b>	<b>\$63,686</b>
Adjustments to reconcile net income to net cash provided by (used in) operating activities .....	<b>102,908</b>	<b>99,063</b>	<b>(264,122)</b>	<b>(50,381)</b>	<b>85,915</b>	<b>(26,617)</b>
<b>Net Cash Provided By (Used In)</b>						
Operating Activities.....	<b>166,594</b>	<b>98,954</b>	<b>(204,121)</b>	<b>(24,358)</b>		<b>37,069</b>
<b>Net Cash Provided By (Used In)</b>						
Investing Activities.....	<b>(49,622)</b>	<b>(3,770)</b>	<b>13,399</b>	<b>264</b>		<b>(39,729)</b>
<b>Net Cash Provided By (Used In)</b>						
Financing Activities .....	<b>(6,215)</b>	<b>114</b>	<b>(59,555)</b>	<b>41,212</b>		<b>(24,444)</b>
<b>Intercompany Investing and Financing Activities – Net.....</b>	<b>(110,684)</b>	<b>(118,767)</b>	<b>243,387</b>	<b>(13,936)</b>		
<b>Net Increase (Decrease) .....</b>	<b>73</b>	<b>(23,469)</b>	<b>(6,890)</b>	<b>3,182</b>		<b>(27,104)</b>
<b>In Cash and Cash Equivalents Balance, Beginning of Period.....</b>	<b>(63)</b>	<b>17,629</b>	<b>22,506</b>	<b>3,181</b>		<b>43,253</b>
<b>Cash and Cash Equivalents Balance, End of Period .....</b>	<b>\$ 10</b>	<b>\$(5,840)</b>	<b>\$15,616</b>	<b>\$ 6,363</b>		<b>\$16,149</b>

**Consolidating Condensed Statement of Cash Flows**

Twelve Months Ended October 31, 2000

<i>(Thousands of Dollars)</i>	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>Cash Flows From Operating Activities:</b>						
Net Income .....	\$33,163	\$ 9,594	\$35,470	\$10,679	\$(55,743)	\$33,163
Adjustments to reconcile net income to net cash provided by (used in) operating activities .....	751	80,742	(196,014)	(35,030)	55,743	(93,808)
<b>Net Cash Provided By (Used In)</b>						
Operating Activities.....	33,914	90,336	(160,544)	(24,351)		(60,645)
<b>Net Cash Provided By (Used In)</b>						
Investing Activities.....	(231)	(13,262)	(4,433)	(9)		(17,935)
<b>Net Cash Provided By (Used In)</b>						
Financing Activities .....	(6,461)	76,305	6,864	25,760		102,468
<b>Intercompany Investing and Financing Activities – Net .....</b>	<b>(27,331)</b>	<b>(130,355)</b>	<b>156,011</b>	<b>1,675</b>		
<b>Net Increase (Decrease) .....</b>	<b>(109)</b>	<b>23,024</b>	<b>(2,102)</b>	<b>3,075</b>		<b>23,888</b>
<b>In Cash and Cash Equivalents Balance, Beginning of Period.....</b>	<b>46</b>	<b>(5,395)</b>	<b>24,608</b>	<b>106</b>		<b>19,365</b>
<b>Cash and Cash Equivalents Balance, End of Period .....</b>	<b>\$ (63)</b>	<b>\$17,629</b>	<b>\$22,506</b>	<b>\$ 3,181</b>		<b>\$43,253</b>

**Consolidating Condensed Statement of Cash Flows**

Twelve Months Ended October 31, 1999

<i>(Thousands of Dollars)</i>	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>Cash Flows From Operating Activities:</b>						
Net Income .....	\$ 30,075	\$ 919	\$ 36,020	\$ 12,575	\$ (49,514)	\$ 30,075
Adjustments to reconcile net income to net cash provided by (used in) operating activities .....	15,774	311	(123,977)	63,782	49,514	5,404
<b>Net Cash Provided By (Used In)</b>						
Operating Activities.....	45,849	1,230	(87,957)	76,357		35,479
<b>Net Cash Provided By (Used In)</b>						
Investing Activities.....		(9,478)	1,868	480		(7,130)
<b>Net Cash Provided By (Used In)</b>						
Financing Activities .....	(6,291)	106,676	(40,326)	(84,597)		(24,538)
<b>Intercompany Investing and Financing Activities – Net.....</b>	(39,526)	(94,163)	128,000	5,689		
<b>Net Increase (Decrease) .....</b>	32	4,265	1,585	(2,071)		3,811
<b>In Cash and Cash Equivalents Balance, Beginning of Period.....</b>	14	(9,660)	23,023	2,177		15,554
<b>Cash and Cash Equivalents Balance, End of Period .....</b>	\$ 46	\$ (5,395)	\$ 24,608	\$ 106		\$ 19,365

**19. Subsequent Event  
(Unaudited)**

On December 19, 2001 we entered into a purchase agreement with The Forecast Group, L.P. (“TFG”), a California homebuilder, to acquire certain assets and assume related liabilities for an estimated purchase price of \$176.0 million plus the assumption of debt net of cash acquired. The transaction closed on January 10, 2002 but the final purchase price is subject to adjustment based on financial performance through January 31, 2002. Under the terms of the agreement the partners in TFG received \$45.5 million of Hovnanian restricted Class A Common Stock amounting to approximately 2,200,000 shares and the balance in cash.

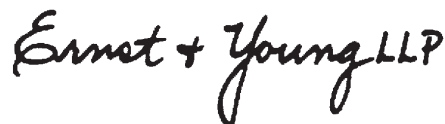
## **Report of Independent Auditors**

To the Stockholders and  
Board of Directors of  
Hovnanian Enterprises, Inc.

We have audited the accompanying consolidated balance sheets of Hovnanian Enterprises, Inc. and subsidiaries as of October 31, 2001 and 2000, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended October 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Hovnanian Enterprises, Inc. and subsidiaries at October 31, 2001 and 2000 and the consolidated results of their operations and their cash flows for each of the three years in the period ended October 31, 2001 in conformity with accounting principles generally accepted in the United States.



Ernst & Young LLP

New York, New York  
December 11, 2001

## Board of Directors and Corporate Officers

Kevork S. Hovnanian  
*Chairman of the Board  
and Director*

Ara K. Hovnanian  
*President, Chief Executive Officer  
and Director*

Arthur M. Greenbaum, Esq.  
*Director and Partner  
Greenbaum, Rowe, Smith,  
Ravin & Davis*

Desmond P. McDonald  
*Director*

John J. Robbins  
*Director*

Stephen D. Weinroth  
*Director and Chairman  
Core Laboratories N.V.*

Paul W. Buchanan  
*Senior Vice President  
Corporate Controller and Director*

Geaton A. DeCesaris, Jr.  
*Chief Operating Officer  
and President of  
Homebuilding Operations  
and Director*

Peter S. Reinhart  
*Senior Vice President  
General Counsel and Director*

J. Larry Sorsby  
*Executive Vice President  
Chief Financial Officer and Director*

Peter S. Corsi  
*Vice President  
Process Redesign and Quality*

Louis J. Csabay  
*Vice President  
Human Resources*

Kevin C. Hake  
*Vice President and Treasurer*

Mark S. Hodges  
*Senior Vice President  
Corporate Operations*

Jane M. Hurd  
*Assistant Vice President  
Audit Services*

Nancy A. Marrazzo  
*Assistant Vice President and  
Assistant Treasurer*

Timothy P. Mason  
*Vice President  
Risk Management*

Bill Moore  
*Assistant Vice President  
Organizational Development  
Strategic Initiatives*

John F. Ulen  
*Vice President and  
Chief Information Officer*

Mark J. Voetsch  
*Vice President  
Corporate Construction Services*

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## Corporate Information

### Annual Meeting

March 8, 2002, 10:30 a.m.  
Simpson Thacher & Bartlett  
425 Lexington Avenue  
New York, New York 10017-3954

### Stock Listing

Hovnanian Enterprises, Inc. Class A common stock is traded on the New York Stock Exchange under the symbol HOV.

### Form 10-K

A copy of form 10-K, as filed with the Securities and Exchange Commission, is available upon request to the Office of the Controller Hovnanian Enterprises, Inc. 10 Highway 35, P.O. Box 500 Red Bank, New Jersey 07701 (732) 747-7800

### Investor Relations Contact

Kevin C. Hake  
*Vice President and Treasurer*  
(732) 747-7800  
Email: ir@khov.com

### Auditors

Ernst & Young LLP  
787 Seventh Avenue  
New York, New York 10019

### Counsel

Simpson Thacher & Bartlett  
425 Lexington Avenue  
New York, New York 10017-3909

### Transfer Agent and Registrar

EquiServe Limited Partnership  
P.O. Box 43010  
Providence, Rhode Island 02940-3010

### Trustee

First Union National Bank  
Corporate Trust Bond Administration  
21 South Street  
Morristown, New Jersey 07960

For additional information, visit our website at **khov.com**





**Hovnanian Enterprises, Inc.**  
10 Highway 35, PO Box 500  
Red Bank, NJ 07701  
(732) 747-7800

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website at [khov.com](http://khov.com)