

CAPITAL PACIFIC HOLDINGS INC

Form 10-Q

January 14, 2003

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**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**Form 10-Q**

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

**For the quarterly period ended November 30, 2002**

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

**Commission File Number: 001-09911**

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**Capital Pacific Holdings, Inc.**

*(Exact name of Registrant as specified in its charter)*

**Delaware**  
*(State or other jurisdiction of  
incorporation or organization)*

**4100 MacArthur Blvd., Suite 200,  
Newport Beach, CA**  
*(Address of principal executive offices)*

**95-2956559**  
*(I.R.S. Employer  
Identification Number)*

**92660**  
*(Zip Code)*

**Registrant's telephone number, including area code:**

**(949) 622-8400**

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Indicate by check mark whether the Registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| <b>Class and Title of<br/>Capital Stock</b> | <b>Shares Outstanding as of<br/>December 31, 2002</b> |
|---|---|
| Common Stock, \$0.10 Par Value              | 13,679,362  |
| Non-Voting Common Stock, \$0.10 Par Value   | 1,235,000   |

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**  
**(In thousands, except share data)**

|   | November 30,<br>2002 | February 28,<br>2002 |
|---|----------------------|----------------------|
|   | (Unaudited)          |                      |
| <b>ASSETS</b>   |                      |                      |
| Cash and cash equivalents   | \$ 14,193            | \$ 5,080             |
| Restricted cash   | 365                  | 365                  |
| Accounts and notes receivable   | 9,313                | 14,537               |
| Real estate projects  | 192,108              | 203,685              |
| Property and equipment  | 7,768                | 971                  |
| Investment in and advances to unconsolidated joint ventures   | 12,836               | 8,549                |
| Prepaid expenses and other assets   | 25,920               | 17,008               |
|   | <u>          </u>    | <u>          </u>    |
| Total assets  | \$ 262,503           | \$ 250,195           |
|   | <u>          </u>    | <u>          </u>    |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                      |                      |
| Accounts payable and accrued liabilities  | \$ 20,163            | \$ 35,369            |
| Notes payable   | 144,334              | 116,265              |
|   | <u>          </u>    | <u>          </u>    |
| Total liabilities   | 164,497              | 151,634              |
|   | <u>          </u>    | <u>          </u>    |
| Negative goodwill   |                      | 5,447                |
|   | <u>          </u>    | <u>          </u>    |
| Stockholders equity:  |                      |                      |
| Common stock, par value \$0.10 per share, 60,000,000 shares authorized; 16,353,951 and 16,230,000 shares issued, respectively; 14,914,362 and 14,878,711 shares outstanding, respectively | 1,635                | 1,623                |
| Additional paid-in capital  | 217,249              | 216,853              |
| Accumulated deficit   | (113,893)            | (120,762)            |
| Treasury stock  | (4,875)              | (4,080)              |
| Accumulated other comprehensive income (loss)   | (2,110)              | (520)                |
|   | <u>          </u>    | <u>          </u>    |
| Total stockholders equity   | 98,006               | 93,114               |
|   | <u>          </u>    | <u>          </u>    |
| Total liabilities and stockholders equity   | \$ 262,503           | \$ 250,195           |
|   | <u>          </u>    | <u>          </u>    |

See accompanying notes to financial statements.

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## CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share data)

|  | Three Months Ended<br>November 30, |           | Nine Months Ended<br>November 30, |            |
|--|------------------------------------|-----------|-----------------------------------|------------|
|  | 2002                               | 2001      | 2002                              | 2001       |
| Sales of homes and land  | \$ 70,398                          | \$ 60,209 | \$ 162,264                        | \$ 218,909 |
| Cost of sales  | (56,302)                           | (46,074)  | (125,359)                         | (164,963)  |
| Interest expense   | (5,118)                            | (5,698)   | (11,696)                          | (21,352)   |
| Selling, general and administrative expenses   | (9,197)                            | (7,594)   | (24,495)                          | (27,780)   |
| Income from unconsolidated joint ventures  | 363                                | 287       | 875                               | 396        |
| Interest and other income, net   | 279                                | 430       | 598                               | 1,129      |
| Income from operations   | 423                                | 1,560     | 2,187                             | 6,339      |
| Minority interest  |                                    |           |                                   | (159)      |
| Income before provision for income taxes and cumulative effect of change in accounting principle | 423                                | 1,560     | 2,187                             | 6,180      |
| Provision for income taxes   | 147                                | 688       | 765                               | 2,663      |
| Income before cumulative effect of change in accounting principle                                | 276                                | 872       | 1,422                             | 3,517      |
| Cumulative effect of change in accounting principle negative goodwill, net of tax effect         |                                    |           | 5,447                             |            |
| Net income   | \$ 276                             | \$ 872    | \$ 6,869                          | \$ 3,517   |
| Earnings per common share basic and diluted:   |                                    |           |                                   |            |
| Income before cumulative effect of change in accounting principle                                | \$ 0.02                            | \$ 0.06   | \$ 0.10                           | \$ 0.24    |
| Cumulative effect of change in accounting principle negative goodwill, net of tax effect         |                                    |           | 0.36                              |            |
| Net income   | \$ 0.02                            | \$ 0.06   | \$ 0.46                           | \$ 0.24    |
| Weighted average common shares basic   | 14,915                             | 14,913    | 14,904                            | 14,530     |
| Weighted average common shares diluted   | 14,957                             | 15,129    | 14,962                            | 14,761     |

See accompanying notes to financial statements.

**Table of Contents****CAPITAL PACIFIC HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(In thousands)**

|  | <b>For the Nine Months<br/>Ended November 30,</b> |                  |
|--|---|------------------|
|  | <b>2002</b>                                       | <b>2001</b>      |
| <b>Operating activities:</b>   |   |                  |
| Net income   | \$ 6,869  | \$ 3,517         |
| Adjustments to reconcile net income to net cash provided by<br>(used in) operating activities: |   |                  |
| Depreciation and amortization  | 398   | 142              |
| Accretion of deferred gain   | (531)   | (531)            |
| Accretion of negative goodwill   |   | (997)            |
| Cumulative effect of change in accounting principle  | (5,447)   |                  |
| Decrease in real estate projects   | 11,577  | 29,540           |
| (Increase) decrease in receivables, prepaid expenses and other<br>assets                       | (3,688)   | 7,945            |
| Decrease in accounts payable and accrued liabilities   | (16,265)  | (17,925)         |
| Minority interest  |   | 159              |
|  | <u>(7,087)</u>                                    | <u>21,850</u>    |
| <b>Investing activities:</b>   |   |                  |
| Purchases of property and equipment, net   | (7,195)   | (921)            |
| Increase in investment in and advances to unconsolidated<br>joint ventures                     | (4,287)   | (2,699)          |
|  | <u>(11,482)</u>                                   | <u>(3,620)</u>   |
| <b>Financing activities:</b>   |   |                  |
| Borrowings on notes payable, net   | 28,069  | 42,336           |
| Retirement of senior unsecured notes payable   |   | (55,592)         |
| Issuance of common stock   | 408   |                  |
| Repurchase of common stock and warrants  | (795)   | (344)            |
|  | <u>27,682</u>                                     | <u>(13,600)</u>  |
| Net increase in cash and cash equivalents  | 9,113   | 4,630            |
| Cash and cash equivalents at beginning of period   | 5,080   | 7,552            |
|  | <u>\$ 14,193</u>                                  | <u>\$ 12,182</u> |

**Non-Cash Activities**

During the nine month period ended November 30, 2001, the Company issued 1,235,000 shares of non-voting common stock to CHF in return for CHF's remaining 7% interest in CPH LLC in connection with the Exchange Transaction described in Note 3 to the financial statements. Below is a summary of amounts recorded as a result of this transaction:



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|  |          |
|--|----------|
| Minority interest acquired                             | \$ 7,902 |
| Issuance of non-voting common stock                    | (5,088)  |
| Deferred income taxes and accrued expenses recorded    | (2,061)  |
| Adjustment of remaining property and equipment to zero | (360)    |
| Negative goodwill recorded                             | (393)    |
|  | <hr/>    |
|  | \$       |
|  | <hr/>    |

See accompanying notes to financial statements.

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**CAPITAL PACIFIC HOLDINGS, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

**1. Basis of Presentation**

The unaudited financial statements presented herein have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by accounting principles generally accepted in the United States. These statements should be read in conjunction with the consolidated financial statements, and notes thereto, included in the Form 10-K for the fiscal year ended February 28, 2002, of Capital Pacific Holdings, Inc. (the Company or CPH, Inc. ). In the opinion of management, the financial statements presented herein include all adjustments (which are solely of a normal recurring nature) necessary to present fairly the Company's financial position and results of operations. The results of operations for the three and nine month periods ended November 30, 2002, are not necessarily indicative of the results that may be expected for the year ending February 28, 2003. The consolidated financial statements include the accounts of the Company, wholly-owned subsidiaries and certain majority owned joint ventures, as well as the accounts of Capital Pacific Holdings, LLC ( CPH LLC ), which is now wholly-owned by the Company. All other investments are accounted for on the equity method. All significant intercompany balances and transactions have been eliminated in consolidation.

**2. Reclassifications**

Certain items in prior period financial statements have been reclassified in order to conform with the current year presentation.

**3. Company Organization and Operations**

The Company is a regional builder and developer with operations throughout selected metropolitan areas of California, Texas, Arizona, Colorado and, until recently, Nevada. The Company's principal business activities are to develop subdivisions and master-planned communities and build and sell single-family homes. The Company's single-family homes are targeted to entry-level, move-up and luxury buyers.

In fiscal year 1998, the Company consummated an equity and restructuring transaction whereby the Company and certain of its subsidiaries transferred to CPH LLC substantially all of their respective assets and CPH LLC assumed all the liabilities of the Company and its subsidiaries. An unaffiliated investment company, California Housing Finance, L.P. ( CHF ) then acquired a 32.07% minority interest in CPH LLC as a result of a cash investment in CPH LLC. From fiscal 1998 through fiscal 2001, the Company expanded its operating strategy to encompass the acquisition and development of commercial and mixed-use projects, as well as ownership of existing commercial properties, primarily through non-majority investments in limited liability companies, with 99.25% of the capital for these projects being provided by CHF. CPH, Inc. and CHF had contingent profits interests (after repayment of debt, the costs of the project, invested capital and preferred return, the latter typically 12%) of approximately 30% to CPH, Inc. and 70% to CHF.

Effective February 23, 2001, CPH, Inc. and CHF consummated the first portion of an interest exchange transaction (the Exchange Transaction ), whereby CPH, Inc. exchanged its 0.75% capital interests and contingent profits interest in the majority of the joint ventures capitalized by CHF, including certain entities which were previously consolidated, (the Divested Joint Ventures ) for approximately 78% of CHF's interest in CPH LLC and all of CHF's interests in certain residential joint ventures. At February 28, 2001 and during the three month period ended May 31, 2001, CPH, Inc. had a 93% interest in CPH LLC and CHF held a 7% minority interest (as compared to 32.07% formerly). As a result of the first portion of the Exchange Transaction, CPH, Inc.'s interest in the total capital of CPH LLC increased by 37% or \$27.2 million. Both CPH, Inc. and CHF had an option to convert CHF's remaining 7% interest in CPH LLC into 1,235,000 shares of non-voting Common Stock of CPH, Inc. at the equivalent of approximately \$6.40 per share. This option was exercised by CPH, Inc. on May 31, 2001, and as a result of this second portion of the Exchange Transaction, CPH, Inc. owned 100% of CPH LLC, and had obtained an additional increment of CPH LLC's

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**CAPITAL PACIFIC HOLDINGS, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

total capital of \$7.9 million. In addition, Capital Pacific Homes, Inc., a wholly-owned subsidiary of the Company, has entered into construction, management and marketing agreements relating to certain of the Divested Joint Ventures with residential components (the Managed Projects), whereby the Company is compensated for performing such services through a management fee arrangement, including reimbursement of all project costs. As a result of the Exchange Transaction, the Company has no further exposure to the economic or entitlement risks associated with the Divested Joint Ventures or the Managed Projects, including no obligation to provide any capital.

The Exchange Transaction was accounted for as the simultaneous acquisition of CHF's minority interest in CPH LLC and certain other residential joint ventures and the disposition of the Company's interest in the Divested Joint Ventures. As a result, no gain was initially recognized, the remaining balance of the Company's property and equipment was adjusted to zero at February 28, 2001, and again at May 31, 2001, a deferred gain of approximately \$3.5 million was recorded on the disposition of one of the Divested Joint Ventures, and the balance of the transaction was recorded as negative goodwill in the amount of \$6.8 million. Negative goodwill represents the portion of the positive difference between the Company's basis in the assets acquired in the Exchange Transaction as compared to the assets which were divested which was not otherwise accounted for as an adjustment to property and equipment or as a deferred gain. Both negative goodwill and the deferred gain were being accreted over five years, which accretion was included as a reduction in selling, general and administrative expenses. As further discussed in Note 9 below, due to a recently promulgated change in accounting principles, the remaining \$5.4 million in unaccreted negative goodwill as of February 28, 2002 increased net income in the quarter ended May 31, 2002 through a cumulative effect of change in accounting principle. The remaining deferred gain will continue to be accreted over the four years of its remaining expected life.

Assets under management, including assets owned by unconsolidated joint ventures (see Note 4 below) and Managed Projects, totaled \$518 million at November 30, 2002 in 61 residential projects. At November 30, 2002, CPH LLC, which is now 100% owned by the Company, had \$247 million in assets and a net worth of \$105 million.

References to the Company are, unless the context indicates otherwise, also references to CPH LLC and the project-specific entities in which the Company has an equity ownership interest. At the current time, all significant financing transactions and arrangements are incurred either by CPH LLC or by the project-specific entities, or in the case of Managed Projects, by the owner of such projects.

**4. Investments in and Advances to Unconsolidated Entities**

The Company is a general partner or a direct or indirect managing member and has a 50 percent or lesser ownership in 14 unconsolidated entities at November 30, 2002. The Company's net investment in and

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advances to unconsolidated entities are as follows at November 30, 2002 and February 28, 2002 (in thousands):

|                                       | <b>Capital<br/>Interest</b> | <b>November 30,<br/>2002</b> | <b>February 28,<br/>2002</b> |
|---------------------------------------|-----------------------------|------------------------------|------------------------------|
| <b>Unconsolidated Joint Ventures:</b> |                             |                              |                              |
| JMP Canyon Estates, L.P.              | 10%                         | \$ 112                       | \$ 112                       |
| JMP Harbor View, L.P.                 | 10%                         | 310                          | 318                          |
| Grand Coto Estates, L.P.              | 10%                         | 627                          | 546                          |
| M.P.E. Partners, L.P.                 | 10%                         | 257                          | 989                          |
| LB/L CPH Providence, LLC              | 10%                         | 462                          | 1,065                        |
| LB/L CPH Longmont, LLC                | 10%                         | 1,138                        | 1,004                        |
| LB/L CPH Laguna Street, LLC           | 10%                         | 1,040                        | 946                          |
| CPH Daily Ranch, L.P.                 | 10%                         | 3,253                        | 3,103                        |
| CPH Sierra Peak, L.P.                 | 50%                         | 5,129                        |                              |
| Other                                 | Various                     | 508                          | 466                          |
|                                       |                             | <u>\$ 12,836</u>             | <u>\$ 8,549</u>              |

The Company's economic interests in the unconsolidated joint ventures vary. Generally, the Company receives a portion of earnings after a preferred return on invested capital is provided. Typically, the majority of capital is provided by capital partners. In addition, the Company is typically required to contribute the full amount of its capital obligation at the commencement of the joint venture's business, but in some cases the Company may have a contingent obligation to contribute additional capital. The Company is typically the direct or indirect managing entity pursuant to terms in each venture's agreement. In the case of Divested Joint Ventures which are now Managed Projects, the Company or a subsidiary manages the development of the project under a management contract. Such management contracts as well as the unconsolidated joint venture agreements typically provide for the payment of a fee to compensate the Company for overhead expenditures as well as reimbursement of all direct project costs. The Company provides for income taxes currently on its share of distributed and undistributed earnings and losses from the investments.

The Company uses the equity method of accounting for its investments in the unconsolidated 50 percent or less owned entities. The accounting policies of the entities are substantially the same as those of the Company.

Following is summarized, combined financial information for the unconsolidated entities at November 30, 2002 and February 28, 2002 and for the three and nine month periods ended November 30, 2002 and November 30, 2001 (in thousands). This information includes in each case the interest of all equity owners of the entities, not just that of the Company and its subsidiaries.

**Assets**

|                      | <b>November 30,<br/>2002</b> | <b>February 28,<br/>2002</b> |
|----------------------|------------------------------|------------------------------|
| Cash                 | \$ 1,068                     | \$ 1,163                     |
| Real estate projects | 111,728                      | 94,818                       |
| Other assets         | 2,521                        | 1,275                        |
|                      | <u>\$ 115,317</u>            | <u>\$ 97,256</u>             |



**Table of Contents****CAPITAL PACIFIC HOLDINGS, INC., AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Liabilities and Equity**

|  | November 30,<br>2002 | February 28,<br>2002 |
|--|----------------------|----------------------|
| Accounts payable and other liabilities | \$ 6,883             | \$ 5,818             |
| Notes payable                          | 4,314                | 5,539                |
|  | <u>11,197</u>        | <u>11,357</u>        |
| Equity                                 | 104,120              | 85,899               |
|  | <u>\$ 115,317</u>    | <u>\$ 97,256</u>     |

**Income Statement**

|                                | Three Months Ended   |                      | Nine Months Ended    |                      |
|--------------------------------|----------------------|----------------------|----------------------|----------------------|
|                                | November 30,<br>2002 | November 30,<br>2001 | November 30,<br>2002 | November 30,<br>2001 |
| Sales of homes and land        | \$ 2,020             | \$ 4,937             | \$ 13,072            | \$ 7,905             |
| Interest and other income, net | 340                  | 2                    | 895                  | 20                   |
|                                | <u>2,360</u>         | <u>4,939</u>         | <u>13,967</u>        | <u>7,925</u>         |
| Costs and expenses             | 2,094                | 4,633                | 12,395               | 7,336                |
| Net income                     | <u>\$ 266</u>        | <u>\$ 306</u>        | <u>\$ 1,572</u>      | <u>\$ 589</u>        |

**5. Notes Payable**

Notes payable at November 30, 2002 and February 28, 2002, are summarized as follows (in thousands):

|   | November 30,<br>2002 | February 28,<br>2002 |
|---|----------------------|----------------------|
| Senior unsecured revolving credit facility, bearing interest varying from LIBOR to prime, as selected by the Company, plus applicable margins   | \$ 107,126           | \$ 90,658            |
| Senior subordinated note, bearing interest at LIBOR plus applicable margin, maturing October 31, 2007   | 20,000               |                      |
| Notes payable to banks, including interest varying from prime plus one quarter percent to LIBOR plus four and one quarter percent, maturing between February 9, 2003 and November 30, 2003, secured by certain real estate projects on a non-recourse basis | 9,853                | 18,011               |
| Other   | <u>7,355</u>         | <u>7,596</u>         |

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\$ 144,334

\$ 116,265

During the third quarter of fiscal 2002, CPH LLC entered into a senior unsecured revolving credit facility (the Senior Facility ) with several participant banks. The facility had a maximum commitment of \$125 million and a two year revolving term. Proceeds from this facility were used to pay down CPH LLC s existing facilities and retire the remaining \$55.6 million of 12 3/4% Senior Notes (the Senior Notes ) at face value. In addition, the Company fixed the interest rate on \$50 million and \$25 million of borrowings at 5.93% and 5.87%, respectively, until September 2003 through interest rate swap agreements with a bank which were required by the terms of the Senior Facility. In October 2002, the Company extended the maturity of the Senior Facility to October 2005 and increased the maximum commitment to \$130 million. In addition, the Company entered into a Senior Subordinated Credit Agreement in the initial amount of \$20 million, with a

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maturity date in October 2007. The Company extended the maturity of the interest rate swaps on the Senior Facility to October 2005, and also entered into an interest swap as required by the terms of the Senior Subordinated Credit Agreement effectively fixing the interest rate on that obligation at 9.50% through its maturity in October 2007.

**6. Earnings Per Common Share**

Basic earnings per common share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding. Diluted earnings per common share includes the effect of the potential shares outstanding, including dilutive securities using the treasury stock method. The table below reconciles the components of the basic earnings per common share calculation to diluted earnings per common share (in thousands, except per share data):

|  | Three Months Ended |        |        |                   |        |        |
|--|--------------------|--------|--------|-------------------|--------|--------|
|  | November 30, 2002  |        |        | November 30, 2001 |        |        |
|  | Income             | Shares | EPS    | Income            | Shares | EPS    |
| Basic earnings per common share:   |                    |        |        |                   |        |        |
| Income available to common stockholders before cumulative effect of change in accounting principle | \$276              | 14,915 | \$0.02 | \$872             | 14,913 | \$0.06 |
| Effect of dilutive securities:   |                    |        |        |                   |        |        |
| Warrants   |                    |        |        |                   | 35     |        |
| Stock options  |                    | 42     |        |                   | 181    |        |
|  | —                  | —      | —      | —                 | —      | —      |
| Diluted earnings per common share before cumulative effect of change in accounting principle       | \$276              | 14,957 | \$0.02 | \$872             | 15,129 | \$0.06 |

|  | Nine Months Ended |        |        |                   |        |        |
|--|-------------------|--------|--------|-------------------|--------|--------|
|  | November 30, 2002 |        |        | November 30, 2001 |        |        |
|  | Income            | Shares | EPS    | Income            | Shares | EPS    |
| Basic earnings per common share:   |                   |        |        |                   |        |        |
| Income available to common stockholders before cumulative effect of change in accounting principle | \$1,422           | 14,904 | \$0.10 | \$3,517           | 14,530 | \$0.24 |
| Effect of dilutive securities:   |                   |        |        |                   |        |        |
| Warrants   |                   |        |        |                   | 44     |        |
| Stock options  |                   | 58     |        |                   | 187    |        |
|  | —                 | —      | —      | —                 | —      | —      |
| Diluted earnings per common share before cumulative effect of change in accounting principle       | \$1,422           | 14,962 | \$0.10 | \$3,517           | 14,761 | \$0.24 |

**7. Stockholders Equity**

The Company has a stock repurchase program in place whereby up to 1,000,000 shares of the Company's outstanding common stock may be repurchased. As of November 30, 2002, 750,100 shares have been repurchased cumulatively under this program. In addition, the Company has



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repurchased, on a cumulative basis, 657,095 of the 790,000 warrants originally issued in connection with the issuance of the Senior Notes. Of the remaining warrants, 123,951 were exercised and 8,954 expired unexercised during the quarter ended May 31, 2002.

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**CAPITAL PACIFIC HOLDINGS, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. Comprehensive Income and Implementation of SFAS No. 133**

The Company follows Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ), as amended. SFAS 133 establishes accounting and reporting standards for derivative instruments and for hedging activities by requiring that all derivatives be recognized in the balance sheet and measured at fair value. The Company's policy is to designate at a derivative's inception the specific assets, liabilities, or future commitments being hedged and monitor the derivative to determine if it remains an effective hedge.

The Company was required under the terms of the Senior Facility to enter into interest rate swap agreements which effectively fix the variable interest rate on a notional amount of \$75 million of outstandings under the Senior Facility. In addition, the Company was required to enter into an interest rate swap agreement in connection with the Senior Subordinated Credit Agreement in the notional amount of \$20 million. The swap agreements have been designated as cash flow hedges and, accordingly, are reflected at their fair value in the consolidated balance sheets. Since applicable interest rates are somewhat lower as of November 30, 2002 than at the time the swaps were entered into, the current fair value of the swaps is negative. The unrealized loss, as of November 30, 2002, of \$2.1 million is recorded in stockholders' equity as accumulated other comprehensive loss.

Amounts to be received or paid as a result of the swap agreements are recognized as adjustments to interest incurred on the related debt instruments. The Company believes that there will be no ineffectiveness related to the interest rate swaps and therefore no portion of the accumulated other comprehensive loss would be reclassified into future earnings. The net effect on the Company's operating results is that interest on the variable-rate debt being hedged is recorded and paid based on fixed interest rates.

**9. New Accounting Pronouncements**

In June 2001, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 141, Business Combinations ( SFAS 141 ). This Statement addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, Business Combinations, and FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises. All business combinations in the scope of this Statement are to be accounted for using one method, the purchase method. The Company has adopted SFAS 141 for all business combinations initiated after June 30, 2001.

Also in June 2001, the FASB issued Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ( SFAS 142 ). SFAS 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, Intangible Assets. This pronouncement addresses, among other things, how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. Goodwill will no longer be amortized but will be assessed at least annually for impairment using a fair value methodology. The Company has adopted this statement for all goodwill and other intangible assets acquired after June 30, 2001 and for all existing goodwill and other intangible assets beginning March 1, 2002. Upon adoption of this standard on March 1, 2002, the Company was required to accrete the remaining balance of negative goodwill through a cumulative effect of change in accounting principle, which increased net income in the first quarter of fiscal 2003 by \$5.4 million, or \$0.36 per diluted share. Other than the accretion of the remaining negative goodwill, the adoption of SFAS 142 did not have a material impact on the Company's financial position or results of operations.

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ( SFAS 144 ). SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS 144 supersedes SFAS

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**CAPITAL PACIFIC HOLDINGS, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

No. 121, and the accounting and reporting provisions of APB Opinion No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, for the disposal of a segment of a business. The provisions of SFAS 144 are effective for financial statements issued for fiscal years beginning after December 15, 2001. The adoption of SFAS 144 did not have a material impact on the Company's financial position or results of operations.

**10. Related Party Transactions**

During the third quarter of fiscal 2003, the Company sold approximately 2,500 acres of undeveloped land to a third party for \$12.9 million under a March 2001 option agreement between the Company and an affiliate of the third party. A former executive of the Company is currently affiliated with the third party purchaser. All material financial terms of the transaction were in place prior to the former executive's affiliation.

**Table of Contents****Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition****Forward-Looking Information Is Subject to Risk and Uncertainty**

Certain statements in the financial discussion and analysis by management contain forward-looking information (as defined in the Private Securities Litigation Reform Act of 1995 and within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended) that involves risk and uncertainty, including projections and assumptions regarding the business environment in which the Company operates. Actual future results and trends may differ materially depending on a variety of factors, including the Company's successful execution of internal performance strategies; changes in general national and regional economic conditions, such as levels of employment, consumer confidence and income; uncertainty arising from acts of terrorism and similar factors; availability to homebuilders of financing for acquisitions, development and construction; availability to homebuyers of permanent mortgages and interest rate levels; the demand for housing; supply levels of land, labor and materials; difficulties in obtaining permits or approvals from governmental authorities; difficulties in marketing homes; regulatory changes and weather and other environmental uncertainties, including water and power shortages; competitive influences; and the outcome of pending and future legal claims and proceedings.

**Results of Operations - General**

As is noted in Note 1 to the financial statements presented herein, the Company is reporting its results on a consolidated basis with the results of its wholly-owned subsidiaries, including CPH LLC. References to the Company in this Item 2 are, unless the context indicates otherwise, also references to such subsidiaries. At the current time, all significant financing transactions and arrangements are incurred either by CPH LLC or by project-specific entities, or in the case of Managed Projects, by the owner of such projects.

The following table illustrates the actual results of the Company's operations, as well as the results including the Company's unconsolidated joint ventures, for the three and nine months ended November 30, 2002 and 2001. The actual results have been adjusted to reflect the inclusion of the operating results of the Company's unconsolidated joint ventures, including the portion attributable to the Company's Joint Venture partners, in order to facilitate the discussion of the overall results in certain portions of the discussion below.

**Results of Operations****(Amounts in thousands)**

|                         | <b>Three Months Ended</b> |                                     |                          |                                     |
|-------------------------|---------------------------|-------------------------------------|--------------------------|-------------------------------------|
|                         | <b>November 30, 2002</b>  |                                     | <b>November 30, 2001</b> |                                     |
|                         | <b>Consolidated</b>       | <b>Including<br/>Joint Ventures</b> | <b>Consolidated</b>      | <b>Including<br/>Joint Ventures</b> |
| Sales of homes and land | \$70,398                  | \$72,418                            | \$60,209                 | \$65,146                            |
| Cost of sales           | 56,302                    | 58,118                              | 46,074                   | 50,305                              |
| Gross margin            | <u>\$ 14,096</u>          | <u>\$ 14,300</u>                    | <u>\$ 14,135</u>         | <u>\$ 14,841</u>                    |
|                         |                           |                                     |                          |                                     |
|                         | <b>Nine Months Ended</b>  |                                     |                          |                                     |
|                         | <b>November 30, 2002</b>  |                                     | <b>November 30, 2001</b> |                                     |
|                         | <b>Consolidated</b>       | <b>Including<br/>Joint Ventures</b> | <b>Consolidated</b>      | <b>Including<br/>Joint Ventures</b> |
| Sales of homes and land | \$ 162,264                | \$ 175,336                          | \$ 218,909               | \$ 226,814                          |
| Cost of sales           | 125,359                   | 136,555                             | 164,963                  | 171,697                             |

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|              |           |           |           |           |
|--------------|-----------|-----------|-----------|-----------|
| Gross margin | \$ 36,905 | \$ 38,781 | \$ 53,946 | \$ 55,117 |
|--------------|-----------|-----------|-----------|-----------|

Cost of sales, as shown above, does not include the amount of previously capitalized interest costs which are included in interest expense. As a result, the gross margin also does not reflect the impact of previously capitalized interest costs included in interest expense. Industry practice among homebuilders varies, but

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Company management feels that gross margin, exclusive of interest expense, is the most relevant comparable measure given the Company's historical capital structure.

In addition to the results shown above, the Company was responsible for the following activity in certain Managed Projects (including the Divested Joint Ventures) for the three and nine months ended November 30, 2002 and 2001:

**Managed and Divested Operations****(Dollar amounts in thousands)**

|                            | Three Months Ended |                   | Nine Months Ended |                   |
|----------------------------|--------------------|-------------------|-------------------|-------------------|
|                            | November 30, 2002  | November 30, 2001 | November 30, 2002 | November 30, 2001 |
| Number of Managed Projects | 1                  | 3                 | 1                 | 3                 |
| Unit closings              | 1                  | 7                 | 7                 | 18                |
| Revenues                   | \$2,000            | \$14,005          | \$16,180          | \$32,647          |

During the three and nine months ended November 30, 2002 and 2001, the Company was responsible for construction and marketing activity in the Managed Projects and the Company's sole economic interest is through management arrangements.

**Operating Data**

The following table shows new home deliveries, lot deliveries, net new orders and average sales prices for the three and nine months ended November 30, 2002 and 2001, including unconsolidated joint ventures but excluding Managed Projects:

|  | Three Months Ended |                   | Nine Months Ended |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | November 30, 2002  | November 30, 2001 | November 30, 2002 | November 30, 2001 |
| New homes delivered:                       |                    |                   |                   |                   |
| California                                 | 57                 | 24                | 110               | 66                |
| Texas                                      | 38                 | 56                | 123               | 230               |
| Nevada                                     |                    |                   |                   | 68                |
| Arizona                                    | 43                 | 52                | 93                | 137               |
| Colorado                                   | 29                 | 31                | 73                | 99                |
| Subtotal                                   | 167                | 163               | 399               | 600               |
| Unconsolidated Joint Ventures (California) | 7                  | 18                | 45                | 29                |
| Total homes delivered                      | 174                | 181               | 444               | 629               |
| Lots delivered                             | 261                | 59                | 349               | 135               |
| Total homes and lots delivered             | 435                | 240               | 793               | 764               |
| Homes and lots net new orders              | 220                | 181               | 662               | 509               |
| Average home sales price:                  |                    |                   |                   |                   |
| California                                 | \$576,000          | \$766,000         | \$607,000         | \$975,000         |
| Texas                                      | 228,000            | 266,000           | 257,000           | 250,000           |
| Nevada                                     |                    |                   |                   | 235,000           |
| Arizona                                    | 149,000            | 156,000           | 147,000           | 155,000           |

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|          |         |         |         |         |
|----------|---------|---------|---------|---------|
| Colorado | 224,000 | 245,000 | 241,000 | 232,000 |
| Combined | 336,000 | 348,000 | 354,000 | 335,000 |

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The following table shows backlog in units and dollars at November 30, 2002 and 2001 for each of the Company's operations, including unconsolidated joint ventures:

|              | Ending Backlog    |                 |                   |                 |
|--------------|-------------------|-----------------|-------------------|-----------------|
|              | November 30, 2002 |                 | November 30, 2001 |                 |
|              | Units             | (\$000s)        | Units             | (\$000s)        |
| California   | 144               | \$50,800        | 88                | \$43,800        |
| Texas        | 102               | 20,600          | 111               | 31,600          |
| Arizona      | 83                | 12,300          | 40                | 5,600           |
| Colorado     | 57                | 11,200          | 52                | 10,100          |
| <b>Total</b> | <b>386</b>        | <b>\$94,900</b> | <b>291</b>        | <b>\$91,100</b> |

**Third Quarter of Fiscal 2003 (Ended November 30, 2002) Compared to Third Quarter of Fiscal 2002 (Ended November 30, 2001)**

The Company reported net income of \$276,000, or \$0.02 per share, in the third quarter of fiscal 2003, as compared to net income of \$872,000, or \$0.06 per share, in the third quarter of fiscal 2002.

On a consolidated basis, sales of homes and land increased to \$70.4 million for the third quarter of fiscal 2003 compared to \$60.2 million for the third quarter of fiscal 2002. This increase is due primarily to a single large land sale of \$12.9 million in the current quarter, offset by a slight decrease in total home closings, combined with a decrease in the Company's average sales price per home to \$336,000 in the third quarter of fiscal 2003 from \$348,000 in the third quarter of fiscal 2002. Sales of homes and land including unconsolidated joint ventures, but excluding Managed Projects, increased from \$65.1 million to \$72.4 million for the respective quarters. Total home closings decreased from 181 in the third quarter of fiscal 2002 to 174 in the third quarter of fiscal 2003, including 18 and 7 homes, respectively, closed in unconsolidated joint ventures. In addition, there was an increase in lot closings from 59 in the third quarter of fiscal 2002 to 261 in the third quarter of fiscal 2003.

The number of actively selling projects has increased from 20 at November 30, 2001 to 28 at November 30, 2002, which affected both backlog and net new orders. The Company currently anticipates opening between 8 and 12 net new communities over the next few quarters.

Backlog has increased from 194 units at February 28, 2002 to 386 units at November 30, 2002, due to the opening of several new communities which have experienced strong sales activity during the current fiscal year as well as increased demand in certain of the Company's markets. However, demand continues to be weak in certain other markets, in particular Colorado and Texas. In order to continue to sell and close homes in these markets, it may become necessary to offer additional incentives to homebuyers, which could have a negative impact on future profitability.

The Company's consolidated gross margin on home and lot closings decreased to 20.0% for the third quarter of fiscal 2003 as compared to 23.5% for the third quarter of fiscal 2002, due primarily to the lower margin land sale noted above. The gross margin on home closings decreased from 23.6% to 22.9% between quarters due in part to weak demand in Colorado and Texas and in part due to the Company's current strategy of moving towards a lower-margin, higher-volume product mix. The Company's gross margin on home and lot closings, including unconsolidated joint ventures, also decreased from 22.8% in the third quarter of fiscal 2002 to 19.7% in the third quarter of fiscal 2003. The Company's measure of gross margin may differ from other homebuilders due to the exclusion of interest expense from cost of sales, as discussed above.

Selling, general and administrative expense of \$9.2 million for the third quarter of fiscal 2003 increased \$1.6 million or 21.1% as compared to the third quarter of fiscal 2002 due principally to an increase in certain non-recurring expenses, including litigation expense and charges related to a reduction in workforce in the Company's Texas division. As a percentage of revenue, selling, general and administrative expense increased from 12.6% for the third quarter of fiscal 2002 to 13.1% for the third quarter of fiscal 2003.





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Income from unconsolidated joint ventures increased from \$287,000 in the third quarter of fiscal 2002 to \$363,000 in the third quarter of fiscal 2003 due to an increased level of profit participation in the active joint ventures in the current period.

Interest and other income decreased from \$430,000 in the third quarter of fiscal 2002 to \$279,000 in the third quarter of fiscal 2003.

Interest incurred was \$3.0 million in the third quarter of fiscal 2003, as compared to \$3.5 million in the third quarter of fiscal 2002, while previously capitalized interest expensed was \$5.1 million during the third quarter of fiscal 2003, as compared to \$5.7 million in the third quarter of fiscal 2002. Once the Company sells out of certain older projects with higher capitalized interest, it anticipates that interest expensed will be closer to its currently lower level of interest incurred.

The Company recorded a provision for income taxes of \$147,000 in the third quarter of fiscal 2003, utilizing an effective tax rate of 34.8%, as compared to \$688,000 in the third quarter of fiscal 2002, with an effective tax rate of 44.1%. The effective tax rate was lower than statutory rates in the third quarter of fiscal 2003 as a result of non-taxable accretion of deferred gain.

***First Nine Months of Fiscal 2003 (Ended November 30, 2002) Compared to First Nine Months of Fiscal 2002 (Ended November 30, 2001)***

The Company reported net income of \$6.9 million, or \$0.46 per share, for the first nine months of fiscal 2003, as compared to net income of \$3.5 million, or \$0.24 per share, for the first nine months of fiscal 2002. Net income for the nine months ended November 30, 2002 included a cumulative effect of change in accounting principle which increased income by \$5.4 million, or \$0.36 per share. Excluding the effect of cumulative change in accounting principle, net income decreased from \$3.5 million for the nine months ended November 30, 2001 to \$1.4 million in the nine months ended November 30, 2002.

On a consolidated basis, sales of homes and land decreased to \$162.3 million for the first nine months of fiscal 2003 compared to \$218.9 million for the first nine months of fiscal 2002. This decrease is due primarily to a decrease in total home closings in the current period, partially offset by an increase in lot sales. The Company's average sales price per home increased slightly to \$354,000 in the first nine months of fiscal 2003 from \$335,000 in the first nine months of fiscal 2002. Sales of homes and land including unconsolidated joint ventures, but excluding Managed Projects, decreased to \$175.3 million from \$226.8 million for the respective periods. Total home closings decreased from 629 in the first nine months of fiscal 2002 to 444 in the first nine months of fiscal 2003, including 29 and 45 homes, respectively, closed in unconsolidated joint ventures. This was partially offset by an increase in lot closings from 135 in the first nine months of fiscal 2002 to 349 in the first nine months of fiscal 2003.

The Company's gross margin on home and lot closings decreased to 22.7% for the first nine months of fiscal 2003 as compared to 24.6% for the first nine months of fiscal 2002 due principally to a higher proportion of lower-margin lot sales in the current period. The gross margin on home and lot closings, including unconsolidated joint ventures, decreased from 24.3% in the first nine months of fiscal 2002 to 22.1% in the first nine months of fiscal 2003. The Company's measure of gross margin may differ from other homebuilders due to the exclusion of interest expense from cost of sales, as discussed above.

Selling, general and administrative expense of \$24.5 million for the first nine months of fiscal 2003 decreased \$3.3 million or 11.8% as compared to the first nine months of fiscal 2002 due principally to a reduction in volume-related sales and marketing costs. As a percentage of revenue, selling, general and administrative expense increased from 12.7% for the first nine months of fiscal 2002 to 15.1% for the first nine months of fiscal 2003. The increased percentage of such expense compared to revenue is primarily due to a lower level of sales activity in the current period.

Income from unconsolidated joint ventures increased from \$396,000 in the first nine months of fiscal 2002 to \$875,000 in the first nine months of fiscal 2003, due to an increased level of profit participation in the active joint ventures in the current quarter.

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Interest and other income decreased from \$1.1 million the first nine months of fiscal 2002 to \$598,000 in the first nine months of fiscal 2003.

Minority interest of \$159,000 for the first nine months of fiscal 2002 primarily represents the share of CPH LLC's income attributable to CHF, until the Company acquired the remaining minority interest in CPH, LLC on May 31, 2001. As CHF no longer holds an ownership interest in CPH LLC, no minority interest was recorded in the current period.

Interest incurred was \$7.9 million in the first nine months of fiscal 2003, as compared to \$12.6 million in the first nine months of fiscal 2002, while previously capitalized interest expensed was \$11.7 million during the first nine months of fiscal 2003, as compared to \$21.4 million in the first nine months of fiscal 2002. Once the Company sells out of certain older projects with higher capitalized interest, it anticipates that interest expensed will be closer to its currently lower level of interest incurred.

The Company recorded a provision for income taxes of \$765,000 in the first nine months of fiscal 2003, utilizing an effective tax rate of 35.0%, as compared to \$2.7 million in the first nine months of fiscal 2002, with an effective tax rate of 43.1%. The effective tax rate was lower than statutory rates in the first nine months of fiscal 2003 as a result of non-taxable accretion of deferred gain.

## **Liquidity and Capital Resources**

The Company's principal cash requirements are for the acquisition, development, construction, marketing and overhead of its projects. When building inventory, the Company uses substantial amounts of cash that are generally obtained from borrowings, available cash flow from operations and partners' contributions to joint ventures.

At the current time, all material financing transactions and arrangements are incurred either by CPH LLC or by certain project specific entities. During the third quarter of fiscal 2002, CPH LLC entered into a senior unsecured revolving credit facility (the "Senior Facility") with several participant banks. The Senior Facility had a maximum commitment of \$125 million and a two year revolving term. Proceeds from the Senior Facility were used to pay down CPH LLC's existing facilities and retire the remaining 12 3/4% Senior Notes during the quarter ending November 30, 2001, as discussed below. The Senior Facility has substantially more favorable pricing than the 12 3/4% Senior Notes which have been retired. In October 2002, the Company extended the maturity of the Senior Facility to October 2005 and increased the maximum commitment to \$130 million. In addition, the Company entered into a Senior Subordinated Note Agreement in the initial amount of \$20 million, with a maturity date in October 2007.

As of November 30, 2002, the Company has in place several credit facilities, including the Senior Facility, totaling \$208 million (the "Facilities") with various bank lenders (the "Banks"), of which approximately \$137 million was outstanding. The Facilities other than the Senior Facility and the Senior Subordinated Note Agreement are secured by liens on various completed or under construction homes and lots held by certain wholly-owned subsidiaries of the Company. Pursuant to the Facilities, the Company is subject to certain covenants, which require, among other things, the maintenance of a consolidated liabilities to net worth ratio, minimum liquidity, minimum net worth and loss limitations, all as defined in the documents that evidence the Facilities. At November 30, 2002, the Company was in compliance with these covenants. The Facilities also define certain events that constitute events of default. As of November 30, 2002, no such event had occurred. Commitment fees are payable annually on some of the Facilities.

Homebuilding activity, excluding Managed Projects, is being financed out of CPH LLC cash, bank financing, and the existing joint ventures, including joint ventures with institutional investors. In addition, development work undertaken in certain of the Company's joint ventures is financed through various non-recourse lending arrangements. The Company anticipates that it will continue to utilize both third party financing and joint ventures to cover financing needs in excess of internally generated cash flow.

Management expects that cash flow generated from operations and from bank financing will be sufficient to cover the debt service and to fund CPH LLC's current development and homebuilding activities for the reasonably foreseeable future, absent force majeure or other unforeseen events, and expects that capital

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commitments from its joint venture partners and other bank facilities will provide sufficient financing for the operation of its joint ventures.

### **Critical Accounting Policies**

The Company's financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and costs and expenses during the reporting period. Management evaluates its estimates and judgments, including those which impact its most critical accounting policies, on an ongoing basis. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances within the framework of current accounting literature. Actual results may differ from these estimates under different assumptions or conditions. The Company's key accounting policies are discussed in detail in the Company's Form 10-K for the fiscal year ended February 28, 2002.

### **Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

The Market Risk Exposure paragraphs are presented to provide an update about material changes to the Quantitative and Qualitative Disclosures about Market Risk paragraphs included in the Company's 2002 Annual Report on Form 10-K filed with the Securities and Exchange Commission and should be read in conjunction with those paragraphs.

The Company is exposed to market risks related to fluctuations in interest rates on its debt. Under the Senior Facility and the Senior Subordinated Credit Agreement, the Company has utilized interest rate swaps in order to fix the interest rate on \$95 million of its variable rate debt. The Company has not used forward or option contracts on foreign currencies or commodities, or other types of derivative financial instruments.

The Company uses debt financing primarily for the purpose of acquiring and developing land and constructing and selling homes. Historically, the Company has made short-term borrowings under its revolving credit facilities to fund those expenditures. In addition, the Company had previously issued \$100 million in fixed-rate 12 3/4% Senior Notes to provide longer-term financing. Prior to the third quarter of fiscal 2002, the Company had repurchased Senior Notes with a face value of \$44.4 million. During the third quarter of fiscal 2002, the Company redeemed at face value the remaining \$55.6 million of the Senior Notes.

For fixed rate debt, changes in interest rates generally affect the fair market value, but not the Company's earnings or cash flows. Conversely, for variable rate debt, changes in interest rates generally do not have an impact on fair market value, but do affect the Company's future earnings and cash flows. The Company does not have an obligation to prepay fixed rate debt prior to maturity, and as a result, interest rate risk and changes in fair market value should not have a significant impact on such debt until the Company would be required to refinance such debt. Based upon the amount of variable rate debt outstanding at the end of the third quarter, and holding the variable rate debt balance constant, each one percentage point increase in interest rates occurring on the first day of an annual period would result in an increase in interest incurred for the coming year of approximately \$500,000.

The Company does not believe that future market interest rate risks related to its debt obligations will have a material impact on the Company's financial position, results of operations or liquidity.

### **Item 4. *Controls and Procedures***

As of December 31, 2002, an evaluation was performed under the supervision and with the participation of the Company's management, including the CEO, CFO, COO and CLO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the CEO, CFO, COO and CLO, concluded that the Company's significant disclosure controls and procedures were effective as of December 31, 2002. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to December 31, 2002.

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

As described in the Company's 10-Q for the period ending August 31, 2002, a former senior executive of the Company filed a suit styled in part as a shareholder derivative suit. This action has been settled and the settlement has received preliminary approval of the Court. In the event the settlement receives final approval from the Court in its current form, the Company will have no financial obligations in connection with the settlement, other than payment of future legal fees of the Company-related defendants and related expenses. The Company is involved in routine claims and litigation arising out of the ordinary course of its business. Although the legal responsibility and financial impact to the Company with respect to other pending claims and litigation cannot be presently ascertained, the Company does not believe that these matters will result in the payment by the Company, giving consideration to any applicable insurance proceeds or contributions by other parties, that, in the aggregate, would be material in relation to the financial position of the Company.

**Item 6. Exhibits and Reports on Form 8-K***(a) Exhibits*

| Exhibit<br>Number | Description   |
|-------------------|---|
| 99.1              | Certification of Hadi Makarechian pursuant to Section 906 of the Sarbanes-Oxley Act of 2002       |
| 99.2              | Certification of Steven O. Spelman, Jr. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

*(b) Reports on Form 8-K*

None filed.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

By: /s/ HADI MAKARECHIAN

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Hadi Makarechian  
*Chairman of the Board,*  
*Chief Executive Officer and President*  
(Principal Executive Officer)

Date: January 14, 2003

By: /s/ STEVEN O. SPELMAN, JR.

---

Steven O. Spelman, Jr.  
*Chief Financial Officer and Corporate Secretary*  
(Principal Financial Officer)

Date: January 14, 2003

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**CERTIFICATIONS**

I, Hadi Makarechian, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Capital Pacific Holdings, Inc.:
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

By: /s/ HADI MAKARECHIAN

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Hadi Makarechian  
*Chairman of the Board,*  
*Chief Executive Officer and President*  
(Principal Executive Officer)

Date: January 14, 2003

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I, Steven O. Spelman, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Capital Pacific Holdings, Inc.:
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

By: /s/ STEVEN O. SPELMAN, JR.

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Steven O. Spelman, Jr.  
*Chief Financial Officer and Corporate Secretary*  
(Principal Financial Officer)

Date: January 14, 2003



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**EXHIBIT INDEX**

| <b>Exhibit<br/>Number</b> | <b>Description</b>  |
|---------------------------|---|
| 99.1                      | Certification of Hadi Makarechian pursuant to Section 906 of the Sarbanes-Oxley Act of 2002       |
| 99.2                      | Certification of Steven O. Spelman, Jr. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |