Example Properties, Inc.

*Annual Report*

Contents

# To Our Stockholders

## Milestones

This fiscal year was truly a foundation-building year for Example Properties, Inc. Fueled by a continued strong economy and robust commercial real estate markets, we significantly increased our revenues and earnings, strengthened our balance sheet, and put in place a solid platform from which we can now aggressively implement our long-term growth strategy.

Among our fiscal accomplishments, we:

* Achieved an almost eleven-fold increase in net income before non-recurring items, to $10.8 million from $1 million a year ago;
* Completely eliminated our long-term debt, which was $10.2 million last fiscal year;
* Improved our stockholders’ equity to $9 million from a negative net worth of $24.3 million;
* Increased our management portfolio to more than 7 million square feet under management at year-end from 6 million square feet; and
* Increased our market capitalization to $37.3 million at June 30, from $27.6 million at the same time last year. (For more information, see the Financial Overview section.)

To put the year in broader perspective, this year marked the Company’s fifth consecutive year of profitability after a difficult period in the beginning due to extremely challenging market conditions. Rather than simply ride the wave of a recovering real estate marketplace and reap short-term rewards, we worked diligently during the year to take steps that will position the Company for continuous, long-term growth.

## Legal Issues

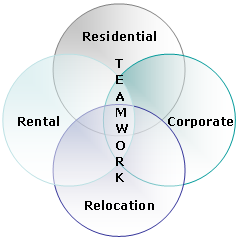
On the legal front, *Connor v. Example*, 314 US 252 (2002) and *Smith v. Example*, F2d 201 (2003) have been dismissed. The primary reason for dismissal in both decisions was the lack of evidence on the part of the prosecution. However, this does raise and interesting question. Has the Company come to a point in its growth where it now needs a dedicated legal staff? Rachel Martin, a managing partner in a firm that does not currently represent the Company, has proposed the Company purchase her firm outright.

Ms. Martin assures us that *Smith v. Example* would never have happened if the Company had an in-house legal staff. Our defense and related legal costs in that case alone cost the Company nearly $1 million. In the case of *Connor v. Example*, Ms. Martin suggests that her firm’s investigative associates could have significantly benefited the Company. From a cost perspective, the Company is seriously considering Ms. Martin’s proposal. This topic will be discussed further at the Winter Meeting in Atlanta.

## Strategy

Our strategy has been—and will continue to be—to build upon Example Properties’ historic strength in transaction services while strengthening and expanding our other service lines. Our departments work together to strengthen and expand service lines. More than providing the Company with expanded sources of revenue, we anticipate that the recurring, fee-based income generated by our non-transactional businesses will mitigate the impact of market cycles on our results.

Figure A: Teamwork is critical to our success.



# Review of Year Results

## Financial Overview

For the fiscal year ended June 30, total revenue increased 15% to $200.5 million from $174.3 million last year. Excluding non-recurring items, earnings before interest expense, income taxes, depreciation and amortization—a widely used measure of a company’s ability to generate cash flow from operations—rose 127% to $15.3 million from $5.2 million a year ago. These results are significant despite the costs involved with the *Smith v. Example* case.[[1]](#footnote-1)

### Net Income

Excluding a deferred tax benefit and other non-recurring expenses and extraordinary items, net income for the year was $10.6 million, an increase over the $1 million recorded last year. Fully diluted earnings per share on this basis increased to $.58 per fully diluted share, vs. $1.8 million, or a loss of $.08 per share, last year.

Non-recurring items in this fiscal year totaled $5.7 million. These include: a gain on the payoff of debt, net of taxes, of $4.6 million; other non-recurring expenses of $1.8 million relating primarily to the relocation of our corporate offices; and a deferred tax benefit of $3.1 million, reflecting the benefit from our net operating loss carry-forward recognized in the fourth quarter of this fiscal year. The Company has additional net operating losses as of June 30, which is available to offset taxable income in future years.

### Bottom Line

We significantly strengthened our balance sheet this year, in large part due to the completion of two common stock transactions that raised aggregate gross proceeds of $18.75 million of equity capital from two strategic investors. As a result, all the Company’s long-term debt was retired, all convertible preferred stock was either retired or converted into common stock, and all historical accrued but undeclared dividends on convertible preferred stock were forgiven. Additionally, the Company secured a $13 million revolving credit facility that is available to fund new initiatives.

# Market Forecast

## Residential

In the South, private housing continues leading the pack. Of course, all of this activity is at the expense of the North. This region hasn’t seen significant growth for a long time and the outlook remains bleak. This ongoing trend is a unique opportunity for the Company providing we are flexible enough to channel our resources properly into the Southern offices.[[2]](#footnote-2)

Figure B: Southern home sales remain strong.



Table 1: The North regularly lags behind.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **New Houses Sold** | | | | | | |
| (Thousands of Houses) | | | | | | |
|  |  | **Northeast** | **Midwest** | **South** | **West** | **U.S.** |
| **2002:** | **June** | 69 | 158 | 441 | 291 | 959 |
|  | **July** | 61 | 190 | 458 | 252 | 961 |
|  | **August** | 54 | 208 | 480 | 283 | 1,025 |
|  | **September** | 94 | 197 | 490 | 276 | 1,057 |
|  | **October** | 62 | 183 | 465 | 295 | 1,005 |
|  | **November** | 60 | 217 | 457 | 288 | 1,022 |
|  | **December** | 59 | 256 | 468 | 269 | 1,052 |
| **2003:** | **January** | 89 | 176 | 466 | 278 | 1,009 |
|  | **February** | 50 | 181 | 442 | 262 | 935 |
|  | **March\*** | 83 | 166 | 503 | 256 | 1,008 |
|  | **April\*** | 69 | 174 | 465 | 291 | 999 |
|  | **May\*** | 65 | 173 | 532 | 338 | 1,108 |
|  | **June\*\*** | 86 | 190 | 537 | 347 | 1,160 |
| \* Revised: \*\*Preliminary. | | | | | | |

## Corporate

Nonresidential construction is wavering slightly. With companies favoring a wait-and-see approach to the current economic downturn, they are not prone to large capital expenditure outlays for new construction. In fact, a majority of businesses are reducing their space needs and are in the market for smaller spaces. As a result, we benefit from their predisposition toward purchasing existing properties in the small (5,000 square feet) and medium (20,000 square feet) range.

## Rental

The corporate rental forecast is also benefiting from the current economic environment. It can be argued that in a time of economic challenge, people and businesses alike are more inclined to use renting as a temporary solution to ever-increasing financial realities. Even though interest rates are low, rental prospects remain favorable for the Company. Additionally, the ever-shifting job markets make this a favorable time for the residential rental market in several of our regions.

## Relocation

With the Northeast continuing to purge both blue- and white-collar jobs, the majority of employment opportunities are still flowing southward. Current forecasts predict population in this burgeoning region will increase at a 15% rate over the next decade. This is why we’ve decided to focus our relocation efforts, and consequently our staffing efforts, in the Boston and Atlanta offices. With the Boston office “sending” displaced workers and the Atlanta office “receiving” them, leveraging our various Southern satellite offices, we will be poised to take advantage of this employment exodus trend for the foreseeable future.

# Today’s Opportunities

## Organizational Restructuring

This year, we put in place a new organizational structure that better reflects how Example Properties is meeting the increased demand for the full spectrum of commercial real estate services from a single provider. In addition to transaction services and management services, we offer clients a variety of financial services and strategic services.

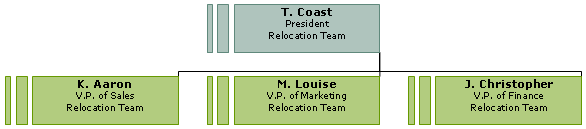
## Relocation Revenue

For the fiscal year, revenue generated by Relocation Services was up nearly 18% as we continued to take advantage of the market’s recovery to capture additional businesses. In Commercial Services, we saw a substantial increase in management and leasing activity, adding approximately 22 million square feet to our commercial portfolio. Our goal is to have an additional 80 million square feet, a total of 102 million square feet, by end of the next fiscal year for our commercial portfolio.

### New Relocation Team

Because revenue generated by relocation services was up 18% last year, we decided to create a new team that will focus solely on relocation. The members of the Relocation Services management team (see the figure below) are all proven managers with an enviable track record of sales and customer service. We expect to see revenues increase significantly this year thanks to their focus and experience. The team will be located in the Company’s Atlanta office.[[3]](#endnote-1)

Figure C: The Relocation management team.



# Long-Term Strategy

## Investment

This year we launched several initiatives to help meet our goal of enhancing the quality of the Company’s service lines and diversifying sources of revenue beyond traditional commercial brokerage. This includes investments in the client service, the national affiliate program, computer equipment, and hiring new employees.

### Client Service

We established the Corporate Relocation Group and Institutional Services Group to allow the Company to respond to the increasing demand from major corporate and institutional clients for expanded services through a single point of contact. We expect these innovative relationship management groups to be key in helping the Company establish more secure, long-term client relationships that can generate a stable, consistent stream of revenue across all service lines.

### National Affiliate Program

We also launched a national affiliate program, which enables the Company to enter markets where it previously did not have a formal presence and to better meet the multi-market needs of national clients. To date, the Company has formed alliances with 17 independent brokerage firms with a presence in 20 markets, as noted on the inside back cover of this report. Our goal is for Example Properties to have internal and affiliated offices in 150 markets within the next two years.[[4]](#endnote-2)

### Infrastructure

We are investing in technology systems designed to keep the Company competitive in future years. Among them is a state-of-the-art, company-wide information sharing and research network—an intranet—to be rolled out over the next 12 to 18 months, which will enable Example professionals across all offices to work smarter and more efficiently as a team, access the latest market intelligence, and more fully address our clients’ needs.

Also, we moved our corporate headquarters operation from New York to Kansas City, Kansas, in the third quarter of the year—a feat that was accomplished without any business interruption. By relocating to the Midwest, Example senior management team is now in closer proximity to a larger number of corporate and institutional clients, allowing us to stay in closer touch with client needs and requirements. The relocation also enhances the Company’s ability to support our offices nationwide.

### Talent

In consolidating industry, we have taken advantage of the opportunity to bring on board a significant number of top professionals who will help drive growth in our core businesses. As a service company, we believe people are our single most important asset. By hiring highly talented people and instituting a strong company-wide culture of teamwork, quality and a dedication to client service, we are building a great company.

## Annual Objectives

In the year ahead, we expect to build upon the momentum we achieved in this fiscal year by continuing to implement our long-term growth strategy, which includes:

### New Relationships

One of our objectives for the immediate future is to develop long-term relationships with key corporations and the top institutional owners of real estate nationwide.

### Untapped Markets

Building a broader, more cohesive system of offices and expanding services for clients with needs in currently underserved markets is critical to growth.

### Identify Revenue Opportunities

Leveraging our historic strength in transaction services to cross-sell other Example services to generate recurring, fee-based income. Along these same lines, capitalizing on leasing opportunities where the Company is currently only providing property management services, and vice versa is a significant opportunity.

1. All financial details can be found in the auditor’s fourth-quarter report. [↑](#footnote-ref-1)
2. The chart and table data is from the Census Bureau’s June 2003 New Residential Sales press release. [↑](#footnote-ref-2)
3. The new team was created to take advantage of current and near-term market trends. [↑](#endnote-ref-1)
4. A detailed list of affiliates can be found on the Company’s intranet site. [↑](#endnote-ref-2)