CENTEX CORP
Form 10-K
May 23, 2008

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

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED MARCH 31, 2008**

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: 1-6776
CENTEX CORPORATION
(Exact name of registrant as specified in its charter)
Nevada
(State of incorporation)
75-0778259
(I.R.S. Employer Identification No.)
2728 N. Harwood, Dallas, Texas 75201
(Address of principal executive offices) (Zip Code)
(214) 981-5000
(Registrant s telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	**Name of each exchange on which registered**
Common Stock ($ .25 par value)	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ü No _

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes _ No ü

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 ü No _

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the Form 10-K. ü

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

þ Large accelerated filer	o Accelerated filer	o Non-accelerated filer (Do not check if a smaller reporting company)	o Smaller Reporting Company

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

On September 30, 2007, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was $3.23 billion based upon the last sale price reported for such date on the New York Stock Exchange. As of May 9, 2008, 123,483,356 shares of the registrant s common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain of the information contained in the definitive Proxy Statement for the registrant s Annual Meeting of Stockholders to be held on July 10, 2008 is incorporated by reference into Part III hereof.

FORM 10-K
March 31, 2008
TABLE OF CONTENTS

PART I

Item 1.	Business	1
Item 1A.	Risk Factors	10
Item 1B.	Unresolved Staff Comments	18
Item 2.	Properties	18
Item 3.	Legal Proceedings	18
Item 4.	Submission of Matters to a Vote of Security Holders	18
Item 4A.	Executive Officers of the Registrant	19

PART II

Item 5.	Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	20
Item 6.	Selected Financial Data	22
Item 7.	Management s Discussion and Analysis of Financial Condition and Results of Operations	23
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	59
Item 8.	Financial Statements and Supplementary Data	61
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	106
Item 9A.	Controls and Procedures	106
Item 9B.	Other Information	106

PART III

	Directors, Executive Officers and Corporate Governance	106

Item 10.		
Item 11.	Executive Compensation	106
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	107
Item 13.	Certain Relationships and Related Transactions, and Director Independence	107
Item 14.	Principal Accountant Fees and Services	107

PART IV

Item 15.	Exhibits and Financial Statement Schedules	107
SIGNATURES		112

PART I

ITEM 1. BUSINESS

General Development of Business

Centex Corporation is a Nevada corporation. Our common stock, par value $.25 per share, began trading publicly in 1969. Our common stock is currently traded on the New York Stock Exchange, or the NYSE. As of May 9, 2008, 123,483,356 shares of our common stock were outstanding. Any reference herein to we, us, our or the Company refers to Centex Corporation and its subsidiary companies or, if the context requires, the particular segment or unit of our business that is being discussed.

Since our founding in 1950 as a Dallas, Texas-based residential construction company, we expanded our business to include a broad range of activities related to construction, construction products and financing, but have more recently refocused our operations on residential construction and related activities, including mortgage financing to our homebuyers. As of March 31, 2008, our subsidiary companies operated in two principal lines of business: Home Building and Financial Services. We provide a brief overview of each line of business below, with a more detailed discussion of each line of business later in this section.

Home Building s operations currently involve the construction and sale of detached and attached single-family homes. The land used for the construction of our homes is acquired through the purchase of finished or partially finished lots and through the purchase of raw land that must be developed.

Financial Services operations consist primarily of mortgage lending, title agency services and the sale of title insurance and other insurance products. These activities include mortgage origination and other related services for homes sold by our subsidiaries and others. We have been in the mortgage lending business since 1973.

Over the last several fiscal years, we have simplified our business portfolio as a result of a number of transactions. The following table summarizes these transactions over the last five fiscal years.

Business	Date	Description
Home Services	April 2008	We sold our home services operations, which were previously included in our Other segment.
Construction Services	March 2007	We sold our commercial construction operations, which were previously a separate reporting segment.
Home Equity	July 2006	We sold our sub-prime home equity lending operations, which were previously included in the Financial Services segment.
International Homebuilding	September 2005	We sold our international homebuilding operations, which were previously included in the Home Building segment.
Commercial Real Estate	February 2004	We simplified the organizational structure of the Company and its affiliates by acquiring a primarily commercial real estate company whose publicly traded securities had previously traded in tandem with our common stock. Those operations have been substantially liquidated.
	January 2004	

Construction Products		We made a tax-free spin-off to our stockholders of our equity interests in our construction products operations, which were previously a separate reporting segment.
Manufactured Homes	June 2003	We made a tax-free spin-off to our stockholders of substantially all of our manufactured housing operations, which were previously included in our Other segment.

For all businesses sold or spun off in the table above, the results of operations and financial position of such businesses are reported as discontinued operations for all periods presented. For additional information on our

discontinued operations, please refer to Note (O), Discontinued Operations of the Notes to Consolidated Financial Statements.

We have refocused our strategy to concentrate on our core homebuilding operations and related activities. Our mortgage lending and title agency services provide our homebuyers with a streamlined home-closing and settlement process, which we believe is important to ensuring customer satisfaction in our homebuilding business. The sales of our construction services and sub-prime home equity operations in fiscal year 2007 and our home service operations in April 2008 are consistent with this strategy. All prior year segment information has been revised in this Report to conform to the current year presentation.

Within our homebuilding operations, we determined that our operating segments are our divisions, which have been aggregated into seven reporting segments. Our homebuilding operations, or Home Building, consist of the following reporting segments: East, Southeast, Central, Texas, Northwest, Southwest and Other homebuilding. For a complete description of the states and markets in each of our homebuilding segments, please refer to the Home Building markets table later in this section.

Our mortgage lending, title agency services and insurance products continue to represent one reporting segment, Financial Services.

Financial Information about Segments

Note (I), Business Segments, of the Notes to Consolidated Financial Statements contains additional information about our business segments for fiscal years 2008, 2007 and 2006.

Description of Business

Beginning in fiscal year 2006, the U.S. housing industry began to experience a significant downturn. We believe the principal factors that have caused this downturn include: increased inventory of new and existing homes for sale, including homes in foreclosure, a decrease in the affordability of housing in selected markets, and a decline in homebuyer demand due to lower consumer confidence in the consumer real estate market and an inability of many homebuyers to sell their existing homes. Moreover, during fiscal year 2008, the mortgage markets experienced significant disruptions, which led to an unprecedented combination of reduced investor demand for mortgage loans and mortgage-backed securities, tightened credit requirements for homebuyers, reduced mortgage loan liquidity and increased credit risk premiums. These events contributed to a significant overall downturn in the U.S. homebuilding and residential mortgage industries and negatively impacted the economy in many local markets. These factors have had a significant negative impact on the homebuilding and mortgage finance industries and on our business and results of operations.

HOME BUILDING

The business of Home Building consists of constructing and selling detached and attached single-family homes. The land used for the construction of our homes is acquired through the purchase of finished or partially finished lots and through the purchase of raw land that must be developed. In fiscal year 2008, approximately 80% of the homes closed were single-family, detached homes.

Markets

Home Building follows a strategy of maximizing its relative market share in those local markets that reward market leaders and provide the highest potential returns. We participate in a wide variety of geographically and economically diverse markets that may fluctuate year to year. As of March 31, 2008, Home Building had substantive homebuilding operations in 74 market areas located in 22 states and the District of Columbia. Each active market is listed below within the reporting segment to which it belongs.

Segment	States	Markets	States and Markets (continued)	
East	Georgia	Savannah	South Carolina	Charleston/N. Charleston
	Maryland	Bethesda/Frederick/Gaithersburg		Myrtle Beach/Conway/ N. Myrtle Beach
		Washington, D.C./Arlington/Alexandria		
	New Jersey	Edison	Virginia	Richmond
		Newark/Union		Virginia Beach/Norfolk/ Newport News
		Trenton/Ewing		
	North Carolina	Burlington		Winchester
		Charlotte/Gastonia/Concord		
		Durham		
		Raleigh/Cary		
		Wilmington		
Southeast	Florida	Cape Coral/Ft. Myers	Florida (cont)	Tampa/St. Petersburg/Clearwater
		Jacksonville		Vero Beach
		Naples/Marco Island		West Palm Beach/Boca Raton/ Boynton Beach
		Orlando		
		Port St. Lucie/Ft. Pierce	Georgia	Atlanta/Sandy Springs/Marietta
		Punta Gorda	Tennessee	Nashville/Davidson/ Murfreesboro
		Sarasota/Bradenton/Venice		
Central	Indiana	Indianapolis	Minnesota	Minneapolis/St. Paul/Bloomington
	Illinois	Chicago/Naperville/Joliet		Rochester
	Michigan	Ann Arbor	Missouri	St. Louis
		Detroit/Livonia/Dearborn		
		Flint		
		Monroe		
		Warren/Farmington Hills/Troy		
Texas	Texas	Austin/Round Rock	Texas (cont)	Houston/Baytown/Sugar Land
		Dallas/Plano/Irving		Killeen/Temple/Ft. Hood
		Ft. Worth/Arlington		San Antonio
Northwest	California	Bakersfield	Colorado	Denver/Aurora
		Fresno		Ft. Collins/Loveland
		Hanford/Corcoran		Greeley
		Merced	Hawaii	Honolulu
		Modesto	Nevada	Reno/Sparks
		Oakland/Fremont/Hayward	Oregon	Portland/Vancouver/Beaverton
		Sacramento/Arden/Arcade/Roseville	Washington	Seattle/Bellevue/Everett
		San Jose/Sunnyvale/Santa Clara		Tacoma
		Stockton		
		Visalia/Porterville		
		Yuba City		

Southwest	Arizona	Phoenix/Mesa	Nevada	Las Vegas/Paradise
	California	El Centro	New Mexico	Albuquerque
		Los Angeles/Long Beach/Glendale		Santa Fe
		Oxnard/Thousand Oaks/Ventura		
		Riverside/San Bernardino/Ontario		
		San Luis Obispo/Paso Robles		
		Santa Ana/Anaheim/Irvine		
		Santa Barbara/Santa Maria/Goleta		

Other homebuilding Other homebuilding includes certain resort/second home projects in Florida that we plan to build-out and liquidate, and holding companies. In addition, Other homebuilding includes amounts consolidated under the caption land held under option agreements not owned and capitalized interest for all regions.

In fiscal year 2008, Home Building closed the sale of 27,202 homes, including first-time, move-up and, in some markets, luxury homes, generally ranging in price from $65 thousand to $3.0 million. The average revenue per unit in fiscal year 2008 was $276,788.

We believe that our business requires in-depth knowledge of each market in order to acquire land in desirable locations, to procure labor and materials, to anticipate consumer preferences and to assess the regulatory environment. Our organizational structure is designed to utilize local market expertise. Additionally, we believe our business requires strong corporate and regional leadership to approve land acquisitions, to procure labor and materials on a national or regional basis when available and to develop, deploy and measure our core business practices. Our regional and corporate structures are designed to develop and leverage these core competencies.

Our neighborhood development process generally consists of three phases: land acquisition, land development and home construction and sale. Generally, we seek to acquire land that is properly zoned and is either ready for development or, to some degree, already developed. We acquire land only after we have completed appropriate due diligence and typically after we have obtained the rights or entitlements to begin development. Before we acquire lots or tracts of land, we will, among other things, complete a feasibility study, which includes soil tests, independent environmental studies and other engineering work, and evaluate the status of necessary zoning and other governmental entitlements required to develop and use the property for home construction. Although we purchase and develop land or lots primarily to support our homebuilding activities, we also sell land or lots to investors and other developers and homebuilders.

Our goal is to own less than two years supply of land and to control, through option agreements, approximately two more years of land that we can acquire over specified time periods or, in certain cases, as the land or lots are needed. At March 31, 2008, Home Building owned 70,222 lots and had options to purchase 18,147 lots. This is considerably less than the 98,311 owned lots and 61,709 optioned lots we held at March 31, 2007. We are transitioning to a strategy that emphasizes the purchase of finished lots on more of a just-in-time basis and away from a strategy where we acquire raw land and undertake all development work. In addition, Home Building enters into joint ventures with other builders and developers for land acquisition and development. For additional discussion of our lot option agreements and participation in joint ventures, see Note (C), Inventories, and Note (G), Commitments and Contingencies, of the Notes to Consolidated Financial Statements.

Following the purchase of land and, if necessary, the entitlement and development process, we begin to market, sell and construct homes. Substantially all of our construction work is performed by independent contractors. Home Building is moving to an operating model of constructing homes from a sold backlog. This operating model will provide more predictable scheduling of independent contractors which will eventually result in increased efficiency and improved profitability.

We market and sell our homes through commissioned employees and independent real estate brokers. We typically conduct home sales from sales offices located in furnished model homes in each neighborhood. Our sales personnel assist prospective homebuyers by providing them with floor plans, price information, tours of the neighborhood and model homes and assisting them with the selection of upgrades and options. As market conditions warrant, we may provide potential homebuyers with a variety of incentives, including discounts and free upgrades, to remain competitive.

Our growth strategy for Home Building has been focused primarily on organically growing our relative market share in those local markets that reward market leaders and provide the highest potential returns. To a lesser extent, we have also grown through the acquisition of other homebuilding companies. There have been no acquisitions of homebuilding companies in the last five fiscal years.

Home Building sells its homes principally under the Centex name and, in certain markets, under a variety of other brand names including several from previous acquisitions. Fox & Jacobs, one of our brand names, primarily markets to first-time buyers. Centex Homes primarily markets its homes to first-time and move-up buyers.

The table below summarizes by reporting segment Home Building s units closed, sales orders and backlog units for the five most recent fiscal years.

Units Closed:

	For the Years Ended March 31,				
	2008	2007	2006	2005	2004
East	**5,345**	6,720	7,116	5,674	5,064
Southeast	**3,417**	5,374	6,426	4,867	4,594
Central	**3,718**	4,789	5,971	5,593	4,990
Texas	**5,772**	7,083	6,899	6,173	6,055
Northwest	**4,062**	4,709	4,580	3,740	3,121
Southwest	**4,537**	6,209	6,786	5,614	4,981
Other homebuilding	**351**	901	1,454	1,726	1,553
	27,202	35,785	39,232	33,387	30,358
Average Revenue Per Unit (in 000 s)	**$ 277**	$ 308	$ 304	$ 270	$ 242

Sales Orders (in Units):

	For the Years Ended March 31,				
	2008	2007	2006	2005	2004
East	**4,787**	5,495	6,840	6,431	5,616
Southeast	**3,234**	3,425	5,703	6,125	5,294
Central	**3,310**	4,271	5,636	5,346	5,320
Texas	**5,413**	6,914	6,994	6,508	6,250
Northwest	**3,629**	4,300	4,597	4,211	3,627
Southwest	**4,124**	4,539	7,196	6,137	5,694
Other homebuilding	**160**	105	1,064	1,804	1,921
	24,657	29,049	38,030	36,562	33,722

Backlog Units:

	As of March 31,				
	2008	2007	2006	2005	2004
East	**1,290**	1,848	3,073	3,349	2,592
Southeast	**1,336**	1,519	3,468	4,191	2,933
Central	**1,116**	1,744	2,262	2,597	2,844
Texas	**1,877**	2,020	2,189	2,094	1,759
Northwest	**1,250**	1,805	2,214	2,197	1,726
Southwest	**874**	1,503	3,173	2,763	2,240
Other homebuilding	**3**	212	1,008	1,398	1,320
	7,746	10,651	17,387	18,589	15,414

For each unit in backlog, we have received a signed customer contract and a customer deposit, which is refundable under certain circumstances. The backlog units included in the table above are net of cancellations. Cancellations occur for a variety of reasons, including a customer s inability to obtain financing, customer relocations or other customer financial hardships. Substantially all of the orders in sales backlog as of March 31, 2008 are scheduled to close during fiscal year 2009.

Competition and Other Factors

The homebuilding industry is highly competitive and fragmented. Traditionally, competition in the industry has occurred at a local level among national, regional and local homebuilders. In recent years, national homebuilders have been able to compete more effectively and increase their share of the national homebuilding market. The top ten builders in calendar year 2007 accounted for approximately 22% of the nation s new housing stock. We believe we ranked fourth in the largest homebuilders in the United States at March 31, 2008, based on publicly reported homebuilding revenues for the most recent twelve-month period for which information is available. Our operations accounted for an estimated 4% of new homes sold in the United States for the twelve months ended March 31, 2008. We calculate our market share by dividing our new home sales by the total single family new home sales as reported by the U. S. Census Bureau. Our top four competitors based on revenues for their most recent fiscal year-end are as follows (listed alphabetically): D. R. Horton, Inc., Lennar Corporation, KB Home and Pulte Homes, Inc. The main competitive factors affecting our operations are location/market, sales price, availability of mortgage financing for customers, construction costs, design and quality of homes, customer service, marketing expertise, availability of land, price of land and reputation. We believe that Home Building competes effectively by building a high quality home, and responding to the specific demands of each market by managing operations at a local level.

We conduct targeted market research to identify what features, amenities and options will be attractive to prospective customers and whether we can satisfy their preferences profitably. Customer preferences can vary across geographical regions and even within them, and can change over time in response to personal or regional factors (such as the interest in some markets for housing with high energy efficiency or for housing located near public transportation) and to changes in economic conditions, such as affordability of housing and availability of financing, which can lead customers to accept smaller or attached housing despite a preference for larger or detached housing. We also use market research techniques to quantify housing supply and demand in a particular market and use this information to guide our strategy for meeting customer demand in the market.

The downturn in the homebuilding industry has significantly impacted competition among the homebuilders. The excess supply of homes for sale and the need for builders to generate cash have caused homebuilders and other home sellers to reduce prices. This increased competition has also resulted in increases in discounts and sales incentives, including increases in seller-paid financing and closing costs, and increases in sales commissions to help stimulate sales and close homes. We believe the increased competition in the homebuilding industry affected all categories of builders, but has had a disproportionate effect on smaller homebuilders that may not be capitalized as well as most of the large homebuilders.

We have used the downturn in the industry as an opportunity to adjust certain of our product offerings and marketing efforts. To simplify our business, reduce costs and offer products that homebuyers can afford, we have reduced the number of floor plans offered across our neighborhoods and also reduced the number of available options and upgrades.

The homebuilding industry will continue to be affected by changes in national and local economic conditions, the supply of new and existing homes for sale, job growth, long-term and short-term interest rates, availability of mortgage products, consumer confidence, governmental policies, zoning restrictions and, to a lesser extent, changes in property taxes, energy costs, federal income tax laws, federal mortgage financing programs and various other demographic factors. The political and economic environments affect both the demand for housing constructed and the subsequent cost of financing. Unexpected weather conditions, such as unusually heavy or prolonged rain or snow, or hurricanes, may affect operations in certain areas.

The homebuilding industry is subject to extensive regulation. Home Building and its contractors must comply with various federal, state and local laws and regulations, including worker health and safety, zoning and land entitlement, building standards, advertising, consumer credit rules and regulations and the extensive and changing federal, state and local laws, regulations and ordinances governing the protection of the environment, including laws related to erosion and storm water pollution control and the protection of endangered species and waters of the United States. We are also subject to other rules and regulations in connection with our construction and sales activities, including requirements as to incorporated building materials and building designs, such as requirements for the use of energy efficient materials or designs. While these regulatory requirements are generally applicable to all regions in which we

operate, regulations in coastal markets tend to be more extensive. All of these regulatory requirements are applicable to all homebuilding companies, and, to date, compliance with these requirements has not had a material impact on Home Building. We believe that we are in compliance with these requirements in all material respects.

As discussed further in Item 3. Legal Proceedings, in May 2008, Home Building agreed to sign a consent decree with the United States Environmental Protection Agency, which we refer to as the EPA, and various states with respect to our prior and future storm water pollution prevention practices at all of Home Building s sites. When the consent decree is signed by all parties, the Justice Department will file suit in Federal Court in accordance with the accepted practice in matters of this nature and simultaneously submit the proposed consent decree for approval by the Court. We anticipate that the consent decree will become final during the second quarter of the fiscal year ending March 31, 2009. Under the proposed consent decree, Home Building will agree to certain management practices related to controlling storm water discharges at all of Home Building s sites, which may result in increased capital expenditures.

We purchase materials, land and services from numerous sources. The principal raw materials required for home construction include concrete and wood products. In addition, we use a variety of other building materials, including roofing, gypsum, insulation, plumbing, and electrical components in the homebuilding process. We attempt to maintain efficient operations by utilizing standardized materials available from a variety of sources. A number of our vendor purchase agreements also allow us to leverage our volume through quantity purchase discounts for the purchasing of a number of product categories. We use many contractors in our various markets and are not dependent on any single contractor.

FINANCIAL SERVICES

Our Financial Services operations include mortgage lending and other related services for purchasers of homes sold by our homebuilding operations and other homebuilders, refinancing of existing mortgages, title agency services and the sale of title insurance and other insurance products, including property and casualty.

We established the predecessor of CTX Mortgage Company, LLC to provide mortgage financing for homes built by Home Building. By opening mortgage offices in Home Building s housing markets, we have been able to provide mortgage financing for an average of 76% of Home Building s non-cash unit sales over the past five years and for 79% of such closings in fiscal year 2008. In 1985, we expanded our mortgage operations to include the origination of mortgage loans that are not associated with the sale of homes built by Home Building. We refer to mortgage financing for homes built by Home Building as Builder loans and to mortgage financing for homes built by others, loans for existing homes and loans to refinance existing mortgages as Retail loans.

As a result of the significant disruptions in the mortgage markets and the related reductions in the mortgage market liquidity, during fiscal year 2006, we began to focus our mortgage operations on Builder loans to support Home Building. Retail mortgage originations represented approximately 54.8%, 53.0%, and 61.3% of total mortgage originations during the fiscal years ended March 31, 2008, 2007, and 2006, respectively. However, we expect Retail mortgage originations to decline during the fiscal year ending March 31, 2009. We anticipate the reduction in total Retail mortgage originations may have a negative impact on Financial Services operating results.

At March 31, 2008, Financial Services loan officers originated Builder loans from 48 offices licensed in 31 states and the District of Columbia and Retail loans from 86 offices licensed in 47 states and the District of Columbia. The offices vary in size depending on loan volume.

The following table shows the unit breakdown of Builder and Retail loans for the five years ended March 31, 2008:

	For the Years Ended March 31,				
	2008	2007	2006	2005	2004
Loan Types (originations):					
Builder	**20,431**	27,141	27,364	22,517	20,865
Retail *(1)*	**24,729**	30,638	43,319	44,816	67,481
	45,160	57,779	70,683	67,333	88,346
Origination Volume (in millions)	**$ 9,991.3**	$ 13,826.0	$ 15,827.4	$ 13,039.0	$ 15,116.0

Percent of Home Building s Closings Financed [(2)]	**79%**	80%	75%	73%	74%

(1) Over the last five fiscal years, the reduction in retail loan originations is primarily attributable to decreases in refinancing activity and homebuyer demand, and our strategic decision to reduce the number of retail loan officers. In fiscal year 2008, retail loan originations were also affected by adverse market conditions that further reduced demand and resulted in a reduction of mortgage loan products.

(2) *Excludes non-financed cash-only closings.*

We provide mortgage origination and other mortgage-related services for Federal Housing Administration (FHA) loans, Department of Veterans Affairs (VA) loans and conventional loans. Our loans are generally first-lien mortgages secured by the home. Substantially all of our loans qualify for inclusion in programs sponsored by the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA), or the Federal Home Loan Mortgage Corporation (FHLMC). Loans qualifying for inclusion in FNMA or FHMLC sponsored programs are known in the industry as conforming loans. The remainder of the loans are either pre-approved and individually underwritten by us or by private investors who subsequently purchase the loans, or are funded by private investors who pay a broker fee to us for broker services rendered.

Financial Services revenues and operating earnings are derived primarily from the sale of mortgage loans, together with all related servicing rights, broker fees, title and other various insurance coverages, interest income and other fees. For substantially all mortgage loans originated, we sell our right to service the mortgage loans and retain no residual interests.

Generally, our business strategy is to originate and sell loans rather than hold them, which reduces our capital investment and related risks. Until the second quarter of fiscal year 2008, mortgage loans held for sale were primarily funded by CTX Mortgage Company, LLC s sale of substantially all the mortgage loans it originated to Harwood Street Funding I, LLC, which we refer to as HSF-I. Following unprecedented disruptions in the mortgage markets during the second quarter of fiscal year 2008, CTX Mortgage Company LLC discontinued sales of mortgage loans to HSF-I, and is now relying on committed bank warehouse credit facilities to provide funding for its loan originations. In November 2007, we terminated HSF-I and all of its outstanding obligations were redeemed. HSF-I was a variable interest entity of which we were the primary beneficiary, and it was consolidated in our financial statements.

Financial Services also holds other mortgage loans, including performing and nonperforming construction loans and other nonperforming mortgage loans. During the year ended March 31, 2008, Financial Services ceased originating new construction loans; however, it will fulfill its existing funding commitments.

We offer title agent, title underwriting, closing and other settlement services in 23 states under the Commerce Title name, including Commerce Title Company, Commerce Title Agency and Commerce Title Insurance Company. Through Westwood Insurance, including Centex Insurance Agency, a multi-line property and casualty insurance agency, we market homeowners and auto insurance to Home Building and Financial Services customers and customers of 10 other homebuilders in 44 states. Westwood Insurance also provides coverage for some commercial customers.

Competition and Other Factors

The financial services industry in the United States is highly competitive. Financial Services competes with the mortgage banking subsidiaries of large commercial banks, mortgage companies, and savings and other financial institutions to supply mortgage financing at attractive rates to homebuyers. Key competitive factors among industry participants are varied and include convenience in obtaining a loan, customer service, marketing and distribution channels, amount and term of the loan, loan origination fees and interest rates. Any increase in competition may lower the rates we can charge borrowers, thereby potentially reducing gain on future loan sales. Our title and insurance operations compete with other providers of title and insurance products to sell their products to purchasers of our homes, as well as to the general public. Many of these competitors have greater resources than we do.

The disruptions in the mortgage markets and downturn in the residential mortgage industry during the fiscal year significantly impacted competition. Many mortgage lenders were unable to finance the origination of new mortgage loans, and as a result, some mortgage lenders ceased or severely restricted operations. Additionally, the decline in homebuyer demand reduced the population of potential mortgage customers. In addition, the disruptions in the mortgage and credit markets significantly reduced the ability of mortgage lenders to sell nonconforming mortgage loans as there are fewer investors willing to accept the risks associated with these loan products. As a result, many mortgage lenders limit their mortgage loan originations to conforming loan products.

Financial Services operations are subject to extensive state and federal regulations, as well as rules and regulations of, and examinations by, FNMA, FHLMC, FHA, VA, Department of Housing and Urban Development, or HUD, GNMA and state regulatory authorities with respect to originating, processing, underwriting, making and selling loans and providing title and other insurance products. In addition, there are other federal and state statutes and

regulations affecting such activities. These rules and regulations, among other things, impose licensing obligations on our Financial Services operations, specify standards for origination procedures, establish eligibility criteria for mortgage loans, provide for inspection and appraisals of properties, regulate payment features and, in some cases, fix maximum interest rates, fees, loan amounts and premiums for title and other insurance. Certain of our Financial Services operations are required to maintain specified net worth levels and submit annual audited financial statements to HUD, VA, FNMA, FHLMC, GNMA and some state regulators.

As an approved FHA lender, CTX Mortgage Company, LLC is subject to examination by the Federal Housing Commissioner at all times to ensure compliance with FHA regulations, policies and procedures. Our title and insurance operations are subject to examination by state authorities. Mortgage origination activities are subject to the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, the Federal Truth-In-Lending Act, the Real Estate Settlement Procedures Act, the Riegle Community Development and Regulatory Improvement Act, the Home Ownership and Equity Protection Act and regulations promulgated under such statutes, as well as other federal and state consumer credit laws. The Real Estate Settlement Procedures Act also applies to our insurance operations. These statutes prohibit discrimination and unlawful kickbacks and referral fees and require the disclosure of certain information to borrowers concerning credit and settlement costs. Many of these regulatory requirements seek to protect the interest of consumers, while others protect the owners or insurers of mortgage loans. Failure to comply with these requirements can lead to loss of approved status, demands for indemnification or loan repurchases from investors, lawsuits by borrowers (including class actions), administrative enforcement actions and, in some cases, rescission or voiding of the loan by the consumer.

EMPLOYEES

The following table presents a breakdown of our employees as of March 31, 2008:

Line of Business	Employees
Home Building	4,143
Financial Services	1,920
Other	467
Total	6,530

The 467 Other employees include our corporate employees. Employees related to our home services operations are not included in the table above as these operations are included in discontinued operations.

NYSE AND SEC CERTIFICATIONS

We submitted our 2007 Annual CEO Certification to the New York Stock Exchange on July 23, 2007. The certification was not qualified in any respect. Additionally, we filed with the Securities and Exchange Commission, or SEC, as exhibits to our Form 10-K for the year ended March 31, 2007, the CEO and CFO certifications required under Section 302 of the Sarbanes-Oxley Act.

AVAILABLE INFORMATION

Anyone seeking information about our business operations and financial performance can receive copies of the 2008 Annual Report to Stockholders, Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, all amendments to those reports and other documents filed with the SEC, without charge, by contacting our Investor Relations office at (214) 981-5000; by writing to Centex Corporation, Investor Relations, P.O. Box 199000, Dallas, Texas 75219 or via email at ir@centex.com. In addition, all filings with the SEC, news releases and quarterly earnings announcements, including live audio and replays of recent quarterly earnings web casts, can be accessed free of charge on our web site (http://www.centex.com). We make our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, or Exchange Act, available on our web site as soon as reasonably practicable after we electronically file the material with, or furnish it to, the SEC. To retrieve any of this information, go to http://www.centex.com, select Investors and select SEC Filings. Our web site also includes our Corporate Governance Guidelines, The Centex Way (our Code of Business Conduct and Ethics) and the

charters for the Audit Committee, the Corporate Governance and Nominating Committee and the Compensation and Management Development Committee of our Board of Directors. Each of these documents is also available in print to any stockholder who requests a copy by addressing a request to Centex Corporation, attention: Corporate Secretary,

2728 N. Harwood, Dallas, Texas 75201. The reference to our web site is merely intended to suggest where additional information may be obtained by investors, and the materials and other information presented on our web site are not incorporated in and should not otherwise be considered part of this Report.

ITEM 1A. RISK FACTORS

The foregoing discussion of our business and operations should be read together with the risk factors set forth below. They describe various risks and uncertainties to which we are or may become subject, many of which are outside of our control. These risks and uncertainties, together with other factors described elsewhere in this Report, have affected, or may in the future affect, our business, financial condition, results of operations, cash flows, strategies or prospects in a material and adverse manner.

HOME BUILDING

The homebuilding industry is undergoing a significant downturn; this downturn has had a material adverse effect on our business and results of operations and is expected to continue through our next fiscal year.

Beginning in fiscal year 2006, the U.S. housing industry began to experience a significant downturn, which has had and continues to have a material adverse effect on our business and results of operations. We believe the principal factors that have caused this downturn include each of the following, the impact of which varies based upon geographic market, product segment and the time since commencement of the downturn:

increased inventory of new and existing homes for sale, including the impact of increases in residential foreclosures,

reduced availability and increased cost of mortgage financing due to the significant mortgage market disruptions,

a decrease in the affordability of housing in selected markets as a result of significant price appreciation in the years preceding the downturn and tightened credit standards for homebuyers,

a decline in homebuyer demand due to lower consumer confidence in the consumer real estate market and an inability of many homebuyers to sell their existing homes, and

pricing pressures resulting from a variety of factors, including the decision of homebuilders to offer significant discounts and sales incentives, to liquidate unsold inventories in order to generate cash, and the need for home prices to fall within mortgage qualification limits.

These conditions have led to, among other things, (i) significant decreases in our homebuilding revenues, (ii) substantial land-related and goodwill impairments, (iii) significant losses on land sales, (iv) write-offs of land deposits and pre-acquisition costs, and (v) joint ventures impairments. As a result, our homebuilding operations incurred substantial losses and may continue to do so for some time. Any worsening in market conditions in the homebuilding industry would have a further material adverse effect on our business and results of operations.

Although we were successful in generating positive operating cash flow and reducing our inventories in fiscal year 2008, we incurred significant operating losses and recorded substantial asset impairment charges which contributed to the substantial net loss we recognized in this period. Many of the factors that have resulted in these losses are beyond our control, and we have limited means at our disposal to mitigate or respond to the effects of these factors on our results of operations.

The market value of land is subject to significant fluctuations, which have resulted in significant impairments and write-offs in our land holdings and may continue to do so.

The risk of owning land can be substantial for homebuilders. There is often a significant lag time between when we acquire land for development and when we sell homes in neighborhoods we have planned, developed and constructed. Inventory carrying costs for land can be significant and can result in reduced margins or losses in a poorly performing project or market. In addition, the market value of land, finished lots and housing inventories can fluctuate significantly as a result of changing economic and market conditions, including the availability of financing, such as the industry downturn we are currently experiencing. If the market value of home inventories, land/lots or other

property decline during this period, we may need to sell homes or other property at a loss or at prices that generate lower margins than we anticipated when we acquired the land. To the extent projected sales prices do not exceed the carrying value of the related assets, or if other market conditions deteriorate, we may be required to record an impairment of our land or home inventories.

During the year ended March 31, 2008, we decided not to pursue development and construction in certain areas where we held land or had made option deposits, which resulted in $120.4 million in write-offs of option deposits and pre-acquisition costs. During the year ended March 31, 2008, we recognized losses of $388.7 million on land sales. In addition, market conditions led to recorded land-related impairments on neighborhoods and land during the year ended March 31, 2008 of $1,792.4 million, including $14.9 million of direct construction impairments. Land-related impairments during the quarter ended March 31, 2008 represented 94 neighborhoods and land investments, some of which have been impaired more than once. These market conditions also adversely affected land values in our Home Building joint ventures. Our share of joint ventures impairments was $100.5 million for the year ended March 31, 2008. These land-related impairments contributed to the significant operating losses we incurred during the year ended March 31, 2008. If market conditions do not improve in future periods, we may experience additional write-offs of option deposits and pre-acquisition costs, losses on land sales, land related impairments and impairments relating to our ownership interest in joint ventures. Additionally, our land-related impairment analyses are affected by market conditions and certain assumptions, such as sales prices, sales rates and discount rates used, and relatively small changes in these assumptions could lead to significant land-related impairments.

Continued cancellations of home sales contracts may have a material adverse effect on our business.

Our backlog reflects the number and value of homes for which we have entered into a sales contract with a customer but have not yet closed the home. We have received a customer deposit for each home reflected in our backlog, and generally we have the right to compel the customer to complete the purchase. In many cases, however, a customer may cancel the contract and receive a complete or partial refund of the deposit for reasons such as his or her inability to obtain mortgage financing or to sell his or her current home. Customers may also decide to run the risk of failing to perform under the contract without legal justification. If the current industry downturn continues, or if mortgage financing becomes less available, more homebuyers may cancel their contracts with us. Significant cancellations have had, and could have in the future, a material adverse effect on our business and results of operations.

Increases in interest rates, decreases in the availability of mortgage financing or other changes in market conditions could make it more difficult or costly for customers to purchase our homes.

Most of our homebuilding customers finance their home purchases through our Financial Services operations or, in some cases, third-party lenders. In general, housing demand is adversely affected by increases in interest rates or by decreases in the availability of mortgage financing as a result of increased credit standards, deteriorating customer credit quality or disruptions or other adverse conditions in mortgage lending markets. Any increases in interest rates could cause potential homebuyers to be less willing or able to purchase our homes. In general, if mortgage rates increase, it could become more difficult or costly for customers to purchase our homes, which would have an adverse effect on our results of operations.

Certain of our homebuyers use down payment assistance programs, which allow homebuyers to receive gift funds from non-profit corporations to be used as a down payment. Homebuilders are a source of funding for these programs. The HUD and Congress are considering limitations and further regulation of these programs. Such restrictions may limit the ability of seller-funded non-profit corporations to fund down payment assistance programs for government-insured mortgage loans. HUD has issued a rule that eliminates seller-funded down payment assistance as an acceptable minimum investment in the property for FHA insured loans. However, the implementation of that rule has been delayed as a result of litigation filed by certain down payment assistance providers. The ultimate outcome of this litigation is uncertain. If, as a result of legislative, regulatory or other action, certain of the gift fund programs that our customers use would no longer be available to them, we would expect to work to provide other financing alternatives, and seek different down payment programs for our customers that meet applicable guidelines. There can be no assurance, however, that any such alternative programs would be as attractive to our customers as the programs offered today and that our sales would not suffer.

Competition for homebuyers could reduce our closings or decrease our profitability.

The homebuilding industry is highly competitive. We compete in each of our markets with many national, regional and local homebuilders. In recent years, national homebuilders have been able to compete more effectively and increase their share of the national homebuilding market. The current downturn in the homebuilding industry has

significantly increased competition among homebuilders, as evidenced by price reductions, increases in discounts and sales commissions and increased sales commissions in an effort to stimulate sales. Any further increases in the level of competition from other national homebuilders or from regional and local homebuilders in the markets in which we operate could reduce the number of homes we close, or cause us to accept reduced margins or losses on home sales.

We also compete with resales of existing or foreclosed homes, homes offered by investors and housing speculators and available rental housing. Increased competitive conditions in the residential resale or rental market in the markets where we operate could decrease demand for new homes, cause us to increase our sales incentives or price discounts in order to maintain sales volumes, increase the volatility of the market for new homes or lead to cancellations of sales contracts in backlog, any of which could adversely affect our operating results.

We conduct certain of our homebuilding operations through joint ventures with independent third parties in which we do not have a majority interest, and we can be adversely impacted by joint venture partners failure to fulfill their obligations.

We conduct a portion of our land acquisition, development and other activities through our participation in joint ventures in which we hold less than a majority interest. These land-related activities typically require substantial capital, and by partnering with other homebuilders or developers and, to a lesser extent, financial partners, Home Building is able to share the risks and rewards of ownership and obtain other strategic advantages.

Total joint venture debt outstanding as of March 31, 2008 and 2007 was $423.2 million and $1.0 billion, respectively. Debt agreements for joint ventures vary by lender in terms of structure and level of recourse. For certain of the joint ventures, we are also liable on a contingent basis, through other guarantees, letters of credit or other arrangements, with respect to a portion of the construction debt. Additionally, we have agreed to indemnify the construction lender for certain environmental liabilities in the case of most joint ventures and most guarantee arrangements provide that we are liable for our proportionate share of the outstanding debt if the joint venture files for voluntary bankruptcy. To date, we have not been requested to perform under the environmental liabilities or voluntary bankruptcy guarantees for any of our joint ventures.

Four of our joint ventures are in default of their joint venture debt agreements. In addition, we expect two other joint ventures to be in default of their joint venture debt agreements subsequent to March 31, 2008. Our joint venture partner to one of these joint ventures filed for bankruptcy during the year ended March 31, 2008. We are in discussions with the joint venture partners and lenders with respect to each joint venture and are evaluating alternatives to mitigate our exposure. We expect to fulfill our contractual obligations under the joint venture agreements. Costs associated with fulfilling such contractual obligations may be less than our share of the joint ventures debt. Recourse under joint venture debt agreements is limited to either the underlying collateral or completion obligations of the joint venture partners. Based upon the terms and debt amounts outstanding for these joint ventures and the terms of the joint venture agreements, we do not believe our exposure related to these joint venture defaults will be material to our financial position or results of operations.

In general, we are subject to various risks of the type described above related to joint venture debt, construction debt and other obligations and liabilities of the joint ventures in which we participate, and these debts, liabilities and obligations may in some cases be material. In the case of many joint ventures, we have the right to be reimbursed by our joint venture partners for any amounts which we pay that exceed our pro rata share of the joint ventures obligations. However, particularly if our joint venture partners have filed for bankruptcy protection or are having financial problems, we may have difficulty collecting the sums they owe us, and therefore, we may be required to pay a disproportionately large portion of the guaranteed amounts. In addition, because we lack a controlling interest in these joint ventures, we are usually unable to require that the joint venture sell assets, return invested capital or take any other action without the consent of at least one of our joint venture partners. As a result, without the consent of one or more joint venture partners, we may be unable to liquidate our joint venture investments to generate cash. If we are able to liquidate joint venture investments, the amounts received upon liquidation may be insufficient to cover the costs we have incurred.

Compliance with regulatory requirements affecting our business could have substantial costs both in time and money, and some regulations could prohibit or restrict some homebuilding activity.

We are subject to extensive and complex laws and regulations that affect the land development and homebuilding process, including laws and regulations related to zoning, permitted land uses, levels of density, building design, warranties, storm water pollution prevention and use of open spaces. In addition, we are subject to a variety of laws and regulations concerning safety and the protection of health and the environment. The particular environmental laws that apply to any given neighborhood vary greatly according to the neighborhood site, the site s environmental

conditions and the present and former uses of the site. In some of the markets where we operate, we are required to pay environmental impact fees, use energy-saving construction materials, such as extra insulation or double-paned windows, and make commitments to municipalities to provide certain infrastructure such as roads and sewage systems. We and the contractors that we engage to work on our jobsites are also subject to laws and

regulations related to workers health and safety, wage and hour practices and immigration. We generally are required to obtain permits and approvals from local authorities to commence and complete residential development or home construction. Such permits and approvals may from time to time be opposed or challenged by local governments, neighboring property owners or other interested parties, adding delays, costs and risks of non-approval to the process. Our obligation to comply with the laws and regulations under which we operate, or the obligation of our independent contractors to comply with these and other laws and regulations, could result in delays in land development and homebuilding activity, cause us to incur substantial costs and prohibit or restrict land development and construction.

It is possible that increasingly stringent requirements will be imposed on developers and homebuilders in the future. Although we cannot predict with any certainty either the nature of the requirements or the effect on our business, they could result in time-consuming and expensive compliance programs and in substantial expenditures, which could cause delays and increase our cost of operations. The additional costs associated with new regulatory requirements or compliance programs may not be recoverable from our homebuyers in the form of higher sales prices which could adversely affect our results of operations.

We may incur increased costs related to repairing construction defects in the homes we sell.

Our Home Building operations are subject to warranty and other claims related to construction defects and other construction-related issues, including compliance with building codes. The costs we incur to resolve those warranty and other claims reduce our profitability, and if we were to experience an unusually high level of claims, or unusually severe claims, our profitability could be adversely affected.

An inability to obtain bonding could limit the number of projects we are able to pursue, and we could be adversely affected if we are required to post additional collateral in respect of bonds issued in connection with past construction projects.

As is customary in the homebuilding industry, we often are required to provide surety bonds to secure our performance under construction contracts, development agreements and other arrangements. Our ability to obtain surety bonds primarily depends upon our credit rating, capitalization, working capital, past performance, management expertise and certain external factors, including the overall capacity of the surety market. Under certain circumstances, such as a claim on a bond, a breach of the contract to which the bond applies, or a material breach of a representation made to a surety, we may be required to provide one or more sureties with additional collateral to support our bond obligations. In addition, in some cases, upon request of a surety, we may be required to cause the surety to be discharged from all bond obligations by providing collateral sufficient to cover all of such surety s bond exposure or alternative funding of such bond obligations. If one or more of our third-party sureties were to request additional collateral, our obligations could be significant, which could have a material adverse effect on our financial position or results of operations.

FINANCIAL SERVICES

General business, economic and market conditions may significantly affect the results of operations of our Financial Services operations.

Our Financial Services operations are sensitive to general business and economic conditions in the United States. These conditions include the liquidity and availability of financing in mortgage finance markets, short-term and long-term interest rates, inflation, fluctuations in both debt and equity capital markets, and the strength of the U.S. economy, as well as the local economies in which we conduct business. If any of these conditions worsen, our Financial Services business could be adversely affected. Also, because Financial Services focuses on providing services to customers who are considering the purchase of a home from Home Building or third parties, reduced home sales will likely also impact Financial Services business in the form of reduced home loans, title services and insurance services.

In addition, our Financial Services business is significantly affected by the fiscal and monetary policies of the federal government and its agencies. We are particularly affected by the policies of the Federal Reserve Board, which regulates the supply of money and credit in the United States. The Federal Reserve Board s policies influence the size of the mortgage origination market. The Federal Reserve Board s policies also influence the yield on our interest-earning assets and the cost of our interest-bearing liabilities. Changes in those policies are beyond our control and difficult to predict and can have a material effect on the results of operations of our Financial Services segment.

13

The mortgage financing industry is highly competitive.

Our Financial Services business operates in a highly competitive industry that could become even more competitive as a result of economic, legislative, regulatory and technological changes. Competition for mortgage loans comes primarily from mortgage banking subsidiaries of large commercial banks, mortgage companies, and savings and other financial institutions. We face competition in such areas as mortgage product offerings, rates and fees, and customer service. Competition has been significantly affected by recent disruptions in the mortgage market, which have significantly reduced the pool of qualified homebuyers. In addition, technological advances such as developments in e-commerce activities have increased consumers accessibility to products and services generally. This has intensified competition among banking as well as nonbanking companies in offering mortgage loans and similar financial products and services.

Changes in lending laws could hurt our Financial Services operations.

Our Financial Services operations are subject to extensive and complex laws and regulations that affect loan origination. These include eligibility requirements for participation in federal loan programs and compliance with consumer lending and similar requirements such as disclosure requirements, prohibitions against discrimination and real estate settlement procedures. They may also subject our operations to examination by applicable agencies. These may limit our ability to provide mortgage financing or title services to potential purchasers of our homes.

FACTORS AFFECTING MULTIPLE BUSINESS SEGMENTS

Market conditions in the mortgage lending and mortgage finance industries have worsened significantly in fiscal year 2008, which adversely affected the availability of credit for some purchasers of our homes, reduced the population of potential mortgage customers and reduced mortgage liquidity. Further tightening of mortgage lending or mortgage financing requirements or further reduced mortgage liquidity could have a material adverse effect on our homebuilding and mortgage lending operations and their respective results of operations.

In fiscal year 2008, the mortgage lending industry experienced significant disruptions due to, among other things, defaults on a variety of nonconforming loan products and a resulting decline in the market value of such loans. In light of these developments, lenders, investors, regulators and other third parties questioned the adequacy of loan documentation and credit requirements for certain types of loan programs made available to borrowers in recent years. This led to reduced investor demand for mortgage loans and mortgage-backed securities, tightened credit underwriting requirements, reduced liquidity and increased credit risk premiums. Among other things, deterioration in credit quality among nonconforming loan borrowers has caused almost all lenders to eliminate most loan products that are not conforming loans, FHA/VA-eligible loans or jumbo loans meeting conforming underwriting guidelines except as to the size of the loan. In general, fewer loan products and tighter loan qualifications make it more difficult for some categories of borrowers to finance the purchase of our homes or obtain mortgage loans from us to finance the purchase of homes sold by others. These developments have resulted in a reduction in demand for the homes that we sell and in the demand for the mortgage loans that we originate. These developments have had and are expected to continue to have a material adverse effect on our business and results of operations.

The adverse market conditions in the mortgage lending industry described above have affected our business in a number of respects. For example, CTX Mortgage Company, LLC has essentially ceased originating sub-prime or other nonconforming loans. Furthermore, due to the reduction in available mortgage loan liquidity, CTX Mortgage Company, LLC decided in the second quarter of fiscal year 2008 to discontinue the origination of new construction loans. In addition, in the second and third quarters of fiscal year 2008, CTX Mortgage Company, LLC ceased selling loans to HSF-I, which had been the principal financing vehicle for its operations, and terminated this financing vehicle.

Further tightening of the mortgage lending markets in the form of reduced numbers or types of loan products, or tighter loan qualification requirements (including credit score and down payment requirements), could further reduce the demand for our homes or the mortgages we originate, which could have a material adverse effect on our business or results of operations. In addition, further disruptions or other adverse conditions in the mortgage finance markets leading to further reduced mortgage liquidity or decreased demand for mortgage loans could result in an inability to sell or finance the loans we originate, or less favorable terms of sale or reduced yield or greater reserves pending sale, which could have a material adverse effect on our business or results of operations.

14

We could be adversely affected by a change in our credit rating or a disruption in the capital markets.

Our ability to sustain or grow our business and to operate in a profitable manner depends to a significant extent upon our ability to access capital. We use capital principally to finance operations, purchase and develop land, construct houses and originate mortgage loans. Until recently, our access to capital was enhanced by the fact that our senior debt securities had an investment-grade credit rating from each of the principal credit rating agencies, and we were able to issue commercial paper. During the quarter ended December 31, 2007, Moody s Investors Service, which we refer to as Moody s, and Standard & Poors, which we refer to as S&P, lowered their ratings of our senior debt, and changed our commercial paper rating to non-prime. On May 7, 2008, S&P further lowered its ratings of our senior debt. See Financial Condition and Liquidity in Item 7 of this Report for additional information about our credit rating. As a result of our current rating, we do not have access to many financing strategies that are available to companies with investment grade ratings. As a consequence, it may become more difficult and costly for us to access the capital that is required in order to implement our business plans and operate our business. We may experience a further downgrade in our credit rating by the rating agencies that would likely result in increased costs for certain of our financing and also further restrict our ability to finance mortgage loan originations.

As a result of the more recent adverse market conditions affecting mortgage loans, which worsened significantly in August 2007, CTX Mortgage Company, LLC no longer relies on asset-backed funding vehicles, such as HSF-I, for its mortgage funding needs. Instead, CTX Mortgage Company, LLC uses committed bank warehouse credit facilities.

On May 7, 2008, S&P lowered our debt rating from BB+ to BB. This downgrade triggered a provision in CTX Mortgage Company, LLC s $450 million committed bank warehouse credit facility which allows the bank to convert the facility to an amortizing loan based on the ultimate sale of the underlying collateral and not to purchase any additional mortgage loans. On May 9, 2008, CTX Mortgage Company, LLC executed an amendment to the bank warehouse credit facility which lowered the commitment to $375 million, reset the debt ratings trigger that provides the bank the option to convert the facility to an amortizing loan if our credit rating falls below BB by S&P and Fitch or below Ba2 by Moody s. A further downgrade in our credit rating by a rating agency could result in the wind-down of the $375 million warehouse credit facility. For more information about our current mortgage financing, see the Financial Condition and Liquidity section of Item 7 of this Report.

A long-term or further disruption in the mortgage finance or capital markets could make it more difficult or more expensive for us to raise capital for use in our business, for our customers to obtain home loans or for us to sell loans originated by our Financial Services operations. Further, a reduction of the positive spread between the rate at which we can borrow and the rate at which we can lend could hurt our ability to profit from our loan origination business.

Our income tax provision and other tax reserves may be insufficient if any taxing authorities are successful in asserting tax positions that are contrary to our position.

Significant judgment is required to determine our provision for income taxes and for our reserves for federal, state, local and other taxes. In the ordinary course of our business, there may be matters for which the ultimate tax outcome is uncertain. Although we believe our approach to determining the tax treatment is appropriate, no assurance can be given that the final tax authority review will not be materially different than that which is reflected in our income tax provision and other tax reserves. Such differences could have a material adverse effect on our income tax provision or benefits, or other tax reserves, in the period in which such determination is made and, consequently, on our results of operations for such period.

From time to time, we are audited by various federal, state and local authorities regarding tax matters. We fully cooperate with all audits. Our audits are in various stages of completion; however, no outcome for a particular audit can be determined with certainty prior to the conclusion of the audit, appeal and, in some cases, litigation process. As each audit is concluded, we record appropriate adjustments, if any, in our financial statements in the period determined. We maintain reserves to provide for potential tax exposures relating to uncertain tax positions, based on reasonable estimates of our potential exposure (including interest and penalties, when applicable) that may result from audits. However, if the reserves are insufficient upon completion of any audit process, there could be an adverse impact on our financial position and results of operations.

New federal laws that adversely affect liquidity in the secondary mortgage market could hurt our business.

The Government-sponsored enterprises, principally FNMA and FHLMC, play a significant role in buying home mortgages and creating investment securities that they either sell to investors or hold in their portfolios. These organizations provide liquidity to the secondary mortgage market. Any new federal laws that restrict or curtail their activities could affect the ability of our customers to obtain mortgage loans or increase mortgage interest rates, which could reduce demand for our homes and/or the loans that we originate and adversely affect our results of operations.

Reductions in tax benefits could make home ownership more expensive or less attractive.

Significant expenses of owning a home, including mortgage interest expense and real estate taxes, generally are deductible expenses for an individual s federal, and in some cases state, income taxes, subject to various limitations under current tax law and policy. If the federal government or a state government changes income tax laws to eliminate or substantially modify these income tax deductions, the after-tax costs of owning a new home would increase for the typical homeowner. If such tax law changes were enacted without other offsetting provisions or effects, they could adversely impact the demand for, and/or sales prices of, new homes, mortgage loans and home equity loans, and our operations might be negatively affected.

Failure to comply with the covenants and conditions imposed by our credit facilities could restrict future borrowing or cause our debt to become immediately due and payable.

We are required to maintain compliance with certain financial covenants in our multi-bank revolving credit facility. Material covenants include a maximum leverage ratio, a minimum tangible net worth requirement and a borrowing base limiting the amount of available borrowings. There can be no assurance that we will continue to comply with the covenants in our multi-bank revolving credit facility, and depending on our future results of operations, we may need to seek waivers or amendments from our lenders in future periods. Furthermore, there can be no assurance that our lenders will agree to such waivers or amendments on terms we regard as satisfactory.

In addition, our committed bank warehouse credit facilities and loan agreements relating to certain of our joint ventures contain various affirmative and negative covenants and guarantees requested by lenders for facilities of these types. In order to continue to borrow funds under these facilities, we will need to continue to be in compliance with these covenants and guarantees.

In general, with respect to our multi-bank revolving credit facility, bank warehouse credit facilities and loan agreements relating to certain of our joint ventures, if we fail to comply with any of the covenants or guarantees contained therein, which may occur if we experience additional asset impairments or incur additional net losses, we may be unable to obtain future financing for working capital, capital expenditures, letters of credit, acquisitions, debt service requirements or other requirements, or the credit providers could cause our debt to become immediately due and payable, or we may be required to make certain payments in connection with our joint venture indebtedness.

We may be subject to claims and liabilities in connection with sales of assets or discontinued businesses.

Over the past several fiscal years, we have completed the sale of our international homebuilding operations, Home Equity and Construction Services in separate transactions to unrelated third parties. In addition, in March 2008, we sold a portfolio of 27 developed, partially developed and undeveloped properties to a joint venture and sold a portfolio of five resort/second home properties to a third party. Finally, in April 2008, we completed the sale of our home services operations. In connection with each of these transactions, we made representations and warranties to the purchasers of the applicable businesses or assets, agreed to retain responsibility for certain actual or contingent liabilities and agreed to indemnify the purchasers against breaches of representations and warranties and other liabilities. In addition, certain of the businesses we sold had bonds or letters of credit outstanding at the date of sale, which were assumed by the purchasers, but for which we retain responsibility under indemnities or other direct contractual relationships with the sureties issuing the bonds or letters of credit. To date, we have not incurred any material losses in respect of claims asserted by the purchasers in connection with these transactions or claims asserted by sureties in respect of outstanding bonds or letters of credit. In addition, our liability to the purchasers is subject to certain limitations, including limitations on the time period during which claims may be asserted and the amounts for which we are liable. However, there can be no assurance that we will not incur future liabilities to the purchasers in connection with these transactions or the sureties issuing any bonds or letters of credit or that the amount of such liabilities will not be material.

16

We may not realize our net deferred tax assets.

As of March 31, 2008, we had gross deferred tax assets of $1.02 billion for which an $830 million valuation allowance was established in fiscal year 2008. The ultimate realization of the deferred tax assets is dependent upon a variety of factors, including taxable income in prior carryback years, estimates of future taxable income, tax planning strategies and reversals of existing taxable temporary differences. The Financial Accounting Standards Board (FASB) provides in Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes, (SFAS 109 that a cumulative loss in recent years is significant negative evidence in considering whether deferred tax assets are realizable. Based on our assessment, including the implementation of certain tax planning strategies, the realization of approximately $830 million of our deferred tax assets is dependent upon future taxable income and, accordingly, we have established a valuation allowance equal to such amount.

The valuation allowance may be increased or decreased as conditions change or if we are unable to implement certain tax planning strategies. An increase in the valuation allowance would reduce the carrying value of the deferred tax assets and increase the provision for income taxes in the reporting period, which would reduce net income for the period and could have a material adverse effect on our financial position and results of operations.

FORWARD-LOOKING STATEMENTS

This report includes various forward-looking statements, which are not facts or guarantees of future performance and which are subject to significant risks and uncertainties.

Certain information included in this Report or in other materials we have filed or will file with the SEC, as well as information included in oral statements or other written statements made or to be made by us, contains or may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Exchange Act and the Private Securities Litigation Reform Act of 1995, as amended. You can identify these statements by the fact that they do not relate to matters of a strictly factual or historical nature and generally discuss or relate to forecasts, estimates or other expectations regarding future events. Generally, the words believe, expect, intend, estimate, anticipate, project, may, can, could, might, will and similar expressions identif statements, including statements related to expected operating and performing results, planned transactions, planned objectives of management, future developments or conditions in the industries in which we participate and other trends, developments and uncertainties that may affect our business in the future. Such statements include information related to anticipated operating results, financial resources, changes in interest rates and other developments and conditions in financing markets, changes in revenues, changes in profitability, interest expense, growth and expansion, our investment in unconsolidated entities, the ability to acquire land, the ability to gain approvals and to open new neighborhoods, the ability to sell homes and properties, the ability to deliver homes from backlog, the ability to secure materials and contractors, the ability to produce the liquidity and capital necessary for our business, the completion of and effects from planned transactions and stock market valuations. From time to time, forward-looking statements also are included in our other periodic reports on Forms 10-K, 10-Q and 8-K, press releases and presentations, on our web site and in other material released to the public.

Forward-looking statements are not historical facts or guarantees of future performance but instead represent only our beliefs at the time the statements were made regarding future events, which are subject to significant risks, uncertainties, and other factors, many of which are outside of our control and certain of which are listed above. Any or all of the forward-looking statements included in this Report and in any other reports or public statements made by us may turn out to be materially inaccurate. This can occur as a result of incorrect assumptions or as a consequence of known or unknown risks and uncertainties. Many of the risks and uncertainties mentioned in this Report or another report or public statement made by us, such as those discussed in the risk factors contained in this Item 1A, will be important in determining whether these forward-looking statements prove to be accurate. Consequently, neither our stockholders nor any other person should place undue reliance on our forward-looking statements and should recognize that actual results may differ materially from those anticipated by us.

All forward-looking statements made in this Report are made as of the date hereof, and the risk that actual results will differ materially from expectations expressed in this Report will increase with the passage of time. We undertake no obligation, and disclaim any duty, to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changes in our expectations or otherwise. However, we may make further

disclosures regarding future events, trends and uncertainties in our subsequent reports on Forms 10-K, 10-Q and 8-K to the extent required under the Exchange Act. The above cautionary discussion of risks, uncertainties and possible inaccurate assumptions relevant to our business include factors we believe could cause our actual results to differ materially from expected and historical results. Other factors beyond those listed above, including factors unknown to us and factors known to us which we have not determined to be material, could also adversely affect us.

This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995 and all of our forward-looking statements are expressly qualified in their entirety by the cautionary statements contained or referenced in this section.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

In addition to land held as inventory in connection with our residential construction activities, we own the following properties:

Home Building owns property in Phoenix, Arizona; Albemarle, North Carolina; Plant City, Florida and Prosper, Texas. These properties consist of office and warehouse space used to support our business.

In addition to land we own and use in our operations, we lease office space under operating leases in the markets in which we operate throughout the United States. We believe that our existing facilities are suitable and adequate for our current and planned levels of operation. For additional information on our operating leases, see Note (G), Commitments and Contingencies, of the Notes to Consolidated Financial Statements.

See Item 1. Business for additional information relating to our properties including land owned or controlled by our Home Building segment.

ITEM 3. LEGAL PROCEEDINGS

In the normal course of our business, we and/or our subsidiaries are named as defendants in certain suits filed in various state and federal courts. We believe that none of the litigation matters in which we, or any of our subsidiaries, are involved, including those described below, are likely to have a material adverse effect on our consolidated financial condition or operations.

In January 2003, we received a request for information from the United States Environmental Protection Agency, which we refer to as the EPA, pursuant to Section 308 of the Clean Water Act seeking information about compliance with permits regulating storm water discharges at projects that we had completed or were building. Subsequently, the EPA limited its request to Home Building s operations at 30 neighborhoods. Home Building has provided the requested information and the United States Department of Justice, which we refer to as the Justice Department, acting on behalf of the EPA, has asserted that some of these and certain other neighborhoods have violated regulatory requirements applicable to storm water discharges, and that injunctive relief and civil penalties may be warranted. Home Building has been exploring methods of settling this matter. In May 2008, Home Building agreed to sign a consent decree with the EPA and various states with respect to our prior and future storm water pollution prevention practices at all of Home Building s sites. When the consent decree is signed by all parties, the Justice Department will file suit in Federal Court in accordance with the accepted practice in matters of this nature and simultaneously submit the proposed consent decree for approval by the Court. A notice of lodging of the proposed consent decree will then be published in the Federal Register, which triggers the opening of a public comment period. The public comment period is typically 30 days. The Justice Department will review and respond to any comments it receives and will then ask the Court to sign and enter the proposed consent decree. The Court may require a hearing before it rules. Once the Court is satisfied, it will sign and enter the consent decree. We anticipate that the consent decree will become final during the second quarter of the fiscal year ending March 31, 2009. Under the proposed consent decree, Home Building will pay a civil penalty of $1,485,000, and will agree to certain management practices related to controlling storm water discharges at all of Home Building s sites.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT

The following is an alphabetical listing of our executive officers as of May 11, 2008, as such term is defined under the rules and regulations of the SEC. Officers are generally elected by the Board of Directors at its meeting immediately following our annual stockholders meeting, with each officer serving at the pleasure of the Board of Directors until a successor has been elected and qualified. There is no family relationship among any of these officers.

Name	Age	Positions with the Company or Business Experience
David L. Barclay	55	President, Western Region, of Centex Real Estate Corporation (since April 2007); Co-President and Co-Chief Operating Officer (West Operating Region) of Centex Real Estate Corporation from March 2006 to April 2007; Executive Vice President West Coast Region of Centex Real Estate Corporation from May 2002 to March 2006; President Northern California Division of Centex Real Estate Corporation from June 1996 to May 2002
Joseph A. Bosch	50	Senior Vice President Human Resources since July 2006; Senior Vice President Human Resources at Tenet Healthcare Corporation from August 2004 to June 2006; Chief People Officer at Pizza Hut, a unit of YUM! Brands, Inc. from June 1997 to July 2004
Timothy R. Eller	59	Chairman of the Board, Chief Executive Officer, President and Chief Operating Officer of Centex Corporation (Chairman of the Board and Chief Executive Officer since April 2004; President and Chief Operating Officer since April 2002); Executive Vice President of Centex Corporation from August 1998 to April 2002; Chairman of the Board of Centex Real Estate Corporation from April 1998 to April 2003, and since April 2006; Chief Executive Officer of Centex Real Estate Corporation from July 1991 to April 2002, and since April 2006; President and Chief Operating Officer of Centex Real Estate Corporation from January 1990 to May 1996
Mark D. Kemp	46	Senior Vice President and Controller of Centex Corporation since September 2004; interim Chief Financial Officer from June 2006 to October 2006; Vice President and Controller of Centex Corporation from December 2002 to September 2004; Partner and employee at Arthur Andersen LLP from December 1983 to August 2002
Catherine R. Smith	44	Executive Vice President and Chief Financial Officer of Centex Corporation since October 2006; Executive Vice President and Chief Financial Officer of Kennametal, Inc. from April 2005 to October 2006; Executive Vice President and Chief Financial Officer of Bell Systems, a business segment of Textron, Inc., from October 2003 to April 2005; various financial positions including Vice President and Chief Financial Officer of the Intelligence and Information Systems business segment of Raytheon Company from August 1986 to September 2003
Robert S. Stewart	54	

		Senior Vice President Strategy, Sales, Marketing and Corporate Development of Centex Corporation since July 2007; Senior Vice President Strategy and Corporate Development from April 2005 to June 2007; Senior Vice President Strategic Planning and Marketing from May 2000 to March 2005; Employee at the Weyerhaeuser Company from March 1977 to May 2000, during which time he held a range of key management positions, including positions in strategic planning
Brian J. Woram	47	Senior Vice President, Chief Legal Officer, General Counsel and Assistant Secretary of Centex Corporation (Secretary from December 2004 to March 2005); Senior Vice President, General Counsel and Assistant Secretary of Centex Real Estate Corporation from September 1998 to December 2004

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Stock Prices and Dividends

	Year Ended March 31, 2008			*Year Ended March 31, 2007*		
	Price			Price		
	High	**Low**	**Dividends**	High	Low	Dividends
Quarter						
First	**$ 49.85**	**$ 39.59**	**$ .04**	$ 64.62	$ 44.13	$ .04
Second	**$ 44.23**	**$ 24.55**	**$ .04**	$ 55.70	$ 42.90	$ .04
Third	**$ 30.75**	**$ 17.77**	**$ .04**	$ 58.42	$ 48.34	$ .04
Fourth	**$ 30.29**	**$ 18.17**	**$ .04**	$ 56.45	$ 40.41	$ .04

The principal market for our common stock is the New York Stock Exchange (ticker symbol CTX). The approximate number of record holders of our common stock at May 9, 2008 was 2,917.

The remaining information called for by this item relating to securities authorized for issuance under equity compensation plans is reported in Note (K), Capital Stock and Employee Benefit Plans, of the Notes to Consolidated Financial Statements.

Share Repurchases

From time to time, we have repurchased shares of our common stock pursuant to publicly announced share repurchase programs. The following table details our common stock repurchases for the three months ended March 31, 2008:

	Issuer Purchases of Equity Securities			
	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares that May Yet Be Purchased Under the Plan
Period				
January 1-31		$		9,399,700
February 1-29		$		9,399,700
March 1-31	8,338	$ 24.21		9,399,700
Total [(1)]	8,338	$ 24.21		

(1) The 8,338 shares repurchased for the quarter ended March 31, 2008 represent the

delivery to us by employees or directors of previously issued shares to satisfy the exercise price of options and/or withholding taxes that arise on the exercise of options or the vesting of restricted stock. These transactions are authorized under the terms of the equity plans under which the options or other equity were awarded; however, these transactions are not considered repurchases pursuant to our share repurchase program.

On May 11, 2006, our Board of Directors authorized the repurchase of 12 million shares of our common stock. After giving effect to repurchases after that date, the current approved repurchase authorization is 9,399,700 shares. Purchases are made in the open market or in block purchases, and such transactions may be effected from time to time or pursuant to share repurchase plans under SEC Rule 10b5-1. The share repurchase authorization has no stated expiration date.

Performance Graph

The following graph compares the yearly change in the cumulative total stockholder return on our common stock during the five fiscal years ended March 31, 2008 with the S&P 500 Index and the S&P Home Building Index.

The comparison assumes $100 was invested on March 31, 2003 in our common stock and in each of the foregoing indices, and assumes reinvestment of dividends in the form of cash or property. This graph is not intended to forecast the future performance of our common stock and may not be indicative of such future performance.

On January 30, 2004, we spun-off shares of common stock and Class B common stock of Eagle Materials Inc. f/k/a Centex Construction Products, Inc., which we refer to as Construction Products, to its stockholders. For each share of Centex common stock owned, stockholders received 0.044322 shares of Construction Products common stock and 0.149019 shares of Construction Products Class B common stock. On June 30, 2003, we spun-off our stock in Cavco Industries, Inc. to our stockholders. For each share of Centex common stock owned, stockholders received 0.05 shares of Cavco. On the respective distribution dates, this number of shares had a public market value of $4.32, $8.13 and $0.97, respectively. For purposes of the following graph, it is assumed that each share of Construction Products and Cavco received in the distribution was immediately sold for its market value and the proceeds reinvested in additional shares of Centex common stock. The value of Centex common stock at March 31, 2008 therefore includes the value of the spin-off shares but not the separate performance of those securities since the respective dates of the spin-offs.

Comparative Five Year Cumulative Total Stockholder Return

Centex Corporation

	2003	2004	2005	2006	2007	2008
Centex Corporation	$ 100	$ 212	$ 225	$ 245	$ 165	$ 96
S&P 500 Index	$ 100	$ 135	$ 144	$ 161	$ 180	$ 171
S&P HB Index	$ 100	$ 213	$ 267	$ 294	$ 202	$ 118

ITEM 6. SELECTED FINANCIAL DATA
Summary of Selected Financial Data (Unaudited) [(1)]
(Dollars in thousands, except per share data)

	For the Years Ended March 31,				
	2008	2007	2006	2005	2004
Revenues	**$ 8,275,562**	$ 11,887,601	$ 12,742,666	$ 9,842,700	$ 8,078,056
Earnings (Loss) from Continuing Operations [(2)]	**$ (2,660,968)**	$ (9,477)	$ 1,212,665	$ 898,571	$ 695,742
Net Earnings (Loss)	**$ (2,657,482)**	$ 268,366	$ 1,289,313	$ 1,011,364	$ 827,686
Stockholders Equity	**$ 2,298,661**	$ 5,112,269	$ 5,011,658	$ 4,280,757	$ 3,050,225
Net Earnings (Loss) as a Percentage of Average Stockholders Equity	**(71.7%)**	5.3%	27.8%	27.6%	29.0%
Total Assets	**$ 8,137,332**	$ 13,199,933	$ 21,364,999	$ 20,011,163	$ 16,077,260
Deferred Income Tax Assets, net	**$ 191,246**	$ 500,703	$ 248,004	$ 202,441	$ 121,445
Total Long-term Debt, Consolidated	**$ 3,321,117**	$ 3,960,310	$ 3,910,816	$ 3,155,640	$ 2,452,358
Debt (with Financial Services reflected on the equity method) [(3)]	**$ 3,325,167**	$ 3,902,117	$ 3,977,982	$ 3,103,510	$ 2,313,358
Financial Services Debt	**337,053**	1,663,040	2,077,215	1,695,855	1,676,718
Total Debt, Consolidated	**$ 3,662,220**	$ 5,565,157	$ 6,055,197	$ 4,799,365	$ 3,990,076
Capitalization (with Financial Services reflected on the equity method and excluding lot option minority interest) [(3)] [(4)]	**$ 5,625,794**	$ 9,037,452	$ 9,027,304	$ 7,424,651	$ 5,364,864
Financial Services Capitalization [(4)]	**586,688**	1,825,467	2,742,764	2,314,465	2,194,533
Lot Option Minority Interest [(4)]	**75,344**	152,936	492,096	415,413	332,668
Consolidating Eliminations	**(249,184)**	(161,492)	(664,376)	(617,248)	(516,280)
Total Capitalization, Consolidated	**$ 6,038,642**	$ 10,854,363	$ 11,597,788	$ 9,537,281	$ 7,375,785
Debt as a Percentage of Capitalization [(4)]					

With Financial Services reflected on the equity method and excluding lot option minority interest *(3)*		**59.1%**		43.2%		44.1%		41.8%		43.1%
Consolidated		**60.7%**		51.3%		52.2%		50.3%		54.1%
Per Common Share										
Earnings (Loss) from Continuing Operations Per Share Basic *(2)*	**$**	**(21.71)**	$	(0.08)	$	9.56	$	7.18	$	5.64
Earnings (Loss) from Continuing Operations Per Share Diluted *(2)*	**$**	**(21.71)**	$	(0.08)	$	9.13	$	6.79	$	5.38
Net Earnings (Loss) Per Share Basic	**$**	**(21.68)**	$	2.23	$	10.16	$	8.08	$	6.71
Net Earnings (Loss) Per Share Diluted	**$**	**(21.68)**	$	2.23	$	9.71	$	7.64	$	6.40
Cash Dividends	**$**	**0.16**	$	0.16	$	0.16	$	0.16	$	0.10
Book Value Per Share Based on Shares Outstanding at Year End	**$**	**18.65**	$	42.61	$	41.04	$	33.51	$	24.87
Average Shares Outstanding										
Basic		**122,577,071**		120,537,235		126,870,887		125,226,596		123,382,068
Diluted		**122,577,071**		120,537,235		132,749,797		132,397,961		129,392,821
Stock Prices										
High	**$**	**49.85**	$	64.62	$	79.66	$	66.14	$	58.40
Low	**$**	**17.77**	$	40.41	$	55.10	$	39.94	$	26.78

(1) The selected financial data presented in this table, excluding stock prices for the periods covered by the financial statements included in this Report and all prior periods, have been derived from our audited financial statements and adjusted to reflect home services operations (sold in April 2008),

Construction Services (sold in March 2007), Home Equity (sold in July 2006), International Homebuilding (sold in September 2005), Construction Products (spun off in January 2004) and Manufactured Homes (spun off in June 2003) as discontinued operations.

(2) Earnings (Loss) from Continuing Operations are Before Cumulative Effect of a Change in Accounting Principle adopted in fiscal year 2004 associated with the initial consolidation of HSF-I pursuant to the provisions of FIN 46.

(3) Represents a supplemental presentation that reflects the Financial Services segment as if accounted for under the equity method. We believe that separate disclosure of the consolidating information is useful because the

Financial Services subsidiaries and related companies operate in a distinctly different financial environment, and we have limited obligations with respect to the indebtedness of our Financial Services subsidiaries and related companies. Management uses this information in its financial and strategic planning. We also use this presentation to allow investors to compare us to homebuilders that do not have financial services operations.

(4) Capitalization is composed of Debt, Minority Interest and Stockholders Equity. In the calculation of Capitalization, minority interest in fiscal years 2008, 2007, 2006, 2005 and 2004 excludes $75.3 million, $152.9 million, $492.1 million, $415.4 million and $332.7 million, respectively, of

minority interests recorded in connection with the consolidation of certain entities with which Home Building has lot option agreements. This supplemental presentation is used by management in its financial and strategic planning and allows investors to compare us to other homebuilders, which may not have similar arrangements.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is intended to help the reader gain a better understanding of our financial condition and our results of operations. It is provided as a supplement to, and should be read in conjunction with, our financial statements and accompanying notes included in this Report.

Executive Summary

Fiscal year 2008 was a very challenging year. Our results of operations for the year ended March 31, 2008 were materially affected by continuing adverse conditions impacting our homebuilding and mortgage lending operations. The market conditions continued to deteriorate significantly during the year ended March 31, 2008, and we are unable to predict whether they will deteriorate further, improve or what effects any future changes in market conditions would have on our business or results of operations. A summary of our results of operations by line of business is as follows (dollars in thousands):

	For the Year Ended March 31,		
	2008	2007	2006
Revenues			
Home Building	**$ 7,965,614**	$ 11,414,827	$ 12,272,203
Financial Services	**309,948**	468,001	462,223
Other		4,773	8,240

310,487

$
3.11

5.91

Granted

35,000

$
1.47

9.33

Exercised

—

—

—

Forfeited/expired

(12,437
)

$
4.52

1.86

Outstanding at September 30, 2013

333,050

$
2.88

5.91

Exercisable at September 30, 2013

236,883

$
3.33

4.79

9

Table of Contents

Note 4. Income Taxes
The Company recognizes a deferred tax asset available from its temporary differences between net income before taxes as reported on its consolidated financial statements and net income for tax purposes, increased by net operating loss carryforwards, which begin to expire in 2023. The Company has recorded a deferred tax asset of $2,138,000 at September 30, 2013 which is partially offset by a valuation reserve in the amount of $1,538,000. For the nine-months ended September 30, 2013, the Company recorded a current income tax benefit of $190,000, principally attributable to its net loss for the current period, offset by state and local taxes of approximately $12,000, resulting in a net benefit of approximately $178,000. The current income tax benefit is expected to be utilized against taxable income generated in the fourth quarter of 2013. The Company does not have any uncertain income tax positions that would require disclosure under the Accounting Standards Codification.

Note 5. Stockholders' Equity
During the first quarter of 2013, the Company purchased 73,473 shares of its Common Stock for approximately $116,000. As of September 30, 2013, it has available approximately $633,000 available under its stock buy-back program for the purchase of additional shares of its Common Stock. The buy-back program was originally scheduled to expire in November 2013, however, in November 2013 the expiration date was extended to November 2014 (See Note 6 below).
Note 6. Subsequent Events

On November 7, 2013 the Company's board of directors declared a dividend of $.015 per common share payable on January 6, 2014 to shareholders of record as of December 19, 2013. In addition, the Company's Board voted to extend its stock buy-back program until it's November 2014 meeting, and increased the funds available to purchase shares of Common Stock on the NASDAQ Capital Market to $750,000. The Company has been actively pursuing the repurchase of its common stock. However, with the reduction in the number of outstanding shares and the various regulations governing such purchases, the Company has had difficulty in repurchasing its shares.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
The following discussion of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this report. Some of the statements in this discussion and elsewhere in this report constitute forward-looking statements within the meaning of Section 21E of the Securities and Exchange Act of 1934. See "Forward-Looking Statements" following the Table of Contents of this report. Because this discussion involves risk and uncertainties, our actual results may differ materially from those anticipated in these forward-looking statements.
The terms "we," "our," "us," or any derivative thereof, as used in this report refer to SmartPros Ltd., a Delaware corporation, its subsidiaries and its predecessors.

Overview
We provide learning solutions for accounting/finance, legal, insurance, securities and engineering professionals – five large vertical markets with mandatory continuing education requirements – as well as for tax compliance, banking and information technology professionals. We provide corporate governance, ethics and compliance training for the general corporate market. We also have content consisting of web-based training in the human resources and health and safety areas. We offer off-the-shelf courses and custom-designed programs with delivery methods suited to the specific needs of our clients. Through Loscalzo Associates Ltd. ("Loscalzo"), one of our wholly-owned subsidiaries, and our Executive Enterprise Institute ("EEI") product line within our Accounting division, we are a leading provider of live training to accountants, tax and financial professionals. These courses are delivered through various state CPA societies, accounting firms, corporations or through seminars, Webinars and conferences that they conduct. Our customers include professional firms of all sizes, and a large number of businesses. We also offer comprehensive support services for training, ranging from course design and implementation, accreditation services to technology solutions.

We measure our operations using both financial and other metrics. The financial metrics include revenues, gross margins, operating expenses and income from continuing operations. Other key metrics include (i) revenues by sales source, (ii) online sales, (iii) cash flows and (iv) EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization).
Some of the most significant issues affecting our business are the following:

Table of Contents

- the increasing recognition by professionals and their employers of the importance of continuing professional education in order to maintain their licenses, remain current on new developments and best practices, develop and improve their skills and to generally remain competitive;
- continuing professional education requirements by governing bodies, including states and professional associations;
- the issuance of new laws, case law and regulations affecting the conduct of business and the relationship between employers and their employees;
- the lack of the issuance of new financial accounting standards and the retreat from attempting to achieve greater compatibility with International Financial Reporting Standards;
- the increased competition in today's economy for skilled employees and the recognition that effective training can be used to recruit, train and redeploy employees;
- the development and acceptance of the Internet as a delivery channel for the types of products and services we offer;
- the securities industry's growing emphasis on applying technology based tools to address the growing complexity of compliance regulations; and
- the need to continuously update the content in our course catalogs.

Over the last five years, our annual net revenues have ranged from $15.9 million to $18.3 million. We experienced an overall decline in revenues from 2009 through 2012. We attribute this decline to a number of factors, but primarily due to general economic conditions as well as the relative absence of changes in laws, regulations and accounting standards. Many companies have looked at their budgets, reduced their headcounts and considered other factors in evaluating their expenditures for continuing education for their employees. Although, we have made acquisitions of companies, assets and product lines that have enhanced our overall content and product offerings, the staggering effects of the economy and the other reasons previously cited have resulted in lowered attendance at our live seminars, pricing pressure on our subscription-based products and until recently reduced interest in custom work. We have countered these pressures by introducing new products and services, such as CPE administration, software designed for those industries having an internal branch audit function, re-mixing our product offerings and changing our selling strategies. We continue to believe that our growth will be through acquisitions, the development of new products and services and cross selling our existing libraries to the various markets we serve.

While we have seen an increase in some of our custom work, our subscription-based revenue in general has not fluctuated much from quarter to quarter or year to year. We have experienced a decline in revenue from live training programs and the sale of engineering courses which have adversely impacted our operating results. We believe that this trend is primarily due to current economic conditions, competition, consolidations in various industries and the relative absence of new accounting standards, laws and regulations. However, we believe that our subscription based products provide a cost-effective means for many companies to provide continuing education for their employees and we have seen an increase in net revenues from custom work during the current period. We are constantly seeking both new markets and new ways to market our products. As we expand our product offerings and the content of our various libraries, we are able to offer more products to the same customer through cross-selling. We also recognize that we will most likely need to invest more money in our sales infrastructure and outbound marketing budgets to drive net revenue.

Business acquisitions or strategic asset purchases are our preferred strategy to increase the breadth and depth of our current product offerings. Unless there are other compelling reasons, we will only consider acquisitions that we believe will be accretive within the first year of ownership. Ultimately, however, our goal is to maximize shareholder value rather than short-term profits. The size of the acquisitions will be determined, in part, by the amount of capital available to us and the liquidity and price of our stock. We may use debt to enhance or augment our ability to consummate larger transactions. We cannot assure that we will be able to identify appropriate acquisition opportunities or negotiate reasonable terms or that any acquired business or assets will deliver the shareholder value that we anticipated at the outset.

With the launch of our SmartPros eCampus (eCampus) Learning Management System (LMS), a robust platform and toolset for managing and deploying corporate training and accredited continuing education programs in multiple formats, we anticipate that this product will help drive opportunities with both existing and new clients. It can also be licensed as a stand-alone-offering to companies of all sizes who are looking for a cost-effective cloud based LMS. In addition, we are developing technology so that our content may be used on iPads, tablets and other similar devices.

Table of Contents

As we seek new business growth strategies and try to mitigate the market's perception that training is a commoditized product, we recognize that many of the clients we service also require solutions for their compliance and other needs. We are finding that our experience in critical compliance areas combined with our technological expertise and resources can combine to provide excellent solutions for clients seeking a one-stop source for their various training and compliance needs. An example of this is our Audit Management System ("AMS"), designed for companies that perform internal audits of their branch offices that we developed in conjunction with a leading securities industry broker-dealer. As we introduce other new products along with AMS, we will have a suite of products addressing financial services regulatory training, branch audit compliance and advisor's disclosure compliance, that will attract the attention of much of the securities market.

There are many risks involved with acquisitions, some of which are discussed in Item 1 of Part 1 under the caption "Certain Risk Factors That May Affect Our Growth and Profitability" of our annual report on Form 10-K for the fiscal year ended December 31, 2012. These risks include seasonality of revenues, integrating the acquired business into our existing operations and corporate structure, retaining key employees and minimizing disruptions to our existing business.

Our common stock ("Common Stock") trades on the NASDAQ Capital Market under the symbol "SPRO."

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements that have been prepared according to accounting principles generally accepted in the United States. In preparing these financial statements, we are required to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. We evaluate these estimates on an ongoing basis. We base these estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. We consider the following accounting policies to be the most important to the portrayal of our financial condition.

Revenue recognition

A large portion of our revenue is in the form of subscription fees for our monthly accounting update programs or access to our library of accounting, financial services training and legal courses. Other sources of revenue include direct sales of programs or courses on a non-subscription basis or from various forms of live training, fees for Web site design, software development, video production, course design and development and ongoing maintenance fees from our client's use of eCampus or our Smartpros' Professional Education Center ("PEC"), our proprietary learning management systems. Subscriptions are billed on an annual basis, payable in advance and deferred at the time of billing. Sales made over the Internet are by credit card only. Renewals are usually sent out 60 days before the subscription period ends. Larger transactions are usually dealt with by contract, the financial terms of which depend on the services being provided. Contracts for development and production services typically provide for a significant upfront payment and a series of payments based on deliverables specifically identified in the contract.

Revenue from subscription services are recognized as earned, deferred at the time of billing or payment and amortized into revenue on a monthly basis over the term of the subscription. Engineering products are non-subscription based and revenue is recognized upon shipment of the product or, in the case of online sales, payment. Revenue from non-subscription services provided to customers, such as Web site design, video production, consulting services and custom projects is generally recognized on a proportional performance basis where sufficient information relating to project status and other supporting documentation is available. The contracts may have different billing arrangements resulting in either unbilled or deferred revenue. We obtain either a signed agreement or purchase order from our non-subscription customers outlining the terms and conditions of the sale or service to be provided. Otherwise, these services are recognized as revenue after completion and delivery to the customer. Revenue from the sale of other products and services are generally recognized upon shipment or, if later, when our obligations are complete and realization of receivable amounts is assured.

Revenue from live training is recognized when the seminar or conference is completed. These are usually one to three day events.

Impairment of long-lived assets

We review long-lived assets and certain intangible assets at least annually or when events or circumstances indicate that the carrying amounts may not be recovered. We recognize that the economy has not yet fully recovered and has impacted the operations of certain divisions of our company. Therefore, we periodically review certain intangible assets related to prior acquisitions. In 2012, we recognized an impairment to assets acquired from an acquisition and management continues to monitor the situation as it relates to our overall operations.

Table of Contents

Stock-based compensation
Compensation costs are recognized in the financial statements for stock options or grants awarded to employees and directors. Options and warrants granted to non-employees recorded as an expense at the date of grant based on the then estimated fair value of the stock-based instrument granted. Options and grants awarded to employees or directors are expensed over their respective vesting periods.
Segment accounting
All of our operations constitute a single segment, that of educational services. Revenues from non-educational services, such as video production are not a material part of our operating income.
Income taxes
We account for deferred tax assets available principally from the temporary differences related to our fixed and intangible assets and our net operating loss carryforwards in accordance with the Accounting Standards Codification. We make significant estimates and assumptions in calculating our current period income tax liability and deferred tax assets. The most significant of these are estimates regarding future period earnings. Our net deferred tax asset is estimated by management using a three-year taxable income projection. In the event that our projections change due to economic uncertainties, we may adjust the realizable amount of our deferred tax asset. Management continues to monitor these projections and assumptions on an ongoing basis.

Results of Operations
Our operating results for the nine and three month periods ended September 30, 2013 are affected by a number of factors including the seasonality of some of our products, primarily live training, offset by increases in net revenues from custom work thus resulting in fluctuations in our operating and our net income/loss. The first nine months of 2013 as compared to the first nine months of 2012, reflected a 6% increase in net revenues with an accompanying increase in cost of revenues. This resulted in a higher gross profit and reduced our operating loss to $471,000 in 2013, from $1.1 million in 2012. Our net loss for the nine month period ended September 30, 2013, as compared to the 2012 period reflected a decrease of approximately $582,000 or 68%. For the current year's quarter we had an operating income of $404 as compared to an operating loss of $309,000 in the same 2012 period. Our net revenues for the nine and three month periods increased by approximately $677,000 and $178,000, respectively, from the comparable 2012 periods. Our core businesses have remained fairly stable and we have seen an increase in some of our custom work. We continue to seek to acquire either content in new or complimentary markets; make our sales force more effective and reduce expenses where appropriate. As previously mentioned, in 2012, we acquired content in the human resources and health and safety areas, markets that we previously did not serve. We are also continuously looking for ways to upgrade our product offerings with either new content or upgrading our existing offerings with current technology.
Comparison of the results of operations for the three months ended September 30, 2013 and 2012
We recorded a $178,000, or 5% increase in net revenues for the three months ended September 30, 2013, compared to the same 2012 period. Our gross profit margin increased to 55.7% in the 2013 period as compared to 54.9% in the 2012 period, as a result of previous cuts in certain direct expenses and increased revenues from custom work in the current year's period. A substantial portion of the increase in net revenues came from our Skye Multimedia Ltd. ("Skye") subsidiary and our Financial Services division. Operating results for the 2013 period were impacted by overall increases in net revenues from some of our divisions, as we continue to seek ways to work in a still sluggish economy. General and administrative expenses were approximately $177,000 lower in the 2013 period as compared to the 2012 period, and depreciation and amortization expense increased approximately $33,000, as we started to amortize our internally developed software. Although we experienced an increase in net revenues from custom work in this quarter, we cannot be certain that it is indicative of future results. We do see growth potential in our content-based businesses in the various verticals that we service and in technology that we have designed for the financial services industry. Custom work is non-repetitive and subject to market conditions and can vary from quarter to quarter. Our live training divisions had relative flat revenues despite reduced attendance at various seminars and the lack of new accounting pronouncements, as they add new services and clients. The live training business primarily recognizes its revenues in the second through fourth quarters of the year.

Online revenues, which previously were primarily derived from the sales of accounting/finance products, continue to be an important factor to our net revenues. Many of our other products, including our Cognistar Legal library, our Financial Campus courses, our engineering courses, our technology training products and our human resources and health and safety coirses, are also delivered online and are also significant generators of net revenues. Approximately 46% of our current period net revenues were derived from online products.

Table of Contents

The following table compares our statement of operations data for the three months ended September 30, 2013 and 2012. The trends suggested by this table may not be indicative of future operating results, which will depend on various factors including the relative mix of products sold (accounting/finance, law, engineering, financial services, sales training – product, technology or compliance and ethics) and the method of sale (video or online) as well as the timing of custom project work, which can vary from quarter to quarter. In addition, our operating results in future periods may also be affected by acquisitions.

	Three months ended September 30,				
	2013		2012		
	Amount	Percentage	Amount	Percentage	Change
Net revenues	$3,756,349	100.0 %	$3,578,399	100.0 %	5.0 %
Cost of revenues	1,608,687	42.8 %	1,595,813	44.6 %	0.8 %
Gross profit	2,147,662	57.2 %	1,982,586	55.4 %	8.3 %
Selling, general and administrative	1,836,413	48.9 %	2,013,599	56.3 %	(8.8)%
Depreciation and amortization	310,845	8.3 %	277,498	7.8 %	12.0 %
Total operating expenses	2,147,258	57.2 %	2,291,097	56.4 %	(6.3)%
Operating income (loss)	404	— %	(308,511)	(8.6)%	(100.1)%
Other income, net	7,633	— %	6,375	— %	19.7 %
Net income (loss) before income tax	8,037	0.2 %	(302,136)	(8.4)%	(102.7)%
Benefit (provision) for income taxes	1,035	— %	(59,592)	(1.7)%	(101.7)%
Net income (loss)	$9,072	0.2 %	$(361,728)	(10.1)%	(102.5)%

Net revenues

The increase in net revenues reflected above was due to: (i) a $243,000 increase in net revenues from our Skye subsidiary; (ii) a $117,000 increase in net revenues from our Financial Services division; and (iii) a $4,000 increase in net revenues from our Accounting/Finance division. These increases were offset by (i) a $62,000 decrease in revenues from our Engineering division; (ii) a $104,000 decrease in net revenues from from our SLE subsidiary and (iii) a $20,000 decrease in net revenues from our other divisions. Under our long-standing policy, revenue is credited to the originating department regardless of the type of service that is performed. For example, our Skye subsidiary may provide a custom e-learning solution for a client of our SLE subsidiary. However, SLE is credited with the entire amount of the sale.

In both of the third quarters of 2013 and 2012, net revenues from the Accounting/Finance division were approximately $2.7 million, or 72% and 75% of net revenues, respectively. Net revenues from subscription-based products and direct sales of course material on a non-subscription basis were $1.9 million in both the 2013 and 2012 periods. Net revenues from other products in our Accounting/Finance division that are not subscription based and live-training decreased by approximately $15,000 in 2013 from the 2012 period, primarily from decreased attendance at live training events. Non-subscription-based revenues fluctuate from period to period and are not indicative of any trends. In the 2013 period, net revenues from online sales of accounting products increased by approximately $85,000 as compared to the 2012 period, primarily as a result of increased usage. Net revenues from our Loscalzo live training subsidiary decreased by $54,000 in the 2013 period compared to the 2012 period. Our EEI live training division's revenues were $18,000 in the 2013 period as compared to $63,000 in 2012 period. The decrease in net revenues is from decreased attendance at live training events offset by increased revenues from CPE administration.

For the three-months ended September 30, 2013, Skye generated net revenues of $372,000 compared to $129,000 in the third quarter of 2012. Skye's income is derived primarily from designing custom training projects and, as such, varies from quarter to quarter. In addition, Skye performs services for other divisions of our company, for which it does not receive any revenue recognition. Although we see an increase in request for proposals from clients, no assurance can be given that these requests will result in signed contracts or future revenues. Skye continues to see competitive pressure from both domestic and foreign sources, especially in pricing, Businesses are continuously evaluating these types of services and products and their cost effectiveness. Often contracts are signed but the work does not begin for a period of time thereafter. Skye continues to market its iReflect product developed in a joint

venture.

Our Financial Services division generated $503,000 of net revenues in the quarter ended September 30, 2013. For the quarter ended September 30, 2012, this division generated $386,000 of net revenues. The increase is primarily due to the recognition of income from new technology based products and increased services to clients. We recently released our AMS system which we believe will have a positive effect on this division's future revenues.

For the quarter ended September 30, 2013, SLE had net revenues of $94,000 compared to net revenues of $198,000 for the comparable 2012 quarter. For the 2013 period, $33,000 of SLE's net revenues was generated by our Working Values Ethics and Compliance division, and $61,000 was generated by our Cognistar Legal division, as compared to $39,000 and $159,000, respectively, in the 2012 period. Net revenues generated by the Working Values Ethics and Compliance division are derived primarily from custom consulting work and can fluctuate from period to period based on a number of factors. The Cognistar Legal division derives its revenue primarily from the sales of its courses and the creation of courses for its clients.

Our Engineering division generated $76,000 of net revenues in the third quarter of 2013 compared to $138,000 in the third quarter of 2012. The decrease is primarily from lower sales to professional organizations. We are currently developing new review courses for those candidates seeking engineering licenses as the testing requirements have changed. Sales of our engineering products are not subscription based. We now include our information technology product, Watch-IT's revenues in the Engineering division.

Net revenues generated by our other divisions, which consist of video production and duplication and consulting in the third quarter of 2013 were $19,000. In comparison, these divisions recorded $39,000 of net revenue for the third quarter of 2012.

Cost of revenues

Cost of revenues includes: (i) production costs – i.e., the salaries, benefits and other costs related to personnel, whether our employees or independent contractors, who are used directly in production, including producing our educational programs and/or upgrading our technology; (ii) royalties paid to third parties; (iii) the cost of materials, such as DVD's and packaging supplies; (iv) costs related to live training; and (v) shipping and other costs. There are many different types of expenses that are characterized as production costs and many of them vary from period to period depending on many factors. Generally, subscription based products have higher profit margins than non-subscription based products and online sales have higher profit margins than sales involving physical delivery of material.

Our gross profit margins for the three months ended September 30, 2013 increased slightly from 55.4% in the comparable 2012 period to 57.2% in the 2013 period, primarily due to the increase in revenues and reduced costs. Although, we have made meaningful reductions in technology personnel offset by increases in outsourced labor, our expenses remained relatively constant at approximately $1.60 million in both the 2013 and 2012 periods. In addition, we have added personnel for the development of new courses in our accounting/finance library and as instructors for our live training divisions. The costs of updating either our course content or existing software are charged to expense as they are incurred.

Cost of revenues increased by approximately $13,000 in the 2013 period as compared to the 2012 period.

- Outside labor and direct production costs. Outside labor includes the cost of hiring actors and production personnel such as directors, producers and cameramen and the outsourcing of non-video technology. The cost of such outside labor, which is primarily technology personnel, increased $70,000. This increase is primarily related to our continual upgrading of existing products and content and custom work. Direct production costs, which are costs related to producing videos, courses, custom projects or live instruction and includes such costs as renting equipment and locations and the use of live instructors for either teaching or developing the courses, increased approximately $45,000. We also continue to expend significant sums updating and introducing new courses in our live training programs. The variation in direct production costs are related to the type of production and other projects and do not reflect any trends in our business. As our business grows we may be required to hire additional production personnel, increasing our cost of revenues. Our course libraries require regular updating.
- Royalties. Royalty expense decreased by $40,000 in the three month period ended September 30, 2013, compared to the corresponding period in 2012. Royalty expense varies from period to period based on sales and usage of our various products. Royalty expense is primarily driven by our accounting course catalog and our engineering product sales. Generally, royalties are paid twice per year and are calculated based on a number of factors, not all of which are available to us on a monthly, or even a quarterly basis. Accordingly, a substantial portion of our royalty expense for the quarter is estimated.
- Salaries. Overall, payroll and related costs attributable to production personnel decreased by $36,000, a result of outsourcing, as noted above.

- Other production related costs. These are other costs directly related to the production of our products or the costs related to live training such as purchases of materials, cost of venues, travel, shipping, and other. These costs decreased $26,000 in the 2013 period from the 2012 period, and is primarily related to venues, travel and other costs from our live training business.

Selling, general and administrative expenses

Selling, general and administrative expenses include corporate overhead, such as compensation and benefits for administrative, sales and marketing and finance personnel, rent, insurance, professional fees, travel and entertainment and office expenses. Selling, general and administrative expenses for the third quarter of 2013 decreased by approximately $177,000, or 8.8%, compared to the same 2012 period. This decrease is attributable to a number of factors, that are highlighted below.

Compensation expense in the third quarter of 2013 period decreased by $131,000 compared to the same 2012 period. The decrease in costs is primarily attributable to the reduction in headcount in 2013. We had 43 and 50 full and part-time general and administrative employees at September 30, 2013 and 2012, respectively. In addition, compensation expense includes stock based compensation expense of $26,000 for the 2013 period and $28,000 for the 2012 period.

Our other selling, general and administrative costs, exclusive of compensation costs, decreased by approximately $46,000 in the third quarter of 2013 as compared to the same period in 2012, primarily a result of reduced expenditures for outsourced sales and customer service. While we have added additional outsourced sales and customer service personnel, we have been able to control those costs by relocating certain positions to Central Europe from Canada and India. However, as we constantly upgrade and expand our technology and Internet capabilities, this results in related increased costs for such things as web-bandwidth and hardware and software maintenance and support. We make every effort to control our costs, and we can only anticipate that some selling, general and administrative expenses, such as insurance, travel and other costs may increase.

Depreciation and amortization

Depreciation and amortization expense increased by approximately $33,000, to approximately $311,000, in the third quarter of 2013 compared to the third quarter of 2012 as we started to amortize the cost of developing our AMS. We expect our depreciation and amortization expense on our fixed and intangible assets to increase in the current year, as older assets are replaced and we start to amortize the cost of internally developed software. In addition, we capitalize internal costs for the development of new courses and other technology, as incurred. We continually replace and add to our computer and other equipment as it ages and as additional equipment is needed to accommodate growth.

Operating income/ (loss)

For the three months ended September 30, 2013, the operating income was approximately $400 compared to an operating loss of approximately $309,000 in the corresponding 2012 period, primarily as a result of increased revenues and a decrease in our selling, general and administrative expenses.

Other income/expense, net

Other income and expense items consist of interest earned on deposits and the net equity loss from our iReflect joint venture. We have no debt other than trade payables and accrued liabilities. For the third quarter of 2013 we had net other income of approximately $7,600 as compared to approximately $6,400 in the same 2012 period.

Income taxes

For the three months ended September 30, 2013, we recorded a net $1,000 current income tax benefit, as compared to a net $60,000 current income tax provision in the same 2012 period. The current benefit is a result of reduced estimates of state and local income taxes.

Net income/(loss)

For the three months ended September 30, 2013 we recorded net income of approximately $9,000. For the comparable period in 2012 we recorded a net loss of approximately $362,000, or $0.08 per share, basic and diluted.

Comparison of the results of operations for nine months ended September 30, 2013 and 2012

We recorded a $678,000, or 6%, increase in net revenues for the nine months ended September 30, 2013 compared to the same 2012 period. Correspondingly our gross profit increased by $471,000, from $5.94 million in the 2012 period to $6.41 million in the 2013 period. Our selling, general and administrative expenses decreased by approximately by $161,000 and our depreciation and amortization expense increased by approximately $33,000. This resulted in an operating loss of approximately $471,000 in the current year's period as compared to an operating loss of

approximately $1.07 million in the

16

Table of Contents

prior year's period. This is a result of increased revenues in certain divisions and various cost saving measures that have been implemented during the past 12 months.

Online revenues continue to be an important factor to our net revenues. In addition to our on-line accounting and finance products, many of our other products, including our Cognistar Legal library, our Financial Campus courses and our technology training products, are also delivered online and also are significant generators of net revenues. Approximately 44% of our net revenues for the nine months ended September 30, 2013 were derived from online products.

The following table compares our statement of operations data for the nine months ended September 30, 2013 and 2012. The trends suggested by this table may not be indicative of future operating results, which will depend on various factors including the relative mix of products sold (accounting/finance, law, engineering, financial services, sales training – product, technology or compliance and ethics) and the method of sale (video or online) as well as the timing of custom project work, which can vary from quarter to quarter. In addition, our operating results in future periods may also be affected by acquisitions.

	Nine months ended September 30,				
	2013		2012		
	Amount	Percentage	Amount	Percentage	Change
Net revenues	$11,506,704	100.0 %	$10,829,467	100.0 %	6.3 %
Cost of revenues	5,095,594	44.3 %	4,889,031	45.1 %	4.2 %
Gross profit	6,411,110	55.7 %	5,940,436	54.9 %	7.9 %
Selling, general and administrative	6,026,968	52.4 %	6,188,018	57.1 %	(2.6)%
Depreciation and amortization	855,133	7.4 %	821,844	7.6 %	4.1 %
Total operating expenses	6,882,101	59.8 %	7,009,862	64.7 %	(1.8)%
Operating loss	(470,991)	(4.1)%	(1,069,426)	(9.9)%	(56.0)%
Other income, net	13,882	0.1 %	14,542	0.1 %	(4.5)%
Net loss before income tax	(457,109)	(4.0)%	(1,054,884)	(9.7)%	(56.7)%
Benefit from income taxes	178,007	1.5 %	193,761	1.8 %	(8.1)%
Net loss	$(279,102)	(2.4)%	$(861,123)	(8.0)%	(67.6)%

Net revenues

The increase in net revenues reflected above was primarily due to: (i) a $270,000 increase in net revenues from our Accounting/Finance division; (ii) a $409,000 increase in net revenues from our Skye subsidiary; and (iii) a $223,000 increase in net revenues from our Financial Services division. These increases were offset by: (i) a $148,000 decrease in net revenues from our SLE subsidiary; (ii) a $92,000 decrease in net revenues from our Engineering division and (iii) a $44,000 decrease in net revenues from our other divisions. Under our long-standing policy, revenue is credited to the originating department regardless of the type of service that is performed.

In the first nine months of 2013, net revenues from the Accounting/Finance division were $8.6 million, or 74% of net revenues, compared to $8.3 million, or 77% of net revenues, in the comparable 2012 period. Net revenues from subscription-based products and direct sales of course material on a non-subscription basis were approximately $5.8 million and $5.6 million in the same 2013 and 2012 nine month periods, respectively. Net revenues from other sources in our Accounting/Finance division that are not subscription based were $129,000 greater in the 2013 period as compared to the 2012 period. Live-training revenues increased by $11,000 in the 2013 period from the 2012 period. Non-subscription-based revenues fluctuate from period to period. In the 2013 period, net revenues from online sales of accounting products increased by approximately $16,000, as compared to the 2012 period, primarily as a result of increased usage of courses sold on a non-subscription basis. Net revenues from our Loscalzo live training subsidiary increased $41,000 in the 2013 period compared to the 2012 period primarily due to timing differences in scheduling and the addition of new clients. Our EEI live training division generated $777,000 in revenue in the 2013 period as compared to $807,000 in 2012 period, a decrease of $30,000 despite eliminating some poorly attended programs. Those decreases were offset in part by revenues earned from CPE administration. EEI's live training business is seasonal and its revenues are primarily earned in the second and fourth calendar quarters. Live training for accounting

professionals remains relatively stable despite the continual postponement of new standards in the United States. For the nine months ended September 30, 2013, Skye generated net revenues of $880,000 compared to $471,000 in the comparable period of 2012. Skye's income is derived primarily from designing custom training projects and, as such, varies

from period to period. As noted above, business organizations are continuing to study these types of products and their cost effectiveness. As economic conditions improve we are seeing more requests for proposals. In addition, Skye performs services for other divisions of our company that is not reflected in its revenue numbers.

Our Financial Services division generated $1.3 million of net revenues for the nine month period ended September 30, 2013, compared to $1.1 million of net revenues for the same 2012 period. The increase is due primarily from the recognition of income from a completed customization project for one client and increased services to clients. This division also has approximately $30,000 in deferred revenue primarily from uncompleted custom work that it anticipates completing through 2013.

For the nine months ended September 30, 2013, SLE had net revenues of $317,000 compared to net revenues of $465,000 for the comparable 2012 period. For the 2013 period, $85,000 of SLE's net revenues was generated by the Working Values Ethics and Compliance division, and $232,000 was generated by the Cognistar Legal division, as compared to $145,000 and $320,000, respectively, in the 2012 period. Net revenues generated by the Working Values Ethics and Compliance division are derived primarily from custom consulting work and can fluctuate from period to period based on a number of factors.

Our Engineering division generated $317,000 of net revenues in the first nine months of 2013 compared to $409,000 in the same 2012 period. The decrease is primarily a result of a decrease in the number of exam candidates, the timing of the licensing exams and the need to rewrite some of our courses. Sales of our engineering products are not subscription based. Sales of our Watch IT information technology program are now included in the revenues of our Engineering division.

Net revenues generated by our other divisions, which consist of video production and duplication and consulting increased by $36,000 in the current period from the prior year.

Cost of revenues

Cost of revenues includes: (i) production costs – i.e., the salaries, benefits and other costs related to personnel, whether our employees or independent contractors, who are used directly in production, including producing our educational programs and/or upgrading our technology; (ii) royalties paid to third parties; (iii) the cost of materials, such as DVD's and packaging supplies; (iv) costs related to live training; and (v) shipping and other costs. There are many different types of expenses that are characterized as production costs and many of them vary from period to period depending on many factors. Generally, subscription based products have higher profit margins than non-subscription based products and online sales have higher profit margins than sales involving physical delivery of material.

Our gross profit margins for the nine months ended September 30, 2013 increased slightly to 55.7% from 54.9% in the same 2012 period. Although we previously made substantial reductions in overhead, the mix of products with varying gross profits resulted in a fairly constant percentage. Our overall expense increased proportionately with the increase in revenues. We have increased the amount of outsourcing for some of our technology projects. We also devote a significant amount of internal and external resources to develop new products and to re-tool existing products and technology. These costs are charged to expense as they are incurred.

Cost of revenues increased by approximately $207,000 in the 2013 period compared to the 2012 period.

- Outside labor and direct production costs. Outside labor includes the cost of hiring actors and production personnel such as directors, producers and cameramen and the outsourcing of non-video technology. The cost of such outside labor, which is primarily technology personnel, increased $341,000. This increase is primarily related to increased custom projects for various clients and the retooling of existing technology. Direct production costs, which are costs related to producing videos, courses, custom projects or live instruction and includes such costs as renting equipment and locations and the use of live instructors for either teaching or developing the courses, decreased $20,000. The decrease is primarily attributable to savings made in costs related to developing courses for our live training business.

The variation in direct production costs are related to the type of production and other projects and do not reflect any trends in our business. As our business grows we may be required to hire additional production personnel, increasing our cost of revenues. Our course libraries require regular updating.

- Royalties. Royalty expense decreased by $18,000 in the nine months period ended September 30, 2013, compared to the corresponding 2012. Royalty expense varies from period to period based on sales and usage of our various products. Royalty expense is primarily driven by our accounting course catalog and our engineering product sales.

Generally, royalties are paid twice per year and are calculated based on a number of factors, not all of which are available to us on a monthly, or even a quarterly basis. Accordingly, a substantial portion of our royalty expense for the period is estimated.

Table of Contents

- Salaries. Overall, payroll and related costs attributable to production personnel decreased by approximately $54,000 in the 2013 period as compared to the 2012 period.
- Other production related costs. These are other costs directly related to the production of our products or the costs related to live training such as purchases of materials, cost of venues, travel, shipping, and other. These costs decreased in the 2013 period by approximately $42,000 to approximately $614,000 in the 2013 period from approximately $656,000 in the 2012 period.

Selling, general and administrative expenses

Selling, general and administrative expenses include corporate overhead, such as compensation and benefits for administrative, sales and marketing and finance personnel, rent, insurance, professional fees, travel and entertainment and office expenses. Selling, general and administrative expenses for the nine months ended September 30, 2013 decreased by approximately $161,000, or 2.6%, compared to the same 2012 period. This decrease is primarily attributable to reduced payrolls and related costs and a reduction in marketing and promotional expenses primarily related to our live training courses, offset by an increase in outsourced customer service and sales as well as costs related to technology.

Compensation expense for the nine months ended September 30, 2013 decreased by $328,000 compared to the same 2012 period. The decrease in compensation expense is primarily attributable to savings from a reduction in headcount and commissions paid to salespeople in 2013. In addition, included in compensation expense is stock based compensation expense of $78,000, which decreased by approximately $9,000 as compared to the same 2012 period. Our other selling, general and administrative costs, exclusive of compensation costs, increased by $167,000. We make every effort to control our costs, and we can only anticipate that some selling, general and administrative expenses, such as insurance, travel and other costs may increase. In addition, we have added additional sales personnel and outsourced our customer service department to third-parties that also has personnel exclusively selling our products.

Depreciation and amortization

Depreciation and amortization expense increased by approximately $33,000 for the nine months ended September 30, 2013 as we started to amortize the costs of internally developed software. Although, we have now fully amortized many of the assets acquired in prior acquisitions, we are continuously purchasing new computer equipment and have begun to amortize the costs related to the development of our AMS and other software as well the development of new course content. Due to this we expect our depreciation and amortization expense on our fixed and intangible assets to increase. We capitalize internal costs for the development of new courses and other technology, as incurred. We continually replace and add to our computer and other equipment as it ages and as additional equipment is needed to accommodate growth.

Operating loss

For the nine months ended September 30, 2013, the operating loss was approximately $471,000 compared to an operating loss of approximately $1.07 million in the corresponding 2012 period. The decrease in operating loss is primarily a result of higher revenues.

Other income/expense, net

Other income and expense items consist of interest earned on deposits and the net loss from our iReflect joint venture. We have no debt other than trade payables and accrued liabilities. For the nine months ended September 30, 2013 we had net other income of approximately $13,900 as compared to a net other income of approximately $14,500 in the comparable 2012 period. The loss from our 50% interest in the iReflect joint venture was $5,604 in the current period compared to $6,250 in the 2012 period.

Income taxes

For the nine months ended September 30, 2013, we recorded a net income tax benefit of $178,000 as compared to a net income tax benefit of $253,000 in the same 2012 period.

Net loss

For the nine months ended September 30, 2013 and 2012, we recorded a net loss of approximately $279,000 and $861,000, respectively, or $0.06 and $.18 per share, basic and diluted, respectively.

19

Liquidity and Capital Resources
At September 30, 2013 we had no long-term debt.
Our working capital as of September 30, 2013 was approximately $1.9 million compared to $2.3 million at December 31, 2012. Our current ratio at September 30, 2013 and December 31, 2012 was 1.31 to 1 and 1.38 to 1, respectively. The current ratio is derived by dividing current assets by current liabilities and is a measure used by lending sources to assess our ability to repay short-term liabilities. The largest component of our current liabilities is deferred revenue, which was $4.8 million at September 30, 2013 and $5.0 million at December 31, 2012.
At September 30, 2013, we had cash and cash equivalents of approximately $5.1 million. For the nine months ended September 30, 2013, we reported a net increase in cash and cash equivalents of approximately $216,000 that includes approximately $823,000 of cash provided by operating activities, offset by approximately $291,000 of cash used in investing activities and approximately $316,000 of cash used in financing activities. The primary components of our operating cash flows are net income or loss adjusted for non-cash expenses, such as depreciation and amortization stock-based compensation and deferred and current income taxes, and the changes in our operating assets and liabilities, such as accounts receivable, accounts payable and deferred revenues.
At September 30, 2013, we had approximately $2.0 million in receivables and $1.0 million in payables and accrued expenses, as compared to $2.6 million of receivables and $980,000 in payables and accrued expenses at December 31, 2012, exclusive of dividends payable.
For the nine months ended September 30, 2013 net cash used in investing activities was approximately $291,000, which included capital expenditures of approximately $788,000, consisting of computer equipment and software purchases of $188,000, $87,000 for course development and $514,000 for capitalized software, as compared to approximately $375,000 expended in the first nine-months of 2012. We also made a capital investment in our iReflect joint venture of $3,000. These expenditures were offset by the redemption of certificates of deposit totaling $500,000
We anticipate that our capital expenditures for the remainder of 2013 will be substantially higher as compared to 2012, as we continue to capitalize the cost of new technology. We continually upgrade our technology hardware and, as such, we anticipate additional capital expenditures relating to equipment purchases over the next 12 months.
Cash used in financing activities for the nine months ended September 30, 2013 reflects dividends paid of approximately $199,000 and the purchase of approximately $116,000 of our common stock under our stock buy back program. In November 2013, our board of directors declared a dividend of $.015 per common share payable on January 6, 2014 to shareholders of record as of December 19, 2013, extended our stock buy back program through it's November 2014 meeting. and increased the funds available to repurchase shares of Common Stock on the NASDAQ Capital Market to $750,000. As of September 30, 2013, approximately $633,000 was available under our stock buy back program. However, with the reduction in the number of outstanding shares and the various regulations governing such purchases, the Company has had difficulty in repurchasing its shares.
We believe that our current cash balances together with cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements for the next 12 months.
In the future, we may issue additional debt or equity securities to satisfy our cash needs. Any debt incurred may be secured or unsecured, bear interest at a fixed or variable rate and may contain other terms and conditions that we deem are reasonable under the circumstances existing at the time. Any sales of equity securities may be at or below current market prices. We cannot assure you that we will be successful in generating sufficient capital to adequately fund our needs.

Item 3. Quantitative and Qualitative Risk Disclosures About Market Risk
As a smaller reporting company we are not required to provide the information required by this Item.

Item 4. Controls and Procedures
Evaluation of Disclosure Controls and Procedures. Management, with the participation of our principal executive officer and principal financial officer, carried out an evaluation of the effectiveness of our “disclosure controls and procedures” (as defined in the Securities Exchange Act of 1934, as amended (the “Exchange Act”) Rules 13a-15(e) and

15d-15(e)) as of the end of the period covered by this quarterly report (the "Evaluation Date"). Based upon that evaluation, our principal executive officer and principal financial officer concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and

20

Table of Contents

forms and (ii) is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.
Changes in Internal Control over Financial Reporting. There were no changes in our internal controls over financial reporting that occurred during the nine-month period ended September 30, 2013 covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

We are not a party to any material legal proceeding.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
Recent Sales of Unregistered Securities
None.
Company Purchases of its Equity Securities
During the three month period ended September 30, 2013, we did not make any repurchases under our stock buy-back program. As set forth below, approximately $633,000 was available under our stock buy back program as of September 30, 2013. In November 2013, our board of directors extended our stock buy-back program through it's November 2014 meeting, and increased the funds available to repurchase shares of Common Stock on the NASDAQ Capital Market to $750,000.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares (or units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Month #1 (July 1-31, 2013)	—	—	—	$632,772
Month #2 (August 1-31, 2013)	—	—	—	—
Month #3 (September 1-30, 2013)	—	—	—	—
Total	—	—	—	$632,772

Item 3. Defaults Upon Senior Securities
None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Table of Contents

Item 6. Exhibits
Exhibits:

Exhibit No.	Description
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.CAL	XBRL Taxonomy Extension Schema Document
101.SCH	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

Table of Contents

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

		SmartPros Ltd.
		(Registrant)
Date:	November 7, 2013	/s/ Allen S. Greene
		Chief Executive Officer (Principal Executive Officer)
Date:	November 7, 2013	/s/ Stanley P. Wirtheim
		Chief Financial Officer (Principal Financial Officer)