

AMERICAN REALTY INVESTORS INC  
Form 10-Q  
May 15, 2006

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**FORM 10-Q**  
**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

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

**FOR THE QUARTER ENDED MARCH 31, 2006**

**Or**

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

**FOR THE TRANSITION PERIOD FROM TO**

**Commission File Number 001-15663**  
**AMERICAN REALTY INVESTORS, INC.**  
**(Exact Name of Registrant as Specified in Its Charter)**

**Nevada**  
**(State or Other Jurisdiction of**  
**Incorporation or Organization)**

**75-2847135**  
**(I.R.S. Employer**  
**Identification No.)**

**1800 Valley View Lane, Suite 300**  
**Dallas, Texas 75234**  
**(Address of principal executive offices)**  
**(Zip Code)**

**(469) 522-4200**  
**(Registrant's telephone number, including area code)**

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**(Former name, former address and former fiscal year, if changed since last report)**

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes . No .

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

**Large accelerated filer**  **Accelerated filer**  **Non-accelerated filer**

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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes . No .

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

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

**Common Stock, \$.01 par value  
(Class)**

**10,895,972  
(Outstanding at March 31, 2006)**

**AMERICAN REALTY INVESTORS, INC.**  
**FORM 10-Q**  
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## AMERICAN REALTY INVESTORS, INC.

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

The accompanying Consolidated Financial Statements have not been audited by independent certified public accountants, but, in the opinion of the management of American Realty Investors, Inc. ("ARI"), all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of ARI's consolidated financial position, consolidated results of operations and consolidated cash flows at the dates and for the periods indicated, have been included.

AMERICAN REALTY INVESTORS, INC.  
CONSOLIDATED BALANCE SHEETS

	March 31, 2006	December 31, 2005
	(dollars in thousands)	
	(unaudited)	
<b>Assets</b>		
Real estate held for investment	\$ 1,091,293	\$ 1,025,661
Less—accumulated depreciation	(159,593)	(153,597)
	931,700	872,064
Real estate held for sale, net of depreciation	169,123	172,303
Real estate subject to sales contract	68,326	68,738
Notes and interest receivable		
Performing (\$44,805 in 2006 and \$44,500 in 2005 from affiliates)	61,347	70,894
Non-performing	11,546	11,546
	72,893	82,440
Less—allowance for estimated losses	(1,003)	(1,000)
	71,890	81,440
Restaurant equipment	13,981	13,911
Less—accumulated depreciation	(7,832)	(7,528)
	6,149	6,383
Marketable securities, at market value	7,936	7,446
Cash and cash equivalents	8,731	13,904
Investments in equity investees	13,660	13,521
Goodwill	11,858	11,858
Other intangibles, net of accumulated amortization (\$616 in 2006 and \$926 in 2005)	1,435	1,449
Other assets (including \$32,535 in 2006 and \$30,441 in 2005 due from affiliate)	104,898	96,689
	\$ 1,395,706	\$ 1,345,795

The accompanying notes are an integral part of these Consolidated Financial Statements.

**AMERICAN REALTY INVESTORS, INC.**  
**CONSOLIDATED BALANCE SHEETS - Continued**

	<b>March 31, 2006</b>	<b>December 31, 2005</b>
	<b>(dollars in thousands)</b>	
	<b>(unaudited)</b>	
<b>Liabilities and Stockholders' Equity</b>		
Liabilities:		
Notes payable (\$44,845 in 2006 and \$45,530 in 2005 to affiliates)	\$ 853,040	\$ 810,118
Interest payable (\$1,046 in 2006 and \$682 in 2005 to affiliates)	8,750	7,826
Liabilities related to assets held for sale	153,124	144,555
Liabilities subject to sales contract	58,781	59,323
Stock-secured notes payable	22,549	22,549
Accounts payable and other liabilities (\$238 in 2006 and \$4,667 in 2005 to affiliates)	88,675	93,842
	1,184,919	1,138,213
Commitments and contingencies		
Minority interest	70,782	59,185
Stockholders' equity:		
Preferred Stock, \$2.00 par value, authorized 50,000,000 shares, issued and outstanding		
Series A Cumulative Convertible Preferred Stock, 3,390,913 shares in 2006 and 2005 (liquidation preference \$33,909), including 900,000 shares in 2006 and 2005 held by subsidiaries	4,982	4,982
Common Stock, \$.01 par value, authorized 100,000,000 shares; issued 11,592,272 shares in 2006 and 2005	114	114
Treasury stock, at cost, 1,443,272 shares in 2006 and 2005	(15,146)	(15,146)
Additional paid-in capital	93,389	93,389
Retained earnings	56,116	64,805
Accumulated other comprehensive income (loss)	550	253
	140,005	148,397
	\$ 1,395,706	\$ 1,345,795

The accompanying notes are an integral part of these Consolidated Financial Statements

**AMERICAN REALTY INVESTORS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(unaudited)**

	<b>For the Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(dollars in thousands)</b>	
<b>Property revenue:</b>		
Rental and other property revenues (\$259 in 2006 and \$182 in 2005 from affiliates)	\$ 45,867	\$ 37,758
Restaurant sales	9,349	8,620
<b>Total operating revenues</b>	<b>55,216</b>	<b>46,378</b>
<b>Expenses:</b>		
Property operating expenses (\$1,923 in 2006 and \$1,644 in 2005 to affiliates)	29,670	26,464
Restaurant cost of sales	6,915	6,754
Depreciation and amortization	6,726	5,572
General and administrative (\$567 in 2006 and \$899 in 2005 to affiliates)	3,892	2,736
Advisory fee to affiliate	3,081	2,906
<b>Total operating expenses</b>	<b>50,284</b>	<b>44,432</b>
<b>Operating income (loss)</b>	<b>4,932</b>	<b>1,946</b>
<b>Other income (expense):</b>		
Interest income from notes receivable (\$657 in 2006 and \$859 in 2005 from affiliates)	1,146	1,590
Gain on foreign currency transaction	2	—
Other income (\$953 in 2006 from affiliate)	1,702	106
Mortgage and loan interest (\$669 in 2006 and \$501 in 2005 to affiliates)	(18,704)	(15,174)
Net income fee to affiliate	—	(1,477)
<b>Total other income (expense)</b>	<b>(15,854)</b>	<b>(14,955)</b>
<b>Loss before gain on land sales, minority interest, and equity in earnings of investees</b>	<b>(10,922)</b>	<b>(13,009)</b>
Gain on land sales	2,740	24,178
Minority interest	830	(921)
Equity in income (loss) of investees	175	60
<b>Income (loss) from continuing operations</b>	<b>(7,177)</b>	<b>10,308</b>
<b>Income (loss) from discontinued operations</b>	<b>(898)</b>	<b>10,370</b>
<b>Net income (loss)</b>	<b>(8,075)</b>	<b>20,678</b>
Preferred dividend requirement	(614)	(650)
<b>Net income (loss) applicable to Common shares</b>	<b>\$ (8,689)</b>	<b>\$ 20,028</b>

The accompanying notes are an integral part of these Consolidated Financial Statements





**AMERICAN REALTY INVESTORS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS - Continued**  
**(unaudited)**

	<b>For the Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(dollars in thousands)</b>	
<b>Basic earnings per share:</b>		
Income (loss) from continuing operations	\$ (0.77)	\$ 0.96
Income (loss) from discontinued operations	(0.09)	1.03
Net income (loss) applicable to Common shares	\$ (0.86)	\$ 1.98
<b>Diluted earnings per share:</b>		
Income (loss) from continuing operations	\$ (0.77)	\$ 0.75
Income (loss) from discontinued operations	(0.09)	0.81
Net income (loss) applicable to Common shares	\$ (0.86)	\$ 1.56
<b>Weighted average Common shares used in computing earnings per share:</b>		
Basic	10,149,000	10,149,000
Diluted	13,106,924	12,907,309

Series A Cumulative Convertible Preferred Stock (2,491,000 shares of Preferred Stock convertible into common stock estimated to be 2,957,000 common shares) and options to purchase 70,750 shares of ARI's common stock were excluded from the computation of diluted earnings per share for the three months ended March 31, 2006, because the effect of their inclusion would be antidilutive.

The accompanying notes are an integral part of these Consolidated Financial Statements.

**AMERICAN REALTY INVESTORS, INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**For the Three Months Ended March 31, 2006**  
**(dollars in thousands)**  
**(unaudited)**

	Series A Preferred Stock	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Stockholders' Equity
Balance, January 1, 2006	\$ 4,982	\$ 114	\$ (15,146)	\$ 93,389	\$ 64,805	\$ 253	\$ 148,397
Comprehensive income							
Unrealized gain on foreign currency translation	—	—	—	—	—	(193)	(193)
Unrealized gain on marketable securities	—	—	—	—	—	490	490
Net income	—	—	—	—	(8,075)	—	(8,075)
Repurchase of Preferred Stock	—	—	—	—	—	—	—
Preferred dividends							
Series A Cumulative Convertible Preferred Stock (\$.25 per share)	—	—	—	$\frac{3}{4}$	(614)	—	(614)
Balance, March 31, 2006	\$ 4,982	\$ 114	\$ (15,146)	\$ 93,389	\$ 56,116	\$ 550	\$ 140,005

The accompanying notes are an integral part of these Consolidated Financial Statements.



**AMERICAN REALTY INVESTORS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(unaudited)**

**For the Three Months**  
**Ended March 31**  
**2006**                      **2005**  
**(dollars in thousands)**

**Cash Flows From Operating Activities:**

Income (loss) from continuing operations	\$	(7,177)	\$	10,308
Adjustments to reconcile net income to net cash used in operating activities				
Gain on sale of land and real estate		(2,740)		(24,178)
Depreciation and amortization		6,726		5,572
Amortization of deferred borrowing costs		1,209		2,072
Equity in (income) loss of investees		(175)		(60)
Gain on foreign currency transaction		(2)		¾
(Increase) decrease in accrued interest receivable		(427)		(336)
(Increase) decrease in other assets		(6,587)		4,496
Increase (decrease) in accrued interest payable		(70)		(888)
Increase (decrease) in minority interest		(36)		(261)
Increase (decrease) in other liabilities		5,292		(2,362)
Net cash used in operating activities		(3,987)		(5,637)

**Cash Flows From Investing Activities:**

Collections on notes receivable		8,716		1,433
Proceeds from sale of notes receivable		¾		27,242
Funding of notes receivable		(2,670)		¾
Acquisition of real estate		(49,239)		(7,806)
Investment in real estate entities		(1,568)		¾
Real estate improvement		(4,655)		¾
Restaurant equipment purchased		(69)		(65)
Proceeds from sale of real estate		6,747		26,225
Notes receivable funded		¾		(647)
Earnest money/escrow deposits		(660)		(671)
Real estate improvements		¾		(16,350)
Distribution from equity investees		¾		406
Net cash provided by (used in) investing activities		(43,398)		29,767

**Cash Flows From Financing Activities:**

Proceeds from notes payable		55,842		38,688
Payments on notes payable		(13,356)		(43,072)
Deferred borrowing costs		(2,568)		(1,212)
Net advances from (payments to) affiliates		3,482		(13,288)
Margin borrowings (payments), net		¾		(38)
Preferred dividends paid		(483)		(230)
Net cash (used in) provided by financing activities		42,917		(19,152)

**Discontinued Operations**

Cash used in operating activities		(705)		¾
Cash provided by investing activities		¾		¾
Net cash provided (used) by discontinued operations		(705)		¾

Net increase (decrease) in cash and cash equivalents	(5,173)	17,291
Cash and cash equivalents, beginning of period	13,904	22,401
Cash and cash equivalents, end of period	\$ 8,731	\$ 39,692

The accompanying notes are an integral part of these Consolidated Financial Statements.

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**AMERICAN REALTY INVESTORS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS - Continued**  
**(unaudited)**

**For the Three Months**  
**Ended March 31,**  
**2006**                      **2005**  
**(dollars in thousands)**

**Supplemental Disclosures of Cash Flow Information:**

Cash paid for interest	\$	18,301	\$	17,068
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**Schedule of Non-Cash Investing and Financing Activities:**

Notes payable assumed from buyer upon sale of real estate	\$	¾	\$	14,422
Increase in minority interest related to acquisition of real estate		14,835		¾
Notes receivable from sale of real estate		¾		27,242
Acquisition of real estate to satisfy note receivable		¾		4,714
Note payable paid by affiliate		¾		700
Unrealized foreign currency translation gain (loss)		¾		706
Unrealized gain (loss) on marketable securities		¾		669

The accompanying notes are an integral part of these Consolidated Financial Statements.

**AMERICAN REALTY INVESTORS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. BASIS OF PRESENTATION**

The accompanying unaudited Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Dollar amounts in tables are in thousands, except per share amounts. Certain balances for 2005 have been reclassified to conform to the 2006 presentation. Hereafter in this document, American Realty Investors, Inc. is referred to as ARI.

Operating results for the three month period ended March 31, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. For further information on the basis of consolidation and accounting policies, refer to the Consolidated Financial Statements and Notes thereto included in ARI's Annual Report on Form 10-K for the year ended December 31, 2005 (the "2005 Form 10-K").

At December 31, 2005 and March 31, 2006, ARI subsidiaries owned 82.2% of the outstanding shares of Transcontinental Realty Investors, Inc. ("TCI"). At March 31, 2006, ARI and TCI have the same advisor (Prime Income Asset Management, LLC or "Prime") and Board of Directors.

At December 31, 2005 and March 31, 2006, ARI subsidiaries owned 20.4% of Income Opportunity Realty Investors, Inc. ("IORI") through TCI's ownership of 24.9% of IORI shares. Two directors of ARI also serve as directors of IORI.

*Stock-based employee compensation.* Effective January 1, 2006 (the "Effective Date"), the Company adopted SFAS No. 123-R using the modified prospective method. SFAS No. 123-R must be applied not only to newly awarded stock-options but also to previously awarded stock-options that were not fully vested on the Effective Date. All of ARI's stock-option grants were fully vested as of the Effective Date. Furthermore, ARI had no outstanding stock-option grants that were modified or settled after the Effective Date; therefore, subsequent to the Effective Date, ARI will recognize no additional compensation costs for previously awarded stock-option grants. In December 2005, the Company's Board of Directors terminated all stock-option plans and has no intent at the present to reinstate any stock-option programs.

**NOTE 2. REAL ESTATE**

In 2006, ARI purchased the following properties:

<b>Property</b>	<b>Location</b>	<b>Sq. Ft./Acres</b>	<b>Purchase Price</b>	<b>Net Cash Paid</b>	<b>Debt Incurred</b>	<b>Interest Rate</b>	<b>Maturity Date</b>
<b><i>First Quarter</i></b>							
<b>Land</b>							
Circle C Ranch	Austin, TX	1,092 Acres	\$21,000	\$ —	\$21,000	8.75% <sup>(1)</sup>	03/08
Pioneer Crossing	Austin, TX	38.542 Acres	614 <sup>(2)</sup>	614	1,515	8.75 <sup>(1)</sup>	06/08
Southwood 1394	Tallahassee, FL	14.52 Acres	1,150	477	748	8.50 <sup>(1)</sup>	02/08
	Farmers					8.50 <sup>(1)</sup>	02/08
Valley Ranch 20	Branch, TX	20 Acres	4,673	1,892	3,038		
Woodmont Fairway						8.25 <sup>(1)</sup>	01/07
Office	Dallas, TX	5.866 Acres	3,833	1,014	3,000		

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Woodmont Merit Drive	Dallas, TX	9.28 Acres	4,560	1,868	2,964	8.00	03/07
<b>Apartments</b>							
Anderson Estates Apts	Oxford, MS	48 Units	1,144 <sup>(3)</sup>	148	996	9.50 <sup>(1)</sup>	12/20
David Jordan Phase II	Greenwood, MS	32 Units	743 <sup>(3)</sup>	98	645	8.50 <sup>(1)</sup>	04/19
David Jordan Phase III	Greenwood, MS	40 Units	812 <sup>(3)</sup>	122	690	8.75 <sup>(1)</sup>	07/22
Leflore Estates / Curtis	Greenwood, MS	104 Units	2,114 <sup>(3)</sup>	337	1,777	7.00	02/22
Moore Apartments	Monticello, AR	32 Units	644 <sup>(3)</sup>	96	548	7.00	01/22
Monticello III Estates	Greenwood, MS	32 Units	455 <sup>(3)</sup>	99	356	8.50	02/19
Riverwalk Phase I	Greenwood, MS	72 Units	1,584 <sup>(3)</sup>	226	1,358	8.25 <sup>(1)</sup>	02/19
Riverwalk Phase II	MS						

(1) Variable interest rate.

(2) Purchased from ARI; purchase price is equal to ARI's cost.

(3) Net of minority interest and other liabilities assumed.



**AMERICAN REALTY INVESTORS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

In 2005, ARI purchased the following properties:

<b>Property</b>	<b>Location</b>	<b>Units / Sq. Ft./Acres</b>	<b>Purchase Price</b>	<b>Net Cash Paid/ (Received)</b>	<b>Debt Incurred</b>	<b>Interest Rate</b>	<b>Maturity Date</b>
<i>First Quarter</i>							
<b>Land</b>							
Katrina <sup>(1)</sup>	Palm Desert, CA	23.0 Acres	\$4,184	\$ —	\$ —	—%	—
Keenan Bridge <sup>(2)</sup>	Farmers Branch, TX	7.5 Acres	510	14	—	—	—
Mandahl Bay	US Virgin Islands	50.8 Acres	7,000	4,101	3,500	7.00	07/05
Mandahl Bay (Gilmore)	US Virgin Islands	1.0 Acres	96	104	—	—	—
Mandahl Bay (Chung)	US Virgin Islands	.7 Acres	95	101	—	¾	—

(1) Exchanged for note receivable. See NOTE 3. "NOTES AND INTEREST RECEIVABLE."

(2) Exchanged for the Bee Street and 2524 Valley View land parcels.

In 2006, ARI sold the following properties:

<b>Property</b>	<b>Location</b>	<b>Units/Acres/ Sq. Ft.</b>	<b>Sales Price</b>	<b>Net Cash Received/ (Paid)</b>	<b>Debt Discharged</b>	<b>Gain on Sale</b>
<i>First Quarter</i>						
<b>Land</b>						
Hollywood Casino	Farmers Branch, TX	10.5 Acres	\$3,225	\$1,207	\$—	\$1,831
Vineyards II	Grapevine, TX	1.5 Acres	1,272	429	745	578
<i>Second Quarter</i>						
<b>Land</b>						
Elm Fork	Carrollton, TX	27.6 Acres	3,500	(827)	2,800	1,596
Nashville	Nashville, TN	16.4 Acres	2,512	—	2,416	1,700
Nashville	Nashville, TN	2.4 Acres	462	—	429	323

(1) Debt assumed by purchaser.

In 2005, ARI sold the following properties:

<b>Property</b>	<b>Location</b>	<b>Units/Acres/ Sq. Ft.</b>	<b>Sales Price</b>	<b>Net Cash Received/ (Paid)</b>	<b>Debt Discharged</b>	<b>Gain on Sale</b>
<i>First Quarter</i>						
<b>Apartments</b>						
Longwood	Long Beach, MS	200 Units	\$6,456	\$ 9	\$6,253 <sup>(1)</sup>	\$56
<b>Land</b>						
Granbury Station	Ft. Worth, TX	15.7 Acres	1,003	265	738 <sup>(1)</sup>	10
Katrina	Palm Desert, CA	9.9 Acres	2,616	574	—	1,323
Katrina	Palm Desert, CA	13.6 Acres	3,703	591	—	1,706
Katrina	Palm Desert, CA	5.5 Acres	1,325	1,281	—	619

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Katrina	Palm Desert, CA	6.5 Acres	1,695	340	—	818
Katrina	Palm Desert, CA	7.4 Acres	2,028	455	—	1,072
Katrina	Palm Desert, CA	81.2 Acres	19,878	(814)	5,100	9,387
Katrina	Palm Desert, CA	24.8 Acres	6,402	1,027	—	2,947
Katy	Katy, TX	130.6 Acres	12,400	4,981		