AVATAR HOLDINGS INC
Form 10-Q
May 10, 2006

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

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2006
or

o **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 0-7616
I.R.S. Employer Identification Number 23-1739078
Avatar Holdings Inc.
(a Delaware Corporation)
201 Alhambra Circle
Coral Gables, Florida 33134
(305) 442-7000

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 x No o

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

Large accelerated filer o Accelerated filerx Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 8,189,463 shares of Avatar s common stock ($1.00 par value) were outstanding as of April 30, 2006.

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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

AVATAR HOLDINGS INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(Dollars in thousands)

	(Unaudited) March 31 2006	December 31 2005
Assets		
Cash and cash equivalents	$ 35,246	$ 38,479
Restricted cash	7,666	6,020
Receivables, net	30,090	29,865
Land and other inventories	425,990	392,843
Land inventory not owned		18,171
Property, plant and equipment, net	41,232	41,444
Investment in unconsolidated joint ventures	52,318	55,781
Prepaid expenses	14,652	13,985
Other assets	8,453	9,110
Deferred income taxes	7,303	3,823
Assets of business transferred under contractual arrangements	16,970	16,889
Total Assets	$ 639,920	$ 626,410
Liabilities and Stockholders Equity		
Liabilities		
Notes, mortgage notes and other debt:		
Corporate	$ 120,000	$ 120,000
Real estate	18,800	24,107
Obligations related to land inventory not owned		18,171
Estimated development liability for sold land	25,335	26,717
Accounts payable	25,114	16,526
Accrued and other liabilities	39,767	42,087
Customer deposits	62,650	57,797
Liabilities of business transferred under contractual arrangements	8,113	8,113
Total Liabilities	299,779	313,518
Commitments and Contingencies		
Stockholders Equity		
Common Stock, par value $1 per share		
Authorized: 50,000,000 shares		
Issued: 10,721,286 shares at March 31, 2006		

10,711,286 shares at December 31, 2005		10,721		10,711
Additional paid-in capital		210,893		214,873
Unearned restricted stock units				(6,583)
Retained earnings		193,551		168,915
		415,165		387,916
Treasury stock: at cost, 2,531,823 shares at March 31, 2006 and December 31, 2005		(75,024)		(75,024)
Total Stockholders Equity		340,141		312,892
Total Liabilities and Stockholders Equity	$	639,920	$	626,410

See notes to consolidated financial statements.

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AVATAR HOLDINGS INC. AND SUBSIDIARIES
Consolidated Statements of Income
For the three months ended March 31, 2006 and 2005
(Unaudited)
(Dollars in thousands except per-share amounts)

	2006	2005
Revenues		
Real estate sales	$ 154,306	$ 90,519
Interest income	637	354
Other	271	350
Total revenues	155,214	91,223
Expenses		
Real estate expenses	115,062	72,803
General and administrative expenses	6,572	6,010
Interest expense		482
Other		21
Total expenses	121,634	79,316
Equity earnings from unconsolidated joint ventures	1,630	7,569
Income from continuing operations before income taxes	35,210	19,476
Income tax expense	(10,574)	(5,467)
Income from continuing operations	24,636	14,009
Discontinued operations:		
Income from operations of discontinued operations		259
Income tax expense		(98)
Income from discontinued operations		161
Net income	$ 24,636	$ 14,170
Basic Earnings Per Share:		
Income from continuing operations	$ 3.01	$ 1.74
Income from discontinued operations		0.02
Net income	$ 3.01	$ 1.76
Diluted Earnings Per Share:		

Income from continuing operations	$ 2.39	$ 1.41
Income from discontinued operations		0.01
Net income	$ 2.39	$ 1.42

See notes to consolidated financial statements.

AVATAR HOLDINGS INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)
For the three months ended March 31, 2006 and 2005
(Dollars in Thousands)

	2006	2005
OPERATING ACTIVITIES		
Net income	$ 24,636	$ 14,170
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,038	1,122
Amortization of stock-based compensation	2,237	725
Impairment of goodwill	654	
Distribution of earnings from an unconsolidated joint venture	5,200	
Equity earnings from unconsolidated joint ventures	(1,629)	(7,569)
Deferred income taxes	(3,355)	398
Excess income tax benefit from exercise of stock options	(116)	
Changes in operating assets and liabilities:		
Restricted cash	(1,646)	(4,727)
Receivables, net	(225)	297
Land and other inventories	(27,525)	(38,018)
Prepaid expenses	(667)	1,517
Other assets	4	5,145
Accounts payable and accrued and other liabilities	(1,308)	(999)
Customer deposits	4,853	9,710
Assets/liabilities of business transferred under contractual arrangements	(81)	
Assts/liabilities of discontinued operations		(84)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	2,070	(18,313)
INVESTING ACTIVITIES		
Investment in property, plant and equipment	(254)	(576)
Investment in unconsolidated joint ventures	(108)	(806)
NET CASH USED IN INVESTING ACTIVITIES	(362)	(1,382)
FINANCING ACTIVITIES		
Proceeds from revolving line of credit		20,000
Principal payments of real estate borrowings	(5,307)	(328)
Proceeds from exercise of stock options	250	
Excess income tax benefit from exercise of stock options	116	
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(4,941)	19,672

DECREASE IN CASH AND CASH EQUIVALENTS	(3,233)	(23)
Cash and cash equivalents at beginning of period	38,479	28,489
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 35,246	$ 28,466

See notes to consolidated financial statements.

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AVATAR HOLDINGS INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)
March 31, 2006
(Dollars in thousands except share and per share data)

Basis of Statement Presentation and Summary of Significant Accounting Policies

The consolidated accompanying financial statements include the accounts of Avatar Holdings Inc. and all subsidiaries, partnerships and other entities in which Avatar Holdings Inc. (Avatar , we , us or our) has a controlling interest and variable interest entities for which we are deemed to be the primary beneficiary. Our investments in unconsolidated joint ventures in which we have less than a controlling interest are accounted for using the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated balance sheets as of March 31, 2006 and December 31, 2005, and the related consolidated statements of income and the consolidated statements of cash flows for the three months ended March 31, 2006 and 2005 have been prepared in accordance with United States generally accepted accounting principles for interim financial information, 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 United States generally accepted accounting principles for complete financial statement presentation. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements have been included. Such adjustments consisted only of normal recurring items. Interim results are not necessarily indicative of results for a full year.

The preparation of the consolidated financial statements in accordance with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates. Due to Avatar s normal operating cycle being in excess of one year, we present unclassified balance sheets.

The balance sheet as of December 31, 2005 was derived from audited financial statements included in our 2005 Form 10-K but does not include all disclosures required by United States generally accepted accounting principles. These consolidated financial statements should be read in conjunction with our December 31, 2005 audited financial statements in our 2005 Annual Report on Form 10-K and the notes the consolidated financial statements included therein.

Reclassifications

Certain 2005 financial statement items have been reclassified to conform to the 2006 presentation.

Land and Other Inventories

Inventories consist of the following:

	March 31, 2006 (Unaudited)	December 31, 2005
Land developed and in process of development	$ 183,102	$ 176,540
Land held for future development or sale	102,948	84,667
Dwelling units completed or under construction	139,322	131,063
Other	618	573
	$ 425,990	$ 392,843

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Land and Other Inventories continued

During the three months ended March 31, 2006, we closed for a cash purchase price of approximately $18,300 on the remaining phases of land in Poinciana which were classified as land inventory not owned and obligations related to inventory not owned on the accompanying consolidated balance sheet as of December 31, 2005.

Goodwill and Indefinite-Lived Intangible Assets

During the three months ended March 31, 2006 we performed an interim impairment test in accordance with SFAS No. 142 *Goodwill and Intangible Assets* on the goodwill associated with the Harbor Islands community because facts and circumstances indicated a potential impairment. Based on this impairment test we determined that this goodwill was impaired because we closed the final housing unit in this community. Since the Harbor Islands community was completed during the three months ended March 31,2006, the associated goodwill of $654 was written-off under the caption of Real Estate Expense in the consolidated statement of income for the three months ended March 31, 2006.

Notes, Mortgage Notes and Other Debt

On March 30, 2004, we issued $120,000 aggregate principal amount of 4.50% Convertible Senior Notes due 2024 (the 4.50% Notes) in a private, unregistered offering, subsequent to which we filed, for the benefit of the 4.50% Notes holders, a shelf registration statement covering resales of the 4.50% Notes and the shares of our common stock issuable upon the conversion of the 4.50% Notes. Interest is payable semiannually on April 1 and October 1. The 4.50% Notes are senior, unsecured obligations and rank equal in right of payment to all of our existing and future unsecured and senior indebtedness. However, the 4.50% Notes are effectively subordinated to all of our existing and future secured debt to the extent of the collateral securing such indebtedness, and to all existing and future liabilities of our subsidiaries. Each $1 in principal amount of the 4.50% Notes is convertible, at the option of the holder, at a conversion price of $52.63, or 19.0006 shares of our common stock, upon the satisfaction of one of the following conditions: a) during any calendar quarter (but only during such calendar quarter) commencing after June 30, 2004 if the closing sale price of our common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of the preceding calendar quarter is more than 120% of the conversion price per share of common stock on such last day; or b) during the five business day period after any five-consecutive-trading-day period in which the trading price per $1 principal amount of the 4.50% Notes for each day of that period was less than 98% of the product of the closing sale price for our common stock for each day of that period and the number of shares of common stock issuable upon conversion of $1 principal amount of the 4.50% Notes, provided that if on the date of any such conversion that is on or after April 1, 2019, the closing sale price of Avatar s common stock is greater than the conversion price, then holders will receive, in lieu of common stock based on the conversion price, cash or common stock or a combination thereof, at our option, with a value equal to the principal amount of the 4.50% Notes plus accrued interest and unpaid interest, as of the conversion date. The satisfaction of these conditions has not been met as of March 31, 2006.

We may, at our option, redeem for cash all or a portion of the 4.50% Notes at any time on or after April 5, 2011. Holders may require us to repurchase the 4.50% Notes for cash on April 1, 2011, April 1, 2014 and April 1, 2019 or in certain circumstances involving a designated event, as defined in the indenture for the 4.50% Notes, holders may require us to purchase all or a portion of their 4.50% Notes. In each case, we will pay a repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest, if any.

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Notes, Mortgage Notes and Other Debt continued

In conjunction with the offering, we used approximately $42,905 of the net proceeds from the offering to purchase 1,141,400 shares of our common stock in privately negotiated transactions at a price of $37.59 per share. We used the balance of the net proceeds from the offering for general corporate purposes including acquisitions of land in Florida.

On September 20, 2005, we entered into a Credit Agreement and a Guaranty Agreement for a $100,000 (expandable up to $175,000), four-year senior unsecured revolving credit facility (the Unsecured Credit Facility), by and among our wholly-owned subsidiary, Avatar Properties Inc. (as Borrower), Wachovia Bank, National Association (as Administrative Agent and Lender), and certain financial institutions as lenders. This Unsecured Credit Facility replaced the three-year, $100,000 revolving secured credit facility (the Secured Credit Facility) entered into on December 30, 2003. Interest on borrowings under the Unsecured Credit Facility ranges from LIBOR plus 1.75% to 2.25%. Our borrowing rate under the Unsecured Credit Facility as of March 31, 2006 was 6.58%.

The initial principal amount under the Unsecured Credit Facility is $100,000; however, so long as no default or event of default has occurred and is continuing, increases may be requested, subject to lender approval, up to $175,000. We received lender approval on October 21, 2005 to increase the principal amount under the Unsecured Credit Facility to $125,000. This Unsecured Credit Facility includes a $7,500 swing line commitment and has a $10,000 sublimit for the issuance of standby letters of credit.

The Unsecured Credit Facility contains customary representations, warranties and covenants limiting liens, guaranties, mergers and consolidations, substantial asset sales, investments and loans. In addition, the Unsecured Credit Facility contains covenants to the effect that we (i) will maintain a minimum consolidated tangible net worth (as defined in the Unsecured Credit Facility), (ii) shall maintain an adjusted EBITDA/debt service ratio (as defined in the Unsecured Credit Facility) of not less than 2.75 to 1.0, (iii) will not permit the leverage ratio (as defined in the Unsecured Credit Facility) to exceed 2.0 to 1.0, and (iv) the sum of the net book value of unentitled land, entitled land, land under development and finished lots shall not exceed 150% of consolidated tangible net worth. Borrowings under the Unsecured Credit Facility may be limited based on the amount of borrowing base available. We are in compliance with these covenants as of March 31, 2006.

In the event of a default under the Unsecured Credit Facility, including cross-defaults relating to specified other debt of Avatar or our consolidated subsidiaries in excess of $1,000, the lenders may terminate the commitments under the Unsecured Credit Facility and declare the amounts outstanding, and all accrued interest, immediately due and payable.

Loans made and other obligations incurred under the Unsecured Credit Facility will mature on September 20, 2009; however, the Unsecured Credit Facility provides that once each fiscal year, Borrower may request a twelve-month extension of the maturity date. As of March 31, 2006, we had borrowings totaling $0 under the Unsecured Credit Facility and approximately $115,933 was available for borrowing under the Unsecured Credit Facility, net of approximately $9,067 outstanding letters of credit.

Payments of all amounts due under the Unsecured Credit Facility are guaranteed by Avatar Holdings Inc. pursuant to the Restated Guaranty Agreement dated as of October 21, 2005.

We made interest payments of $613 and $328 for the three months ended March 31, 2006 and 2005, respectively. Interest expense of $1,990 and $1,423 was capitalized for the three months ended March 31, 2006 and 2005, respectively.

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Warranty Costs

Warranty reserves for houses are established to cover potential costs for materials and labor with regard to warranty-type claims to be incurred subsequent to the closing of a house. Reserves are determined based on historical data and other relevant factors. We may have recourse against the subcontractors for claims relating to workmanship and materials. Warranty reserves are included in Accrued and Other Liabilities in the consolidated balance sheets.

During the three months ended March 31, 2006 and 2005 changes in the warranty accrual consisted of the following (unaudited):

	2006	2005
Accrued warranty reserve as of January 1	$ 1,616	$ 1,370
Estimated warranty expense	949	490
Amounts charged against warranty reserve	(641)	(877)
Accrued warranty reserve as of March 31	$ 1,924	$ 983

Earnings Per Share

We present earnings per share in accordance with SFAS No. 128, *Earnings Per Share*. Basic earnings per share is computed by dividing earnings available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of Avatar.

The weighted average number of shares outstanding in calculating basic earnings per share includes the issuance of 10,000 shares of Avatar common stock for the three months ended March 31, 2006, due to the exercise of stock options. Avatar did not issue any shares of common stock during the first quarter of 2005.

The following table represents a reconciliation of the income from continuing operations, net income and weighted average shares outstanding for the calculation of basic and diluted earnings per share for the three months ended March 31, 2006 and 2005 (unaudited):

	2006	2005
Numerator:		
Basic earnings per share income from continuing operations	$ 24,636	$ 14,009
Interest expense on 4.50% Notes, net of tax	816	827
Diluted earnings per share income from continuing operations	$ 25,452	$ 14,836
Basic earnings per share net income	$ 24,636	$ 14,170
Interest expense on 4.50% Notes, net of tax	816	827
Diluted earnings per share net income	$ 25,452	$ 14,997
Denominator:		
Basic weighted average shares outstanding	8,184,352	8,058,129
Effect of dilutive restricted stock	143,088	174,476

Effect of dilutive employee stock options	37,568	42,154
Effect of dilutive 4.50% Notes	2,280,068	2,280,068
Diluted weighted average shares outstanding	10,645,076	10,554,827

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Repurchase and Exchange of Common Stock

During the three months ended March 31, 2006, we did not repurchase shares of our common stock and/or the 4.50% Notes under previous authorizations by the Board of Directors to make purchases from time to time, in the open market, through privately negotiated transactions or otherwise, depending on market and business conditions and other factors. As of March 31, 2006, the remaining authorization is $15,829.

Comprehensive Income

Net income and comprehensive income are the same for the three months ended March 31, 2006 and 2005.

Stock-Based Compensation

The Amended and Restated 1997 Incentive and Capital Accumulation Plan (2005 Restatement), as amended (the Incentive Plan) provides that stock options, including incentive stock options and non-qualified stock options; stock appreciation rights; stock awards; performance-conditioned stock awards (restricted stock units); and stock units may be granted to officers, employees and directors of Avatar. The exercise prices of stock options may not be less than the market value of our common stock on the date of grant. Stock option awards under the Incentive Plan generally expire 10 years after the date of grant.

As of March 31, 2006, an aggregate of 1,110,102 shares of our Common Stock, subject to certain adjustments, were available for issuance under the Incentive Plan, including an aggregate of 786,912 options and stock units granted. There were 323,190 shares available for grant at March 31, 2006.

Prior to January 1, 2006, we accounted for our stock-based compensation plans in accordance with the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and related interpretations, as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). Accordingly, for restricted stock units granted, compensation expense was recognized in the consolidated statements of income prior to January 1, 2006 based on the market price of Avatar s common stock on the date the specified hurdle price was probable to be achieved, provided such provisions are applicable, or the date of grant. For stock options granted, no compensation expense was recognized in the consolidated statements of income prior to January 1, 2006 since all stock options granted had exercise prices greater than the market value of Avatar s stock on the grant date. Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123 (revised 2004), "*Share-Based Payment* (SFAS No. 123(R)) using the modified-prospective transition method. Under this transition method, compensation expense recognized during the three months ended March 31, 2006 included: (a) compensation expense for all share-based awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation expense for all share-based awards granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). In accordance with the modified-prospective-transition method, results for prior periods have not been restated.

As a result of the adoption of SFAS No. 123(R), the charge to income from continuing operations before income taxes and net income for the three months ended March 31, 2006 was $34 and $21. This additional charge had no effect on either basic or diluted earnings per share for the three months ended March 31, 2006.

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Stock-Based Compensation continued

Prior to the adoption of SFAS No. 123(R), we presented all tax benefits related to deductions resulting from the exercise of restricted stock units and stock options as operating activities in the consolidated statements of cash flows. SFAS No. 123(R) requires that tax benefits resulting from tax deductions in excess of the compensation expense recognized for those options (excess tax benefits) be classified and reported as both operating cash outflow and a financing cash inflow upon adoption.

SFAS No. 123, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* , requires disclosure of pro forma income and pro forma income per share as if the fair value based method had been applied in measuring compensation expense. The following table summarizes pro forma net income and earnings per share in accordance with SFAS No. 123, for the three months ended March 31, 2005 had compensation expense for stock-based compensation awarded under our stock-based incentive compensation plan been based on fair value at the grant date. For purposes of this pro forma disclosure, the value of the stock options granted is estimated using the Black-Scholes option-pricing model and the Monte-Carlo option valuation model (like a lattice model) for restricted stock units granted.

	2005 (Unaudited)
Net income as reported	$ 14,170
Add: Stock-based compensation expense included in reported net income, net of related tax expense	449
Deduct: stock-based compensation expense determined using the fair value method, net of related tax expense	(495)
Net income pro forma	$ 14,124
Earnings Per Share:	
Basic	
As reported	$ 1.76
Pro forma	$ 1.75
Diluted	
As reported	$ 1.42
Pro forma	$ 1.42

Compensation expense related to the stock option and restricted stock unit awards during the three months ended March 31, 2006 was $681, of which $71 related to stock options resulting from the adoption of SFAS No. 123(R) and $610 related to restricted stock units. During the three months ended March 31, 2005, compensation expense related to our restricted stock unit awards was $725. The income tax benefit recognized in the consolidated statements of income during the three months ended March 31, 2006 for the restricted stock unit awards was $38. The income tax benefit recognized in the consolidated statement of income during the three months ended March 31, 2005 for the restricted stock unit awards was $226.

Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) — continued

Stock-Based Compensation — continued

Cash received from stock option exercised during the three months ended March 31, 2006 and 2005 was $250 and $0, respectively. The tax benefit related to stock options exercised during the three months ended March 31, 2006 and 2005 was $116 and $0, respectively.

The fair value of each stock option is estimated on the grant date using the Black-Scholes option-pricing model. No stock options were granted during the three months ended March 31, 2006 or during the three months ended March 31, 2005. A summary of the status of the stock options outstanding as of March 31, 2006 as well as the activity during the three months then ended is presented below (unaudited):

	2006	
	Stock Options	Weighted Average Exercise Price
Outstanding at beginning of year	250,102	$ 25.00
Exercised	(10,000)	25.00
Outstanding at end of period	240,102	$ 25.00
Exercisable at end of period	120,102	$ 25.00

The weighted average remaining contractual life of stock options outstanding as of March 31, 2006 was 4.9 years. The total intrinsic value of stock options exercised during the three months ended March 31, 2006 and 2005 was $306 and $0, respectively.

Under SFAS No. 123(R), the fair value of each restricted stock award is estimated on the grant date using the Monte-Carlo option valuation model (like a lattice model). No restricted stock units were granted during the three months ended March 31, 2005. A summary of the status of the restricted stock units outstanding as of March 31, 2006 as well as the activity during the three months then ended is presented below (unaudited):

	2006	
	Restricted Stock Units	Weighted Average Grant Date Fair Value
Outstanding at beginning of year	543,854	$ 25.10
Granted	600	56.03
Outstanding at end of period	544,454	$ 25.13

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Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Stock-Based Compensation continued

As of March 31, 2006, there was $10,116 of unrecognized compensation expense related to unvested restricted stock units and unvested stock options, of which $9,614 relates to restricted stock units and $502 relates to stock options. That expense is expected to be recognized over a weighted-average period of 2.7 years.

During March 2003, we entered into earnings participation award agreements with certain executive officers providing for stock awards relating to achievement of performance goals. The cash award entitles the executives to a cash payment with respect to each fiscal year beginning 2003 and ending 2007 equal to a percentage of Avatar s gross profit (as defined) over minimum levels established. The stock award entitles the executives to receive a number of shares of our Common Stock having a fair market value (as defined) equal to a percentage of the excess of actual gross profit (as defined) from January 1, 2003 through December 31, 2007 over minimum levels established. Pursuant to this compensation agreement compensation expense of $1,518 and $0 was recognized for the three months ended March 31, 2006 and 2005, respectively. The income tax benefit recognized in the consolidated statement of income during the three months ended March 31, 2006 for this stock award was $577.

Income Taxes

The components of income tax expense from continuing operations for the three months ended March 31, 2006 and 2005 are as follows (unaudited):

	2006	2005
Current		
Federal	$ 11,913	$ 4,408
State	2,016	746
Total current	13,929	5,154
Deferred		
Federal	(2,869)	268
State	(486)	45
Total deferred	(3,355)	313
Total income tax expense	$ 10,574	$ 5,467

Notes to Consolidated Financial Statements (dollars in thousands except share and per share data) (Unaudited) continued

Income Taxes continued

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of deferred income tax assets and liabilities are as follows: