

## Section 1: 10-Q (10-Q)

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 March 31, 2019

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



Setting the standard for energy-efficient homes®

**Meritage Homes Corporation**

(Exact Name of Registrant as Specified in its Charter)

Maryland

(State or Other Jurisdiction of  
Incorporation or Organization)

86-0611231

(IRS Employer  
Identification No.)

8800 E. Raintree Drive, Suite 300,  
Scottsdale, Arizona

(Address of Principal Executive Offices)

85260

(Zip Code)

(480) 515-8100

(Registrant's telephone number, including area code)

N/A

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by 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, a 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	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

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 Act.

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

Common shares outstanding as of April 25, 2019: 38,264,142

MERITAGE HOMES CORPORATION  
FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2019  
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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)

	<u>March 31, 2019</u>	<u>December 31, 2018</u>
<b>Assets</b>		
Cash and cash equivalents	\$ 327,499	\$ 311,466
Other receivables	79,990	77,285
Real estate	2,744,578	2,742,621
Deposits on real estate under option or contract	44,827	51,410
Investments in unconsolidated entities	15,661	17,480
Property and equipment, net	53,798	54,596
Deferred tax asset	25,939	26,465
Prepays, other assets and goodwill	103,575	84,156
Total assets	<u>\$ 3,395,867</u>	<u>\$ 3,365,479</u>
<b>Liabilities</b>		
Accounts payable	\$ 124,562	\$ 128,169
Accrued liabilities	189,763	177,862
Home sale deposits	29,171	28,636
Loans payable and other borrowings	13,785	14,773
Senior notes, net	1,295,515	1,295,284
Total liabilities	<u>1,652,796</u>	<u>1,644,724</u>
<b>Stockholders' Equity</b>		
Preferred stock, par value \$0.01. Authorized 10,000,000 shares; none issued and outstanding at March 31, 2019 and December 31, 2018	—	—
Common stock, par value \$0.01. Authorized 125,000,000 shares; 38,264,142 and 38,072,659 shares issued and outstanding at March 31, 2019 and December 31, 2018, respectively	383	381
Additional paid-in capital	498,683	501,781
Retained earnings	1,244,005	1,218,593
Total stockholders' equity	<u>1,743,071</u>	<u>1,720,755</u>
Total liabilities and stockholders' equity	<u>\$ 3,395,867</u>	<u>\$ 3,365,479</u>

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 March 31,	
	2019	2018
<b>Homebuilding:</b>		
Home closing revenue	\$ 698,650	\$ 728,532
Land closing revenue	9,495	14,032
Total closing revenue	708,145	742,564
Cost of home closings	(582,188)	(604,202)
Cost of land closings	(9,129)	(15,242)
Total cost of closings	(591,317)	(619,444)
Home closing gross profit	116,462	124,330
Land closing gross profit/(loss)	366	(1,210)
Total closing gross profit	116,828	123,120
<b>Financial Services:</b>		
Revenue	3,228	3,048
Expense	(1,504)	(1,484)
Earnings from financial services unconsolidated entities and other, net	2,978	2,656
Financial services profit	4,702	4,220
Commissions and other sales costs	(52,555)	(52,752)
General and administrative expenses	(33,566)	(30,893)
Interest expense	(4,085)	(136)
Other income, net	1,046	5,325
Earnings before income taxes	32,370	48,884
Provision for income taxes	(6,958)	(5,010)
Net earnings	\$ 25,412	\$ 43,874
<b>Earnings per common share:</b>		
Basic	\$ 0.66	\$ 1.08
Diluted	\$ 0.65	\$ 1.07
<b>Weighted average number of shares:</b>		
Basic	38,215	40,488
Diluted	38,849	41,140

See accompanying notes to unaudited consolidated financial statements

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

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities:</b>		
Net earnings	\$ 25,412	\$ 43,874
Adjustments to reconcile net earnings to net cash provided by/(used in) operating activities:		
Depreciation and amortization	5,832	5,866
Stock-based compensation	5,861	5,209
Equity in earnings from unconsolidated entities	(2,174)	(2,610)
Distributions of earnings from unconsolidated entities	3,996	3,244
Other	1,827	2,301
Changes in assets and liabilities:		
Increase in real estate	(1,753)	(87,732)
Decrease in deposits on real estate under option or contract	6,583	7,406
(Increase)/decrease in other receivables, prepaids and other assets	(1,654)	5,426
Decrease in accounts payable and accrued liabilities	(12,211)	(15)
Increase/(decrease) in home sale deposits	535	(298)
Net cash provided by/(used in) operating activities	<u>32,254</u>	<u>(17,329)</u>
<b>Cash flows from investing activities:</b>		
Investments in unconsolidated entities	(1,110)	—
Purchases of property and equipment	(5,240)	(6,383)
Proceeds from sales of property and equipment	74	30
Maturities/sales of investments and securities	566	1,018
Payments to purchase investments and securities	(566)	(1,018)
Net cash used in investing activities	<u>(6,276)</u>	<u>(6,353)</u>
<b>Cash flows from financing activities:</b>		
Repayment of loans payable and other borrowings	(988)	(2,197)
Repayment of senior notes	—	(175,000)
Proceeds from issuance of senior notes	—	206,000
Payment of debt issuance costs	—	(3,315)
Repurchase of shares	(8,957)	—
Net cash (used in)/provided by financing activities	<u>(9,945)</u>	<u>25,488</u>
Net increase in cash and cash equivalents	16,033	1,806
Cash and cash equivalents, beginning of period	311,466	170,746
Cash and cash equivalents, end of period	<u>\$ 327,499</u>	<u>\$ 172,552</u>

See Supplemental Disclosure of Cash Flow Information in Note 14.

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 primarily to 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 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 March 31, 2019, we were actively selling homes in 260 communities, with base prices ranging from approximately \$189,000 to \$1,286,000.

**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, 2018. 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 normal and recurring adjustments that are considered 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 fiscal 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 \$51.1 million and \$76.1 million are included in cash and cash equivalents at March 31, 2019 and December 31, 2018, 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, and capitalized direct overhead costs incurred during development, 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 that 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 home construction and land development 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 \$44.8 million and \$51.4 million as of March 31, 2019 and December 31, 2018, 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. 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, although our participation in such ventures is currently very limited. See Note 5 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			
	March 31, 2019		December 31, 2018	
	Outstanding	Estimated work remaining to complete	Outstanding	Estimated work remaining to complete
<b>Sureties:</b>				
Sureties related to owned projects and lots under contract	\$ 369,832	\$ 163,422	\$ 339,221	\$ 133,662
<b>Total Sureties</b>	<b>\$ 369,832</b>	<b>\$ 163,422</b>	<b>\$ 339,221</b>	<b>\$ 133,662</b>
<b>Letters of Credit ("LOCs"):</b>				
LOCs for land development	65,521	N/A	70,287	N/A
LOCs for general corporate operations	3,750	N/A	3,750	N/A
<b>Total LOCs</b>	<b>\$ 69,271</b>	<b>N/A</b>	<b>\$ 74,037</b>	<b>N/A</b>

**Accrued Liabilities.** Accrued liabilities at March 31, 2019 and December 31, 2018 consisted of the following (in thousands):

	As of	
	March 31, 2019	December 31, 2018
Accruals related to real estate development and construction activities	\$ 55,205	\$ 54,589
Payroll and other benefits	29,887	60,209
Accrued interest	33,746	13,296
Accrued taxes	10,875	7,548
Warranty reserves	23,213	24,552
Lease liability <sup>(1)</sup>	27,194	—
Other accruals	9,643	17,668
<b>Total</b>	<b>\$ 189,763</b>	<b>\$ 177,862</b>

(1) Refer to Note 4 for additional information related to our leases.

**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 and a major mechanical warranty typically during the first one to two years after the close of the home and a structural warranty that typically extends 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 may 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 March 31, 2019 and December 31, 2018 reflected in the table below are case-specific reserves for two warranty matters related to (1) alleged stucco defects in Florida; and (2) a foundation design and performance matter affecting a single community in Texas.

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

	Three Months Ended March 31,	
	2019	2018
Balance, beginning of period	\$ 24,552	\$ 23,328
Additions to reserve from new home deliveries	3,387	3,407
Warranty claims	(4,726)	(2,923)
Adjustments to pre-existing reserves	—	—
<b>Balance, end of period</b>	<b>\$ 23,213</b>	<b>\$ 23,812</b>

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 based on the information available to us we have established reserves to cover our anticipated net exposure related to these claims. Our review of these stucco related matters 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 March 31, 2019, 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. Additionally, we have received claims related to a foundation design and performance matter affecting a single community in Texas requiring repairs to be made to homes within that community. Our repair efforts are ongoing and our estimate of costs to resolve this matter are updated regularly as progress is made. As of March 31, 2019, taking into account sources of future potential recovery from contractors involved with the design and construction of the homes and their insurers as well as from our general liability insurer, we believe our reserves are sufficient to cover repairs and related claims. See Note 16 in the accompanying unaudited consolidated financial statements for additional information regarding both of these matters.

**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.

#### **Recent Accounting Pronouncements.**

In August 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2018-15, *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract* ("ASU 2018-15"), which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. ASU 2018-15 is effective for us beginning January 1, 2020. ASU 2018-15 is required to be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. We are currently evaluating the impact adopting this guidance will have on our financial statements.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement* ("ASU 2018-13"), which modifies the disclosure requirements of fair value measurements. ASU 2018-13 is effective for us beginning January 1, 2020. Certain disclosures are required to be applied on a retrospective basis and others on a prospective basis. We are currently evaluating the impact adopting this guidance will have on our financial statement disclosures.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). ASU 2016-02 amended the previous accounting standards for lease accounting and resulted in the requirement that lessees recognize leases with lease terms of greater than twelve months on their balance sheets. We adopted ASU 2016-02 on January 1, 2019 using a modified retrospective method and did not restate prior period financial statements. We elected the practical expedient package which allows us to carry forward our original assessment of whether contracts contained leases, lease classification and the initial direct costs. We also elected the practical expedient that allows lessees the option to account for lease and non-lease components together as a single component for all classes of underlying assets. The adoption of ASU 2016-02 resulted in a gross up on our consolidated balance sheet for right-of-use ("ROU") assets and lease liabilities of \$20.5 million and \$28.7 million, respectively, as of January 1, 2019. Our ROU assets are included in the Prepaids, other assets and goodwill line item and the corresponding lease obligations are included in the Accrued liabilities line item on our consolidated balance sheet. The adoption of ASU 2016-02 had no impact on our consolidated income statements.

## NOTE 2 — REAL ESTATE AND CAPITALIZED INTEREST

Real estate consists of the following (in thousands):

	As of	
	March 31, 2019	December 31, 2018
Homes under contract under construction <sup>(1)</sup>	\$ 610,236	\$ 480,143
Unsold homes, completed and under construction <sup>(1)</sup>	555,712	644,717
Model homes <sup>(1)</sup>	142,340	146,327
Finished home sites and home sites under development <sup>(2)</sup>	1,436,290	1,471,434
<b>Total</b>	<b>\$ 2,744,578</b>	<b>\$ 2,742,621</b>

- (1) Includes the allocated land and land development costs associated with each lot for these homes.
- (2) 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 have chosen not to currently 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 March 31,	
	2019	2018
Capitalized interest, beginning of period	\$ 88,454	\$ 78,564
Interest incurred	21,443	20,869
Interest expensed	(4,085)	(136)
Interest amortized to cost of home and land closings	(16,398)	(17,469)
<b>Capitalized interest, end of period</b>	<b>\$ 89,414</b>	<b>\$ 81,828</b>

## 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 March 31, 2019 (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	—	\$ —	\$ —
Option contracts — non-refundable deposits, committed (1)	3,620	244,783	27,493
Purchase contracts — non-refundable deposits, committed (1)	5,569	198,841	12,738
Purchase and option contracts — refundable deposits, committed	764	30,325	481
Total committed	<u>9,953</u>	<u>473,949</u>	<u>40,712</u>
Purchase and option contracts — refundable deposits, uncommitted (2)	9,567	335,126	4,115
Total lots under contract or option	<u>19,520</u>	<u>\$ 809,075</u>	<u>\$ 44,827</u>
Total purchase and option contracts not recorded on balance sheet (3)	<u>19,520</u>	<u>\$ 809,075</u>	<u>\$ 44,827</u> (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 March 31, 2019.

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 include terms that more accurately reflect our revised orders pace expectations.

#### NOTE 4 - LEASES

We lease certain office space and equipment for use in our operations. We assess each of these contracts to determine whether the arrangement contains a lease as defined by ASC 842, *Leases* ("ASC 842"). In order to meet the definition of a lease under ASC 842, the contractual arrangement must convey to us the right to control the use of an identifiable asset for a period of time in exchange for consideration. We recognize lease expense for these leases on a straight-line basis over the lease term and combine lease and non-lease components for all leases. Some of our leases contain renewal options and in accordance with

ASC 842, our lease terms include those renewals only to the extent that they are reasonably certain to be exercised. The exercise of these lease renewal options is generally at our discretion. In accordance with ASC 842, the lease liability is equal to the present value of the remaining lease payments while the ROU asset is based on the lease liability, subject to adjustment, such as for lease incentives. Our leases do not provide a readily determinable implicit interest rate and therefore, we must estimate our incremental borrowing rate. In determining our incremental borrowing rate, we considered the lease period, market interest rates, current interest rates on our senior notes and the effects of collateralization.

Our lease population at March 31, 2019 is comprised of operating leases where we are the lessee and those leases are primarily real estate for office space for our corporate office, division offices and design centers, in addition to leases of certain equipment. As allowed by ASC 842, we adopted an accounting policy election to not record leases with lease terms of twelve months or less on the consolidated balance sheet.

Lease cost included in our consolidated income statements in General and administrative expenses and Commissions and other sales costs is in the table below (dollars in thousands). Our short-term lease costs and sublease income are de minimis.

	<b>Three Months Ended March 31, 2019</b>
Operating lease cost	\$ 1,777

ROU assets are classified within Prepaids, other assets and goodwill on our consolidated balance sheet, while lease liabilities are classified within Accrued liabilities on our consolidated balance sheet. The following table contains additional information about our leases (dollars in thousands):

	<b>At March 31, 2019</b>
ROU assets	\$ 19,140
Lease liabilities	\$ 27,194
ROU assets obtained in exchange for new operating lease obligations <sup>(1)</sup>	\$ —
Non-cash lease expense	\$ 1,168
Cash payments on lease liabilities	\$ 1,876
Weighted-average remaining lease term	4.8 years
Weighted-average discount rate (incremental borrowing rate)	5.06%

(1) No new lease commitments commenced during the three months ended March 31, 2019.

Maturities of our operating lease liabilities as of March 31, 2019 are as follows (in thousands):

<b>Year ended December 31,</b>	
2019 (excluding the three months ended March 31, 2019)	\$ 5,577
2020	6,843
2021	5,681
2022	5,077
2023	4,243
Thereafter	3,415
<b>Total payments</b>	<b>30,836</b>
Less: imputed interest	(3,642)
<b>Present value of lease liabilities</b>	<b>\$ 27,194</b>

## NOTE 5 - 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 March 31, 2019, we had two active equity-method land ventures.

As of March 31, 2019, 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 March 31, 2019 and December 31, 2018 was \$1.8 million and \$2.8 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	
	March 31, 2019	December 31, 2018
<b>Assets:</b>		
Cash	\$ 7,171	\$ 9,595
Real estate	58,072	57,631
Other assets	3,489	3,644
<b>Total assets</b>	<b>\$ 68,732</b>	<b>\$ 70,870</b>
<b>Liabilities and equity:</b>		
Accounts payable and other liabilities	\$ 6,053	\$ 8,682
Notes and mortgages payable	26,818	26,808
Equity of:		
Meritage <sup>(1)</sup>	14,723	14,472
Other	21,138	20,908
<b>Total liabilities and equity</b>	<b>\$ 68,732</b>	<b>\$ 70,870</b>
<b>Three Months Ended March 31,</b>		
	2019	2018
Revenue	\$ 8,998	\$ 7,332
Costs and expenses	(6,116)	(3,935)
<b>Net earnings of unconsolidated entities</b>	<b>\$ 2,882</b>	<b>\$ 3,397</b>
Meritage's share of pre-tax earnings <sup>(1)(2)</sup>	\$ 2,174	\$ 2,610

- (1) 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 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.
- (2) Our share of pre-tax earnings is recorded in Earnings from financial services unconsolidated entities and other, net and Other income, net on our unaudited consolidated income statements and 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 \$15.7 million and \$17.5 million as of March 31, 2019 and December 31, 2018, respectively. We believe these ventures are in compliance with their respective debt agreements, if

applicable, and such debt is non-recourse to us. Subsequent to March 31, 2019 we sold our interest in one of our land joint ventures located in Arizona, reducing our Investments in unconsolidated entities balance by \$7.3 million.

#### NOTE 6 — LOANS PAYABLE AND OTHER BORROWINGS

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

	As of	
	March 31, 2019	December 31, 2018
Other borrowings, real estate notes payable <sup>(1)</sup>	13,785	\$ 14,773
\$780.0 million unsecured revolving credit facility with interest approximating LIBOR (approximately 2.49% at March 31, 2019) plus 1.75% or Prime (5.50% at March 31, 2019) plus 0.75%	—	—
<b>Total</b>	<b>\$ 13,785</b>	<b>\$ 14,773</b>

(1) Reflects balance of non-recourse non-interest bearing notes payable in connection with land purchases.

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 refreshed permitting the size of the facility to increase to a maximum of \$880.0 million, subject to certain conditions, including the availability of additional bank commitments. 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 were in compliance with all Credit Facility covenants as of March 31, 2019.

We had no outstanding borrowings under the Credit Facility as of March 31, 2019 or December 31, 2018. During the three months ended March 31, 2019, we had no borrowings or repayments. During the three months ended March 31, 2018, we had \$285.0 million of gross borrowings and repayments. As of March 31, 2019, we had outstanding letters of credit issued under the Credit Facility totaling \$69.3 million, leaving \$710.7 million available under the Credit Facility to be drawn.

#### NOTE 7 — SENIOR NOTES, NET

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

	As of	
	March 31, 2019	December 31, 2018
7.15% senior notes due 2020. At March 31, 2019 and December 31, 2018 there was approximately \$569 and \$711 in net unamortized premium, respectively.	300,569	300,711
7.00% senior notes due 2022	300,000	300,000
6.00% senior notes due 2025. At March 31, 2019 and December 31, 2018 there was approximately \$5,114 and \$5,318 in net unamortized premium, respectively.	405,114	405,318
5.125% senior notes due 2027	300,000	300,000
Net debt issuance costs	(10,168)	(10,745)
<b>Total</b>	<b>\$ 1,295,515</b>	<b>\$ 1,295,284</b>

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 March 31, 2019.

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 8 — 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.
- 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			
	March 31, 2019		December 31, 2018	
	Aggregate Principal	Estimated Fair Value	Aggregate Principal	Estimated Fair Value
7.15% senior notes	\$ 300,000	\$ 309,750	\$ 300,000	\$ 307,500
7.00% senior notes	\$ 300,000	\$ 320,250	\$ 300,000	\$ 309,750
6.00% senior notes	\$ 400,000	\$ 418,000	\$ 400,000	\$ 379,520
5.125% senior notes	\$ 300,000	\$ 290,910	\$ 300,000	\$ 255,750

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 9 — EARNINGS PER SHARE

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

	Three Months Ended March 31,	
	2019	2018
Basic weighted average number of shares outstanding	38,215	40,488
Effect of dilutive securities:		
Unvested restricted stock	634	652
Diluted average shares outstanding	38,849	41,140
Net earnings	\$ 25,412	\$ 43,874
Basic earnings per share	\$ 0.66	\$ 1.08
Diluted earnings per share	\$ 0.65	\$ 1.07
Antidilutive stock not included in the calculation of diluted earnings per share	139	1



## NOTE 10 — 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, 2018	\$ —	\$ —	\$ 32,962	\$ —	\$ —	\$ 32,962
Additions	—	—	—	—	—	—
Balance at March 31, 2019	\$ —	\$ —	\$ 32,962	\$ —	\$ —	\$ 32,962

## NOTE 11 — STOCKHOLDERS' EQUITY

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

	Three Months Ended March 31, 2019				
	(In thousands)				
	Number of Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Total
Balance at December 31, 2018	38,073	\$ 381	\$ 501,781	\$ 1,218,593	\$ 1,720,755
Net earnings	—	—	—	25,412	25,412
Stock-based compensation expense	—	—	5,861	—	5,861
Issuance of stock	400	4	(4)	—	—
Share repurchases	(209)	(2)	(8,955)	—	(8,957)
Balance at March 31, 2019	38,264	\$ 383	\$ 498,683	\$ 1,244,005	\$ 1,743,071

	Three Months Ended March 31, 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	—	—	—	(583)	(583)
Net earnings	—	—	—	43,874	43,874
Issuance of stock	301	3	(3)	—	—
Stock-based compensation expense	—	—	5,216	—	5,216
Balance at March 31, 2018	40,632	\$ 406	\$ 589,791	\$ 1,035,135	\$ 1,625,332

## NOTE 12 — 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. 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 701,163 shares remain available for grant at March 31, 2019. 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 authorizes 1,250,000 shares of stock to be awarded, of which 776,809 shares remain available at March 31, 2019. 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 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. A portion of the performance-based restricted stock awards granted to our executive officers 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):

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Stock-based compensation expense	\$ 5,861	\$ 5,209
Non-vested shares granted	377,514	306,164
Performance-based non-vested shares granted	94,152	157,637
Restricted stock awards vested (includes performance-based awards)	400,323	301,575

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

	<b>As of</b>	
	<b>March 31, 2019</b>	<b>December 31, 2018</b>
Unrecognized stock-based compensation cost	\$ 28,410	\$ 24,954
Weighted average years expense recognition period	2.95	2.24
Total equity awards outstanding <sup>(1)</sup>	1,356,443	1,301,745

(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 months ended March 31, 2019 or 2018, other than minor administrative costs.

#### NOTE 13 — INCOME TAXES

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

	Three Months Ended March 31,	
	2019	2018
Federal	\$ 5,742	\$ 2,946
State	1,216	2,064
Total	\$ 6,958	\$ 5,010

The effective tax rate for the three months ended March 31, 2019 and March 31, 2018 was 21.5% and 10.2%, respectively. The lower 2018 rate 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 provided for a single year extension of energy tax credits for homes sold in 2017 that met 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, resulting in a \$6.3 million reduction of the federal tax provision in 2018. In the first quarter of 2019, we recorded a relatively minor tax benefit from our efforts to capture additional energy credits from 2016 and 2017. We also recorded a tax benefit from equity-based compensation for awards vested in the quarter. These tax benefits had a favorable impact on our 2019 effective tax rate.

At March 31, 2019 and December 31, 2018, 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 March 31, 2019.

At March 31, 2019, we had no remaining federal NOL carry forward or un-utilized federal tax credits. At March 31, 2019, and December 31, 2018 we had tax benefits for state NOL carry forwards of \$1.0 million, net of federal benefit, that begin to expire in 2028.

At March 31, 2019, we have income taxes payable of \$4.3 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 March 31, 2019.

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 2014. We have one state income tax examination being conducted at this time and do not expect it to have a material outcome.

The tax benefits from NOLs, built-in losses, and tax credits would be materially reduced or potentially eliminated if we experience an "ownership change" as defined under IRC §382. Based on our analysis performed as of March 31, 2019 we do not believe that we have experienced an ownership change. As a protective measure, our stockholders held a Special Meeting of Stockholders on February 16, 2009 and approved an amendment to our Articles of Incorporation that restricts certain transfers of our common stock. The amendment is intended to help us avoid an unintended ownership change and thereby preserve the value of any tax benefit for future utilization.

#### NOTE 14 — SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

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

	Three Months Ended March 31,	
	2019	2018
Cash paid during the year for:		
Interest, net of interest capitalized	\$ (16,907)	\$ (15,961)
Non-cash operating activities:		
Real estate acquired through notes payable	\$ —	\$ 1,697

#### NOTE 15 — 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 March 31,	
	2019	2018
Homebuilding revenue <sup>(1)</sup> :		
West	\$ 272,966	\$ 317,228
Central	191,606	191,870
East	243,573	233,466
Consolidated total	\$ 708,145	\$ 742,564
Homebuilding segment operating income:		
West	\$ 18,308	\$ 21,121
Central	12,336	14,267
East	9,693	11,359
Total homebuilding segment operating income	40,337	46,747
Financial services segment profit	4,702	4,220
Corporate and unallocated costs <sup>(2)</sup>	(9,630)	(7,272)
Interest expense	(4,085)	(136)
Other income, net <sup>(3)</sup>	1,046	5,325
Net earnings before income taxes	\$ 32,370	\$ 48,884

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

	Three Months Ended March 31,	
	2019	2018
Land closing revenue:		
West	\$ —	\$ 12,455
Central	—	125
East	9,495	1,452
Total	<u>\$ 9,495</u>	<u>\$ 14,032</u>

- (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 three months ended March 31, 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 March 31, 2019					
	West	Central	East	Financial Services	Corporate and Unallocated	Total
Deposits on real estate under option or contract	\$ 6,659	\$ 12,999	\$ 25,169	\$ —	\$ —	\$ 44,827
Real estate	1,164,724	715,356	864,498	—	—	2,744,578
Investments in unconsolidated entities	7,481	6,375	—	—	1,805	15,661
Other assets	54,503 (1)	106,268 (2)	83,949 (3)	749	345,332 (4)	590,801
Total assets	<u>\$ 1,233,367</u>	<u>\$ 840,998</u>	<u>\$ 973,616</u>	<u>\$ 749</u>	<u>\$ 347,137</u>	<u>\$ 3,395,867</u>

- (1) Balance consists primarily of property and equipment and cash.
- (2) Balance consists primarily of development reimbursements from local municipalities and cash.
- (3) Balance consists primarily of goodwill (see Note 10), prepaid expenses and other assets and property and equipment.
- (4) Balance consists primarily of cash, prepaid expenses and other assets and our deferred tax asset.

	At December 31, 2018					
	West	Central	East	Financial Services	Corporate and Unallocated	Total
Deposits on real estate under option or contract	\$ 7,514	\$ 13,870	\$ 30,026	\$ —	\$ —	\$ 51,410
Real estate	1,188,975	679,422	874,224	—	—	2,742,621
Investments in unconsolidated entities	8,320	6,396	—	—	2,764	17,480
Other assets	51,115 (1)	117,150 (2)	85,869 (3)	1,013	298,821 (4)	553,968
Total assets	<u>\$ 1,255,924</u>	<u>\$ 816,838</u>	<u>\$ 990,119</u>	<u>\$ 1,013</u>	<u>\$ 301,585</u>	<u>\$ 3,365,479</u>

- (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 goodwill (see Note 10), cash and property and equipment.
- (4) Balance consists primarily of cash.

## NOTE 16 — 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 \$23.2 million of total warranty reserves related to a foundation design and performance 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 March 31, 2019, the claim we made for this matter under our general liability insurance policies has initially been denied, which we 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 March 31, 2019, taking into account sources of potential future recovery from the contractors involved with the design and construction of these homes and their insurers as well as from our general liability insurer, we believe our reserves are sufficient to cover repairs and related claims.

Also included within our case specific reserves are reserves for alleged stucco defects in homes in certain Florida communities we developed prior to 2016. We are involved in legal proceedings relating to such stucco defects. Our review of these stucco related matters is ongoing and our estimate of and reserve for 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 and thus our related reserves. As of March 31, 2019, after considering potential recoveries from the contractors involved and their insurers and the potential recovery under our general liability insurance policies, we believe our reserves are sufficient to cover the existing stucco related repairs and 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 (the “Exchange Act”). 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 and first move-up buyers; 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; 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: changes in interest rates and the availability and pricing of residential mortgages; legislation related to tariffs; the availability and cost of finished lots and undeveloped land; shortages in the availability and cost of labor; the success of strategic initiatives; the ability of our potential buyers to sell their existing homes; inflation in the cost of materials used to develop communities and construct homes; the adverse effect of slow absorption rates; impairments of our real estate inventory; cancellation rates; competition; changes in tax laws that adversely impact us or our homebuyers; a change to the feasibility of projects under option or contract that could result in the write-down or write-off of earnest 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 this Form 10-Q and our Form 10-K for the year ended December 31, 2018 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 first quarter of 2019 reflected an improvement in home buying sentiment and activity for the entire homebuilding industry as buyers responded to increased affordability from the decline in interest rates and increased availability of affordable home offerings. We believe the demand seen so far in the spring selling season reflects the sustained positive macroeconomic factors in the economy with low unemployment levels, wage growth, and a shortage in the supply of new homes, particularly at entry-level price points. With the meaningful re-entry of millennials into the home buying market and the desire to downsize in the baby boomer generation, we believe demand for affordable new homes will outpace demand for other product offerings. Accordingly, homebuilders with attractive, lower price-point product in desirable locations should be poised to capture this demand for nicely appointed but reasonably priced homes, as buyers in this environment are primarily motivated by affordability.

At Meritage, we continue to demonstrate our commitment to the first-time and first move-up buyer through our focus on simplification and our key strategic initiatives such as home closing gross margin improvement, selling, general and administrative cost control and community count stability. We believe the successful execution of these initiatives will position us to improve profitability as we realize the benefits of our transition. We have made considerable progress as 35.8% of our active communities are targeted to first-time buyers and those buyers represented 44.7% of our orders in the first quarter of 2019, increases of 11.9% and 17.0%, respectively, over the first quarter of 2018 percentages. We expect to continue to deliver on our operational initiatives as we are opening an increasing number of communities that target the first-time as well as the first move-up buyer. We believe this strategy will allow us to achieve higher gross margins and better opportunities to leverage our overhead costs as we build and sell to the largest segments of the home buying population.

### *Summary Company Results*

Our first quarter 2019 results reflect growth in our entry-level business and improved orders and closings compared to the prior year quarter. Total home closing revenue was \$698.7 million for the three months ended March 31, 2019, with a 2.3% increase in the number of homes closed over the prior year period. Home closing revenue decreased \$29.9 million compared to the first quarter of 2018 due to a \$26,500 decrease in average sales price resulting from our shift in focus to the first-time and first move-up buyer in addition to incremental incentives offered in the latter half of the fourth quarter of 2018 and early in 2019 to help drive order volume. The decrease in home closing revenue and lower year-over-year home closing gross margin resulted in \$7.9 million lower home closing gross profit which, combined with a \$3.9 million increase in interest expense, a \$4.3 million decrease in other income, net and a higher income tax provision, contributed to a 42.1% decline in net income of \$25.4 million for the three months ended March 31, 2019 versus \$43.9 million in the first quarter of 2018. Other income, net was favorably impacted in the first quarter of 2018 as a result of receiving a \$4.8 million settlement from long-standing litigation with no comparable activity in the first quarter of 2019. Additionally, first quarter 2019 results reflect a higher provision for income taxes of 21.5% versus 10.2% in the first quarter of 2018 due to a cumulative retroactive extension of equity tax credits for homes closed in 2017 that was recorded in 2018.

On a consolidated basis, we experienced year-over-year growth in orders for the three months ended March 31, 2019 over the prior year. For the three months ended March 31, 2019, orders and order value improved by 7.3% and 1.5%, respectively to 2,530 orders valued at \$977.0 million versus 2,358 orders valued at \$962.8 million in the prior year. We ended the first quarter of 2019 with 3,198 homes in backlog valued at \$1.3 billion, declines of 8.8% and 12.6%, respectively, over March 31, 2018. The decline in year-over-year backlog, despite the increase in orders, was due to a higher backlog conversion rate in the first quarter of 2019 as a result of closing more of our available spec inventory, consistent with our entry-level strategy.

### *Company Positioning*

We believe that the investments in our new communities, particularly those designed for the first-time and first move-up homebuyer, and industry-leading innovation in our energy-efficient product offerings and automation create a differentiated strategy that has aided us in our success 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;
- Improving the overall customer experience, most recently through a simplification of the customer sale and construction process and option selection process for move-up buyers at Studio M;
- Demonstrating our commitment to innovation through a new fully-automated and secured digital loan pre-approval process available on our website;
- Enhancing our website and sales offices through investments in technology. All of our LiVE.NOW® communities feature interactive technology tools offering homebuyers the ability to electronically search for available homes with their desired home features and based on their preferred availability or move-in dates;
- Improving our home closing gross profit by growing revenue while managing costs, allowing us to better leverage our overhead; and
- Actively and strategically acquiring and developing land in key markets in order to maintain and grow our lot supply and active community count.

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 ensure that we 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 costs through national and regional vendor relationships with a focus on quality construction and warranty management;
- Carefully managing our liquidity and a strong balance sheet, as we ended the quarter with \$327.5 million in cash and cash equivalents and with a 42.9% debt-to-capital ratio and a 36.0% net debt-to-capital ratio;
- Maximizing returns to our shareholders, most recently through our share repurchase program; and
- Promoting a positive environment for our employees in order to develop and motivate them and to minimize turnover and to maximize recruitment efforts.

### ***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, warranty reserves and valuation of deferred tax assets. There have been no significant changes to our critical accounting policies during the three months ended March 31, 2019 compared to those disclosed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our 2018 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 March 31,		Quarter over Quarter	
	2019	2018	Change \$	Change %
<b>Home Closing Revenue</b>				
<b>Total</b>				
Dollars	\$ 698,650	\$ 728,532	\$ (29,882)	(4.1)%
Homes closed	1,765	1,725	40	2.3 %
Average sales price	\$ 395.8	\$ 422.3	\$ (26.5)	(6.3)%
<b>West Region</b>				
Arizona				
Dollars	\$ 98,454	\$ 90,996	\$ 7,458	8.2 %
Homes closed	297	275	22	8.0 %
Average sales price	\$ 331.5	\$ 330.9	\$ 0.6	0.2 %
California				
Dollars	\$ 85,837	\$ 159,391	\$ (73,554)	(46.1)%
Homes closed	132	231	(99)	(42.9)%
Average sales price	\$ 650.3	\$ 690.0	\$ (39.7)	(5.8)%
Colorado				
Dollars	\$ 88,675	\$ 54,386	\$ 34,289	63.0 %
Homes closed	169	94	75	79.8 %
Average sales price	\$ 524.7	\$ 578.6	\$ (53.9)	(9.3)%
<b>West Region Totals</b>				
Dollars	\$ 272,966	\$ 304,773	\$ (31,807)	(10.4)%
Homes closed	598	600	(2)	(0.3)%
Average sales price	\$ 456.5	\$ 508.0	\$ (51.5)	(10.1)%
<b>Central Region - Texas</b>				
<b>Central Region Totals</b>				
Dollars	\$ 191,606	\$ 191,745	\$ (139)	(0.1)%
Homes closed	543	542	1	0.2 %
Average sales price	\$ 352.9	\$ 353.8	\$ (0.9)	(0.3)%
<b>East Region</b>				
Florida				
Dollars	\$ 90,824	\$ 112,787	\$ (21,963)	(19.5)%
Homes closed	226	260	(34)	(13.1)%
Average sales price	\$ 401.9	\$ 433.8	\$ (31.9)	(7.4)%
Georgia				
Dollars	\$ 42,139	\$ 24,973	\$ 17,166	68.7 %
Homes closed	119	73	46	63.0 %
Average sales price	\$ 354.1	\$ 342.1	\$ 12.0	3.5 %
North Carolina				
Dollars	\$ 56,541	\$ 50,673	\$ 5,868	11.6 %
Homes closed	156	128	28	21.9 %
Average sales price	\$ 362.4	\$ 395.9	\$ (33.4)	(8.4)%
South Carolina				
Dollars	\$ 19,582	\$ 22,121	\$ (2,539)	(11.5)%
Homes closed	57	66	(9)	(13.6)%
Average sales price	\$ 343.5	\$ 335.2	\$ 8.4	2.5 %

Tennessee							
Dollars	\$	24,992	\$	21,460	\$	3,532	16.5 %
Homes closed		66		56		10	17.9 %
Average sales price	\$	378.7	\$	383.2	\$	(4.5)	(1.2)%
<b>East Region Totals</b>							
Dollars	\$	234,078	\$	232,014	\$	2,064	0.9 %
Homes closed		624		583		41	7.0 %
Average sales price	\$	375.1	\$	398.0	\$	(22.8)	(5.7)%

	Three Months Ended March 31,		Quarter over Quarter	
	2019	2018	Change \$	Change %
<b>Home Orders <sup>(1)</sup></b>				
<b>Total</b>				
Dollars	\$ 976,979	\$ 962,796	\$ 14,183	1.5 %
Homes ordered	2,530	2,358	172	7.3 %
Average sales price	\$ 386.2	\$ 408.3	\$ (22.2)	(5.4)%
<b>West Region</b>				
Arizona				
Dollars	\$ 145,398	\$ 153,161	\$ (7,763)	(5.1)%
Homes ordered	457	459	(2)	(0.4)%
Average sales price	\$ 318.2	\$ 333.7	\$ (15.5)	(4.6)%
California				
Dollars	\$ 108,474	\$ 160,398	\$ (51,924)	(32.4)%
Homes ordered	167	219	(52)	(23.7)%
Average sales price	\$ 649.5	\$ 732.4	\$ (82.9)	(11.3)%
Colorado				
Dollars	\$ 105,248	\$ 97,095	\$ 8,153	8.4 %
Homes ordered	204	175	29	16.6 %
Average sales price	\$ 515.9	\$ 554.8	\$ (38.9)	(7.0)%
<b>West Region Totals</b>				
<i>Dollars</i>	\$ 359,120	\$ 410,654	\$ (51,534)	(12.5)%
<i>Homes ordered</i>	828	853	(25)	(2.9)%
<i>Average sales price</i>	\$ 433.7	\$ 481.4	\$ (47.7)	(9.9)%
<b>Central Region - Texas</b>				
<b>Central Region Totals</b>				
<i>Dollars</i>	\$ 306,265	\$ 279,503	\$ 26,762	9.6 %
<i>Homes ordered</i>	870	809	61	7.5 %
<i>Average sales price</i>	\$ 352.0	\$ 345.5	\$ 6.5	1.9 %
<b>East Region</b>				
Florida				
Dollars	\$ 126,074	\$ 112,670	\$ 13,404	11.9 %
Homes ordered	301	263	38	14.4 %
Average sales price	\$ 418.9	\$ 428.4	\$ (9.5)	(2.2)%
Georgia				
Dollars	\$ 50,227	\$ 50,870	\$ (643)	(1.3)%
Homes ordered	144	148	(4)	(2.7)%
Average sales price	\$ 348.8	\$ 343.7	\$ 5.1	1.5 %
North Carolina				
Dollars	\$ 82,985	\$ 61,485	\$ 21,500	35.0 %
Homes ordered	230	157	73	46.5 %
Average sales price	\$ 360.8	\$ 391.6	\$ (30.8)	(7.9)%
South Carolina				
Dollars	\$ 25,214	\$ 28,674	\$ (3,460)	(12.1)%
Homes ordered	81	80	1	1.3 %
Average sales price	\$ 311.3	\$ 358.4	\$ (47.1)	(13.2)%
Tennessee				
Dollars	\$ 27,094	\$ 18,940	\$ 8,154	43.1 %
Homes ordered	76	48	28	58.3 %
Average sales price	\$ 356.5	\$ 394.6	\$ (38.1)	(9.7)%
<b>East Region Totals</b>				
<i>Dollars</i>	\$ 311,594	\$ 272,639	\$ 38,955	14.3 %

<i>Homes ordered</i>	832	696	136	19.5 %
<i>Average sales price</i>	\$ 374.5	\$ 391.7	\$ (17.2)	(4.4)%

(1) Home orders for any period represent the aggregate sales price of all homes ordered, net of cancellations. We do not include orders contingent upon the sale of a customer's existing home as a sales contract until the contingency is removed.

	Three Months Ended March 31,			
	2019		2018	
	Ending	Average	Ending	Average
<b>Active Communities</b>				
<b>Total</b>	<b>260</b>	<b>266.0</b>	<b>253</b>	<b>248.5</b>
<b>West Region</b>				
Arizona	34	37.0	37	37.5
California	21	19.0	15	17.5
Colorado	23	21.5	17	14.0
<b>West Region Totals</b>	<b>78</b>	<b>77.5</b>	<b>69</b>	<b>69.0</b>
<b>Central Region - Texas</b>				
<b>Central Region Totals</b>	<b>84</b>	<b>89.5</b>	<b>97</b>	<b>94.5</b>
<b>East Region</b>				
Florida	32	31.5	28	28.0
Georgia	19	20.5	21	20.0
North Carolina	25	25.0	20	18.5
South Carolina	11	11.5	12	12.5
Tennessee	11	10.5	6	6.0
<b>East Region Totals</b>	<b>98</b>	<b>99.0</b>	<b>87</b>	<b>85.0</b>

	Three Months Ended March 31,	
	2019	2018
<b>Cancellation Rates <sup>(1)</sup></b>		
<b>Total</b>	<b>12%</b>	<b>14%</b>
<b>West Region</b>		
Arizona	11%	12%
California	15%	19%
Colorado	7%	8%
<b>West Region Totals</b>	<b>11%</b>	<b>13%</b>
<b>Central Region - Texas</b>		
<b>Central Region Totals</b>	<b>13%</b>	<b>16%</b>
<b>East Region</b>		
Florida	9%	11%
Georgia	12%	11%
North Carolina	10%	16%
South Carolina	21%	9%
Tennessee	8%	2%
<b>East Region Totals</b>	<b>11%</b>	<b>11%</b>

(1) Cancellation rates are computed as the number of canceled units for the period divided by the gross sales units for the same period.

	At March 31,		Quarter over Quarter	
	2019	2018	Change \$	Change %
<b>Order Backlog <sup>(1)</sup></b>				
<b>Total</b>				
Dollars	\$ 1,295,295	\$ 1,482,205	\$ (186,910)	(12.6)%
Homes in backlog	3,198	3,508	(310)	(8.8)%
Average sales price	\$ 405.0	\$ 422.5	\$ (17.5)	(4.1)%
<b>West Region</b>				
Arizona				
Dollars	\$ 180,556	\$ 181,979	\$ (1,423)	(0.8)%
Homes in backlog	503	510	(7)	(1.4)%
Average sales price	\$ 359.0	\$ 356.8	\$ 2.1	0.6 %
California				
Dollars	\$ 89,095	\$ 223,982	\$ (134,887)	(60.2)%
Homes in backlog	126	306	(180)	(58.8)%
Average sales price	\$ 707.1	\$ 732.0	\$ (24.9)	(3.4)%
Colorado				
Dollars	\$ 120,115	\$ 157,602	\$ (37,487)	(23.8)%
Homes in backlog	220	280	(60)	(21.4)%
Average sales price	\$ 546.0	\$ 562.9	\$ (16.9)	(3.0)%
<b>West Region Totals</b>				
<i>Dollars</i>	\$ 389,766	\$ 563,563	\$ (173,797)	(30.8)%
<i>Homes in backlog</i>	849	1,096	(247)	(22.5)%
<i>Average sales price</i>	\$ 459.1	\$ 514.2	\$ (55.1)	(10.7)%
<b>Central Region - Texas</b>				
<b>Central Region Totals</b>				
<i>Dollars</i>	\$ 488,009	\$ 470,392	\$ 17,617	3.7 %
<i>Homes in backlog</i>	1,308	1,287	21	1.6 %
<i>Average sales price</i>	\$ 373.1	\$ 365.5	\$ 7.6	2.1 %
<b>East Region</b>				
Florida				
Dollars	\$ 200,182	\$ 196,470	\$ 3,712	1.9 %
Homes in backlog	447	449	(2)	(0.4)%
Average sales price	\$ 447.8	\$ 437.6	\$ 10.3	2.3 %
Georgia				
Dollars	\$ 54,483	\$ 76,358	\$ (21,875)	(28.6)%
Homes in backlog	148	226	(78)	(34.5)%
Average sales price	\$ 368.1	\$ 337.9	\$ 30.2	8.9 %
North Carolina				
Dollars	\$ 93,818	\$ 107,578	\$ (13,760)	(12.8)%
Homes in backlog	251	272	(21)	(7.7)%
Average sales price	\$ 373.8	\$ 395.5	\$ (21.7)	(5.5)%
South Carolina				
Dollars	\$ 37,987	\$ 42,027	\$ (4,040)	(9.6)%
Homes in backlog	113	113	—	— %
Average sales price	\$ 336.2	\$ 371.9	\$ (35.8)	(9.6)%
Tennessee				
Dollars	\$ 31,050	\$ 25,817	\$ 5,233	20.3 %
Homes in backlog	82	65	17	26.2 %
Average sales price	\$ 378.7	\$ 397.2	\$ (18.5)	(4.7)%
<b>East Region Totals</b>				
<i>Dollars</i>	\$ 417,520	\$ 448,250	\$ (30,730)	(6.9)%
<i>Homes in backlog</i>	1,041	1,125	(84)	(7.5)%

*Average sales price*

\$ 401.1 \$

398.4 \$

2.7

0.7 %

(1) Our backlog represents net sales that have not closed.



## ***Operating Results***

*Companywide.* In the first quarter of 2019, despite the lower number of homes in backlog entering the year, home closing volume improved by 2.3% to 1,765 closings valued at \$698.7 million compared to 1,725 closings valued at \$728.5 million in the corresponding prior year period. The increase in closings year-over-year was driven by improved backlog conversion due to selling and closing more speculative inventory homes in the first quarter of 2019 compared to the prior year. Home closing revenue decreased by 4.1% due to a \$26,500 reduction in average sales price reflective of a higher percentage of entry-level homes in our closing mix related to our strategic transition to the first-time and first move-up homebuyers. Home order volume improved by 7.3% to 2,530 homes valued at \$977.0 million in the first quarter of 2019 as compared to 2,358 homes valued at \$962.8 million in the first quarter of 2018. The improvement in orders was primarily aided by a 7.0% increase in average active communities in the first quarter of 2019 compared to prior year and a flat year-over-year Companywide orders pace at 9.5 homes ordered per average active community. We ended the quarter with 260 actively selling communities, a 2.8% increase over prior year. We ended the quarter with 3,198 homes in backlog valued at \$1.3 billion, 8.8% and 12.6% decreases from 2018, respectively.

*West.* The West Region closed 598 homes and generated \$273.0 million in home closing revenue in the first quarter of 2019 compared to 600 homes and \$304.8 million in the first quarter of 2018. The decrease in home closing revenue is due to a 10.1% decrease in average sales price combined with relatively flat home closing volume. The slight reduction in closing volume was related to California which entered the year with lower backlog stemming from fewer communities open in 2018 and slower sales in the fourth quarter of 2018. The decline was nearly offset by year-over-year increases in closing volume in Colorado and Arizona. The decline in average sales price was driven by Colorado where entry-level product is contributing more meaningfully to the closing mix in the first quarter of 2019 compared to prior year and the lessened impact of California in the Region's closing mix. The Region ended the first quarter of 2019 with 828 orders valued at \$359.1 million versus 853 orders valued at \$410.7 million in the first quarter of 2018. The 2.9% decline in order volume was primarily driven by California where a 29.6% decline in orders pace compared to the prior year contributed to a 23.7% reduction in orders. Average active communities in California improved by 8.6%, however, these new communities opened late in the quarter and contributed minimally to first quarter orders. Orders improved by 16.6% in Colorado due to a 53.6% improvement in average active communities and orders were down minimally in Arizona compared to prior year. We opened ten communities throughout the Region in the first quarter of 2019 and we anticipate even more West Region community openings in the next two quarters, the majority of which will be targeted toward the first-time homebuyer. The Region ended the quarter with 849 homes in backlog valued at \$389.8 million, a 30.8% decline in value from prior year reflecting a 10.7% reduction in average sales price and a 22.5% decrease in the number of homes.

*Central.* In the first quarter of 2019, the Central Region, made up of our Texas markets, closed 543 homes and generated \$191.6 million in home closing revenue, relatively flat with prior year results of 542 homes and \$191.7 million of home closing revenue. Orders and order value grew by 7.5% and 9.6%, respectively, to 870 units valued at \$306.3 million compared to 809 units valued at \$279.5 million in the prior year quarter. Order volume improved in the first quarter of 2019 due to a 12.8% increase in orders pace in the Region despite a 5.3% decrease in average community count compared to the prior year. We are responding to the entry-level demand in this Region with a strong transition to first-time buyer product offerings and we attribute the improved orders pace to that transition and to targeted incentives offered in the first quarter of 2019. Approximately 45% of our first quarter 2019 orders resulted from communities designated as entry-level and we expect that percentage to continue to grow as most of the projected community openings throughout the Region in 2019 are designated as entry-level. The Region ended the first quarter of 2019 with 1,308 units in backlog valued at \$488.0 million, 1.6% and 3.7% increases, respectively, over the prior year.

*East.* During the three months ended March 31, 2019, the East Region delivered 624 closings and \$234.1 million in home closing revenue compared to 583 closings and \$232.0 million in home closing revenue in the prior year, improvements of 7.0% and 0.9%, respectively. Average sales price decreased by \$22,800 in the first quarter of 2019 compared to prior year resulting from our transition to entry-level product. Orders and order volume in the East Region improved by 19.5% and 14.3%, respectively, for the first quarter of 2019 with 832 units valued at \$311.6 million compared to 696 units valued at \$272.6 million in the prior year. The improvement in orders is primarily due to a 16.5% increase in average active communities combined with a 2.4% increase in orders pace. The East Region ended the quarter with 1,041 homes in backlog valued at \$417.5 million compared to 1,125 homes valued at \$448.3 million at March 31, 2018, 7.5% and 6.9% decreases, respectively.

### ***Land Closing Revenue and Gross Profit/(Loss)***

From time to time, we may sell certain lots or land parcels to other homebuilders, developers or investors if we feel the sale will provide a greater economic benefit to us than continuing home construction or where we are looking to diversify our land positions in the specific geography. As a result of such sales, we recognized land closing revenue of \$9.5 million and \$14.0

million for the three months ending March 31, 2019 and 2018, respectively. We recognized land closing gross profit of \$0.4 million in the first quarter of 2019 compared to a loss of \$1.2 million in the first quarter of 2018.

**Other Operating Information (dollars in thousands)**

	<b>Three Months Ended March 31,</b>			
	<b>2019</b>		<b>2018</b>	
	Dollars	Percent of Home Closing Revenue	Dollars	Percent of Home Closing Revenue
<b>Home Closing Gross Profit <sup>(1)</sup></b>				
<b>Total</b>	\$ 116,462	16.7%	\$ 124,330	17.1%
<b>West</b>	\$ 45,395	16.6%	\$ 50,205	16.5%
<b>Central</b>	\$ 34,363	17.9%	\$ 36,276	18.9%
<b>East</b>	\$ 36,704	15.7%	\$ 37,849	16.3%

- (1) Home closing gross profit represents home closing revenue less cost of home closings, including impairments. Cost of home closings includes land and lot development costs, direct home construction costs, an allocation of common community costs (such as model complex costs and architectural, legal and zoning costs), interest, sales tax, impact fees, warranty, construction overhead and closing costs.

*Companywide.* Home closing gross margin for the first quarter of 2019 decreased by 40 basis points compared to the same prior year period and combined with lower home closing revenue, resulted in a \$7.9 million decrease in home closing gross profit. The reduction in home closing revenue and gross margin compared to prior year is partially due to targeted incentives that were offered in the latter half of the fourth quarter of 2018 and early in the first quarter of 2019 on slow-moving move-up inventory and in highly competitive markets. First quarter 2018 gross margin was positively impacted by 20 basis points from a one-time \$1.4 million settlement related to Chinese drywall costs incurred in prior periods with no similar recoveries in the first quarter of 2019. We expect our improved backlog conversion and simplified product offerings will help improve gross margin and gain operating leverage as we progress throughout the year.

*West.* Home closing gross margin for the West Region improved by 10 basis points to 16.6% for the first quarter of 2019 versus 16.5% in the first quarter of 2018. Lower home closing revenue resulting from increased incentives and lower average sales prices related to our shift to entry-level product was offset by construction efficiencies driven by our simplified product offerings providing slightly improved year-over-year gross margin in the Region.

*Central.* The Central Region provided the highest home closing gross margin in the company during the first quarter of 2019. Home closing gross margin of 17.9% for the quarter ending March 31, 2019 was down compared to 18.9% in the prior year. The year-over-year decline in gross margin for the Region is primarily due to targeted incentives offered on speculative inventory homes that were available to both sell and close in the first quarter of 2019.

*East.* Home closing gross margin in the East Region declined 60 basis points year-over-year to 15.7% in the first quarter of 2019 versus 16.3% for the comparable 2018 period. Margins in the first quarter of 2018 were positively impacted by 60 basis points from the above-mentioned settlement related to Chinese drywall with no similar recoveries in the first quarter of 2019.

**Financial Services Profit (in thousands)**

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Financial services profit	\$ 4,702	\$ 4,220

Financial services profit represents the net profit of our financial services operations, including the operating profit generated by our wholly-owned title company, Carefree Title, as well as our portion of earnings from a mortgage joint venture. Financial services profit improved year over year due to higher closing volume.

*Selling, General and Administrative Expenses and Other Expenses (\$ in thousands)*

	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Commissions and other sales costs</b>		
Dollars	\$ (52,555)	\$ (52,752)
Percent of home closing revenue	7.5%	7.2%
<b>General and administrative expenses</b>		
Dollars	\$ (33,566)	\$ (30,893)
Percent of home closing revenue	4.8%	4.2%
<b>Interest expense</b>		
Dollars	\$ (4,085)	\$ (136)
<b>Other income, net</b>		
Dollars	\$ 1,046	\$ 5,325
<b>Provision for income taxes</b>		
Dollars	\$ (6,958)	\$ (5,010)

**Commissions and Other Sales Costs.** Commissions and other sales costs are comprised of internal and external commissions and related sales and marketing expenses such as advertising and sales office costs. These costs were \$52.6 million for the three months ended March 31, 2019, relatively flat with the prior year period. As a percentage of home closing revenue, commissions and other sales costs increased 30 basis points to 7.5% during the three months ended March 31, 2019 due primarily to higher external commissions paid in the first quarter of 2019 compared to the prior year due partially to sales campaigns to capture orders on our available spec inventory that was able to close in the first quarter of 2019.

**General and Administrative Expenses.** General and administrative expenses represent corporate and divisional overhead expenses such as salaries and bonuses, occupancy, insurance and travel expenses. For the three months ended March 31, 2019, general and administrative expenses were \$33.6 million as compared to \$30.9 million for the 2018 period. As a percentage of home closing revenue, these costs increased 60 basis points for the three month period ending March 31, 2019 to 4.8%, primarily the result of decreased leverage from lower home closing revenue combined with the impact of \$2.5 million in one-time charges related to severance costs and accelerated equity compensation costs in the first quarter of 2019 compared to the prior year. The charges related to equity compensation costs are due to a revision in executive compensation as a result of changes in tax law, effective for us in 2019.

**Interest Expense.** Interest expense is comprised of interest incurred, but not capitalized, on our senior notes, other borrowings, and our amended and restated unsecured revolving credit facility ("Credit Facility"). Interest expense for the three months ended March 31, 2019 totaled \$4.1 million compared to \$0.1 million in the corresponding prior year period. This year-over-year increase is due to less interest capitalized to assets under development resulting from more efficient turnover of inventory related to our simplified construction strategy.

**Other Income, Net.** Other income, net, primarily consists of (i) sublease income, (ii) interest earned on our cash and cash equivalents, (iii) payments and awards related to legal settlements and (iv) our portion of pre-tax income or loss from non-financial services joint ventures. For the three months ended March 31, 2019, Other income, net was \$1.0 million versus \$5.3 million in 2018. Other income, net was favorably impacted in the first quarter of 2018 as a result of receiving a \$4.8 million settlement from long-standing litigation related to a previous joint venture in Nevada.

**Income Taxes.** Our effective tax rate was 21.5% and 10.2% for the three months ended March 31, 2019 and 2018, respectively. The reduced rate in 2018 was favorably impacted by the enactment of the Bipartisan Budget Act of 2018 in February 2018, which included a retroactive extension of the Internal Revenue Code §45L new energy efficient homes credit, which had previously expired in 2016. This extension provision provided for a single year extension of energy tax credits for homes sold in 2017 that met the qualification criteria. In accordance with ASC 740, the effects of these tax credits were recorded in the first quarter of 2018, based on the date of enactment, regardless of the retroactive treatment. In the first quarter of 2019, we recorded a relatively minor tax benefit from our efforts to capture additional energy credits from 2016 and 2017. We also recorded a tax benefit from equity-based compensation for awards vested in the quarter. These tax benefits had a favorable impact on our 2019 effective tax rate.

## *Liquidity and Capital Resources*

### *Overview*

Our principal uses of capital in the first three months of 2019 were acquisition and development of new and strategic lot positions, operating expenses, home construction, repurchasing our common stock and the payment of routine liabilities. We used funds generated by operations to meet our short-term working capital requirements. We remain focused on acquiring desirable land positions, generating increasing margins in our homebuilding operations and maintaining a strong balance sheet to support future needs and growth, while leveraging land options where possible.

### *Operating Cash Flow Activities*

During the three months ended March 31, 2019, net cash provided by operating activities totaled \$32.3 million versus net cash used in operating activities of \$17.3 million in the first quarter of 2018. Operating cash flows in 2019 and 2018 benefited from cash generated by net earnings of \$25.4 million and \$43.9 million, respectively. For the three months ended March 31, 2019, net earnings were offset mainly by a decrease in accounts payable and accrued liabilities of \$12.2 million. For the three months ended March 31, 2018, net earnings were offset by an increase in real estate of \$87.7 million, reflecting land development and home construction spending.

### *Investing Cash Flow Activities*

During the three months ended March 31, 2019, net cash used in investing activities totaled \$6.3 million as compared to \$6.4 million for the same period in 2018. Cash used in investing activities in the first three months of 2019 and 2018 is mainly attributable to the purchases of property and equipment of \$5.2 million and \$6.4 million for the 2019 and 2018 periods, respectively.

### *Financing Cash Flow Activities*

During the three months ended March 31, 2019, net cash used in financing activities totaled \$9.9 million as compared to net cash provided by financing activities of \$25.5 million for the same period in 2018. The net cash used in financing activities in 2019 primarily reflects repurchases of our common stock of \$9.0 million. The net cash provided by financing activities in 2018 is primarily the result of \$206.0 million in net proceeds received from our 6.00% bond issuance offset partially by the \$175.0 million repayment of our 4.50% senior notes.

### *Overview of Cash Management*

Cash flows for each of our communities depend on their stage of the development cycle and can differ substantially from reported earnings. Early stages of development or expansion require significant cash outlays for land acquisitions, zoning plat and other approvals, community and lot development, and construction of model homes, roads, utilities, landscape and other amenities. Because these costs are a component of our inventory and not recognized in our income statement until a home closes, we incur significant cash outlays prior to recognition of earnings. In the later stages of a community, cash inflows may significantly exceed earnings reported for financial statement purposes, as the cash outflow associated with home and land construction was previously incurred. From a liquidity standpoint, we are currently actively acquiring and developing lots in our markets to maintain and grow our lot supply and active community count. We are also using our cash on hand and draws under our Credit Facility, as needed, to fund operations in newer markets. We have spent the last several years building a pipeline of desirable land positions to position us for growth in an improving homebuilding environment and to replenish our supply of lots, however in recent quarters our cash generated from operations have exceeded our cash outlays. Accordingly, we expect future cash needs and our expected growth in the near term to be funded from our on-going operations.

During the three months ended March 31, 2019, we closed 1,765 homes, purchased about 1,900 lots for \$66.8 million, spent \$74.4 million on land development and started construction on 1,966 homes. We primarily purchase undeveloped land or partially-finished lots requiring development dollars in order to bring them to a finished status ready for home construction. We exercise strict controls and believe we have a prudent strategy for Company-wide cash management, including those related to cash outlays for land and inventory acquisition and development. We ended the first quarter of 2019 with \$327.5 million of cash and cash equivalents, an increase of \$16.0 million from December 31, 2018 and had no outstanding borrowings on our Credit Facility.

We expect to generate cash from the sale of our inventory, but we intend to redeploy most of that cash to acquire and develop strategic and well-positioned lots to grow our business. We believe that we currently have strong liquidity. Nevertheless, we may seek additional capital to strengthen our liquidity position, enable us to opportunistically acquire additional land inventory in anticipation of improving market conditions, and/or strengthen our long-term capital structure. Such additional capital may be in the form of equity or debt financing and may be from a variety of sources. There can be no assurances that we would be able to obtain such additional capital on terms acceptable to us, if at all, and such additional equity or debt financing could dilute the interests of our existing stockholders or increase our interest costs. We may also from time to time engage in opportunistic repurchases of our common stock in open market or privately-negotiated transactions as well as repurchase our outstanding senior notes.

On February 13, 2019, the Board of Directors authorized a new stock repurchase program, authorizing the expenditure of up to \$100.0 million to repurchase shares of our common stock. This program followed the completion of the \$100.0 million stock repurchase program approved in July 2018 and completed in the fourth quarter of 2018. There is no stated expiration for this program. The repurchases of the Company's shares may be made in the open market, in privately negotiated transactions, or otherwise. The timing and amount of repurchases, if any, will be determined by the Company's management at its discretion and be based on a variety of factors such as market price of the Company's common stock, corporate and contractual requirements, prevailing market and economic conditions and legal requirements. The share repurchase program may be modified, suspended or discontinued at any time. The Company intends to retire any shares repurchased. In the three months ended March 31, 2019, we purchased and retired 208,840 shares of our common stock at an aggregate purchase price of \$9.0 million and as of March 31, 2019, \$91.0 million remained available under this program.

We believe that our leverage ratios provide useful information to the users of our financial statements regarding our financial position and cash and debt management. Debt-to-capital and net debt-to-capital are calculated as follows (dollars in thousands):

	As of	
	March 31, 2019	December 31, 2018
Notes payable and other borrowings	\$ 1,309,300	\$ 1,310,057
Stockholders' equity	1,743,071	1,720,755
<b>Total capital</b>	<b>\$ 3,052,371</b>	<b>\$ 3,030,812</b>
Debt-to-capital <sup>(1)</sup>	42.9%	43.2%
Notes payable and other borrowings	\$ 1,309,300	\$ 1,310,057
Less: cash and cash equivalents	(327,499)	(311,466)
<b>Net debt</b>	<b>981,801</b>	<b>998,591</b>
Stockholders' equity	1,743,071	1,720,755
<b>Total net capital</b>	<b>\$ 2,724,872</b>	<b>\$ 2,719,346</b>
Net debt-to-capital <sup>(2)</sup>	36.0%	36.7%

- (1) Debt-to-capital is computed as senior notes, net and loans payable and other borrowings divided by the aggregate of total senior notes, net and loans payable and other borrowings and stockholders' equity.
- (2) Net debt-to-capital is computed as net debt divided by the aggregate of net debt and stockholders' equity. Net debt is total senior notes, net and loans payable and other borrowings, less cash and cash equivalents. The most directly comparable GAAP financial measure is the ratio of debt to total capital. We believe the ratio of net debt-to-capital is a relevant financial measure for investors to understand the leverage employed in our operations and as an indicator of our ability to obtain financing.

We have never declared cash dividends, nor do we intend to declare cash dividends in the foreseeable future. We plan to retain our cash to finance the continuing development of the business and increase our liquidity. Future cash dividends, if any, will depend upon financial condition, results of operations, capital requirements, statutory requirements, compliance with certain restrictive debt covenants, as well as other factors considered relevant by our Board of Directors.

### ***Credit Facility Covenants***

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 were in compliance with all Credit Facility covenants as of March 31, 2019. Our actual financial covenant calculations as of March 31, 2019 are reflected in the table below.

<b>Financial Covenant (dollars in thousands):</b>	<b>Covenant Requirement</b>	<b>Actual</b>
Minimum Tangible Net Worth	>\$1,214,870	\$1,703,641
Leverage Ratio	< 60%	33%
Interest Coverage Ratio <sup>(1)</sup>	> 1.50	4.60
Minimum Liquidity <sup>(1)</sup>	>\$85,852	\$1,038,228
Investments other than defined permitted investments	<\$511,092	\$15,661

(1) We are required to meet either the Interest Coverage Ratio or Minimum Liquidity, but not both.

### ***Off-Balance Sheet Arrangements***

Reference is made to Notes 1, 3, 5 and 16 in the accompanying notes to the unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q, which are incorporated by reference herein. These Notes discuss our off-balance sheet arrangements with respect to land acquisition contracts and option agreements, and land development joint ventures, including the nature and amounts of financial obligations relating to these items. In addition, these Notes discuss the nature and amounts of certain types of commitments that arise in connection with the ordinary course of our land development and homebuilding operations, including commitments of land development joint ventures for which we might be obligated.

### ***Seasonality***

Historically, we have experienced seasonal variations in our quarterly operating results and capital requirements. We typically take orders for more homes in the first half of the fiscal year than in the second half, which creates additional working capital requirements in the second and third quarters to build our inventories to satisfy seasonally higher deliveries in the second half of the year. We expect this seasonal pattern to continue over the long term.

### ***Recently Issued Accounting Pronouncements***

See Note 1 to our unaudited consolidated financial statements included in this report for discussion of recently issued accounting standards.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Our fixed rate debt is made up primarily of \$1.3 billion in principal of our senior notes. Except in limited circumstances, we do not have an obligation to prepay our fixed-rate debt prior to maturity and, as a result, interest rate risk and changes in fair value should not have a significant impact on our fixed rate borrowings until we would be required to repay such debt and access the capital markets to issue new debt. Our Credit Facility is subject to interest rate changes as the borrowing rates are based on LIBOR or Prime (see Note 6 in the accompanying notes to the unaudited consolidated financial statements included in this Form 10-Q).

Our operations are interest rate sensitive. As overall housing demand is adversely affected by increases in interest rates, a significant increase in mortgage interest rates may negatively affect the ability of homebuyers to secure adequate financing. Higher interest rates could adversely affect our revenues, gross margins and net income and would also increase our variable rate borrowing costs. We do not enter into, or intend to enter into, derivative financial instruments for trading or speculative purposes.

**Item 4. Controls and Procedures**

In order to ensure that the information we must disclose in our filings with the SEC is recorded, processed, summarized and reported on a timely basis, we have developed and implemented disclosure controls and procedures. Our management, with the participation of our chief executive officer and chief financial officer, has reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e), as of the end of the period covered by this Form 10-Q (the "Evaluation Date"). Based on such evaluation, management has concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective at a reasonable assurance level in ensuring that information that is required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that information required to be disclosed in our reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

During the fiscal quarter covered by this Form 10-Q, there has not been any change in our internal control over financial reporting that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

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. In addition to our warranty reserve, we have approximately \$509,000 of total reserves not related to warranty or construction defect matters. See Note 1 and Note 16 of the accompanying unaudited consolidated financial statements for additional information related to construction defect and warranty related reserves. 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 unaudited consolidated financial condition, results of operations or cash flows that have not been sufficiently reserved.

### Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item IA. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2018, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may eventually prove to materially adversely affect our business, financial condition and/or operating results.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We have never declared cash dividends, nor do we intend to declare cash dividends in the foreseeable future. We plan to retain our cash to finance the continuing development of the business. Future cash dividends, if any, will depend upon financial condition, results of operations, capital requirements, statutory requirements, compliance with certain restrictive debt covenants, as well as other factors considered relevant by our Board of Directors.

#### *Issuer Purchases of Equity Securities*

On February 13, 2019, the Board of Directors authorized a new stock repurchase program, authorizing the expenditure of up to \$100.0 million to repurchase shares of our common stock. This program follows the completion of the \$100.0 million stock repurchase program approved in July 2018 and completed in the fourth quarter of 2018. There is no stated expiration for this program. The repurchases of the Company's shares may be made in the open market, in privately negotiated transactions, or otherwise. The timing and amount of repurchases, if any, will be determined by the Company's management at its discretion and be based on a variety of factors such as the market price of the Company's common stock, corporate and contractual requirements, prevailing market and economic conditions and legal requirements. The share repurchase program may be modified, suspended or discontinued at any time. As of March 31, 2019, there was \$91.0 million available under this program to repurchase shares.

A summary of the Company's repurchase activity for the three months ended March 31, 2019 is as follows:

Period	Total Number of Shares Purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs
January 1 - January 31, 2019	—	\$ —	—	\$ —
February 1 - February 28, 2019	—	\$ —	—	\$ —
March 1 - March 31, 2019	208,840	\$ 42.89	208,840	\$ 91,043,337
<b>Total</b>	<b>208,840</b>		<b>208,840</b>	



**Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description</b>	<b>Page or Method of Filing</b>
3.1	Restated Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Exhibit 3 of Form 8-K dated June 20, 2002
3.1.1	Amendment to Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Exhibit 3.1 of Form 8-K dated September 15, 2004
3.1.2	Amendment to Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Appendix A of the Proxy Statement for the Registrant's 2006 Annual Meeting of Stockholders
3.1.3	Amendment to Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Appendix B of Proxy Statement for the Registrant's 2008 Annual Meeting of Stockholders
3.1.4	Amendment to Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Appendix A of the Definitive Proxy Statement filed with the Securities and Exchange Commission on January 9, 2009
3.2	Amended and Restated Bylaws of Meritage Homes Corporation	Incorporated by reference to Exhibit 3.1 of Form 8-K dated May 10, 2017
31.1	Rule 13a-14(a)/15d-14(a) Certification of Steven J. Hilton, Chief Executive Officer	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Hilla Sferruzza, Chief Financial Officer	Filed herewith
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer	Furnished herewith
101.0	The following financial statements from the Meritage Homes Corporation Quarterly Report on Form 10-Q for the three months ended March 31, 2019 were formatted in XBRL (Extensible Business Reporting Language); (i) Unaudited Consolidated Balance Sheets, (ii) Unaudited Consolidated Income Statements, (iii) Unaudited Consolidated Statements of Cash Flows, and (iv) Notes to Unaudited Consolidated Financial Statements.	

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MERITAGE HOMES CORPORATION,  
a Maryland Corporation

By: /s/ HILLA SFERRUZZA  
Hilla Sferruzza  
*Chief Financial Officer and Chief Accounting Officer*  
*(Duly Authorized Officer and Principal Financial Officer)*

Date: April 29, 2019

## INDEX OF EXHIBITS

- 3.1 [Restated Articles of Incorporation of Meritage Homes Corporation](#)
- 3.1.1 [Amendment to Articles of Incorporation of Meritage Homes Corporation](#)
- 3.1.2 [Amendment to Articles of Incorporation of Meritage Homes Corporation](#)
- 3.1.3 [Amendment to Articles of Incorporation of Meritage Homes Corporation](#)
- 3.1.4 [Amendment to Articles of Incorporation of Meritage Homes Corporation](#)
- 3.2 [Amended and Restated Bylaws of Meritage Homes Corporation](#)
- 31.1 [Rule 13a-14\(a\)/15d-14\(a\) Certification of Steven J. Hilton, Chief Executive Officer](#)
- 31.2 [Rule 13a-14\(a\)/15d-14\(a\) Certification of Hilla Sferruzza, Chief Financial Officer](#)
- 32.1 [Section 1350 Certification of Chief Executive Officer and Chief Financial Officer](#)
- 101.0 The following financial statements from the Meritage Homes Corporation Quarterly Report on Form 10-Q for the three months ended March 31, 2019 were formatted in XBRL (Extensible Business Reporting Language); (i) Unaudited Consolidated Balance Sheets, (ii) Unaudited Consolidated Income Statements, (iii) Unaudited Consolidated Statements of Cash Flows, and (iv) Notes to Unaudited Consolidated Financial Statements.

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## Section 2: EX-31.1 (EXHIBIT 31.1)

**EXHIBIT 31.1**

### **RULE 13a-14(a)/15d-14(a) CERTIFICATION**

I, Steven J. Hilton, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Meritage Homes Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 29, 2019

/s/ Steven J. Hilton

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Steven J. Hilton  
Chief Executive Officer  
(Principal Executive Officer)

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## Section 3: EX-31.2 (EXHIBIT 31.2)

**EXHIBIT 31.2**

### RULE 13a-14(a)/15d-14(a) CERTIFICATION

I, Hilla Sferruzza, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Meritage Homes Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 29, 2019

/s/ Hilla Sferruzza

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Hilla Sferruzza  
Executive Vice President and Chief Financial Officer (Principal  
Financial Officer)

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## Section 4: EX-32.1 (EXHIBIT 32.1)

**EXHIBIT 32.1**

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Meritage Homes Corporation (the "Company") for the period ending March 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, the undersigned, certify, to the best of our knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

MERITAGE HOMES CORPORATION,  
a Maryland Corporation

By: /s/ Steven J. Hilton

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Steven J. Hilton  
Chief Executive Officer  
(Principal Executive Officer)

April 29, 2019

By: /s/ Hilla Sferruzza

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Hilla Sferruzza  
*Executive Vice President and Chief Financial Officer*  
*(Principal Financial Officer)*

April 29, 2019

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