

Meritage Homes CORP  
Form 10-Q  
July 30, 2018

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

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

For the quarterly period ended June 30, 2018

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 1-9977

Meritage Homes Corporation  
(Exact Name of Registrant as Specified in its Charter)  
Maryland 86-0611231  
(State or Other Jurisdiction of (IRS Employer  
Incorporation or Organization) Identification No.)

8800 E. Raintree Drive, Suite 300, 85260  
Scottsdale, Arizona  
(Address of Principal Executive Offices) (Zip Code)  
(480) 515-8100  
(Registrant's telephone number, including area code)

N/A  
(Former Name, Former Address and Formal Fiscal Year, if Changed Since Last Report)  
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No   
Indicate by a checkmark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No   
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange

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Act. "

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

Common shares outstanding as of July 26, 2018: 40,649,453

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MERITAGE HOMES CORPORATION  
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2018  
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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

MERITAGE HOMES CORPORATION AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED BALANCE SHEETS  
 (in thousands, except share amounts)

	June 30, 2018	December 31, 2017
Assets		
Cash and cash equivalents	\$169,426	\$170,746
Other receivables	78,395	79,317
Real estate	2,870,047	2,731,380
Real estate not owned	38,864	38,864
Deposits on real estate under option or contract	48,880	59,945
Investments in unconsolidated entities	16,639	17,068
Property and equipment, net	52,122	33,631
Deferred tax asset	36,294	35,162
Prepays, other assets and goodwill	84,227	85,145
Total assets	\$3,394,894	\$3,251,258
Liabilities		
Accounts payable	\$154,819	\$140,516
Accrued liabilities	173,770	181,076
Home sale deposits	37,130	34,059
Liabilities related to real estate not owned	34,978	34,978
Loans payable and other borrowings	16,552	17,354
Senior notes, net	1,294,705	1,266,450
Total liabilities	1,711,954	1,674,433
Stockholders' Equity		
Preferred stock, par value \$0.01. Authorized 10,000,000 shares; none issued and outstanding at June 30, 2018 and December 31, 2017	—	—
Common stock, par value \$0.01. Authorized 125,000,000 shares; issued 40,649,453 and 40,330,741 shares at June 30, 2018 and December 31, 2017, respectively	406	403
Additional paid-in capital	593,561	584,578
Retained earnings	1,088,973	991,844
Total stockholders' equity	1,682,940	1,576,825
Total liabilities and stockholders' equity	\$3,394,894	\$3,251,258
See accompanying notes to unaudited consolidated financial statements		

MERITAGE HOMES CORPORATION AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED INCOME STATEMENTS  
 (in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Homebuilding:				
Home closing revenue	\$872,383	\$797,780	\$1,600,915	\$1,458,397
Land closing revenue	5,112	4,198	19,144	16,353
Total closing revenue	877,495	801,978	1,620,059	1,474,750
Cost of home closings	(712,868 )	(656,870 )	(1,317,070 )	(1,210,219 )
Cost of land closings	(5,799 )	(4,198 )	(21,041 )	(13,858 )
Total cost of closings	(718,667 )	(661,068 )	(1,338,111 )	(1,224,077 )
Home closing gross profit	159,515	140,910	283,845	248,178
Land closing gross (loss)/profit	(687 )	—	(1,897 )	2,495
Total closing gross profit	158,828	140,910	281,948	250,673
Financial Services:				
Revenue	3,870	3,649	6,918	6,593
Expense	(1,693 )	(1,551 )	(3,177 )	(2,930 )
Earnings from financial services unconsolidated entities and other, net	3,474	3,459	6,130	6,184
Financial services profit	5,651	5,557	9,871	9,847
Commissions and other sales costs	(60,823 )	(54,701 )	(113,575 )	(103,021 )
General and administrative expenses	(34,205 )	(29,591 )	(65,098 )	(59,213 )
(Loss)/earnings from other unconsolidated entities, net	(156 )	570	(202 )	943
Interest expense	(44 )	(1,620 )	(180 )	(2,445 )
Other income, net	1,934	2,080	7,305	3,190
Earnings before income taxes	71,185	63,205	120,069	99,974
Provision for income taxes	(17,347 )	(21,625 )	(22,357 )	(34,822 )
Net earnings	\$53,838	\$41,580	\$97,712	\$65,152
Earnings per common share:				
Basic	\$1.32	\$1.03	\$2.41	\$1.62
Diluted	\$1.31	\$0.98	\$2.37	\$1.54
Weighted average number of shares:				
Basic	40,647	40,317	40,568	40,248
Diluted	41,164	42,781	41,193	42,836

See accompanying notes to unaudited consolidated financial statements

MERITAGE HOMES CORPORATION AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (in thousands)

	Six Months Ended	
	June 30,	
	2018	2017
Cash flows from operating activities:		
Net earnings	\$97,712	\$65,152
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	12,608	7,872
Stock-based compensation	8,976	5,785
Equity in earnings from unconsolidated entities	(5,978 )	(7,127 )
Distributions of earnings from unconsolidated entities	6,834	6,712
Other	2,407	10
Changes in assets and liabilities:		
Increase in real estate	(155,809 )	(211,384 )
Decrease in deposits on real estate under option or contract	11,093	9,308
Decrease/(increase) in other receivables, prepaids and other assets	1,634	(9,428 )
Increase/(decrease) in accounts payable and accrued liabilities	6,997	(5,497 )
Increase in home sale deposits	3,071	7,849
Net cash used in operating activities	(10,455 )	(130,748 )
Cash flows from investing activities:		
Investments in unconsolidated entities	(417 )	(408 )
Distributions of capital from unconsolidated entities	—	1,250
Purchases of property and equipment	(15,726 )	(8,322 )
Proceeds from sales of property and equipment	92	86
Maturities/sales of investments and securities	1,065	1,258
Payments to purchase investments and securities	(1,065 )	(1,258 )
Net cash used in investing activities	(16,051 )	(7,394 )
Cash flows from financing activities:		
Repayment of Credit Facility, net	—	(15,000 )
Repayment of loans payable and other borrowings	(2,499 )	(5,725 )
Repayment of senior notes and senior convertible notes	(175,000 )	(52,098 )
Proceeds from issuance of senior notes	206,000	300,000
Payment of debt issuance costs	(3,315 )	(3,998 )
Net cash provided by financing activities	25,186	223,179
Net (decrease)/increase in cash and cash equivalents	(1,320 )	85,037
Cash and cash equivalents, beginning of period	170,746	131,702
Cash and cash equivalents, end of period	\$169,426	\$216,739
See Supplemental Disclosure of Cash Flow Information in Note 13.		
See accompanying notes to unaudited consolidated financial statements		

MERITAGE HOMES CORPORATION AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — ORGANIZATION AND BASIS OF PRESENTATION

Organization. Meritage Homes is a leading designer and builder of single-family homes. We primarily build in historically high-growth regions of the United States and offer a variety of homes that are designed to appeal to homebuyers primarily focused on first-time and first move-up buyers. We have homebuilding operations in three regions: West, Central and East, which are comprised of nine states: Arizona, California, Colorado, Texas, Florida, Georgia, North Carolina, South Carolina and Tennessee. We also operate a wholly-owned title company, Carefree Title Agency, Inc. ("Carefree Title"). Carefree Title's core business includes title insurance and closing/settlement services we offer to our homebuyers. Through our predecessors, we commenced our homebuilding operations in 1985. Meritage Homes Corporation was incorporated in 1988 in the state of Maryland.

Our homebuilding and marketing activities are conducted under the name of Meritage Homes in each of our homebuilding markets. In limited cases, we also offer luxury homes under the brand name of Monterey Homes in some markets. At June 30, 2018, we were actively selling homes in 253 communities, with base prices ranging from approximately \$179,000 to \$1,311,000.

Basis of Presentation. The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2017. The consolidated financial statements include the accounts of Meritage Homes Corporation and those of our consolidated subsidiaries, partnerships and other entities in which we have a controlling financial interest, and of variable interest entities (see Note 3) in which we are deemed the primary beneficiary (collectively, "us", "we", "our" and "the Company"). Intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the accompanying unaudited financial statements include all adjustments (consisting only of normal recurring entries), necessary for the fair presentation of our results for the interim periods presented. Results for interim periods are not necessarily indicative of results to be expected for the full year.

Cash and Cash Equivalents. Liquid investments with an initial maturity of three months or less are classified as cash equivalents. Amounts in transit from title companies or closing agents for home closings of approximately \$56.4 million and \$107.1 million are included in cash and cash equivalents at June 30, 2018 and December 31, 2017, respectively.

Real Estate. Real estate is stated at cost unless the asset is determined to be impaired, at which point the inventory is written down to fair value as required by Accounting Standards Codification ("ASC") 360-10, Property, Plant and Equipment ("ASC 360-10"). Inventory includes the costs of land acquisition, land development, home construction, capitalized interest, real estate taxes, capitalized direct overhead costs incurred during development and home construction that benefit the entire community, less impairments, if any. Land and development costs are typically allocated and transferred to homes under construction when construction begins. Home construction costs are accumulated on a per-home basis, while selling and marketing costs are expensed as incurred. Cost of home closings includes the specific construction costs of the home and all related allocated land acquisition, land development and other common costs (both incurred and estimated to be incurred) that are allocated based upon the total number of homes expected to be closed in each community or phase. Any changes to the estimated total development costs of a community or phase are allocated to the remaining homes in the community or phase. When a home closes, we may have incurred costs for goods and services that have not yet been paid. An accrued liability to capture such obligations is recorded in connection with the home closing and charged directly to Cost of home closings.

We rely on certain estimates to determine our construction and land development costs. Construction and land costs are comprised of direct and allocated costs, including estimated future costs. In determining these costs, we compile project budgets that are based on a variety of assumptions, including future construction schedules and costs to be incurred. It is possible that actual results could differ from budgeted amounts for various reasons, including construction and weather delays, labor or material shortages, increases in costs that have not yet been committed, changes in governmental requirements, or other unanticipated issues encountered during construction and development and other factors beyond our control. To address uncertainty in these budgets, we assess, update and revise project budgets on a regular basis, utilizing the most current information available to estimate construction and land costs.



Typically, a community's life cycle ranges from three to five years, commencing with the acquisition of the land, continuing through the land development phase, if applicable, and concluding with the sale, construction and closing of the homes. Actual community lives will vary based on the size of the community, the sales absorption rate and whether the land purchased was raw, partially-developed or in finished status. Master-planned communities encompassing several phases and super-block land parcels may have significantly longer lives and projects involving smaller finished lot purchases may be shorter.

All of our land inventory and related real estate assets are reviewed for recoverability, as our inventory is considered "long-lived" in accordance with GAAP. Impairment charges are recorded to write down an asset to its estimated fair value if the undiscounted cash flows expected to be generated by the asset are lower than its carrying amount. Our determination of fair value is based on projections and estimates. Changes in these expectations may lead to a change in the outcome of our impairment analysis, and actual results may also differ from our assumptions. Such an analysis is conducted if there is an indication of a decline in value of our land and real estate assets. If an impairment of a community is required, the impairment charges are allocated to each lot on a straight-line basis.

**Deposits.** Deposits paid for land options and purchase contracts are recorded and classified as Deposits on real estate under option or contract until the related land is purchased. Deposits are reclassified as a component of real estate inventory at the time the deposit is applied to the acquisition price of the land based on the terms of the underlying agreements. To the extent they are non-refundable, deposits are charged to expense if the land acquisition contract is terminated or no longer considered probable. Since our acquisition contracts typically do not require specific performance, we do not consider such contracts to be contractual obligations to purchase the land and our total exposure under such contracts is limited to the loss of the non-refundable deposits and any ancillary capitalized costs. Our deposits on real estate under option or contract were \$48.9 million and \$59.9 million as of June 30, 2018 and December 31, 2017, respectively.

**Goodwill.** In accordance with ASC 350, Intangibles, Goodwill and Other ("ASC 350"), we analyze goodwill on an annual basis (or whenever indication of impairment exists) through a qualitative assessment to determine whether it is necessary to perform a goodwill impairment test. ASC 350 states that an entity may first assess qualitative factors to determine whether it is necessary to perform a goodwill impairment test. Such qualitative factors include: (1) macroeconomic conditions, such as a deterioration in general economic conditions, (2) industry and market considerations such as deterioration in the environment in which the entity operates, (3) cost factors such as increases in raw materials and labor costs, and (4) overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings. If the qualitative analysis determines that additional impairment testing is required, impairment testing in accordance with ASC 350 would be initiated. We continually evaluate our qualitative inputs to assess whether events and circumstances have occurred that indicate the goodwill balance may not be recoverable.

**Off-Balance Sheet Arrangements - Joint Ventures.** We may participate in land development joint ventures as a means of accessing larger parcels of land and lot positions, expanding our market opportunities, managing our risk profile and leveraging our capital base. See Note 4 for additional discussion of our investments in unconsolidated entities.

**Off-Balance Sheet Arrangements - Other.** In the normal course of business, we may acquire lots from various development entities pursuant to option and purchase agreements. The purchase price generally approximates the market price at the date the contract is executed (with possible future escalators). See Note 3 for additional information on off-balance sheet arrangements.

**Surety Bonds and Letters of Credit.** We provide surety bonds or letters of credit in support of our obligations relating to the development of our projects and other corporate purposes. Surety bonds are generally posted in lieu of letters of credit or cash deposits. The amount of these obligations outstanding at any time varies depending on the stage and level of completion of our development activities. Bonds are generally not released until all development activities under the bond are complete. In the event a bond or letter of credit is drawn upon, we would be obligated to reimburse

the issuer for any amounts advanced under the bond or letter of credit. We believe it is unlikely that any significant amounts of these bonds or letters of credit will be drawn upon.

The table below outlines our surety bond and letter of credit obligations (in thousands):

	As of June 30, 2018		December 31, 2017	
	Outstanding	Estimated work remaining to complete	Outstanding	Estimated work remaining to complete
<b>Sureties:</b>				
Sureties related to owned projects and lots under contract	\$345,297	\$ 160,981	\$296,387	\$ 120,320
Total Sureties	\$345,297	\$ 160,981	\$296,387	\$ 120,320
<b>Letters of Credit (“LOCs”):</b>				
LOCs for land development	74,254	N/A	70,922	N/A
LOCs for general corporate operations	3,750	N/A	3,750	N/A
Total LOCs	\$78,004	N/A	\$74,672	N/A

Accrued Liabilities. Accrued liabilities at June 30, 2018 and December 31, 2017 consisted of the following (in thousands):

	As of	
	June 30, 2018	December 31, 2017
Accruals related to real estate development and construction activities	\$65,468	\$53,522
Payroll and other benefits	39,559	58,186
Accrued interest	13,404	15,369
Accrued taxes	15,218	14,067
Warranty reserves	23,659	23,328
Other accruals	16,462	16,604
Total	\$173,770	\$181,076

Revenue Recognition. In accordance with ASC 606 Revenue from Contracts with Customers, we apply the following steps in determining the timing and amount of revenue to recognize: (1) identify the contract with our customer; (2) identify the performance obligation(s) in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract, if applicable; and (5) recognize revenue when (or as) we satisfy the performance obligation. The performance obligation and subsequent revenue recognition for our three sources of revenue are outlined below:

Revenue from closings of residential real estate is recognized when closings have occurred, the risks and rewards of ownership are transferred to the buyer, and we have no continuing involvement with the property, which is generally upon the close of escrow. Revenue is reported net of any discounts and incentives.

Revenue from land sales is recognized when a significant down payment is received, title passes and collectability of the receivable is reasonably assured, and we have no continuing involvement with the property, which is generally upon the close of escrow.

- Revenue from financial services is recognized when closings have occurred and all financial services have been rendered, which is generally upon the close of escrow.

Revenue expected to be recognized in any future year related to remaining performance obligations (if any) and contract liabilities expected to be recognized as revenue, excluding revenue pertaining to contracts that have an original expected duration of one year or less, is not material. Our three sources of revenue are disaggregated by type in the accompanying unaudited consolidated income statements.

Warranty Reserves. We provide home purchasers with limited warranties against certain building defects and we have certain obligations related to those post-construction warranties for closed homes. The specific terms and conditions

of these limited warranties vary by state, but overall the nature of the warranties include a complete workmanship and materials warranty typically during the first one to two years after the close of the home and a structural warranty that typically extends

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up to 10 years subsequent to the close of the home. With the assistance of an actuary, we have estimated the reserves for the structural warranty based on the number of homes still under warranty and historical data and trends for our communities. We also use industry data with respect to similar product types and geographic areas in markets where our experience is incomplete to draw a meaningful conclusion. We regularly review our warranty reserves and adjust them, as necessary, to reflect changes in trends as information becomes available. Included in the warranty reserve balances at June 30, 2018 and December 31, 2017 reflected in the table below are case-specific reserves for three warranty matters related to (1) alleged stucco defects in Florida; (2) a potentially faulty solar component in various locations provided by a bankrupt manufacturer; and (3) a foundation design matter affecting a single community in Texas.

A summary of changes in our warranty reserves follows (in thousands):

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Balance, beginning of period	\$23,812	\$22,477	\$23,328	\$22,660
Additions to reserve from new home deliveries	4,146	4,310	7,553	8,125
Warranty claims	(4,299 )	(3,167 )	(7,222 )	(7,165 )
Adjustments to pre-existing reserves	—	—	—	—
Balance, end of period	\$23,659	\$23,620	\$23,659	\$23,620

Warranty reserves are included in Accrued liabilities on the accompanying unaudited consolidated balance sheets, and additions and adjustments to the reserves, if any, are included in Cost of home closings within the accompanying unaudited consolidated income statements. These reserves are intended to cover costs associated with our contractual and statutory warranty obligations, which include, among other items, claims involving defective workmanship and materials. We believe that our total reserves, coupled with our contractual relationships and rights with our trade partners and the general liability insurance we maintain, are sufficient to cover our general warranty obligations. However, as unanticipated changes in legal, weather, environmental or other conditions could have an impact on our actual warranty costs, future costs could differ significantly from our estimates.

We have received claims related to stucco installation from homeowners in certain Florida communities and we established reserves to cover our anticipated exposure related to the repairs based on the information available to us as of June 30, 2018. Our review of the stucco related matter is ongoing and our estimate of future costs of repairs is based on our judgment, various assumptions and internal data. Due to the degree of judgment and the potential for variability in our underlying assumptions and data, as we obtain additional information, we may revise our estimate. As of June 30, 2018, after taking into account potential recovery under our general liability insurance policies and potential recoveries from the contractors involved and their insurers, we believe our reserves are sufficient to cover the repairs related to the existing stucco claims.

#### Recent Accounting Pronouncements.

In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-04, Intangibles - Goodwill and Other (Topic 350), Simplifying the Accounting for Goodwill Impairment ("ASU 2017-04"), which simplifies the accounting for goodwill impairments by eliminating the second step of the goodwill impairment test. Under the new guidance, an impairment loss will reflect the amount by which the carrying amount of a reporting unit exceeds its fair value, not to exceed the carrying amount of goodwill. ASU 2017-04 is effective for us beginning January 1, 2020, with early adoption permitted. We have elected to early adopt ASU 2017-04 effective January 1, 2018 and it did not have a material impact on our financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). ASU 2016-15 adds and clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows, reducing the existing diversity in practice that has resulted from the lack of consistent principles on this topic. ASU 2016-15 was effective for us beginning January

1, 2018. A retrospective transition method was required on adoption and it did not have a material impact on our statement of cash flows.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases with lease terms of greater than twelve months on their balance sheets. ASU 2016-02 will be effective for us beginning January 1, 2019. ASU 2016-02 requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an

option to use certain transition relief. We are currently evaluating the impact adopting this guidance will have on our financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), (“ASU 2014-09”). ASU 2014-09 requires entities to recognize revenue that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. We adopted ASU 2014-09 on January 1, 2018 using a modified retrospective method.

The adoption of ASU 2014-09 did not have an impact on the amount or timing of our homebuilding revenues, although forfeited customer deposits, typically an immaterial amount on an annual basis, that were previously included in Other income, net are reported as Home closing revenue in our consolidated statements of operations effective January 1, 2018. Additionally, as a result of the adoption of ASU 2014-09, there was an immaterial adjustment to our opening balance of Retained earnings with respect to the timing of expenses resulting from ceasing the capitalization of certain selling costs we incur as part of the selling process. The majority of these previously capitalized costs were allocated to either Real estate or Property and equipment, net on our opening 2018 consolidated balance sheet, with an immaterial amount recognized as a cumulative effect adjustment to the opening balance of retained earnings.

As of and for the three and six months ended June 30, 2018 the adoption of ASU 2014-09 did not have a material impact on our balance sheet, net earnings, stockholders' equity or our statement of cash flows. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

**NOTE 2 — REAL ESTATE AND CAPITALIZED INTEREST**

Real estate consists of the following (in thousands):

	As of	
	June 30, 2018	December 31, 2017
Homes under contract under construction <sup>(1)</sup>	\$715,373	\$566,474
Unsold homes, completed and under construction <sup>(1)</sup>	562,435	516,577
Model homes <sup>(1)</sup>	138,441	142,026
Finished home sites and home sites under development <sup>(2)</sup>	1,453,798	1,506,303
Total	\$2,870,047	\$2,731,380

(1) Includes the allocated land and land development costs associated with each lot for these homes.

Includes raw land, land held for development and land held for sale, less impairments, if any. Land held for development primarily reflects land and land development costs related to land where development activity is not currently underway but is expected to begin in the future. For these parcels, we may have chosen not to currently

(2) develop certain land holdings as they typically represent a portion or phases of a larger land parcel that we plan to build out over several years. We do not capitalize interest for inactive assets, and all ongoing costs of land ownership (i.e. property taxes, homeowner association dues, etc.) are expensed as incurred.

Subject to sufficient qualifying assets, we capitalize our development period interest costs incurred in connection with our real estate development and construction activities. Capitalized interest is allocated to active real estate when incurred and charged to cost of closings when the related property is delivered. A summary of our capitalized interest is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Capitalized interest, beginning of period	\$81,828	\$70,885	\$78,564	\$68,196
Interest incurred	21,374	19,280	42,243	37,175
Interest expensed	(44 )	(1,620 )	(180 )	(2,445 )

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Interest amortized to cost of home and land closings	(18,715 )	(16,218 )	(36,184 )	(30,599 )
Capitalized interest, end of period	\$84,443	\$72,327	\$84,443	\$72,327

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## NOTE 3 — VARIABLE INTEREST ENTITIES AND CONSOLIDATED REAL ESTATE NOT OWNED

We enter into purchase and option agreements for land or lots as part of the normal course of business. These purchase and option agreements enable us to acquire properties at one or multiple future dates at pre-determined prices. We believe these acquisition structures reduce our financial risk associated with land acquisitions and allow us to better leverage our balance sheet.

Based on the provisions of the relevant accounting guidance, we have concluded that when we enter into a purchase or option agreement to acquire land or lots from an entity, a variable interest entity, or “VIE”, may be created. We evaluate all purchase and option agreements for land to determine whether they are a VIE. ASC 810, Consolidation, requires that for each VIE, we assess whether we are the primary beneficiary and, if so, consolidate the VIE in our financial statements and reflect such assets and liabilities as Real estate not owned. The liabilities related to consolidated VIEs are generally excluded from our debt covenant calculations.

In order to determine if we are the primary beneficiary, we must first assess whether we have the ability to control the activities of the VIE that most significantly impact its economic performance. Such activities include, but are not limited to: the ability to determine the budget and scope of land development work, if any; the ability to control financing decisions for the VIE; the ability of the VIE to acquire additional land or dispose of land not under contract with Meritage; and the ability to change or amend the existing option contract with the VIE. If we are not determined to control such activities, we are not considered the primary beneficiary of the VIE. If we do have the ability to control such activities, we will continue our analysis to determine if we are also expected to absorb a potentially significant amount of the VIE’s losses or, if no party absorbs the majority of such losses, if we will benefit from a potentially significant amount of the VIE’s expected gains.

In substantially all cases, creditors of the entities with which we have option agreements have no recourse against us and the maximum exposure to loss in our option agreements is limited to non-refundable option deposits and any capitalized pre-acquisition costs. Often, we are at risk for items over budget related to land development on property we have under option if we are the land developer. In these cases, we have contracted to complete development at a fixed cost for our benefit, but on behalf of the land owner, and any budget savings or shortfalls are typically borne by us. Some of our option deposits may be refundable to us if certain contractual conditions are not performed by the party selling the lots.

The table below presents a summary of our lots under option at June 30, 2018 (dollars in thousands):

	Projected Number of Lots	Purchase Price	Option/ Earnest Money Deposits—Cash	
Purchase and option contracts recorded on balance sheet as Real estate not owned	228	\$38,864	\$ 3,886	
Option contracts — non-refundable deposits, committed (1)	2,907	219,491	26,432	
Purchase contracts — non-refundable deposits, committed (1)	5,854	229,643	18,353	
Purchase and option contracts —refundable deposits, committed	866	33,091	1,021	
Total committed	9,855	521,089	49,692	
Purchase and option contracts — refundable deposits, uncommitted (2)	10,728	271,343	3,074	
Total lots under contract or option	20,583	\$792,432	\$ 52,766	
Total purchase and option contracts not recorded on balance sheet (3)	20,355	\$753,568	\$ 48,880	(4)

(1) Deposits are non-refundable except if certain contractual conditions are not performed by the selling party.

(2) Deposits are refundable at our sole discretion. We have not completed our acquisition evaluation process and we have not internally committed to purchase these lots.

(3) Except for our specific performance contracts recorded on our balance sheet as Real estate not owned, none of our purchase or option contracts require us to purchase lots.

(4) Amount is reflected on our consolidated balance sheet in Deposits on real estate under option or contract as of June 30, 2018.

Generally, our options to purchase lots remain effective so long as we purchase a pre-established minimum number of lots each month or quarter, as determined by the respective agreement. Although the pre-established number is typically structured to approximate our expected rate of home construction starts and sales absorptions, during a weakened homebuilding market, we may purchase lots at an absorption level that exceeds our sales and home starts pace in order to meet the pre-

established minimum number of lots or we will work to restructure our original contract to terms that more accurately reflect our revised orders pace expectations.

#### NOTE 4 - INVESTMENTS IN UNCONSOLIDATED ENTITIES

We may enter into land development joint ventures as a means of accessing larger parcels of land, expanding our market opportunities, managing our risk profile and leveraging our capital base. While purchasing land through a joint venture can be beneficial, currently we do not view joint ventures as critical to the success of our homebuilding operations. Based on the structure of each joint venture, it may or may not be consolidated into our results. Our joint venture partners are generally other homebuilders, land sellers or other real estate investors. We generally do not have a controlling interest in these ventures, which means our joint venture partners could cause the venture to take actions we disagree with, or fail to take actions we believe should be undertaken, including the sale of the underlying property to repay debt or recoup all or part of the partners' investments. As of June 30, 2018, we had three active equity-method land ventures.

As of June 30, 2018, we also participated in one mortgage joint venture, which is engaged in mortgage activities and provides services to both our homebuyers as well as other buyers. Our investment in this mortgage joint venture as of June 30, 2018 and December 31, 2017 was \$1.6 million and \$2.2 million, respectively.

Summarized condensed combined financial information related to unconsolidated joint ventures that are accounted for using the equity method was as follows (in thousands):

	As of	
	June 30, 2018	December 31, 2017
Assets:		
Cash	\$8,441	\$ 8,942
Real estate	57,553	55,552
Other assets	3,451	4,323
Total assets	\$69,445	\$ 68,817
Liabilities and equity:		
Accounts payable and other liabilities	\$6,492	\$ 7,516
Notes and mortgages payable	26,572	25,194
Equity of:		
Meritage <sup>(1)</sup>	14,736	14,521
Other	21,645	21,586
Total liabilities and equity	\$69,445	\$ 68,817

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Revenue	\$9,982	\$13,430	\$17,314	\$21,029
Costs and expenses	(3,408 )	(6,106 )	(7,343 )	(10,586 )
Net earnings of unconsolidated entities	\$6,574	\$7,324	\$9,971	\$10,443
Meritage's share of pre-tax earnings <sup>(1) (2)</sup>	\$3,368	\$4,068	\$5,978	\$7,250

Balance represents Meritage's interest, as reflected in the financial records of the respective joint ventures. This balance may differ from the balance reported in our consolidated financial statements due to the following reconciling items: (i) timing differences for revenue and distributions recognition, (ii) step-up basis and (1) corresponding amortization, (iii) capitalization of interest on qualified assets, (iv) income deferrals as discussed in Note (2) below and (v) the cessation of allocation of losses from joint ventures in which we have previously written down our investment balance to zero and where we have no commitment to fund additional losses.

Our share of pre-tax earnings is recorded in Earnings from financial services unconsolidated entities and other, net and (Loss)/earnings from other unconsolidated entities, net on our unaudited consolidated income statements and (2) excludes joint venture profit related to lots we purchased from the joint ventures, if any. Such profit is deferred until homes are delivered by us and title passes to a homebuyer.

Our total investment in all of these joint ventures is \$16.6 million and \$17.1 million as of June 30, 2018 and December 31, 2017, respectively. We believe these ventures are in compliance with their respective debt agreements, if applicable, and such debt is non-recourse to us.

#### NOTE 5 — LOANS PAYABLE AND OTHER BORROWINGS

Loans payable and other borrowings consist of the following (in thousands):

	As of	
	June 30, 2018	December 31, 2017
Other borrowings, real estate notes payable <sup>(1)</sup>	\$16,552	\$17,354
\$780 million unsecured revolving credit facility with interest approximating LIBOR (approximately 2.09% at June 30, 2018) plus 1.75% or Prime (5.00% at June 30, 2018) plus 0.75%	—	—
Total	\$16,552	\$17,354

(1) Reflects balance of non-recourse notes payable in connection with land purchases, with interest rates ranging from 0% to 8%.

The Company entered into an amended and restated unsecured revolving credit facility ("Credit Facility") in 2014 that has been amended from time to time. In June 2018 the aggregate commitment was increased to \$780.0 million, and the maturity date extended to July 2022. The accordion feature was also refreshed permitting the size of the facility to increase to a maximum of \$880.0 million. Borrowings under the Credit Facility are unsecured but availability is subject to, among other things, a borrowing base. The Credit Facility also contains certain financial covenants, including (a) a minimum tangible net worth requirement of \$1.1 billion (which amount is subject to increase over time based on subsequent earnings and proceeds from equity offerings), and (b) a maximum leverage covenant that prohibits the leverage ratio (as defined therein) from exceeding 60%. In addition, we are required to maintain either (i) an interest coverage ratio (EBITDA to interest expense, as defined therein) of at least 1.50 to 1.00 or (ii) liquidity (as defined therein) of an amount not less than our consolidated interest incurred during the trailing 12 months.

We had no outstanding borrowings under the Credit Facility as of June 30, 2018 and December 31, 2017. During the three and six months ended June 30, 2018, we had \$285.0 million in gross borrowings and repayments. During the three months ended June 30, 2017 we had \$85.0 million of gross borrowings and \$145.0 million of repayments. During the six months ended June 30, 2017, we had \$245.0 million of gross borrowings and \$260.0 million of repayments. As of June 30, 2018, we had outstanding letters of credit issued under the Credit Facility totaling \$78.0 million, leaving \$702.0 million available under the Credit Facility to be drawn.



## NOTE 6 — SENIOR NOTES, NET

Senior notes, net consist of the following (in thousands):

	As of	
	June 30, 2018	December 31, 2017
4.50% senior notes due 2018	\$—	\$175,000
7.15% senior notes due 2020. At June 30, 2018 and December 31, 2017 there was approximately \$995 and \$1,280 in net unamortized premium, respectively.	300,995	301,280
7.00% senior notes due 2022	300,000	300,000
6.00% senior notes due 2025. At June 30, 2018 there was approximately \$5,727 in net unamortized premium. <sup>(1)</sup>	405,727	200,000
5.125% senior notes due 2027	300,000	300,000
Net debt issuance costs	(12,017 )	(9,830 )
Total	\$1,294,705	\$1,266,450

\$200.0 million of the total \$400.0 million 6.00% Senior Notes due 2025 outstanding at December 31, 2017 was <sup>(1)</sup> issued at par and had no unamortized premium.

In March 2018, the Company completed an offering of \$200.0 million aggregate principal amount of 6.00% Senior Notes due 2025 (the "Additional Notes"). The Additional Notes were issued as an add-on to the existing \$200.0 million of 6.00% Senior Notes due 2025 that were issued in June 2015 which resulted in a combined \$400.0 million aggregate principal amount of 6.00% Senior Notes due 2025 outstanding as of June 30, 2018. The Additional Notes were issued at a premium of 103% of the principal amount and the net proceeds were used to repay outstanding borrowings under the Credit Facility, which included borrowings used for the redemption of the Company's \$175.0 million of 4.50% Senior Notes that were due to mature on March 1, 2018.

The indentures for all of our senior notes contain covenants including, among others, limitations on the amount of secured debt we may incur, and limitations on sale and leaseback transactions and mergers. We believe we are in compliance with all such covenants as of June 30, 2018.

Obligations to pay principal and interest on the senior notes are guaranteed by substantially all of our wholly-owned subsidiaries (each a "Guarantor" and, collectively, the "Guarantor Subsidiaries"), each of which is directly or indirectly 100% owned by Meritage Homes Corporation. Such guarantees are full and unconditional, and joint and several. In the event of a sale or other disposition of all of the assets of any Guarantor, by way of merger, consolidation or otherwise, or a sale or other disposition of all of the equity interests of any Guarantor then held by Meritage and its subsidiaries, then that Guarantor may be released and relieved of any obligations under its note guarantee. There are no significant restrictions on our ability or the ability of any Guarantor to obtain funds from their respective subsidiaries, as applicable, by dividend or loan. We do not provide separate financial statements of the Guarantor Subsidiaries because Meritage (the parent company) has no independent assets or operations and the guarantees are full and unconditional and joint and several. Subsidiaries of Meritage Homes Corporation that are non-guarantor subsidiaries are, individually and in the aggregate, minor.

## NOTE 7 — FAIR VALUE DISCLOSURES

We account for non-recurring fair value measurements of our non-financial assets and liabilities in accordance with ASC 820-10 Fair Value Measurement ("ASC 820"). This guidance defines fair value, establishes a framework for measuring fair value and addresses required disclosures about fair value measurements. This standard establishes a three-level hierarchy for fair value measurements based upon the significant inputs used to determine fair value. Observable inputs are those which are obtained from market participants external to the company while unobservable inputs are generally developed internally, utilizing management's estimates, assumptions and specific knowledge of the assets/liabilities and related markets. The three levels are defined as follows:

Level 1 — Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 — Valuation is determined from quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar instruments in markets that are not active, or by model-based techniques in which all significant

inputs are observable in the market.

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Level 3 — Valuation is derived from model-based techniques in which at least one significant input is unobservable and based on the company's own estimates about the assumptions that market participants would use to value the asset or liability.

Financial Instruments: The fair value of our fixed-rate debt is derived from quoted market prices by independent dealers (level 2 inputs as per the discussion above) and is as follows (in thousands):

	As of		As of	
	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
	Aggregate Principal	Estimated Fair Value	Aggregate Principal	Estimated Fair Value
4.50% senior notes	N/A	N/A	\$ 175,000	\$ 175,228
7.15% senior notes	\$ 300,000	\$ 317,250	\$ 300,000	\$ 326,250
7.00% senior notes	\$ 300,000	\$ 323,250	\$ 300,000	\$ 337,500
6.00% senior notes	\$ 400,000	\$ 405,000	\$ 200,000	\$ 214,000
5.125% senior notes	\$ 300,000	\$ 277,500	\$ 300,000	\$ 305,250

Due to the short-term nature of other financial assets and liabilities, including our Loans payable and other borrowings, we consider the carrying amounts of our other short-term financial instruments to approximate fair value.

#### NOTE 8 — EARNINGS PER SHARE

Basic and diluted earnings per common share were calculated as follows (in thousands, except per share amounts):

	Three Months		Six Months	
	Ended June 30, 2018	2017	Ended June 30, 2018	2017
Basic weighted average number of shares outstanding	40,647	40,317	40,568	40,248
Effect of dilutive securities:				
Convertible debt <sup>(1)</sup>	—	1,991	—	2,083
Unvested restricted stock	517	473	625	505
Diluted average shares outstanding	41,164	42,781	41,193	42,836
Net earnings as reported	\$ 53,838	\$ 41,580	\$ 97,712	\$ 65,152
Interest attributable to Convertible Notes, net of income taxes <sup>(1)</sup>	—	354	—	739
Net earnings for diluted earnings per share	\$ 53,838	\$ 41,934	\$ 97,712	\$ 65,891
Basic earnings per share	\$ 1.32	\$ 1.03	\$ 2.41	\$ 1.62
Diluted earnings per share <sup>(1)</sup>	\$ 1.31	\$ 0.98	\$ 2.37	\$ 1.54
Antidilutive stock not included in the calculation of diluted earnings per share	1	59	1	2

In accordance with ASC 260-10, Earnings Per Share, ("ASC 260-10") we calculate the dilutive effect of (1) convertible securities using the "if-converted" method based on the number of days our Convertible Notes were outstanding during the period. All of the Convertible Notes were retired in the second half of 2017.



## NOTE 9 — ACQUISITIONS AND GOODWILL

Goodwill. Over the past several years, we entered new markets through the acquisition of the homebuilding assets and operations of local/regional homebuilders in Georgia, South Carolina and Tennessee. As a result of these transactions, we recorded approximately \$33.0 million of goodwill. Goodwill represents the excess of the purchase price of our acquisitions over the fair value of the net assets acquired. Our acquisitions are recorded in accordance with ASC 805, Business Combinations and ASC 820, using the acquisition method of accounting. The purchase price for acquisitions is allocated based on estimated fair value of the assets and liabilities at the date of the acquisition. The combined excess purchase price of our acquisitions over the fair value of the net assets is classified as goodwill and is included on our consolidated balance sheet in Prepaids, other assets and goodwill. In accordance with ASC 350, we assess the recoverability of goodwill annually, or more frequently, if impairment indicators are present.

A summary of the carrying amount of goodwill follows (in thousands):

	West	Central	East	Financial Services	Corporate	Total
Balance at December 31, 2017	\$ —	\$ —	—\$32,962	\$ —	\$ —	—\$32,962
Additions	—	—	—	—	—	—
Impairments	—	—	—	—	—	—
Balance at June 30, 2018	\$ —	\$ —	—\$32,962	\$ —	\$ —	—\$32,962

## NOTE 10 — STOCKHOLDERS' EQUITY

A summary of changes in stockholders' equity is presented below (in thousands):

Six Months Ended June 30, 2018

(In thousands)

	Number of Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Total
Balance at December 31, 2017	40,331	\$ 403	\$584,578	\$991,844	\$1,576,825
Adoption of ASU 2014-09 <sup>(1)</sup>	—	—	—	(583)	(583)
Net earnings	—	—	—	97,712	97,712
Exercise/vesting of stock-based awards	318	3	(3)	—	—
Stock-based compensation expense	—	—	8,986	—	8,986
Balance at June 30, 2018	40,649	\$ 406	\$593,561	\$1,088,973	\$1,682,940

(1) Refer to Note 1 for additional information related to the adoption of ASU 2014-09.

Six Months Ended June 30, 2017

(In thousands)

	Number of Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Total
Balance at December 31, 2016	40,031	\$ 400	\$572,506	\$848,589	\$1,421,495
Net earnings	—	—	—	65,152	65,152
Exercise/vesting of stock-based awards	289	3	(3)	—	—
Stock-based compensation expense	—	—	5,792	—	5,792
Balance at June 30, 2017	40,320	\$ 403	\$578,295	\$913,741	\$1,492,439

## NOTE 11 — STOCK BASED AND DEFERRED COMPENSATION

We have two stock-based compensation plans, the Amended and Restated 2006 Stock Incentive Plan (the "2006 Plan") and the Meritage Homes Corporation 2018 Stock Incentive Plan (the "2018 Plan"), collectively the "Stock Plans". The 2006 Plan was approved by our Board of Directors and adopted in 2006 and has been amended or restated from time to time. The 2018 Plan was approved by our Board of Directors and our stockholders and adopted in May 2018, authorizing 1,250,000 shares for issuance. Both plans are administered by our Board of Directors and allow for the grant of stock appreciation rights, restricted stock awards, restricted stock units, performance share awards and performance-based awards in addition to non-qualified and incentive stock options. The Stock Plans authorize awards to officers, key employees, non-employee directors and consultants. The 2006 Plan authorizes 5,350,000 shares of common stock to be awarded, of which 643,793 shares remain available for grant at June 30, 2018. Upon expiration of the 2006 Plan in May 2019, any available shares from expired, terminated or forfeited awards that remain under the 2006 Plan and prior plans will be available for grant under the 2018 Plan. The 2018 Plan has 1,250,000 shares available for grant at June 30, 2018. We believe that such awards provide a means of performance-based compensation to attract and retain qualified employees and better align the interests of our employees with those of our stockholders. Non-vested stock awards are usually granted with a five-year ratable vesting period for employees and with a three-year cliff vesting for both non-vested stock and performance-based awards granted to certain senior executive officers and non-employee directors.

Compensation cost related to time-based restricted stock awards is measured as of the closing price on the date of grant and is expensed, less forfeitures, on a straight-line basis over the vesting period of the award. Compensation cost related to performance-based restricted stock awards is also measured as of the closing price on the date of grant but is expensed in accordance with ASC 718-10-25-20, Compensation – Stock Compensation ("ASC 718"), which requires an assessment of probability of attainment of the performance target. As our performance targets are dependent on performance over a specified measurement period, once we determine that the performance target outcome is probable, the cumulative expense is recorded immediately with the remaining expense recorded on a straight-line basis through the end of the award vesting period. For the three and six months ended June 30, 2018, stock compensation increased as compared to prior year partially due to a change in the compensation structure for certain executives to all performance-based equity grants. A portion of the performance-based restricted stock awards granted contain market conditions as defined by ASC 718. The guidance in ASC 718 requires that compensation expense for stock awards with market conditions be expensed based on a derived grant date fair value and expensed over the service period. We engage a third party to perform a valuation analysis on the awards containing market conditions and our associated expense with those awards is based on the derived fair value from that analysis and is being expensed straight-line over the service period of the awards. Below is a summary of compensation expense and stock award activity (dollars in thousands):

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2018	2017	2018	2017
Stock-based compensation expense	\$3,767	\$2,490	\$8,976	\$5,785
Non-vested shares granted	—	—	306,164	16,500
Performance-based non-vested shares granted	—	—	157,637	154,120
Restricted stock awards vested (includes performance-based awards)	17,137	6,190	318,712	289,764

The following table includes additional information regarding our Plan (dollars in thousands):

	As of	
	June 30,	December
	2018	31, 2017
Unrecognized stock-based compensation cost	\$25,155	\$18,439
Weighted average years expense recognition period	2.71	2.48
Total equity awards outstanding <sup>(1)</sup>	1,331,946	1,269,657

(1) Includes unvested restricted stock, performance-based awards (assuming 100% payout) and restricted stock units.

We also offer a non-qualified deferred compensation plan ("deferred compensation plan") to highly compensated employees in order to allow them additional pre-tax income deferrals above and beyond the limits that qualified plans, such as 401(k) plans, impose on highly compensated employees. We do not currently offer a contribution match on the deferred compensation plan. All contributions to the plan to date have been funded by the employees and, therefore, we have no associated expense related to the deferred compensation plan for the three and six months ended June 30, 2018 or 2017, other than minor administrative costs.

#### NOTE 12 — INCOME TAXES

Components of the income tax provision are as follows (in thousands):

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2018	2017	2018	2017
Federal	\$14,425	\$19,215	\$17,371	\$30,788
State	2,922	2,410	4,986	4,034
Total	\$17,347	\$21,625	\$22,357	\$34,822

The effective tax rate for the three and six months ended June 30, 2018 was 24.4% and 18.6%, respectively, and for the three and six months ended June 30, 2017 was 34.2% and 34.8%, respectively. The lower 2018 effective tax rates reflect lower corporate tax rates as a result of the Tax Cuts and Jobs Act of 2017 (the "Tax Act") passed in December 2017 and the lower year-to-date rate also reflects the impact from the President signing the Bipartisan Budget Act of 2018 in February 2018, which included a retroactive extension of the Internal Revenue Code ("IRC") §45L new energy efficient homes credit that had previously expired in 2016. This extension provision provides for a single year extension of energy tax credits for homes sold in 2017 that meet the qualification criteria. Under ASC 740, the effects of these tax credits were required to be recorded in 2018, based on the date of enactment, regardless of the retroactive treatment. Our tax rate for 2017 does not include energy credits, but was favorably impacted by the homebuilding manufacturing deduction, which was eliminated for 2018 under the Tax Act. We anticipate that with the completion of our 2017 income tax returns, future guidance and additional information and interpretations with respect to the Tax Act will cause us to further adjust the provisional amounts recorded as of December 31, 2017. In accordance with SEC Staff Accounting Bulletin No. 118, we will record such adjustments in the period that relevant guidance or additional information becomes available and our analysis is completed.

At June 30, 2018 and December 31, 2017, we have no unrecognized tax benefits. We believe that our current income tax filing positions and deductions will be sustained on audit and do not anticipate any adjustments that will result in a material change. Our policy is to accrue interest and penalties on unrecognized tax benefits and include them in federal income tax expense.

We determine our deferred tax assets and liabilities in accordance with ASC 740-10, Income Taxes. We evaluate our deferred tax assets, including the benefit from net operating losses ("NOLs"), by jurisdiction to determine if a valuation allowance is required. Companies must assess whether a valuation allowance should be established based on the consideration of all available evidence using a "more likely than not" standard with significant weight being given to evidence that can be objectively verified. This assessment considers, among other matters, the nature, frequency and severity of cumulative losses, forecasts of future profitability, the length of statutory carry forward periods, experiences with operating losses and experiences of utilizing tax credit carry forwards and tax planning alternatives. We have no valuation allowance on our deferred tax assets and NOL carryovers at June 30, 2018.

At June 30, 2018, we had no remaining federal NOL carry forward or un-utilized federal tax credits. At June 30, 2018, and December 31, 2017 we had tax benefits for state NOL carry forwards of \$1.8 million, net of federal benefit, that begin to expire in 2028.

At June 30, 2018, we have income taxes payable of \$8.2 million, which primarily consists of current federal and state tax accruals, net of estimated tax payments and tax credits. This amount is recorded in Accrued liabilities on the accompanying unaudited balance sheet at June 30, 2018.

We conduct business and are subject to tax in the U.S. and several states. With few exceptions, we are no longer subject to U.S. federal, state, or local income tax examinations by taxing authorities for years prior to 2013. We have one state income tax examination of multiple years under audit at this time and do not expect it to have a material outcome.

## NOTE 13 — SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

The following table presents certain supplemental cash flow information (in thousands):

	Six Months Ended June 30,	
	2018	2017
Interest capitalized, net	\$4,602	\$161
Income taxes paid	\$22,353	\$34,426
Non-cash operating activities:		
Real estate not owned increase	\$—	\$9,987
Real estate acquired through notes payable	\$1,697	\$5,786

## NOTE 14 — OPERATING AND REPORTING SEGMENTS

We operate with two principal business segments: homebuilding and financial services. As defined in ASC 280-10, Segment Reporting, we have nine homebuilding operating segments. The homebuilding segments are engaged in the business of acquiring and developing land, constructing homes, marketing and selling those homes and providing warranty and customer services. We aggregate our homebuilding operating segments into reporting segments based on similar long-term economic characteristics and geographical proximity. Our current reportable homebuilding segments are as follows:

West: Arizona, California and Colorado

Central: Texas

East: Florida, Georgia, North Carolina, South Carolina and Tennessee

Management's evaluation of segment performance is based on segment operating income, which we define as home and land closing revenues less cost of home and land closings, commissions and other sales costs, land development and other land sales costs and other costs incurred by or allocated to each segment, including impairments. Each reportable segment follows the same accounting policies described in Note 1, "Organization and Basis of Presentation." Operating results for each segment may not be indicative of the results for such segment had it been an independent, stand-alone entity for the periods presented.

The following segment information is in thousands:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Homebuilding revenue <sup>(1)</sup> :				
West	\$351,647	\$369,574	\$668,875	\$681,378
Central	260,106	225,679	451,976	400,510
East	265,742	206,725	499,208	392,862
Consolidated total	\$877,495	\$801,978	\$1,620,059	\$1,474,750
Homebuilding segment operating income:				
West	\$33,062	\$35,131	\$54,183	\$59,143
Central	25,576	23,230	39,843	37,120
East	14,564	5,285	25,923	7,721
Total homebuilding segment operating income	73,202	63,646	119,949	103,984
Financial services segment profit	5,651	5,557	9,871	9,847
Corporate and unallocated costs <sup>(2)</sup>	(9,402)	(7,028)	(16,674)	(15,545)
(Loss)/earnings from other unconsolidated entities, net	(156)	570	(202)	943
Interest expense	(44)	(1,620)	(180)	(2,445)
Other income, net <sup>(3)</sup>	1,934	2,080	7,305	3,190
Net earnings before income taxes	\$71,185	\$63,205	\$120,069	\$99,974



(1) Homebuilding revenue includes the following land closing revenue, by segment, as outlined in the table below:

	Three Months		Six Months	
	Ended June 30, 2018	2017	Ended June 30, 2018	2017
Land closing revenue:				
West	\$1,935	\$—	\$14,390	\$11,800
Central	762	—	887	122
East	2,415	4,198	3,867	4,431
Total	\$5,112	\$4,198	\$19,144	\$16,353

(2) Balance consists primarily of corporate costs and numerous shared service functions such as finance and treasury that are not allocated to the homebuilding or financial services reporting segments.

(3) For the six months ended June 30, 2018, Other income, net includes a favorable \$4.8 million legal settlement from long-standing litigation related to a previous joint venture in Nevada.

At June 30, 2018

	West	Central	East	Financial Services	Corporate and Unallocated	Total
Deposits on real estate under option or contract	\$ 11,790	\$ 15,512	\$ 21,578	\$ —	\$ —	\$ 48,880
Real estate	1,235,184	739,853	895,010	—	—	2,870,047
Investments in unconsolidated entities	8,073	6,974	—	—	1,592	16,639
Other assets	58,486	(1)104,174	(2)117,332	(3)741	178,595	(4)459,328
Total assets	\$ 1,313,533	\$ 866,513	\$ 1,033,920	\$ 741	\$ 180,187	\$ 3,394,894

(1) Balance consists primarily of cash and property and equipment.

(2) Balance consists primarily of development reimbursements from local municipalities and cash.

(3) Balance consists primarily of real estate not owned, goodwill (see Note 9) and property and equipment.

(4) Balance consists primarily of cash and our deferred tax asset.

At December 31, 2017

	West	Central	East	Financial Services	Corporate and Unallocated	Total
Deposits on real estate under option or contract	\$ 15,557	\$ 21,309	\$ 23,079	\$ —	\$ —	\$ 59,945
Real estate	1,174,285	700,460	856,635	—	—	2,731,380
Investments in unconsolidated entities	7,833	6,999	—	—	2,236	17,068
Other assets	58,470	(1)110,173	(2)144,681	(3)1,249	128,292	(4)442,865
Total assets	\$ 1,256,145	\$ 838,941	\$ 1,024,395	\$ 1,249	\$ 130,528	\$ 3,251,258

(1) Balance consists primarily of cash and property and equipment.

(2) Balance consists primarily of development reimbursements from local municipalities and cash.

(3) Balance consists primarily of real estate not owned, cash, and goodwill (see Note 9).

(4) Balance consists primarily of cash and our deferred tax asset.



NOTE 15 — COMMITMENTS AND CONTINGENCIES

We are involved in various routine legal and regulatory proceedings, including, without limitation, warranty claims and litigation and arbitration proceedings alleging construction defects. In general, the proceedings are incidental to our business, and most exposure is subject to and should be covered by warranty and indemnity obligations of our consultants and subcontractors. Additionally, some such claims are also covered by insurance. With respect to the majority of pending litigation matters, our ultimate legal and financial responsibility, if any, cannot be estimated with certainty and, in most cases, any potential losses related to these matters are not considered probable. Historically, most disputes regarding warranty claims are resolved prior to litigation. We believe there are no pending legal or warranty matters that could have a material adverse impact upon our consolidated financial condition, results of operations or cash flows that have not been sufficiently reserved.

As discussed in Note 1 under the heading “Warranty Reserves”, we have case specific reserves within our \$23.7 million of total warranty reserves related to a foundation design matter affecting a single community in Texas. In addition to the repairs required to be made to homes within that community, we have been named as a defendant in several lawsuits filed by homeowners in that community. As of June 30, 2018, the claim we made for this matter under our general liability insurance policy has initially been denied, which we vehemently disagree with and have disputed with our insurance carrier. We regularly review our reserves, and adjust them, as necessary to reflect changes as more information becomes available. As of June 30, 2018, taking into account sources of potential recovery from the contractors involved with the construction design of the homes and their insurers, we believe our reserves are sufficient to cover repairs and related claims.

### Special Note of Caution Regarding Forward-Looking Statements

In passing the Private Securities Litigation Reform Act of 1995 (“PSLRA”), Congress encouraged public companies to make “forward-looking statements” by creating a safe-harbor to protect companies from securities law liability in connection with forward-looking statements. We intend to qualify both our written and oral forward-looking statements for protection under the PSLRA.

The words “believe,” “expect,” “anticipate,” “forecast,” “plan,” “intend,” “may,” “will,” “should,” “could,” “estimate,” “project” and similar expressions identify forward-looking statements, which speak only as of the date the statement was made. All statements we make other than statements of historical fact are forward-looking statements within the meaning of that term in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

Forward-looking statements in this Quarterly Report include: statements concerning trends and economic factors in the homebuilding industry in general, and our markets and results specifically; our operating strategy and initiatives, including our strategy to expand the number of communities that target the first-time buyer segment; demand and pricing trends in the short-term throughout our geographies; that we may opportunistically repurchase our debt and equity securities; the benefits of our land acquisition strategy and structures, including the use and the benefits of option contracts and joint ventures; that we expect to redeploy cash generated from operations to acquire and develop lot positions; our expectation that existing guarantees, letters of credit and performance and surety bonds will not be drawn on; the adequacy of our insurance coverage and warranty reserves; the expected outcome of legal proceedings we are involved in and the sufficiency of our reserves relating thereto; the sufficiency of our liquidity and capital resources to support our business strategy; our ability and willingness to acquire land under option or contract; our strategy and trends and expectations concerning sales prices, sales pace, closings, orders, cancellations, material and labor costs for land development and home construction, gross margins, gross profit, revenues, net earnings, operating leverage, backlog, land prices, changes in and location of active communities, and the amount, type and timing of new community openings; seasonality; our future cash needs; that we may seek to raise additional debt and equity capital; and our intentions regarding the payment of dividends and the use of derivative contracts; our perceptions about the importance of joint ventures to our business; and the impact of changes in interest rates.

Important factors that could cause actual results to differ materially from those in forward-looking statements, and that could negatively affect our business include, but are not limited to, the following: the availability and cost of finished lots and undeveloped land; shortages in the availability and cost of labor; changes in interest rates and the availability and pricing of residential mortgages; changes in tax laws that adversely impact us or our homebuyers; inflation in the cost of materials used to develop communities and construct homes; the success of strategic initiatives; the ability of our potential buyers to sell their existing homes; cancellation rates; the adverse effect of slow absorption rates; slowing in the growth of first-time homebuyers; competition; impairments of our real estate inventory; a change to the feasibility of projects under option or contract that could result in the write-down or write-off of earnest money or option deposits; our potential exposure to and impacts from natural disasters or severe weather conditions; home warranty and construction defect claims; failures in health and safety performance; our success in prevailing on contested tax positions; our ability to obtain performance and surety bonds in connection with our development work; the loss of key personnel; failure to comply with laws and regulations; our limited geographic diversification; fluctuations in quarterly operating results; our level of indebtedness; our ability to obtain financing if our credit ratings are downgraded; our ability to successfully integrate acquired companies and achieve anticipated benefits from these acquisitions; our compliance with government regulations; the effect of legislative and other governmental actions, orders, policies or initiatives that impact housing, labor availability, construction, mortgage availability, our access to capital, the cost of capital or the economy in general, or other initiatives that seek to restrain growth of new housing construction or similar measures; legislation relating to energy and climate change; the replication of our energy-efficient technologies by our competitors; our exposure to information technology failures and security breaches; negative publicity that affects our reputation; and other factors identified in documents filed by the Company with the Securities and Exchange Commission, including those set forth in our Form 10-K for the year ended December 31, 2017 under the caption “Risk Factors,” which can be found on our website.

Forward-looking statements express expectations of future events. All forward-looking statements are inherently uncertain as they are based on various expectations and assumptions concerning future events and they are subject to

numerous known and unknown risks and uncertainties that could cause actual events or results to differ materially from those projected. Due to these inherent uncertainties, the investment community is urged not to place undue reliance on forward-looking statements. In addition, we disclaim and undertake no obligations to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to projections over time, except as required by law.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Overview and Outlook

The housing market has remained healthy during the first six months of 2018 as a solid economy assisted by low unemployment levels, wage growth and a shortage in the supply of homes, particularly at entry-level price points, has overcome concerns from potential impacts of rising interest rates and stock market volatility. We believe that these factors will continue to create a positive demand environment for our sector, particularly among the first-time homebuyer segment where lower-priced homes continue to offer affordable solutions for home buyers.

The desire for new homes continues to be strong across most of our markets, especially for our entry-level LiVE.NOW.® communities that target first-time or move-down homebuyers looking for a lower priced product. We continue to focus on our key strategic initiatives such as home closing gross margin improvement, selling, general and administrative cost control and community count growth that we believe will position us to improve profitability, with our focus on the first-time and first move-up buyer. First-time buyers represented nearly half of our orders in the second quarter of 2018 and we expect that growth to continue as we are opening an increased number of communities that target the first-time buyer segment. Our entry-level product is also attracting move-down buyers with select floor plans and price points that appeal to an age-targeted audience.

### Summary Company Results

Our second quarter 2018 results delivered on several of our key strategic initiatives, with growth in our entry-level business, growing orders pace in our markets and performance gains reflected in our improved home closing gross margins, most notably in our East region. Total home closing revenue was \$872.4 million for the three months ended June 30, 2018, an increase of \$74.6 million over the corresponding prior year period, due to 233 additional homes closed. The increase in home closing revenue and 60-basis-point improvement in home closing gross margin provided \$18.6 million in additional home closing gross profit which, combined with a \$1.6 million decrease in interest expense and a lower income tax provision, contributed to \$53.8 million in net income for the three months ended June 30, 2018, a 29.5% improvement over the \$41.6 million in the corresponding 2017 period. Second quarter 2018 results reflect a lower provision for income taxes due to a lower effective tax rate of 24.4% versus 34.2% in 2017 as a result of the Tax Act signed into law in December 2017, which resulted in a lower corporate tax rate. Similar to the second quarter, year-to-date results reflect \$142.5 million in additional home closing revenue and \$35.7 million higher home closing gross profit versus the six months ended June 30, 2017. Higher gross profit combined with a \$4.1 million increase in Other income, net and lower year-over-year interest expense led to net income of \$97.7 million for the six months ended June 30, 2018 compared to \$65.2 million for the 2017 period.

On a consolidated basis, we experienced year over year growth in closings and orders, both in units and value, for the three and six months ended June 30, 2018 over the prior year. We ended the second quarter of 2018 with 3,619 homes in backlog valued at \$1.5 billion, 5.6% and 5.5% improvements, respectively, over June 30, 2017. The growth in year-over-year backlog is the result of a 7.5% improvement in year-to-date orders at June 30, 2018 compared to the prior year, as our average sales price on homes in backlog was down slightly stemming from our pivot to entry-level product. The percentage of actively selling communities that target to the first-time buyer grew to 34.0% in the second quarter of 2018, as compared to 24.5% in the prior year second quarter.

### Company Positioning

We believe that the investments in our new communities, particularly those designed for the first-time homebuyer, and industry-leading innovation in energy-efficient product offerings and automation create a differentiated strategy that has aided us in our growth in the highly competitive new home market.

Our focus includes the following strategic initiatives:

- Expanding the number of LiVE.NOW® communities that target the growing first-time homebuyer segment;
- Improving the overall customer experience, most recently through a simplification of the customer purchase and selection processes;

- Enhancing our website and sales offices through investments in technology. As of June 30, 2018 all of our LiVE.NOW communities feature interactive tools offering homebuyers the ability to search for available homes with their desired home features and based on their preferred availability or move-in dates;

Improving our home closing gross margin by growing revenue while managing costs, allowing us to better leverage our overhead;  
• Actively acquire and develop land in key markets in order to maintain and grow our lot supply and active community count; and

In order to maintain focus on growing our business, we also remain committed to the following:

- Increasing orders and order pace through the use of our consumer and market research to build homes that offer our buyers their desired features and amenities;
- Expanding market share in our smaller markets;
- Continuing to innovate and promote our energy efficiency program and our M.Connected® Automation Suite to create differentiation for the Meritage brand;
- Managing construction efficiencies and cost increases through national and regional vendor relationships with a focus on quality construction and warranty management;
- Generating additional working capital and maintaining adequate liquidity, most recently through a \$200 million add-on to our existing \$200.0 million of 6.00% Senior Notes due 2025 and through the expansion and extension of our Credit Facility; and
- Promoting a positive environment for our employees in order to develop and motivate them and to minimize turnover.

#### Critical Accounting Policies

The accounting policies we deem most critical to us and that involve the most difficult, subjective or complex judgments include revenue recognition, valuation of real estate, goodwill, deferred tax assets and warranty reserves as well as the calculation of compensation cost relating to share-based payments. Other than the adoption of ASU 2014-09, as described in Note 1 in the accompanying unaudited consolidated financial statements, there have been no significant changes to our critical accounting policies during the six months ended June 30, 2018 compared to those disclosed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our 2017 Annual Report on Form 10-K.

## Home Closing Revenue, Home Orders and Order Backlog

The composition of our closings, home orders and backlog is constantly changing and is based on a changing mix of communities with various price points between periods as new projects open and existing projects wind down.

Further, individual homes within a community can range significantly in price due to differing square footage, option selections, lot sizes and quality and location of lots (e.g. cul-de-sac, view lots, greenbelt lots). These variations result in a lack of meaningful comparability between our home orders, closings and backlog due to the changing mix between periods. The tables on the following pages present operating and financial data that we consider most critical to managing our operations (dollars in thousands):

	Three Months Ended June 30,		Quarter over Quarter		
	2018	2017	Change \$	Change %	
<b>Home Closing Revenue</b>					
<b>Total</b>					
Dollars	\$872,383	\$797,780	\$74,603	9.4	%
Homes closed	2,139	1,906	233	12.2	%
Average sales price	\$407.8	\$418.6	\$(10.7)	(2.6)	%
<b>West Region</b>					
<b>Arizona</b>					
Dollars	\$118,272	\$141,015	\$(22,743)	(16.1)	%
Homes closed	366	419	(53)	(12.6)	%
Average sales price	\$323.1	\$336.6	\$(13.4)	(4.0)	%
<b>California</b>					
Dollars	\$142,019	\$140,270	\$1,749	1.2	%
Homes closed	206	231	(25)	(10.8)	%
Average sales price	\$689.4	\$607.2	\$82.2	13.5	%
<b>Colorado</b>					
Dollars	\$89,421	\$88,289	\$1,132	1.3	%
Homes closed	162	154	8	5.2	%
Average sales price	\$552.0	\$573.3	\$(21.3)	(3.7)	%
<b>West Region Totals</b>					
Dollars	\$349,712	\$369,574	\$(19,862)	(5.4)	%
Homes closed	734	804	(70)	(8.7)	%
Average sales price	\$476.4	\$459.7	\$16.8	3.6	%
<b>Central Region - Texas</b>					
<b>Central Region Totals</b>					
Dollars	\$259,344	\$225,679	\$33,665	14.9	%
Homes closed	741	610	131	21.5	%
Average sales price	\$350.0	\$370.0	\$(20.0)	(5.4)	%
<b>East Region</b>					
<b>Florida</b>					
Dollars	\$110,467	\$82,448	\$28,019	34.0	%
Homes closed	252	187	65	34.8	%
Average sales price	\$438.4	\$440.9	\$(2.5)	(0.6)	%
<b>Georgia</b>					
Dollars	\$34,835	\$25,366	\$9,469	37.3	%
Homes closed	104	73	31	42.5	%
Average sales price	\$335.0	\$347.5	\$(12.5)	(3.6)	%
<b>North Carolina</b>					
Dollars	\$77,075	\$59,560	\$17,515	29.4	%

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Homes closed	195	132	63	47.7	%
Average sales price	\$395.3	\$451.2	\$(56.0)	(12.4)	%
South Carolina					
Dollars	\$26,885	\$23,866	\$3,019	12.6	%
Homes closed	76	70	6	8.6	%
Average sales price	\$353.8	\$340.9	\$12.8	3.8	%
Tennessee					
Dollars	\$14,065	\$11,287	\$2,778	24.6	%
Homes closed	37	30	7	23.3	%
Average sales price	\$380.1	\$376.2	\$3.9	1.0	%
East Region Totals					
Dollars	\$263,327	\$202,527	\$60,800	30.0	%
Homes closed	664	492	172	35.0	%
Average sales price	\$396.6	\$411.6	\$(15.1)	(3.7)	%
	Six Months Ended June		Quarter over		
	30,		Quarter		
	2018	2017	Chg \$	Chg %	
Home Closing Revenue					
Total					
Dollars	\$1,600,915	\$1,458,397	\$142,518	9.8	%
Homes closed	3,864	3,487	377	10.8	%
Average sales price	\$414.3	\$418.2	\$(3.9)	(0.9)	%
West Region					
Arizona					
Dollars	\$209,268	\$241,565	\$(32,297)	(13.4)	%
Homes closed	641	715	(74)	(10.3)	%
Average sales price	\$326.5				