Meritage Homes CORP
Form 10-Q
October 30, 2015

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

FORM 10-Q

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

For the quarterly period ended September 30, 2015

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

(Exact Name of Registrant as Specified in its Charter)

Maryland	86-0611231
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
8800 E. Raintree Drive, Suite 300, Scottsdale, Arizona	85260
(Address of Principal Executive Offices)	(Zip Code)

(480) 515-8100
(Registrant's telephone number, including area code)
(Former Name, Former Address and Formal Fiscal Year, if Changed Since Last Report)

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

Indicate by a checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Date File required to be submitted and posted 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 and post such files). Yes x No

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

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

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

Common shares outstanding as of October 28, 2015: 39,665,797

MERITAGE HOMES CORPORATION
FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2015
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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)

	September 30, 2015	December 31, 2014
Assets		
Cash and cash equivalents	$235,409	$103,333
Other receivables	59,617	56,763
Real estate	2,088,690	1,877,682
Real estate not owned	—	4,999
Deposits on real estate under option or contract	91,526	94,989
Investments in unconsolidated entities	10,374	10,780
Property and equipment, net	34,403	32,403
Deferred tax asset	66,850	64,137
Prepaids, other assets and goodwill	77,017	71,052
Total assets	$2,663,886	$2,316,138
Liabilities		
Accounts payable	$113,869	$83,619
Accrued liabilities	161,803	154,144
Home sale deposits	39,587	29,379
Liabilities related to real estate not owned	—	4,299
Loans payable and other borrowings	41,898	30,722
Senior and convertible senior notes	1,104,060	904,486
Total liabilities	1,461,217	1,206,649
Stockholders' Equity		
Preferred stock, par value $0.01. Authorized 10,000,000 shares; none issued and outstanding at September 30, 2015 and December 31, 2014	—	—
Common stock, par value $0.01. Authorized 125,000,000 shares; issued 39,665,797 and 39,147,153 shares at September 30, 2015 and December 31, 2014, respectively	397	391
Additional paid-in capital	556,121	538,788
Retained earnings	646,151	570,310
Total stockholders' equity	1,202,669	1,109,489
Total liabilities and stockholders' equity	$2,663,886	$2,316,138

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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Homebuilding:				
Home closing revenue	$661,884	$545,524	$1,770,184	$1,454,103
Land closing revenue	8,072	11,252	16,285	16,622
Total closing revenue	669,956	556,776	1,786,469	1,470,725
Cost of home closings	(536,267)	(434,286)	(1,434,843)	(1,140,305)
Cost of land closings	(7,445)	(11,729)	(14,992)	(18,084)
Total cost of closings	(543,712)	(446,015)	(1,449,835)	(1,158,389)
Home closing gross profit	125,617	111,238	335,341	313,798
Land closing gross profit/(loss)	627	(477)	1,293	(1,462)
Total closing gross profit	126,244	110,761	336,634	312,336
Financial Services:				
Revenue	3,000	2,749	8,276	7,099
Expense	(1,253)	(1,238)	(3,914)	(3,444)
Earnings from financial services unconsolidated entities and other, net	3,854	2,783	9,155	7,281
Financial services profit	5,601	4,294	13,517	10,936
Commissions and other sales costs	(48,097)	(40,211)	(134,876)	(107,250)
General and administrative expenses	(28,774)	(29,218)	(86,074)	(75,460)
Loss from other unconsolidated entities, net	(123)	(134)	(415)	(364)
Interest expense	(4,187)	(460)	(11,962)	(4,569)
Other (expense)/income, net	(3,996)	1,998	(3,445)	6,395
Earnings before income taxes	46,668	47,030	113,379	142,024
Provision for income taxes	(16,360)	(14,453)	(37,538)	(48,991)
Net earnings	$30,308	$32,577	$75,841	$93,033
Earnings per common share:				
Basic	$0.76	$0.83	$1.92	$2.39
Diluted	$0.73	$0.79	$1.83	$2.27
Weighted average number of shares:				
Basic	39,663	39,123	39,568	38,977
Diluted	42,192	41,656	42,134	41,564

See accompanying notes to unaudited consolidated financial statements

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

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net earnings	$75,841	$93,033
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	10,294	8,154
Stock-based compensation	12,418	9,035
Excess income tax benefit from stock-based awards	(2,040)	(2,197)
Equity in earnings from unconsolidated entities	(8,740)	(6,917)
Distributions of earnings from unconsolidated entities	9,446	8,784
Other	1,246	8,361
Changes in assets and liabilities:		
Increase in real estate	(198,520)	(343,763)
Decrease/(increase) in deposits on real estate under option or contract	2,719	(27,552)
Increase in receivables, prepaids and other assets	(6,067)	(19,502)
Increase in accounts payable and accrued liabilities	39,949	33,920
Increase in home sale deposits	10,208	9,015
Net cash used in operating activities	(53,246)	(229,629)
Cash flows from investing activities:		
Investments in unconsolidated entities	(300)	(245)
Purchases of property and equipment	(12,334)	(16,367)
Proceeds from sales of property and equipment	92	173
Maturities of investments and securities	—	115,584
Payments to purchase investments and securities	—	(35,697)
Cash paid for acquisitions	—	(130,677)
Net cash used in investing activities	(12,542)	(67,229)
Cash flows from financing activities:		
Proceeds from Credit Facility, net	—	—
Repayment of loans payable and other borrowings	(4,044)	(6,524)
Proceeds from issuance of senior notes	200,000	—
Debt issuance costs	(3,013)	—
Excess income tax benefit from stock-based awards	2,040	2,197
Proceeds from issuance of common stock, net	—	110,420
Proceeds from stock option exercises	2,881	734
Net cash provided by financing activities	197,864	106,827
Net increase/(decrease) in cash and cash equivalents	132,076	(190,031)
Cash and cash equivalents, beginning of period	103,333	274,136
Cash and cash equivalents, end of period	$235,409	$84,105

See Supplemental Disclosure of Cash Flow Information in Note 13.
See accompanying notes to unaudited consolidated financial statements

MERITAGE HOMES CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — ORGANIZATION AND BASIS OF PRESENTATION

Organization. Meritage Homes is a leading designer and builder of single-family homes. We primarily build in historically high-growth regions of the United States and offer a variety of homes that are designed to appeal to a wide range of homebuyers, including first-time, move-up, active adult and luxury. 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. In August 2014, we entered the Atlanta, Georgia and Greenville, South Carolina markets through the acquisition of the homebuilding assets and operations of Legendary Communities ("Legendary Communities"). We also operate a wholly-owned title company, Carefree Title Agency, Inc. ("Carefree Title"). Carefree Title's core business includes title insurance and closing/settlement services we offer to our homebuyers. Through our predecessors, we commenced our homebuilding operations in 1985. Meritage Homes Corporation was incorporated in 1988 in the state of Maryland.

Our homebuilding and marketing activities are conducted under the name of Meritage Homes in each of our homebuilding markets, other than Tennessee, where we currently operate under the name of Phillips Builders, and in the Greenville market where we currently operate under the Legendary Communities brand for all communities open for sales as of the date of our acquisition and as Meritage Homes for all subsequently opened Greenville communities. We also offer luxury homes in some markets under the brand name of Monterey Homes. At September 30, 2015, we were actively selling homes in 250 communities, with base prices ranging from approximately $130,000 to $1,350,000.

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, 2014. The consolidated financial statements include the accounts of Meritage Homes Corporation and those of our consolidated subsidiaries, partnerships and other entities in which we have a controlling financial interest, and of variable interest entities (see Note 3) in which we are deemed the primary beneficiary (collectively, “us”, “we”, “our” and “the Company”). Intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the accompanying unaudited financial statements include all adjustments (consisting only of normal recurring entries), necessary for the fair presentation of our results for the interim periods presented. Results for interim periods are not necessarily indicative of results to be expected for the full year. Certain reclassifications have been made to prior year results to conform to current year presentation.

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 $58.7 million and $59.2 million are included in cash and cash equivalents at September 30, 2015 and December 31, 2014, respectively.

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

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 delays, labor or material shortages, increases in costs that have not yet been committed, changes in governmental requirements, or other unanticipated issues encountered during construction and development and other factors beyond our control. To address uncertainty in these budgets, we assess, update and revise project budgets on a regular basis, utilizing the most current information available to estimate construction and land costs.

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

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

Deposits. Deposits paid related to 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 used to offset the acquisition price of the lots based on the terms of the underlying agreements. To the extent they are non-refundable, deposits are charged to expense if the land acquisition 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 were $91.5 million and $95.0 million as of September 30, 2015 and December 31, 2014, respectively.

Goodwill. In accordance with ASC 350, Intangibles, Goodwill and Other ("ASC 350"), we analyze goodwill on at least an annual basis to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. ASC 350 states that an entity may assess qualitative factors first to determine whether it is necessary to perform a two-step 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, the two-step 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. See Note 9 for additional information related to goodwill.

Off-Balance Sheet Arrangements - Joint Ventures. In the past, we have participated 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; however, in recent years, such ventures have not been a significant avenue for us to access lots. See Note 4 for additional discussion of our investments in unconsolidated entities.

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

information on off-balance sheet arrangements.
Surety Bonds and Letters of Credit. We provide letters of credit in support of our obligations relating to the development of our projects and other corporate purposes. For some projects, surety bonds may be 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 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. 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):

	At September 30, 2015		At December 31, 2014	
	Outstanding	Estimated work remaining to complete	Outstanding	Estimated work remaining to