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Meritage Homes CORP  
Form 10-Q  
October 28, 2016

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

FORM 10-Q  
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended September 30, 2016  
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 (IRS Employer  
Incorporation or Organization) Identification No.)

8800 E. Raintree Drive, Suite 300, 85260  
Scottsdale, Arizona  
(Address of Principal Executive Offices) (Zip Code)  
(480) 515-8100

(Registrant's telephone number, including area code)

N/A

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

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

Indicate by a checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data 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 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

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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 October 26, 2016: 40,024,984

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MERITAGE HOMES CORPORATION  
FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2016  
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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<br>30, 2016 | December<br>31, 2015 |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
| Assets                                                                                                                                                           |                       |                      |
| Cash and cash equivalents                                                                                                                                        | \$107,915             | \$262,208            |
| Other receivables                                                                                                                                                | 76,371                | 57,296               |
| Real estate                                                                                                                                                      | 2,429,014             | 2,098,302            |
| Deposits on real estate under option or contract                                                                                                                 | 91,053                | 87,839               |
| Investments in unconsolidated entities                                                                                                                           | 11,831                | 11,370               |
| Property and equipment, net                                                                                                                                      | 33,983                | 33,970               |
| Deferred tax asset                                                                                                                                               | 57,552                | 59,147               |
| Prepays, other assets and goodwill                                                                                                                               | 65,436                | 69,645               |
| Total assets                                                                                                                                                     | \$2,873,155           | \$2,679,777          |
| Liabilities                                                                                                                                                      |                       |                      |
| Accounts payable                                                                                                                                                 | \$148,260             | \$106,440            |
| Accrued liabilities                                                                                                                                              | 180,687               | 161,163              |
| Home sale deposits                                                                                                                                               | 36,988                | 36,197               |
| Loans payable and other borrowings                                                                                                                               | 45,183                | 23,867               |
| Senior and convertible senior notes, net                                                                                                                         | 1,094,632             | 1,093,173            |
| Total liabilities                                                                                                                                                | 1,505,750             | 1,420,840            |
| Stockholders' Equity                                                                                                                                             |                       |                      |
| Preferred stock, par value \$0.01. Authorized 10,000,000 shares; none issued and outstanding at September 30, 2016 and December 31, 2015                         | —                     | —                    |
| Common stock, par value \$0.01. Authorized 125,000,000 shares; issued 40,024,984 and 39,669,094 shares at September 30, 2016 and December 31, 2015, respectively | 400                   | 397                  |
| Additional paid-in capital                                                                                                                                       | 570,223               | 559,492              |
| Retained earnings                                                                                                                                                | 796,782               | 699,048              |
| Total stockholders' equity                                                                                                                                       | 1,367,405             | 1,258,937            |
| Total liabilities and stockholders' equity                                                                                                                       | \$2,873,155           | \$2,679,777          |
| 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<br>September 30, |            | Nine Months Ended<br>September 30, |              |
|-------------------------------------------------------------------------|-------------------------------------|------------|------------------------------------|--------------|
|                                                                         | 2016                                | 2015       | 2016                               | 2015         |
| Homebuilding:                                                           |                                     |            |                                    |              |
| Home closing revenue                                                    | \$735,870                           | \$661,884  | \$2,127,332                        | \$1,770,184  |
| Land closing revenue                                                    | 16,987                              | 8,072      | 21,187                             | 16,285       |
| Total closing revenue                                                   | 752,857                             | 669,956    | 2,148,519                          | 1,786,469    |
| Cost of home closings                                                   | (604,891 )                          | (536,267 ) | (1,755,260 )                       | (1,434,843 ) |
| Cost of land closings                                                   | (16,092 )                           | (7,445 )   | (19,485 )                          | (14,992 )    |
| Total cost of closings                                                  | (620,983 )                          | (543,712 ) | (1,774,745 )                       | (1,449,835 ) |
| Home closing gross profit                                               | 130,979                             | 125,617    | 372,072                            | 335,341      |
| Land closing gross profit                                               | 895                                 | 627        | 1,702                              | 1,293        |
| Total closing gross profit                                              | 131,874                             | 126,244    | 373,774                            | 336,634      |
| Financial Services:                                                     |                                     |            |                                    |              |
| Revenue                                                                 | 3,139                               | 3,000      | 9,115                              | 8,276        |
| Expense                                                                 | (1,398 )                            | (1,253 )   | (4,152 )                           | (3,914 )     |
| Earnings from financial services unconsolidated entities and other, net | 4,215                               | 3,854      | 10,802                             | 9,155        |
| Financial services profit                                               | 5,956                               | 5,601      | 15,765                             | 13,517       |
| Commissions and other sales costs                                       | (52,478 )                           | (48,097 )  | (155,034 )                         | (134,876 )   |
| General and administrative expenses                                     | (33,258 )                           | (28,774 )  | (91,774 )                          | (86,074 )    |
| Earnings/(loss) from other unconsolidated entities, net                 | 440                                 | (123 )     | 856                                | (415 )       |
| Interest expense                                                        | (167 )                              | (4,187 )   | (5,127 )                           | (11,962 )    |
| Other income/(expense), net                                             | 1,435                               | (3,996 )   | 3,263                              | (3,445 )     |
| Earnings before income taxes                                            | 53,802                              | 46,668     | 141,723                            | 113,379      |
| Provision for income taxes                                              | (16,915 )                           | (16,360 )  | (43,989 )                          | (37,538 )    |
| Net earnings                                                            | \$36,887                            | \$30,308   | \$97,734                           | \$75,841     |
| Earnings per common share:                                              |                                     |            |                                    |              |
| Basic                                                                   | \$0.92                              | \$0.76     | \$2.45                             | \$1.92       |
| Diluted                                                                 | \$0.88                              | \$0.73     | \$2.33                             | \$1.83       |
| Weighted average number of shares:                                      |                                     |            |                                    |              |
| Basic                                                                   | 40,022                              | 39,663     | 39,958                             | 39,568       |
| Diluted                                                                 | 42,608                              | 42,192     | 42,541                             | 42,134       |
| See accompanying notes to unaudited consolidated financial statements   |                                     |            |                                    |              |

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

|                                                                                 | Nine Months Ended<br>September 30, |            |
|---------------------------------------------------------------------------------|------------------------------------|------------|
|                                                                                 | 2016                               | 2015       |
| Cash flows from operating activities:                                           |                                    |            |
| Net earnings                                                                    | \$97,734                           | \$75,841   |
| Adjustments to reconcile net earnings to net cash used in operating activities: |                                    |            |
| Depreciation and amortization                                                   | 11,470                             | 10,294     |
| Stock-based compensation                                                        | 11,042                             | 12,418     |
| Excess income tax provision/(benefit) from stock-based awards                   | 540                                | (2,040 )   |
| Equity in earnings from unconsolidated entities                                 | (11,658 )                          | (8,740 )   |
| Distributions of earnings from unconsolidated entities                          | 11,439                             | 9,446      |
| Other                                                                           | 4,942                              | 1,246      |
| Changes in assets and liabilities:                                              |                                    |            |
| Increase in real estate                                                         | (318,490 )                         | (198,520 ) |
| (Increase)/decrease in deposits on real estate under option or contract         | (3,160 )                           | 2,719      |
| Increase in other receivables, prepaids and other assets                        | (14,201 )                          | (6,067 )   |
| Increase in accounts payable and accrued liabilities                            | 61,206                             | 39,949     |
| Increase in home sale deposits                                                  | 791                                | 10,208     |
| Net cash used in operating activities                                           | (148,345 )                         | (53,246 )  |
| Cash flows from investing activities:                                           |                                    |            |
| Investments in unconsolidated entities                                          | (242 )                             | (300 )     |
| Purchases of property and equipment                                             | (12,256 )                          | (12,334 )  |
| Proceeds from sales of property and equipment                                   | 144                                | 92         |
| Maturities/sales of investments and securities                                  | 645                                | —          |
| Payments to purchase investments and securities                                 | (645 )                             | —          |
| Net cash used in investing activities                                           | (12,354 )                          | (12,542 )  |
| Cash flows from financing activities:                                           |                                    |            |
| Proceeds from Credit Facility, net                                              | 25,000                             | —          |
| Repayment of loans payable and other borrowings                                 | (18,286 )                          | (4,044 )   |
| Proceeds from issuance of senior notes                                          | —                                  | 200,000    |
| Debt issuance costs                                                             | —                                  | (3,013 )   |
| Excess income tax (provision)/benefit from stock-based awards                   | (540 )                             | 2,040      |
| Proceeds from stock option exercises                                            | 232                                | 2,881      |
| Net cash provided by financing activities                                       | 6,406                              | 197,864    |
| Net (decrease)/increase in cash and cash equivalents                            | (154,293 )                         | 132,076    |
| Cash and cash equivalents, beginning of period                                  | 262,208                            | 103,333    |
| Cash and cash equivalents, end of period                                        | \$107,915                          | \$235,409  |
| 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. 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. We also offer luxury homes in some markets under the brand name of Monterey Homes. At September 30, 2016, we were actively selling homes in 237 communities, with base prices ranging from approximately \$162,000 to \$1,440,000.

**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, 2015. The consolidated financial statements include the accounts of Meritage Homes Corporation and those of our consolidated subsidiaries, partnerships and other entities in which we have a controlling financial interest, and of variable interest entities (see Note 3) in which we are deemed the primary beneficiary (collectively, "us", "we", "our" and "the Company"). Intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the accompanying unaudited financial statements include all adjustments (consisting only of normal recurring entries), necessary for the fair presentation of our results for the interim periods presented. Results for interim periods are not necessarily indicative of results to be expected for the full year.

**Cash and Cash Equivalents.** Liquid investments with an initial maturity of three months or less are classified as cash equivalents. Amounts in transit from title companies or closing agents for home closings of approximately \$64.9 million and \$74.5 million are included in cash and cash equivalents at September 30, 2016 and December 31, 2015, respectively. Included in our balance as of September 30, 2016 and December 31, 2015 is \$0.1 million and \$20.0 million, respectively, of money market funds that are invested in short term (three months or less) government securities.

**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. Such an analysis is conducted if there is an indication of a decline in value of our land and real estate assets. 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 on real estate under option or contract were \$91.1 million and \$87.8 million as of September 30, 2016 and December 31, 2015, 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 first assess qualitative factors 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. Under the guidelines contained in ASC 350, we evaluate goodwill for impairments annually or more frequently if deterioration in our inputs exists. 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 vehicle 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. 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. 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<br>September 30, 2016 |                                            | December 31, 2015 |                                            |
|------------------------------------------------------------|-----------------------------|--------------------------------------------|-------------------|--------------------------------------------|
|                                                            | Outstanding                 | Estimated work<br>remaining to<br>complete | Outstanding       | Estimated work<br>remaining to<br>complete |
| <b>Sureties:</b>                                           |                             |                                            |                   |                                            |
| Sureties related to joint ventures                         | \$—                         | \$ —                                       | \$87              | \$ 87                                      |
| Sureties related to owned projects and lots under contract | 234,014                     | 73,207                                     | 250,639           | 103,200                                    |
| <b>Total Sureties</b>                                      | <b>\$234,014</b>            | <b>\$ 73,207</b>                           | <b>\$250,726</b>  | <b>\$ 103,287</b>                          |
| <b>Letters of Credit (“LOCs”):</b>                         |                             |                                            |                   |                                            |
| LOCs in lieu of deposits for contracted lots               | \$250                       | N/A                                        | \$—               | N/A                                        |
| LOCs for land development                                  | 28,375                      | N/A                                        | 23,934            | N/A                                        |
| LOCs for general corporate operations                      | 3,750                       | N/A                                        | 3,750             | N/A                                        |
| <b>Total LOCs</b>                                          | <b>\$32,375</b>             | <b>N/A</b>                                 | <b>\$27,684</b>   | <b>N/A</b>                                 |

Accrued Liabilities. Accrued liabilities at September 30, 2016 and December 31, 2015 consisted of the following (in thousands):

|                                                                         | As of<br>September 30, 2016 |                  | December 31, 2015 |  |
|-------------------------------------------------------------------------|-----------------------------|------------------|-------------------|--|
| Accruals related to real estate development and construction activities | \$65,929                    | \$37,509         |                   |  |
| Payroll and other benefits                                              | 42,112                      | 41,240           |                   |  |
| Accrued taxes                                                           | 8,687                       | 9,950            |                   |  |
| Warranty reserves                                                       | 21,966                      | 21,615           |                   |  |
| Legal reserves (1)                                                      | 1,602                       | 18,812           |                   |  |
| Other accruals                                                          | 40,391                      | 32,037           |                   |  |
| <b>Total</b>                                                            | <b>\$180,687</b>            | <b>\$161,163</b> |                   |  |

(1) See Note 15 for additional information related to our legal reserves.

**Warranty Reserves.** We provide home purchasers with limited warranties against certain building defects and we have certain obligations related to those post-construction warranties for closed homes. The specific terms and conditions of these limited warranties vary by state, but overall the nature of the warranties include a complete workmanship and materials warranty typically during the first one to two years after the close of the home and a structural warranty that typically extends up to 10 years subsequent to the close of the home. With the assistance of an actuary, we have estimated these reserves for the structural warranty based on the number of homes still under warranty and historical data and trends for our communities. We also use industry data with respect to similar product types and geographic areas in markets where our experience is incomplete to draw a meaningful conclusion. We regularly review our warranty reserves and adjust them, as necessary, to reflect changes in trends as information becomes available. Based on such reviews of warranty costs incurred, no adjustments were made to our warranty reserve in the three months ended September 30, 2016 and September 30, 2015. We decreased our warranty reserve balance by \$275,000 in the nine months ended September 30, 2016, which decreased our cost of sales. In the nine months ended September 30, 2015 we increased our warranty reserve balance by \$750,000, which increased our cost of sales. A summary of changes in our warranty reserves follows (in thousands):

| Three Months<br>Ended September<br>30,<br>2016 |      | Nine Months<br>Ended September<br>30,<br>2015 |      |
|------------------------------------------------|------|-----------------------------------------------|------|
|                                                | 2015 | 2016                                          | 2015 |

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|                                               |          |          |           |           |
|-----------------------------------------------|----------|----------|-----------|-----------|
| Balance, beginning of period                  | \$22,699 | \$21,993 | \$21,615  | \$22,080  |
| Additions to reserve from new home deliveries | 4,110    | 3,376    | 12,068    | 9,000     |
| Warranty claims                               | (4,843 ) | (4,229 ) | (11,442 ) | (10,690 ) |
| Adjustments to pre-existing reserves          | —        | —        | (275 )    | 750       |
| Balance, end of period                        | \$21,966 | \$21,140 | \$21,966  | \$21,140  |

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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 trades 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.

#### Recent Accounting Pronouncements.

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-15, Classification of Certain Cash Receipts and Cash Payments (Topic 230), ("ASU 2016-15"). ASU 2016-15 adds and clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows, reducing the existing diversity in practice that has resulted from the lack of consistent principles on this topic. ASU 2016-15 is effective for us beginning January 1, 2018. Early adoption is permitted. We are currently evaluating the impact adopting this guidance will have on classifications in our statement of cash flows.

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for us beginning January 1, 2017. We are currently evaluating the potential impact of adopting this guidance but do not expect it to have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets. ASU 2016-02 will be effective for us beginning January 1, 2019, and early adoption is permitted. ASU 2016-02 requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. We are currently evaluating the impact adopting this guidance will have on our financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest — Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-03"). ASU 2015-03 requires that debt issuance costs related to a recognized debt liability, other than those related to a revolving debt arrangement, be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. In August 2015, the FASB issued ASU 2015-15, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements - Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting ("ASU 2015-15"), which clarifies the treatment of debt issuance costs from line-of-credit arrangements after the adoption of ASU 2015-03. In particular, ASU 2015-15 clarifies that the SEC staff would not object to an entity deferring and presenting debt issuance costs related to a line-of-credit arrangement as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. ASU 2015-03 represents a change in accounting principle and was effective on January 1, 2016 and was applied on a retrospective basis. The adoption of ASU 2015-03 resulted in a retrospective reclassification of our debt costs as described above from Prepaids, other assets and goodwill to Senior and convertible senior notes, net on our December 31, 2015 balance sheet in the amount of \$10.7 million. As allowed by ASU 2015-15, we elected not to reclassify deferred debt issuance costs associated with our Credit Facility and continue to present these capitalized costs as an asset.

In February 2015, the FASB issued ASU 2015-02, Consolidation: Amendments to the Consolidation Analysis (Topic 810) ("ASU 2015-02"). ASU 2015-02 changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. ASU 2015-02 was effective for us beginning January 1, 2016 and

had no effect on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), (“ASU 2014-09”). ASU 2014-09 requires entities to recognize revenue that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services by applying the following steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 supersedes the revenue

recognition requirements in ASU 605, Revenue Recognition, most industry-specific guidance throughout the industry topics of the ASC, and some cost guidance related to construction-type and production-type contracts. Subsequent to the issuance of ASU 2014-09, the FASB issued several amendments in 2016 to the original standard including ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing and ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow Scope Improvements and Practical Expedients. These amendments do not change the core principle of the guidance stated in ASU 2014-09. Rather, they are intended to clarify and improve understanding of certain topics included within the revenue standard. ASU 2014-09 and the related amendments are effective for us on January 1, 2018. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016. We are currently evaluating the potential impact adopting this guidance will have on our consolidated financial statements.

## NOTE 2 — REAL ESTATE AND CAPITALIZED INTEREST

Real estate consists of the following (in thousands):

|                                                                     | As of       |             |
|---------------------------------------------------------------------|-------------|-------------|
|                                                                     | September   | December    |
|                                                                     | 30, 2016    | 31, 2015    |
| Homes under contract under construction <sup>(1)</sup>              | \$632,454   | \$456,138   |
| Unsold homes, completed and under construction <sup>(1)</sup>       | 377,490     | 307,425     |
| Model homes <sup>(1)</sup>                                          | 150,662     | 138,546     |
| Finished home sites and home sites under development <sup>(2)</sup> | 1,268,408   | 1,196,193   |
| Total                                                               | \$2,429,014 | \$2,098,302 |

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

Includes raw land, land held for development and land held for sale. Land held for development primarily reflects land and land development costs related to land where development activity is not currently underway but is expected to begin in the future. For these parcels, we may have chosen not to currently 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    |           | Nine Months     |           |
|------------------------------------------------------|-----------------|-----------|-----------------|-----------|
|                                                      | Ended September |           | Ended September |           |
|                                                      | 30,             |           | 30,             |           |
|                                                      | 2016            | 2015      | 2016            | 2015      |
| Capitalized interest, beginning of period            | \$64,682        | \$58,870  | \$61,202        | \$54,060  |
| Interest incurred                                    | 17,372          | 17,857    | 52,644          | 49,665    |
| Interest expensed                                    | (167 )          | (4,187 )  | (5,127 )        | (11,962 ) |
| Interest amortized to cost of home and land closings | (14,256 )       | (11,144 ) | (41,088 )       | (30,367 ) |
| Capitalized interest, end of period <sup>(1)</sup>   | \$67,631        | \$61,396  | \$67,631        | \$61,396  |

Approximately \$383,000 and \$445,000 of the capitalized interest is related to our joint venture investments and is a (1) component of Investments in unconsolidated entities on our consolidated balance sheet as of September 30, 2016 and December 31, 2015, respectively.





**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 by determining 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 September 30, 2016 (dollars in thousands):

|                                                                                                          | Projected<br>Number<br>of Lots | Purchase<br>Price | Option/<br>Earnest<br>Money<br>Deposits—Cash |     |
|----------------------------------------------------------------------------------------------------------|--------------------------------|-------------------|----------------------------------------------|-----|
| Purchase and option contracts recorded on balance sheet as Real estate not owned                         | —                              | \$—               | \$ —                                         |     |
| Option contracts not recorded on balance sheet — non-refundable deposits, committed (1)                  | 4,395                          | 437,644           | 63,645                                       |     |
| Purchase contracts not recorded on balance sheet — non-refundable deposits, committed (1)                | 4,330                          | 266,086           | 20,079                                       |     |
| Purchase contracts not recorded on balance sheet —refundable deposits, committed                         | 820                            | 31,414            | 1,855                                        |     |
| Total committed (on and off balance sheet)                                                               | 9,545                          | 735,144           | 85,579                                       |     |
| Total purchase and option contracts not recorded on balance sheet — refundable deposits, uncommitted (2) | 7,343                          | 361,238           | 5,474                                        |     |
| Total lots under contract or option                                                                      | 16,888                         | \$1,096,382       | \$ 91,053                                    |     |
| Total purchase and option contracts not recorded on balance sheet (3)                                    | 16,888                         | \$1,096,382       | \$ 91,053                                    | (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 committed to purchase these lots.

- (3) Except for our specific performance contracts recorded on our balance sheet as Real estate not owned, if any, none of our option agreements 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 September 30, 2016.

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, during a weakened homebuilding market, we may purchase lots at an absorption level that exceeds our sales and home starts pace in order to meet the pre-established minimum number of lots or we will work to restructure our original contract to terms that more accurately reflect our revised sales pace expectations.

#### NOTE 4 - INVESTMENTS IN UNCONSOLIDATED ENTITIES

In the past, we have entered 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, in recent years they have not been a significant source of land for us. Based on the structure of these joint ventures, they 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 September 30, 2016, we had two active equity-method land ventures.

We have two separate ongoing legal proceedings related to a minority ownership interest in one of our inactive joint ventures, the South Edge joint venture. The first involves pending litigation regarding the amount of attorneys' fees that are payable by us relating to resolved litigation about the guarantee related to that venture. The other South Edge related matter involves pending arbitration proceedings regarding claims we have asserted against certain members of the inactive joint venture. See Note 15 regarding the outstanding litigation related to this joint venture.

As of September 30, 2016, 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 September 30, 2016 and December 31, 2015 was \$1.8 million and \$2.5 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     |          |
|----------------------------------------|-----------|----------|
|                                        | September | December |
|                                        | 30,       | 31, 2015 |
|                                        | 2016      |          |
| Assets:                                |           |          |
| Cash                                   | \$10,311  | \$7,888  |
| Real estate                            | 31,233    | 33,366   |
| Other assets                           | 5,129     | 4,514    |
| Total assets                           | \$46,673  | \$45,768 |
| Liabilities and equity:                |           |          |
| Accounts payable and other liabilities | \$5,858   | \$7,331  |
| Notes and mortgages payable            | 12,594    | 13,345   |
| Equity of:                             |           |          |
| Meritage <sup>(1)</sup>                | 9,136     | 8,194    |
| Other                                  | 19,085    | 16,898   |
| Total liabilities and equity           | \$46,673  | \$45,768 |

|                                                         | Three Months<br>Ended September<br>30, |          | Nine Months<br>Ended September<br>30, |           |
|---------------------------------------------------------|----------------------------------------|----------|---------------------------------------|-----------|
|                                                         | 2016                                   | 2015     | 2016                                  | 2015      |
| Revenue                                                 | \$13,374                               | \$10,252 | \$34,875                              | \$25,406  |
| Costs and expenses                                      | (5,762 )                               | (4,649 ) | (15,408 )                             | (12,057 ) |
| Net earnings of unconsolidated entities                 | \$7,612                                | \$5,603  | \$19,467                              | \$13,349  |
| Meritage's share of pre-tax earnings <sup>(1) (2)</sup> | \$4,681                                | \$3,754  | \$11,719                              | \$8,763   |

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 (1) 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. As discussed in Note 2 to these unaudited combined financial statements, balances do not include \$383,000 and \$445,000 of capitalized interest that is a component of our investment balances at September 30, 2016 and December 31, 2015, respectively.

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

The joint venture assets and liabilities noted in the table above primarily represent two active land ventures, one mortgage venture and various inactive ventures. Our total investment in all of these joint ventures is \$11.8 million and \$11.4 million as of September 30, 2016 and December 31, 2015, respectively. We believe these ventures are in compliance with their respective debt agreements, if applicable, and such debt is non-recourse to us.

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

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

|                                                                                                                                                                                                    | As of<br>September<br>30,<br>2016 | December<br>31, 2015 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|----------------------|
| Other borrowings, real estate notes payable <sup>(1)</sup>                                                                                                                                         | \$20,183                          | \$23,867             |
| \$500 million unsecured revolving credit facility with interest approximating LIBOR<br>(approximately 0.53% at September 30, 2016) plus 1.75% or Prime (3.50% at September 30,<br>2016) plus 0.75% | 25,000                            | —                    |
| Total                                                                                                                                                                                              | \$45,183                          | \$23,867             |

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

The Company has a \$500.0 million unsecured revolving credit facility ("Credit Facility"), with an accordion feature that permits the size of the facility to increase to a maximum of \$600.0 million. In June 2016, the maturity date of a substantial portion of the credit facility was extended whereby \$60.0 million matures in July 2019 with the remainder maturing in July 2020. 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 \$670.3 million (which amount is subject to increase over time based on subsequent earnings and proceeds from equity offerings), and (b) a maximum leverage covenant that prohibits the leverage ratio (as defined therein) from exceeding 60%. In addition, we are required to maintain either (i) an interest coverage ratio (EBITDA to interest expense, as defined therein) of at least 1.50 to 1.00 or (ii) liquidity (as defined therein) of an amount not less than our consolidated interest incurred during the trailing 12 months.

We had \$25.0 million of outstanding borrowings under the Credit Facility as of September 30, 2016 and no borrowings at December 31, 2015. During the three months ended September 30, 2016, we had \$50.0 million and \$25.0 million of gross borrowings and repayments, respectively, with no activity for the 2015 period. During the nine months ended September 30, 2016 we had \$106.0 million of gross borrowings and \$81.0 million of repayments. During the nine months ended September 30, 2015, gross borrowings and repayments each totaled \$210.0 million. As of September 30, 2016 we had

outstanding borrowings of \$25.0 million and outstanding letters of credit issued under the Credit Facility totaling \$32.4 million, respectively, leaving \$442.6 million available under the Credit Facility to be drawn.

#### NOTE 6 — SENIOR AND CONVERTIBLE SENIOR NOTES, NET

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

|                                                                                                                                                               | As of<br>September<br>30, 2016 | December<br>31, 2015 |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|----------------------|
| 4.50% senior notes due 2018                                                                                                                                   | \$175,000                      | \$175,000            |
| 7.15% senior notes due 2020. At September 30, 2016 and December 31, 2015 there was approximately \$1,991 and \$2,418 in net unamortized premium, respectively | 301,991                        | 302,418              |
| 7.00% senior notes due 2022                                                                                                                                   | 300,000                        | 300,000              |
| 6.00% senior notes due 2025                                                                                                                                   | 200,000                        | 200,000              |
| 1.875% convertible senior notes due 2032 <sup>(1)</sup>                                                                                                       | 126,500                        | 126,500              |
| Net debt issuance costs                                                                                                                                       | (8,859 )                       | (10,745 )            |
| Total                                                                                                                                                         | \$1,094,632                    | \$1,093,173          |

<sup>(1)</sup> The Convertible Notes may be redeemed by the note-holders on the fifth, tenth and fifteenth anniversary dates of the September 18, 2012 issuance date of the Convertible Notes.

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 September 30, 2016. Our convertible senior notes do not have any financial covenants.

The convertible senior notes are convertible into shares of our common stock at an initial conversion rate of 17.1985 shares of our common stock per \$1,000 principal amount of convertible senior notes. This corresponds to an initial conversion price of \$58.14 per share and represented a 47.5% conversion premium based on the closing price of our common stock on the issue date of the convertible senior notes.

Obligations to pay principal and interest on the senior and convertible 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 nonguarantor subsidiaries are, individually and in the aggregate, minor.

#### NOTE 7 — FAIR VALUE DISCLOSURES

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

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

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

inputs are observable in the market.

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

If the only observable inputs are from inactive markets or for transactions which the company evaluates as "distressed", the use of Level 1 inputs should be modified by the company to properly address these factors, or the reliance of such inputs may be limited, with a greater weight attributed to Level 3 inputs. Refer to Notes 1 and 2 for additional information regarding the valuation of our non-financial assets.

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                  |                            |                        |                            |
|---------------------------------|------------------------|----------------------------|------------------------|----------------------------|
|                                 | September 30, 2016     |                            | December 31, 2015      |                            |
|                                 | Aggregate<br>Principal | Estimated<br>Fair<br>Value | Aggregate<br>Principal | Estimated<br>Fair<br>Value |
| 4.50% senior notes              | \$175,000              | \$178,938                  | \$175,000              | \$175,000                  |
| 7.15% senior notes              | \$300,000              | \$333,750                  | \$300,000              | \$315,750                  |
| 7.00% senior notes              | \$300,000              | \$334,500                  | \$300,000              | \$313,500                  |
| 6.00% senior notes              | \$200,000              | \$212,500                  | \$200,000              | \$197,500                  |
| 1.875% convertible senior notes | \$126,500              | \$126,184                  | \$126,500              | \$124,128                  |

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

#### NOTE 8 — EARNINGS PER SHARE

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

|                                                                                          | Three Months<br>Ended September<br>30, |          | Nine Months<br>Ended September<br>30, |          |
|------------------------------------------------------------------------------------------|----------------------------------------|----------|---------------------------------------|----------|
|                                                                                          | 2016                                   | 2015     | 2016                                  | 2015     |
| Basic weighted average number of shares outstanding                                      | 40,022                                 | 39,663   | 39,958                                | 39,568   |
| Effect of dilutive securities:                                                           |                                        |          |                                       |          |
| Convertible senior notes <sup>(1)</sup>                                                  | 2,176                                  | 2,176    | 2,176                                 | 2,176    |
| Stock options and unvested restricted stock                                              | 410                                    | 353      | 407                                   | 390      |
| Diluted average shares outstanding                                                       | 42,608                                 | 42,192   | 42,541                                | 42,134   |
| Net earnings as reported                                                                 | \$36,887                               | \$30,308 | \$97,734                              | \$75,841 |
| Interest attributable to convertible senior notes, net of income taxes                   | 403                                    | 385      | 1,210                                 | 1,189    |
| Net earnings for diluted earnings per share                                              | \$37,290                               | \$30,693 | \$98,944                              | \$77,030 |
| Basic earnings per share                                                                 | \$0.92                                 | \$0.76   | \$2.45                                | \$1.92   |
| Diluted earnings per share <sup>(1)</sup>                                                | \$0.88                                 | \$0.73   | \$2.33                                | \$1.83   |
| Antidilutive stock options not included in the calculation of diluted earnings per share | 17                                     | 3        | 5                                     | —        |

(1) In accordance with ASC 260-10, Earnings Per Share, ("ASC 260-10") we calculate the dilutive effect of convertible securities using the "if-converted" method.



**NOTE 9 — ACQUISITIONS AND GOODWILL**

Goodwill. Over the past several years, we entered new markets through the acquisition of the homebuilding assets and operations of local/regional homebuilders in Georgia, South Carolina and Tennessee. As a result of these transactions, we recorded approximately \$33.0 million of goodwill. Goodwill represents the excess of the purchase price of our acquisitions over the fair value of the net assets acquired. Our acquisitions are recorded in accordance with ASC 805, Business Combinations ("ASC 805") 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<br>Services | Corporate | Total     |
|-------------------------------|------|---------|-----------|-----------------------|-----------|-----------|
| Balance at December 31, 2015  | \$ — | \$ —    | —\$32,962 | \$ —                  | \$ —      | —\$32,962 |
| Additions                     | —    | —       | —         | —                     | —         | —         |
| Impairments                   | —    | —       | —         | —                     | —         | —         |
| Balance at September 30, 2016 | \$ — | \$ —    | —\$32,962 | \$ —                  | \$ —      | —\$32,962 |

**NOTE 10 — STOCKHOLDERS' EQUITY**

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

| Nine Months Ended September 30, 2016<br>(In thousands) |                  |                 |                                  |                      |             |
|--------------------------------------------------------|------------------|-----------------|----------------------------------|----------------------|-------------|
|                                                        | Number<br>Shares | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Total       |
| Balance at December 31, 2015                           | 39,669           | \$ 397          | \$559,492                        | \$699,048            | \$1,258,937 |
| Net earnings                                           | —                | —               | —                                | 97,734               | 97,734      |
| Exercise/vesting of stock-based awards                 | 356              | 3               | 229                              | —                    | 232         |
| Excess income tax provision from stock-based awards    | —                | —               | (540)                            | —                    | (540)       |
| Stock-based compensation expense                       | —                | —               | 11,042                           | —                    | 11,042      |
| Balance at September 30, 2016                          | 40,025           | \$ 400          | \$570,223                        | \$796,782            | \$1,367,405 |

| Nine Months Ended September 30, 2015<br>(In thousands) |                  |                 |                                  |                      |             |
|--------------------------------------------------------|------------------|-----------------|----------------------------------|----------------------|-------------|
|                                                        | Number<br>Shares | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Total       |
| Balance at December 31, 2014                           | 39,147           | \$ 391          | \$538,788                        | \$570,310            | \$1,109,489 |
| Net earnings                                           | —                | —               | —                                | 75,841               | 75,841      |
| Exercise/vesting of stock-based awards                 | 519              | 6               | 2,875                            | —                    | 2,881       |
| Excess income tax benefit from stock-based awards      | —                | —               | 2,040                            | —                    | 2,040       |
| Stock-based compensation expense                       | —                | —               | 12,418                           | —                    | 12,418      |
| Balance at September 30, 2015                          | 39,666           | \$ 397          | \$556,121                        | \$646,151            | \$1,202,669 |

**NOTE 11 — STOCK BASED AND DEFERRED COMPENSATION**

We have a stock compensation plan, the Amended and Restated 2006 Stock Incentive Plan (the "Plan"), that was adopted in 2006 and has been amended or restated from time to time. The Plan was approved by our stockholders and is administered by our Board of Directors. The provisions of the Plan 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 Plan authorizes awards to officers, key employees, non-employee directors and consultants for up to 5,350,000 shares of common stock, of which 1,729,563 shares remain available for grant at September 30, 2016. The available shares include shares from expired, terminated or forfeited awards under prior plans that have since expired and are thus available for grant under the Plan. We believe that such awards provide a means of performance-based compensation to attract and retain qualified employees and better align the interests of our employees with those of our stockholders. Non-vested stock awards are usually granted with a five-year ratable vesting period for employees and with a three-year cliff vesting for both non-vested stock and performance-based awards granted to certain senior executive officers and non-employee directors.

Compensation cost related to time-based restricted stock awards is measured as of the closing price on the date of grant and is expensed 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. Beginning with grants in 2014, a portion of the performance-based restricted stock awards granted contain market conditions as defined by ASC 718. The guidance in ASC 718 requires that compensation expense for stock awards with market conditions be expensed based on a derived grant date fair value and expensed over the service period. We engaged a third party to perform a valuation analysis on the awards containing market conditions and our associated expense with those awards is based on the derived fair value from that analysis and is being expensed straight-line over the service period of the awards. Below is a summary of compensation expense and stock award activity (dollars in thousands):

|                                                                    | Three Months Ended September 30, 2016 |         | Nine Months Ended September 30, 2016 |          |
|--------------------------------------------------------------------|---------------------------------------|---------|--------------------------------------|----------|
|                                                                    | 2016                                  | 2015    | 2016                                 | 2015     |
| Stock-based compensation expense                                   | \$3,729                               | \$3,953 | \$11,042                             | \$12,418 |
| Non-vested shares granted                                          | 3,500                                 | 20,600  | 497,365                              | 424,387  |
| Performance-based non-vested shares granted                        | —                                     | —       | 66,698                               | 66,187   |
| Stock options exercised                                            | —                                     | 3,000   | 14,400                               | 146,640  |
| Restricted stock awards vested (includes performance-based awards) | 6,940                                 | 1,800   | 341,490                              | 372,004  |

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

|                                                     | As of September 30, 2016 |                   |
|-----------------------------------------------------|--------------------------|-------------------|
|                                                     | September 30, 2016       | December 31, 2015 |
| Unrecognized stock-based compensation cost          | \$21,678                 | \$18,545          |
| Weighted average years expense recognition period   | 2.82                     | 2.34              |
| Total stock-based awards outstanding <sup>(1)</sup> | 1,169,625                | 1,078,877         |

(1) Includes options outstanding and unvested restricted stock and performance-based awards (at target level) and restricted stock units.

In 2013, we began to 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 401k plans, impose on highly compensated employees. We do not currently offer a contribution match on the deferred compensation plan. All contributions to the plan to date have been funded by the employees and, therefore, we have no associated expense related to the deferred compensation plan for the three and nine months ended September 30, 2016 or 2015, other than minor administrative costs.

## NOTE 12 — INCOME TAXES

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

|         | Three Months    |           | Nine Months     |           |
|---------|-----------------|-----------|-----------------|-----------|
|         | Ended September |           | Ended September |           |
|         | 30,             |           | 30,             |           |
|         | 2016            | 2015      | 2016            | 2015      |
| Federal | \$ 15,032       | \$ 14,251 | \$ 38,141       | \$ 33,678 |
| State   | 1,883           | 2,109     | 5,848           | 3,860     |
| Total   | \$ 16,915       | \$ 16,360 | \$ 43,989       | \$ 37,538 |

The effective tax rate for the three and nine months ended September 30, 2016 was 31.4% and 31.0%, respectively, and for the three and nine months ended September 30, 2015 was 35.1% and 33.1%, respectively. Our tax rate has been favorably impacted in both years by the homebuilding manufacturing deduction. Due to the timing of enabling legislation related to federal energy tax credits, the 2016 effective tax rate for both the three and nine months ended September 30, 2016 was reduced, whereas prior year rates not were impacted until the fourth quarter.

On December 18, 2015, Congress passed the Protecting Americans from Tax Hikes (PATH) Act of 2015. The PATH Act was the enabling legislation for claiming federal energy tax credits on homes qualifying in 2015 and 2016. Under ASC 740, the effects of new legislation are not recognized until the period that includes the date of enactment. In accordance with ASC 740, at September 30, 2015 we did not recognize the benefit on our effective tax rate of claiming federal energy tax credits for qualifying 2015 homes. Rather, such benefit was recognized in the fourth quarter of 2015.

At September 30, 2016 and December 31, 2015, we have no unrecognized tax benefits due to the lapse of applicable statutes of limitations and completion of audits for prior years. 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 ("ASC 740"). We evaluate our deferred tax assets, including the benefit from 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 September 30, 2016.

At September 30, 2016, we had no remaining federal NOL carry forward or un-utilized federal tax credits. At September 30, 2016, and December 31, 2015 we had tax benefits for state NOL carry forwards of \$1.7 million and \$1.5 million, respectively, net of federal benefit, that begin to expire in 2028.

At September 30, 2016, we have income taxes payable of \$3.0 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 September 30, 2016.

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 2012. We have one state income tax examination of multiple years under audit at this time and do not expect it to have a material outcome.

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 Internal Revenue Code §382. Based on our analysis performed

as of September 30, 2016 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 13 — SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

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

|                                            | Nine Months<br>Ended September<br>30, |            |
|--------------------------------------------|---------------------------------------|------------|
|                                            | 2016                                  | 2015       |
| Interest capitalized, net                  | \$(9,053 )                            | \$(3,732 ) |
| Income taxes paid                          | \$43,860                              | \$37,984   |
| Non-cash operating activities:             |                                       |            |
| Real estate not owned decrease             | \$—                                   | \$(4,999 ) |
| Real estate acquired through notes payable | \$14,199                              | \$15,220   |

## NOTE 14 — OPERATING AND REPORTING SEGMENTS

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

West: Arizona, California and Colorado <sup>(1)</sup>

Central: Texas

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

(1) Activity for our wind-down Nevada operations is reflected in the West Region's results.

Management's evaluation of segment performance is based on segment operating income, which we define as homebuilding and land revenues less cost of home construction, 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<br>September 30, |           | Nine Months Ended<br>September 30, |             |
|---------------------------------------------------------|-------------------------------------|-----------|------------------------------------|-------------|
|                                                         | 2016                                | 2015      | 2016                               | 2015        |
| Homebuilding revenue <sup>(1)</sup> :                   |                                     |           |                                    |             |
| West                                                    | \$330,805                           | \$270,202 | \$924,494                          | \$696,854   |
| Central                                                 | 200,446                             | 191,132   | 571,036                            | 524,633     |
| East                                                    | 221,606                             | 208,622   | 652,989                            | 564,982     |
| Consolidated total                                      | \$752,857                           | \$669,956 | \$2,148,519                        | \$1,786,469 |
| Homebuilding segment operating income:                  |                                     |           |                                    |             |
| West                                                    | \$27,829                            | \$24,347  | \$71,387                           | \$53,800    |
| Central                                                 | 18,635                              | 19,524    | 52,313                             | 54,682      |
| East                                                    | 9,737                               | 13,849    | 27,918                             | 35,427      |
| Total homebuilding segment operating income             | 56,201                              | 57,720    | 151,618                            | 143,909     |
| Financial services segment profit                       | 5,956                               | 5,601     | 15,765                             | 13,517      |
| Corporate and unallocated costs <sup>(2)</sup>          | (10,063 )                           | (8,347 )  | (24,652 )                          | (28,225 )   |
| Earnings/(loss) from other unconsolidated entities, net | 440                                 | (123 )    | 856                                | (415 )      |
| Interest expense                                        | (167 )                              | (4,187 )  | (5,127 )                           | (11,962 )   |
| Other income, net                                       | 1,435                               | (3,996 )  | 3,263                              | (3,445 )    |
| Net earnings before income taxes                        | \$53,802                            | \$46,668  | \$141,723                          | \$113,379   |

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

|                       | Three Months<br>Ended<br>September 30, |         | Nine Months<br>Ended September<br>30, |          |
|-----------------------|----------------------------------------|---------|---------------------------------------|----------|
|                       | 2016                                   | 2015    | 2016                                  | 2015     |
| Land closing revenue: |                                        |         |                                       |          |
| West                  | \$15,543                               | \$—     | \$15,608                              | \$—      |
| Central               | 947                                    | 7,677   | 4,659                                 | 14,194   |
| East                  | 497                                    | 395     | 920                                   | 2,091    |
| Total                 | \$16,987                               | \$8,072 | \$21,187                              | \$16,285 |

(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 reporting segments.

|                                                  | At September 30, 2016 |           |           |                       |                              |             |
|--------------------------------------------------|-----------------------|-----------|-----------|-----------------------|------------------------------|-------------|
|                                                  | West                  | Central   | East      | Financial<br>Services | Corporate and<br>Unallocated | Total       |
| Deposits on real estate under option or contract | \$26,027              | \$29,757  | \$35,269  | \$ —                  | \$ —                         | \$91,053    |
| Real estate                                      | 1,145,566             | 590,472   | 692,976   | —                     | —                            | 2,429,014   |
| Investments in unconsolidated entities           | 382                   | 9,623     | —         | —                     | 1,826                        | 11,831      |
| Other assets                                     | 59,158                | 87,842    | (1)76,465 | (2)847                | 116,945                      | (3)341,257  |
| Total assets                                     | \$1,231,133           | \$717,694 | \$804,710 | \$ 847                | \$ 118,771                   | \$2,873,155 |

|                                                  | At December 31, 2015 |           |           |                    |                           |             |
|--------------------------------------------------|----------------------|-----------|-----------|--------------------|---------------------------|-------------|
|                                                  | West                 | Central   | East      | Financial Services | Corporate and Unallocated | Total       |
| Deposits on real estate under option or contract | \$28,488             | \$30,241  | \$29,110  | \$ —               | \$ —                      | \$87,839    |
| Real estate                                      | 1,008,457            | 505,954   | 583,891   | —                  | —                         | 2,098,302   |
| Investments in unconsolidated entities           | 204                  | 8,704     | —         | —                  | 2,462                     | 11,370      |
| Other assets                                     | 55,112               | 87,313    | (1)77,548 | (2)898             | 261,395                   | (3)482,266  |
| Total assets                                     | \$1,092,261          | \$632,212 | \$690,549 | \$ 898             | \$ 263,857                | \$2,679,777 |

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

(2) Balance consists primarily of goodwill (see Note 9), prepaid permits and fees to local municipalities and cash.

(3) Balance consists primarily of cash and our deferred tax assets.

#### NOTE 15 — COMMITMENTS AND CONTINGENCIES

We are involved in various routine legal and regulatory proceedings, including, without limitation, warranty claims and litigation and arbitration proceedings alleging construction defects. In general, the proceedings are incidental to our business, and most exposure is subject to and should be covered by warranty and indemnity obligations of our consultants and subcontractors. Additionally, some such claims are also covered by insurance. With respect to the majority of such legal proceedings, 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 without the initiation of legal proceedings. We believe there are not any 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.

#### Joint Venture Litigation

Since 2008, we have been involved in litigation initiated by the lender group for a large Nevada-based land acquisition and development joint venture in which we held a 3.53% interest. We were the only builder joint venture partner to have fully performed its obligations with respect to takedowns of lots from the joint venture, having completed our first takedown in April 2007 and having tendered full performance of our second and final takedown in April 2008. The joint venture and the lender group rejected our tender of performance for our second and final takedown, and as a result we contended, among other things, that the rejection by the joint venture and the lender group of our tender of full performance was wrongful and constituted a breach of contract and should release us of liability with respect to the takedown and extinguish or greatly reduce our exposure under all guarantees. On December 9, 2010, three of the lenders filed a petition seeking to place the venture into an involuntary bankruptcy (JP Morgan Chase Bank, N.A. v. South Edge, LLC (Case No. 10-32968-bam)). On June 6, 2011, we received a demand letter from the lenders requesting full payment of \$13.2 million the lenders claimed to be owed under the springing repayment guarantee, including past-due interest and penalties. The lenders claimed that the involuntary bankruptcy filed by three of the co-lenders triggered the springing repayment guarantee. We contested the Lenders' claim on the basis that the repayment guarantee was not properly triggered by the lenders' filing of the involuntary bankruptcy, the lenders breached their contract with us by refusing to accept the April 2008 tender of our performance and by refusing to release their lien in connection with our second and final takedown in this project. The U.S. District Court of Nevada entered judgments in favor of JP Morgan in a combined amount of \$16.6 million, which included prejudgment interest and attorneys' fees, which we paid in January 2016. The only outstanding issue in that case involves the amount of attorneys' fees that will be payable by us related to the now resolved appeal of that case, for which we are fully reserved.

We contend that four of our co-venturers in the South Edge entity (KB Home, Toll Brothers, Pardee Homes and Beazer Homes) are liable to Meritage for certain issues and events related to the South Edge joint venture and property, and we have filed an arbitration claim against those builders to recover certain amounts from them based on



breach of contract, unjust enrichment, and other claims.

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

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

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

Forward-looking statements in this Quarterly Report include: statements concerning trends in the homebuilding industry in general, and our markets and results specifically; our operating strategy and initiatives, including our strategy to expand into the first-time buyer segment; the benefits of our land acquisition strategy and structures, including the use and the benefits of land banking and joint ventures; that we expect to redeploy cash generated from operations to acquire and develop lot positions; management estimates regarding joint venture exposure; expectations regarding our industry and our business for the remainder of 2016 and beyond; 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; our strategy, legal positions and 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, seasonality and the timing of new community openings; our future cash needs; that we may seek to raise additional debt and equity capital; and our intentions regarding the payment of dividends and the use of derivative contracts; our perceptions about the importance of joint ventures to our business; and the impact of seasonality and changes in interest rates.

Important factors that could cause actual results to differ materially from those in forward-looking statements, and that could negatively affect our business include, but are not limited to, the following: the availability and cost of finished lots and undeveloped land; interest rates and changes in the availability and pricing of residential mortgages; fluctuations in the availability and cost of labor; changes in tax laws that adversely impact us or our homebuyers; the continued availability of energy tax credits; reversal of the current economic recovery; the ability of our potential buyers to sell their existing homes; cancellation rates; inflation in the cost of materials used to develop communities and construct homes; the adverse effect of slower order absorption rates; impairments of our real estate inventory; a change to the feasibility of projects under option or contract that could result in the write-down or write-off of option deposits; our potential exposure to natural disasters or severe weather conditions; competition; construction defect and home warranty claims; failures in health and safety performance; our success in prevailing on contested tax positions; our ability to obtain performance bonds in connection with our development work; the loss of key personnel; enactment of new laws or regulations and our 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; our ability to successfully integrate acquired companies and achieve anticipated benefits from these acquisitions; our compliance with government regulations and the effect of legislative 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; and other factors identified in documents filed by the Company with the Securities and Exchange Commission, including those set forth in our Form 10-K for the year ended December 31, 2015 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 undertake no obligations to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to projections over time, except as required by law.

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

### Overview and Outlook

The housing market has generally experienced a steady level of growth throughout 2016 supported by a stable economic environment with low interest rates, modest wage growth and lower unemployment. The demand for new homes has resulted in rising average sales prices in some geographies, as well as rising land and labor costs and, in some markets, labor shortages. These cost increases are out-pacing home price increases in many markets, creating pressure on both margins and cycle times. We believe the current homebuilding cycle will continue on a slow but steady improvement trajectory, which should help better align the rising land and labor prices with consumer demand. We continue to strategically focus on expanding our presence in markets through acquisitions and development of well-located communities offering homes with energy-efficient features and appealing designs. We are always considering new market opportunities and we have entered six new markets over the last five years. We are also focused on expanding our presence in the growing first-time homebuyer segment as we continue to open new communities featuring plans targeted to that demographic.

### Summary Company Results

Total home closing revenue was \$735.9 million and \$2.1 billion for the three and nine months ended September 30, 2016, respectively, representing 11.2% and 20.2% increases over the corresponding prior year periods. Due to higher home closing revenue with \$74.0 million and \$357.1 million increases for the three and nine months ended September 30, 2016, respectively, we benefited from higher home closing gross profit in both periods. This revenue growth was the principle driver of our higher net income of \$36.9 million and \$97.7 million for the three and nine months ended September 30, 2016, respectively, as compared to \$30.3 million and \$75.8 million for the respective 2015 periods. Net income also benefited from lower interest expense than the prior year for both the three- and nine-month periods of 2016 as we have more inventory under development that qualifies for interest capitalization. Interest income from municipalities related to reimbursable land development costs favorably impacted Other income/(expense) in both the third quarter and year to date of 2016 while an adverse legal ruling unfavorably impacted the same periods in the prior year, which further contributed to the improved net income in 2016.

On a consolidated basis, we experienced year-over-year growth in closings, orders and backlog, in both units and value for both the three and nine months ended September 30, 2016 as compared to prior year. We ended the third quarter of 2016 with 3,251 homes in backlog, valued at \$1.4 billion, representing 6.8% and 8.8% increases over September 30, 2015, respectively. Our average sales price for homes in backlog increased 1.8% to \$423,200 at September 30, 2016 from \$415,700 at September 30, 2015, with increases reported in nearly all our markets.

### Company Positioning

We believe that the investments in our new communities, new markets and industry-leading energy-efficient product offerings create a differentiated strategy that has aided us in our growth in the highly competitive new home market. We remain focused on our main goals of growing our orders pace and returning to normalized gross margins while controlling overhead costs and maintaining a strong balance sheet. To help meet these goals, we continue to focus on the following initiatives:

- Continuing to actively acquire and develop land in key markets in order to maintain and grow our lot supply and active community count;
- Introducing LiVE.NOW, our newest 'entry-level plus' collection of product offerings that targets the growing first-time homebuyer segment;
- Expanding market share in our smaller markets;
- Managing cost increases through national and regional vendor relationships with a focus on quality construction and warranty management;
- Generating additional revenue while managing costs, allowing us to improve overhead operating leverage in all of our markets;
- Generating additional working capital and maintaining adequate liquidity;
- Increasing orders pace through the use of our consumer and market research to build homes that offer our buyers their desired features and amenities;
- Continuing to innovate and promote our energy efficiency program to drive sales;

Adapting sales and marketing efforts to increase traffic and allow us to favorably compete with both resale and new homes;

Actively monitoring and adjusting our sales, construction and closing processes through customer satisfaction surveys; and

Promoting a positive environment for our employees in order to retain our employees and minimize turnover.

#### Critical Accounting Policies

The accounting policies we deem most critical to us and that involve the most difficult, subjective or complex judgments include revenue recognition, valuation of real estate, goodwill, deferred tax assets and warranty reserves as well as the calculation of compensation cost relating to share-based payments. There have been no significant changes to our critical accounting policies during the nine months ended September 30, 2016 compared to those disclosed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our 2015 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<br>Ended September<br>30,<br>2016 |           | Quarter over<br>Quarter |        |   |
|------------------------|------------------------------------------------|-----------|-------------------------|--------|---|
|                        | 2015                                           |           | Chg \$                  | Chg %  |   |
| Home Closing Revenue   |                                                |           |                         |        |   |
| Total                  |                                                |           |                         |        |   |
| Dollars                | \$735,870                                      | \$661,884 | \$73,986                | 11.2   | % |
| Homes closed           | 1,800                                          | 1,712     | 88                      | 5.1    | % |
| Average sales price    | \$408.8                                        | \$386.6   | \$22.2                  | 5.7    | % |
| West Region            |                                                |           |                         |        |   |
| Arizona                |                                                |           |                         |        |   |
| Dollars                | \$89,092                                       | \$92,888  | \$(3,796)               | (4.1)  | % |
| Homes closed           | 253                                            | 302       | (49)                    | (16.2) | % |
| Average sales price    | \$352.1                                        | \$307.6   | \$44.5                  | 14.5   | % |
| California             |                                                |           |                         |        |   |
| Dollars                | \$142,056                                      | \$120,387 | \$21,669                | 18.0   | % |
| Homes closed           | 251                                            | 236       | 15                      | 6.4    | % |
| Average sales price    | \$566.0                                        | \$510.1   | \$55.9                  | 11.0   | % |
| Colorado               |                                                |           |                         |        |   |
| Dollars                | \$84,114                                       | \$56,927  | \$27,187                | 47.8   | % |
| Homes closed           | 167                                            | 123       | 44                      | 35.8   | % |
| Average sales price    | \$503.7                                        | \$462.8   | \$40.9                  | 8.8    | % |
| West Region Totals     |                                                |           |                         |        |   |
| Dollars                | \$315,262                                      | \$270,202 | \$45,060                | 16.7   | % |
| Homes closed           | 671                                            | 661       | 10                      | 1.5    | % |
| Average sales price    | \$469.8                                        | \$408.8   | \$61.0                  | 14.9   | % |
| Central Region - Texas |                                                |           |                         |        |   |
| Central Region Totals  |                                                |           |                         |        |   |
| Dollars                | \$199,499                                      | \$183,455 | \$16,044                | 8.7    | % |
| Homes closed           | 542                                            | 517       | 25                      | 4.8    | % |
| Average sales price    | \$368.1                                        | \$354.8   | \$13.3                  | 3.7    | % |
| East Region            |                                                |           |                         |        |   |
| Florida                |                                                |           |                         |        |   |
| Dollars                | \$85,647                                       | \$90,285  | \$(4,638)               | (5.1)  | % |
| Homes closed           | 206                                            | 202       | 4                       | 2.0    | % |
| Average sales price    | \$415.8                                        | \$447.0   | \$(31.2)                | (7.0)  | % |
| Georgia                |                                                |           |                         |        |   |
| Dollars                | \$27,477                                       | \$20,663  | \$6,814                 | 33.0   | % |
| Homes closed           | 83                                             | 62        | 21                      | 33.9   | % |
| Average sales price    | \$331.0                                        | \$333.3   | \$(2.3)                 | (0.7)  | % |
| North Carolina         |                                                |           |                         |        |   |

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|                     |           |           |            |        |   |
|---------------------|-----------|-----------|------------|--------|---|
| Dollars             | \$71,641  | \$63,532  | \$8,109    | 12.8   | % |
| Homes closed        | 177       | 165       | 12         | 7.3    | % |
| Average sales price | \$404.8   | \$385.0   | \$19.8     | 5.1    | % |
| South Carolina      |           |           |            |        |   |
| Dollars             | \$22,658  | \$25,812  | \$(3,154 ) | (12.2) | % |
| Homes closed        | 76        | 80        | (4 )       | (5.0 ) | % |
| Average sales price | \$298.1   | \$322.7   | \$(24.6 )  | (7.6 ) | % |
| Tennessee           |           |           |            |        |   |
| Dollars             | \$13,686  | \$7,935   | \$5,751    | 72.5   | % |
| Homes closed        | 45        | 25        | 20         | 80.0   | % |
| Average sales price | \$304.1   | \$317.4   | \$(13.3 )  | (4.2 ) | % |
| East Region Totals  |           |           |            |        |   |
| Dollars             | \$221,109 | \$208,227 | \$12,882   | 6.2    | % |
| Homes closed        | 587       | 534       | 53         | 9.9    | % |
| Average sales price | \$376.7   | \$389.9   | \$(13.2 )  | (3.4 ) | % |



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|                        | Nine Months Ended<br>September 30, |             | Quarter over<br>Quarter |         |
|------------------------|------------------------------------|-------------|-------------------------|---------|
|                        | 2016                               | 2015        | Chg \$                  | Chg %   |
| Home Closing Revenue   |                                    |             |                         |         |
| Total                  |                                    |             |                         |         |
| Dollars                | \$2,127,332                        | \$1,770,184 | \$357,148               | 20.2 %  |
| Homes closed           | 5,238                              | 4,603       | 635                     | 13.8 %  |
| Average sales price    | \$406.1                            | \$384.6     | \$21.5                  | 5.6 %   |
| West Region            |                                    |             |                         |         |
| Arizona                |                                    |             |                         |         |
| Dollars                | \$258,139                          | \$227,367   | \$30,772                | 13.5 %  |
| Homes closed           | 749                                | 717         | 32                      | 4.5 %   |
| Average sales price    | \$344.6                            | \$317.1     | \$27.5                  | 8.7 %   |
| California             |                                    |             |                         |         |
| Dollars                | \$418,834                          | \$302,573   | \$116,261               | 38.4 %  |
| Homes closed           | 738                                | 565         | 173                     | 30.6 %  |
| Average sales price    | \$567.5                            | \$535.5     | \$32.0                  | 6.0 %   |
| Colorado               |                                    |             |                         |         |
| Dollars                | \$231,913                          | \$166,914   | \$64,999                | 38.9 %  |
| Homes closed           | 474                                | 364         | 110                     | 30.2 %  |
| Average sales price    | \$489.3                            | \$458.6     | \$30.7                  | 6.7 %   |
| West Region Totals     |                                    |             |                         |         |
| Dollars                | \$908,886                          | \$696,854   | \$212,032               | 30.4 %  |
| Homes closed           | 1,961                              | 1,646       | 315                     | 19.1 %  |
| Average sales price    | \$463.5                            | \$423.4     | \$40.1                  | 9.5 %   |
| Central Region - Texas |                                    |             |                         |         |
| Central Region Totals  |                                    |             |                         |         |
| Dollars                | \$566,377                          | \$510,439   | \$55,938                | 11.0 %  |
| Homes closed           | 1,563                              | 1,466       | 97                      | 6.6 %   |
| Average sales price    | \$362.4                            | \$348.2     | \$14.2                  | 4.1 %   |
| East Region            |                                    |             |                         |         |
| Florida                |                                    |             |                         |         |
| Dollars                | \$252,311                          | \$254,607   | \$(2,296)               | (0.9) % |
| Homes closed           | 619                                | 589         | 30                      | 5.1 %   |
| Average sales price    | \$407.6                            | \$432.3     | \$(24.7)                | (5.7) % |
| Georgia                |                                    |             |                         |         |
| Dollars                | \$76,874                           | \$49,178    | \$27,696                | 56.3 %  |
| Homes closed           | 229                                | 156         | 73                      | 46.8 %  |
| Average sales price    | \$335.7                            | \$315.2     | \$20.5                  | 6.5 %   |
| North Carolina         |                                    |             |                         |         |
| Dollars                | \$198,525                          | \$148,721   | \$49,804                | 33.5 %  |
| Homes closed           | 474                                | 389         | 85                      | 21.9 %  |
| Average sales price    | \$418.8                            | \$382.3     | \$36.5                  | 9.5 %   |
| South Carolina         |                                    |             |                         |         |
| Dollars                | \$71,577                           | \$77,630    | \$(6,053)               | (7.8) % |
| Homes closed           | 231                                | 247         | (16)                    | (6.5) % |
| Average sales price    | \$309.9                            | \$314.3     | \$(4.4)                 | (1.4) % |
| Tennessee              |                                    |             |                         |         |
| Dollars                | \$52,782                           | \$32,755    | \$20,027                | 61.1 %  |

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|                     |           |           |          |        |
|---------------------|-----------|-----------|----------|--------|
| Homes closed        | 161       | 110       | 51       | 46.4 % |
| Average sales price | \$327.8   | \$297.8   | \$30.0   | 10.1 % |
| East Region Totals  |           |           |          |        |
| Dollars             | \$652,069 | \$562,891 | \$89,178 | 15.8 % |
| Homes closed        | 1,714     | 1,491     | 223      | 15.0 % |
| Average sales price | \$380.4   | \$377.5   | \$2.9    | 0.8 %  |

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|                            | Three Months<br>Ended September<br>30, |           | Quarter over<br>Quarter |         |   |
|----------------------------|----------------------------------------|-----------|-------------------------|---------|---|
|                            | 2016                                   | 2015      | Chg \$                  | Chg %   |   |
| Home Orders <sup>(1)</sup> |                                        |           |                         |         |   |
| Total                      |                                        |           |                         |         |   |
| Dollars                    | \$715,562                              | \$629,977 | \$85,585                | 13.6    | % |
| Homes ordered              | 1,737                                  | 1,567     | 170                     | 10.8    | % |
| Average sales price        | \$412.0                                | \$402.0   | \$10.0                  | 2.5     | % |
| West Region                |                                        |           |                         |         |   |
| Arizona                    |                                        |           |                         |         |   |
| Dollars                    | \$116,815                              | \$96,867  | \$19,948                | 20.6    | % |
| Homes ordered              | 345                                    | 272       | 73                      | 26.8    | % |
| Average sales price        | \$338.6                                | \$356.1   | \$(17.5 )               | (4.9 )  | % |
| California                 |                                        |           |                         |         |   |
| Dollars                    | \$125,920                              | \$110,076 | \$15,844                | 14.4    | % |
| Homes ordered              | 216                                    | 203       | 13                      | 6.4     | % |
| Average sales price        | \$583.0                                | \$542.2   | \$40.8                  | 7.5     | % |
| Colorado                   |                                        |           |                         |         |   |
| Dollars                    | \$66,213                               | \$43,782  | \$22,431                | 51.2    | % |
| Homes ordered              | 121                                    | 84        | 37                      | 44.0    | % |
| Average sales price        | \$547.2                                | \$521.2   | \$26.0                  | 5.0     | % |
| West Region Totals         |                                        |           |                         |         |   |
| Dollars                    | \$308,948                              | \$250,725 | \$58,223                | 23.2    | % |
| Homes ordered              | 682                                    | 559       | 123                     | 22.0    | % |
| Average sales price        | \$453.0                                | \$448.5   | \$4.5                   | 1.0     | % |
| Central Region - Texas     |                                        |           |                         |         |   |
| Central Region Totals      |                                        |           |                         |         |   |
| Dollars                    | \$178,934                              | \$165,206 | \$13,728                | 8.3     | % |
| Homes ordered              | 488                                    | 452       | 36                      | 8.0     | % |
| Average sales price        | \$366.7                                | \$365.5   | \$1.2                   | 0.3     | % |
| East Region                |                                        |           |                         |         |   |
| Florida                    |                                        |           |                         |         |   |
| Dollars                    | \$95,946                               | \$94,114  | \$1,832                 | 1.9     | % |
| Homes ordered              | 208                                    | 227       | (19 )                   | (8.4 )  | % |
| Average sales price        | \$461.3                                | \$414.6   | \$46.7                  | 11.3    | % |
| Georgia                    |                                        |           |                         |         |   |
| Dollars                    | \$28,841                               | \$23,143  | \$5,698                 | 24.6    | % |
| Homes ordered              | 85                                     | 67        | 18                      | 26.9    | % |
| Average sales price        | \$339.3                                | \$345.4   | \$(6.1 )                | (1.8 )  | % |
| North Carolina             |                                        |           |                         |         |   |
| Dollars                    | \$61,537                               | \$57,168  | \$4,369                 | 7.6     | % |
| Homes ordered              | 149                                    | 138       | 11                      | 8.0     | % |
| Average sales price        | \$413.0                                | \$414.3   | \$(1.3 )                | (0.3 )  | % |
| South Carolina             |                                        |           |                         |         |   |
| Dollars                    | \$22,434                               | \$26,766  | \$(4,332 )              | (16.2 ) | % |
| Homes ordered              | 71                                     | 88        | (17 )                   | (19.3 ) | % |
| Average sales price        | \$316.0                                | \$304.2   | \$11.8                  | 3.9     | % |
| Tennessee                  |                                        |           |                         |         |   |

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|                     |          |          |         |       |   |
|---------------------|----------|----------|---------|-------|---|
| Dollars             | \$18,922 | \$12,855 | \$6,067 | 47.2  | % |
| Homes ordered       | 54       | 36       | 18      | 50.0  | % |
| Average sales price | \$350.4  | \$357.1  | \$(6.7) | (1.9) | % |

East Region Totals

|                     |           |           |          |     |   |
|---------------------|-----------|-----------|----------|-----|---|
| Dollars             | \$227,680 | \$214,046 | \$13,634 | 6.4 | % |
| Homes ordered       | 567       | 556       | 11       | 2.0 | % |
| Average sales price | \$401.6   | \$385.0   | \$16.6   | 4.3 | % |

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

## Edgar Filing: Meritage Homes CORP - Form 10-Q

|                            | Nine Months Ended<br>September 30, |             | Quarter over<br>Quarter |       |   |
|----------------------------|------------------------------------|-------------|-------------------------|-------|---|
|                            | 2016                               | 2015        | Chg \$                  | Chg % |   |
| Home Orders <sup>(1)</sup> |                                    |             |                         |       |   |
| Total                      |                                    |             |                         |       |   |
| Dollars                    | \$2,365,508                        | \$2,188,604 | \$176,904               | 8.1   | % |
| Homes ordered              | 5,797                              | 5,532       | 265                     | 4.8   | % |
| Average sales price        | \$408.1                            | \$395.6     | \$12.5                  | 3.2   | % |
| West Region                |                                    |             |                         |       |   |
| Arizona                    |                                    |             |                         |       |   |
| Dollars                    | \$322,807                          | \$290,172   | \$32,635                | 11.2  | % |
| Homes ordered              | 935                                | 880         | 55                      | 6.3   | % |
| Average sales price        | \$345.2                            | \$329.7     | \$15.5                  | 4.7   | % |
| California                 |                                    |             |                         |       |   |
| Dollars                    | \$442,863                          | \$419,987   | \$22,876                | 5.4   | % |
| Homes ordered              | 775                                | 750         | 25                      | 3.3   | % |
| Average sales price        | \$571.4                            | \$560.0     | \$11.4                  | 2.0   | % |
| Colorado                   |                                    |             |                         |       |   |
| Dollars                    | \$237,237                          | \$213,610   | \$23,627                | 11.1  | % |
| Homes ordered              | 459                                | 454         | 5                       | 1.1   | % |
| Average sales price        | \$516.9                            | \$470.5     | \$46.4                  | 9.9   | % |
| West Region Totals         |                                    |             |                         |       |   |
| Dollars                    | \$1,002,907                        | \$923,769   | \$79,138                | 8.6   | % |
| Homes ordered              | 2,169                              | 2,084       | 85                      | 4.1   | % |
| Average sales price        | \$462.4                            | \$443.3     | \$19.1                  | 4.3   | % |
| Central Region - Texas     |                                    |             |                         |       |   |
| Central Region Totals      |                                    |             |                         |       |   |
| Dollars                    | \$597,947                          | \$574,533   | \$23,414                | 4.1   | % |
| Homes ordered              | 1,629                              | 1,644       | (15)                    | (0.9) | % |
| Average sales price        | \$367.1                            | \$349.5     | \$17.6                  | 5.0   | % |
| East Region                |                                    |             |                         |       |   |
| Florida                    |                                    |             |                         |       |   |
| Dollars                    | \$295,453                          | \$295,634   | \$(181)                 | (0.1) | % |
| Homes ordered              | 702                                | 693         | 9                       | 1.3   | % |
| Average sales price        | \$420.9                            | \$426.6     | \$(5.7)                 | (1.3) | % |
| Georgia                    |                                    |             |                         |       |   |
| Dollars                    | \$102,392                          | \$64,051    | \$38,341                | 59.9  | % |
| Homes ordered              | 305                                | 197         | 108                     | 54.8  | % |
| Average sales price        | \$335.7                            | \$325.1     | \$10.6                  | 3.3   | % |
| North Carolina             |                                    |             |                         |       |   |
| Dollars                    | \$205,562                          | \$191,460   | \$14,102                | 7.4   | % |
| Homes ordered              | 497                                | 467         | 30                      | 6.4   | % |
| Average sales price        | \$413.6                            | \$410.0     | \$3.6                   | 0.9   | % |
| South Carolina             |                                    |             |                         |       |   |
| Dollars                    | \$95,123                           | \$85,767    | \$9,356                 | 10.9  | % |
| Homes ordered              | 296                                | 283         | 13                      | 4.6   | % |
| Average sales price        | \$321.4                            | \$303.1     | \$18.3                  | 6.0   | % |
| Tennessee                  |                                    |             |                         |       |   |
| Dollars                    | \$66,124                           | \$53,390    | \$12,734                | 23.9  | % |

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|                     |           |           |          |         |
|---------------------|-----------|-----------|----------|---------|
| Homes ordered       | 199       | 164       | 35       | 21.3 %  |
| Average sales price | \$332.3   | \$325.5   | \$6.8    | 2.1 %   |
| East Region Totals  |           |           |          |         |
| Dollars             | \$764,654 | \$690,302 | \$74,352 | 10.8 %  |
| Homes ordered       | 1,999     | 1,804     | 195      | 10.8 %  |
| Average sales price | \$382.5   | \$382.7   | \$(0.2 ) | (0.1 )% |

Home orders for any period represent the aggregate sales price of all homes ordered, net of cancellations. We do (1)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 |         |        |         |
|------------------------|--------------------|---------|--------|---------|
|                        | September 30,      |         |        |         |
|                        | 2016               |         | 2015   |         |
|                        | Ending             | Average | Ending | Average |
| Active Communities     |                    |         |        |         |
| Total                  | 237                | 239.0   | 250    | 245.0   |
| West Region            |                    |         |        |         |
| Arizona                | 40                 | 41.5    | 41     | 42.0    |
| California             | 29                 | 27.0    | 26     | 23.0    |
| Colorado               | 10                 | 11.0    | 15     | 15.5    |
| West Region Totals     | 79                 | 79.5    | 82     | 80.5    |
| Central Region - Texas |                    |         |        |         |
| Central Region Totals  | 74                 | 73.5    | 70     | 68.0    |
| East Region            |                    |         |        |         |
| Florida                | 26                 | 26.0    | 31     | 30.5    |
| Georgia                | 17                 | 17.0    | 17     | 16.5    |
| North Carolina         | 19                 | 20.5    | 25     | 25.0    |
| South Carolina         | 15                 | 15.5    | 17     | 18.5    |
| Tennessee              | 7                  | 7.0     | 8      | 6.0     |
| East Region Totals     | 84                 | 86.0    | 98     | 96.5    |

|                        | Nine Months Ended |         |        |         |
|------------------------|-------------------|---------|--------|---------|
|                        | September 30,     |         |        |         |
|                        | 2016              |         | 2015   |         |
|                        | Ending            | Average | Ending | Average |
| Active Communities     |                   |         |        |         |
| Total                  | 237               | 245.5   | 250    | 239.5   |
| West Region            |                   |         |        |         |
| Arizona                | 40                | 40.5    | 41     | 41.0    |
| California             | 29                | 26.5    | 26     | 25.0    |
| Colorado               | 10                | 13.0    | 15     | 16.0    |
| West Region Totals     | 79                | 80.0    | 82     | 82.0    |
| Central Region - Texas |                   |         |        |         |
| Central Region Totals  | 74                | 73.0    | 70     | 64.5    |
| East Region            |                   |         |        |         |
| Florida                | 26                | 28.5    | 31     | 30.0    |
| Georgia                | 17                | 17.0    | 17     | 15.0    |
| North Carolina         | 19                | 22.5    | 25     | 23.0    |
| South Carolina         | 15                | 16.5    | 17     | 18.5    |
| Tennessee              | 7                 | 8.0     | 8      | 6.5     |
| East Region Totals     | 84                | 92.5    | 98     | 93.0    |

|                                   | Three<br>Months<br>Ended<br>September<br>30,<br>2016 |      | Nine<br>Months<br>Ended<br>September<br>30,<br>2015 |      |
|-----------------------------------|------------------------------------------------------|------|-----------------------------------------------------|------|
| Cancellation Rates <sup>(1)</sup> |                                                      |      |                                                     |      |
| Total                             | 14 %                                                 | 15 % | 12 %                                                | 12 % |
| West Region                       |                                                      |      |                                                     |      |
| Arizona                           | 12 %                                                 | 11 % | 12 %                                                | 9 %  |
| California                        | 19 %                                                 | 14 % | 13 %                                                | 10 % |
| Colorado                          | 13 %                                                 | 18 % | 10 %                                                | 11 % |
| West Region Totals                | 14 %                                                 | 14 % | 12 %                                                | 10 % |
| Central Region - Texas            |                                                      |      |                                                     |      |
| Central Region Totals             | 16 %                                                 | 19 % | 15 %                                                | 15 % |
| East Region                       |                                                      |      |                                                     |      |
| Florida                           | 13 %                                                 | 11 % | 11 %                                                | 14 % |
| Georgia                           | 12 %                                                 | 16 % | 13 %                                                | 13 % |
| North Carolina                    | 10 %                                                 | 11 % | 8 %                                                 | 10 % |
| South Carolina                    | 15 %                                                 | 9 %  | 8 %                                                 | 8 %  |
| Tennessee                         | 7 %                                                  | 23 % | 8 %                                                 | 10 % |
| East Region Totals                | 12 %                                                 | 12 % | 10 %                                                | 12 % |

(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 September 30, |             | Quarter over<br>Quarter |        |   |
|------------------------------|------------------|-------------|-------------------------|--------|---|
|                              | 2016             | 2015        | Chg \$                  | Chg %  |   |
| Order Backlog <sup>(1)</sup> |                  |             |                         |        |   |
| Total                        |                  |             |                         |        |   |
| Dollars                      | \$1,375,857      | \$1,264,872 | \$110,985               | 8.8    | % |
| Homes in backlog             | 3,251            | 3,043       | 208                     | 6.8    | % |
| Average sales price          | \$423.2          | \$415.7     | \$7.5                   | 1.8    | % |
| West Region                  |                  |             |                         |        |   |
| Arizona                      |                  |             |                         |        |   |
| Dollars                      | \$182,574        | \$129,023   | \$53,551                | 41.5   | % |
| Homes in backlog             | 503              | 355         | 148                     | 41.7   | % |
| Average sales price          | \$363.0          | \$363.4     | \$(0.4)                 | (0.1)  | % |
| California                   |                  |             |                         |        |   |
| Dollars                      | \$208,175        | \$241,377   | \$(33,202)              | (13.8) | % |
| Homes in backlog             | 326              | 397         | (71)                    | (17.9) | % |
| Average sales price          | \$638.6          | \$608.0     | \$30.6                  | 5.0    | % |
| Colorado                     |                  |             |                         |        |   |
| Dollars                      | \$167,475        | \$168,329   | \$(854)                 | (0.5)  | % |
| Homes in backlog             | 317              | 358         | (41)                    | (11.5) | % |
| Average sales price          | \$528.3          | \$470.2     | \$58.1                  | 12.4   | % |
| West Region Totals           |                  |             |                         |        |   |
| Dollars                      | \$558,224        | \$538,729   | \$19,495                | 3.6    | % |
| Homes in backlog             | 1,146            | 1,110       | 36                      | 3.2    | % |
| Average sales price          | \$487.1          | \$485.3     | \$1.8                   | 0.4    | % |
| Central Region - Texas       |                  |             |                         |        |   |
| Central Region Totals        |                  |             |                         |        |   |
| Dollars                      | \$381,764        | \$373,135   | \$8,629                 | 2.3    | % |
| Homes in backlog             | 1,008            | 1,036       | (28)                    | (2.7)  | % |
| Average sales price          | \$378.7          | \$360.2     | \$18.5                  | 5.1    | % |
| East Region                  |                  |             |                         |        |   |
| Florida                      |                  |             |                         |        |   |
| Dollars                      | \$161,148        | \$143,597   | \$17,551                | 12.2   | % |
| Homes in backlog             | 370              | 341         | 29                      | 8.5    | % |
| Average sales price          | \$435.5          | \$421.1     | \$14.4                  | 3.4    | % |
| Georgia                      |                  |             |                         |        |   |
| Dollars                      | \$58,944         | \$31,457    | \$27,487                | 87.4   | % |
| Homes in backlog             | 171              | 94          | 77                      | 81.9   | % |
| Average sales price          | \$344.7          | \$334.6     | \$10.1                  | 3.0    | % |
| North Carolina               |                  |             |                         |        |   |
| Dollars                      | \$118,515        | \$110,907   | \$7,608                 | 6.9    | % |
| Homes in backlog             | 283              | 263         | 20                      | 7.6    | % |
| Average sales price          | \$418.8          | \$421.7     | \$(2.9)                 | (0.7)  | % |
| South Carolina               |                  |             |                         |        |   |
| Dollars                      | \$53,657         | \$34,257    | \$19,400                | 56.6   | % |
| Homes in backlog             | 153              | 106         | 47                      | 44.3   | % |
| Average sales price          | \$350.7          | \$323.2     | \$27.5                  | 8.5    | % |
| Tennessee                    |                  |             |                         |        |   |
| Dollars                      | \$43,605         | \$32,790    | \$10,815                | 33.0   | % |

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|                     |           |           |          |      |   |
|---------------------|-----------|-----------|----------|------|---|
| Homes in backlog    | 120       | 93        | 27       | 29.0 | % |
| Average sales price | \$363.4   | \$352.6   | \$10.8   | 3.1  | % |
| East Region Totals  |           |           |          |      |   |
| Dollars             | \$435,869 | \$353,008 | \$82,861 | 23.5 | % |
| Homes in backlog    | 1,097     | 897       | 200      | 22.3 | % |
| Average sales price | \$397.3   | \$393.5   | \$3.8    | 1.0  | % |

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

## Operating Results

Companywide. Home closing revenue for the three months ended September 30, 2016 increased 11.2% to \$735.9 million when compared to the same quarter of the prior year, driven by a 5.1% increase in volume for 88 additional home closings with higher average sales prices of \$22,200 or 5.7%. Home orders also improved during the quarter, with order value growing by 13.6% to \$715.6 million on 1,737 homes in 2016 as compared to \$630.0 million on 1,567 homes in 2015. This was primarily the result of the 10.8% additional units, along with a \$10,000 increase in average sales prices. Improved home orders and higher average sales prices resulted in our 208-home and \$111.0 million increase in ending backlog, 6.8% and 8.8% higher than the prior year, respectively. In the three months ended September 30, 2016, the orders pace grew in many of the markets in which we operate, providing a consolidated 14.1% year-over-year improvement with 7.3 homes ordered per average number of communities in 2016 compared to 6.4 in the comparable 2015 period.

For the nine months ended September 30, 2016, home closings grew by 635 units and \$357.1 million for ending home closing revenue of \$2.1 billion, 20.2% higher than the nine month period in 2015. The combination of improved order volume and higher average sales prices, 4.8% and 3.2%, respectively, led to 5,797 homes ordered with a value of \$2.4 billion as of September 30, 2016.

West. During the three months ended September 30, 2016, the West region led the company in home closing volume and revenue, as well as year-over-year growth in home closing revenue. Home closing revenue rose 16.7% over the 2015 period, mainly from the \$61,000 increase in average sales prices, resulting in 671 closings valued at \$315.3 million for the three months ended September 30, 2016, compared to 661 closings and \$270.2 million, respectively, for 2015. Order units and value in the West Region improved by 22.0% and 23.2%, respectively, ending the quarter with 682 orders valued at \$308.9 million versus 559 orders valued at \$250.7 million in the prior year. The additional 123 units ordered is a result of the improved orders pace of 8.6 for the quarter ended September 30, 2016 as compared to 6.9 in 2015, demonstrating the high demand in the Region.

California was the largest contributor to home closing revenue in the Region during the third quarter with \$142.1 million on 251 units, 18.0% and 6.4% increases over 2015, respectively. We opened several new communities across California during the period, resulting in a 17.4% increase in average active communities over prior year. This increase contributed to a 6.4% increase in orders along with a 14.4% increase in order value, resulting from a \$40,800 increase in average sales prices. The exceptionally fast sell out of several Northern California communities contributed to some slowing in orders pace, however California still maintains a pace that exceeds the company average. Colorado provided the largest gains on closings within the Region over prior year with 47.8% and 35.8% increases in home closing revenue and units, respectively. The increase in closings, coupled with a \$40,900 increase in average sales prices resulted in \$84.1 million in home closing revenue in the third quarter of 2016 compared to \$56.9 million in 2015. Colorado also provided higher orders year over year, with a 103.7% improvement in orders pace which more than offset the 29.0% decline in the average number of actively-selling communities. This translated to a 44.0% increase in orders over the third quarter of 2015, ending with 121 homes ordered valued at \$66.2 million. The tremendous demand in this market is evidenced in the rising average sales prices and the 11.0 orders per average number of communities, the highest orders pace in the company. We expect the rising average sales prices to temper as we introduce more communities targeted to first time move-up homebuyers currently expected to open for sales in 2017. Home closing revenue in Arizona declined by 4.1% to \$89.1 million, as we closed 16.2% fewer units than in 2015 mainly due to a slower spring selling season in 2016 than prior year. The 27.7% improved orders pace, from 6.5 in 2015 to 8.3 in 2016, provided total order value growth of 20.6%, or \$19.9 million. As evidenced by the stronger orders pace, demand is strengthening in some segments of the Arizona market, particularly in some of our newly opened communities that appeal to the first time homebuyer segment which have lower average sales prices.

Year-to-date results in the West Region reflect the largest improvements in closings and associated revenue in the company over prior year. The number and value of units closed versus prior year increased by 19.1% and 30.4%, respectively, with increases in all states within the Region. Orders and order value also improved in all states for a total increase of \$79.1 million or 8.6%, with 85 additional orders and a \$19,100 increase in average sales price. Demand in the West remains high, providing the strongest orders pace in the Company. The high demand, as well as a shift in product mix compared to prior year, has helped to drive improving average sales prices in each market in the West. The Region ended the third quarter with overall growth in ending backlog of \$19.5 million on 36 additional units, ending the quarter with 1,146 homes valued at \$558.2 million.

Central. In the third quarter of 2016, the Central Region, made up of our Texas markets, closed 542 homes and generated \$199.5 million in home closing revenue, 4.8% and 8.7% improvements, respectively, leading to overall home closing revenue growth of \$16.0 million. Orders also improved in the third quarter, growing by 8.0% to a total of 488 units valued at \$178.9 million as compared to 452 units valued at \$165.2 million in the prior year. Average community count increased by

8.1% in the third quarter while orders pace remained consistent with prior year at 6.6 orders per average number of communities. While our Houston market continues to perform below recent years and there has been some softening at higher price points in our Dallas/Ft. Worth market, the Central Region historically provides our least volatile results year-over-year. We remain confident in the long-term outlook for the Region and we have significant plans for growth through community openings scheduled over the next twelve months.

Year-to-date results in the Central Region echoed the third quarter results with 6.6% and 11.0% increases in closings and revenue, respectively. Order value improved by \$23.4 million over prior year, primarily as a result of a \$17,600 increase in average sales prices coupled with a slight decline in orders. Average community count year to date improved 13.2% over prior year. The Region ended the quarter with backlog of 1,008 homes valued at \$381.8 million, a 2.3% improvement in backlog value primarily driven by an \$18,500 increase in average sales prices.

East. Our East region generated 587 closings and \$221.1 million in revenue in the third quarter of 2016, 9.9% and 6.2% increases, respectively, from the same period in 2015. Order value in the East region grew \$13.6 million on 11 additional units over prior year primarily as a result of a \$16,600 increase in average sales prices despite a 10.9% decrease in average community count. The Region benefited from a 13.8% higher orders pace with significant improvements over prior year in nearly all of our markets. We anticipate opening several new communities in the Region during the first quarter of 2017 in advance of the spring selling season.

The Florida market, as the largest contributor to the Region's results, reported \$85.6 million in home closing revenue on 206 closings. The 2.0% increase in homes closed during the quarter was offset by an average sales price decline of \$31,200, resulting in a 5.1% decrease in revenue compared to prior year. A shift in product mix in the state directly contributed to the sales price decline as several luxury communities with above-average sales prices contributed a higher percentage of closings in the third quarter of 2015 than 2016. The Florida market generated 208 orders for the three-month period ending September 30, 2016, an 8.4% decrease from 2015, which was offset by an 11.3% increase in average sales price for a total order value of \$95.9 million. The improvement in average sales prices on orders during the quarter relates primarily to product mix with a larger percentage of 2016 order value from communities at higher price points than the comparable 2015 period. The order volume decline was largely the result of 14.8% fewer average communities during the quarter, which was partially offset by an 8.1% improvement in orders pace over prior year. Several community openings are planned in Florida in the early part of 2017. Operations in North Carolina expanded their overall contribution to the Region's results year-over-year, with 177 homes closed and \$71.6 million in home closing revenue, 7.3% and 12.8% improvements, respectively. In addition, North Carolina contributed 149 homes ordered and \$61.5 million in order value in the third quarter of 2016. Order volume and value increased by 8.0% and 7.6%, respectively, over the prior year due primarily to the 32.7% improvement in orders pace despite a temporary reduction in the average community count. New community openings in the North Carolina market are scheduled for the first half of 2017. Tennessee generated significant home closing revenue growth in the third quarter of 2016, \$5.8 million higher than the respective period in 2015 on 20 more units, representing 72.5% and 80.0% increases over prior year. The largest driver for this was the 23.1% increase in average actively-selling communities year to date, which also contributed to the 50.0% higher number of units ordered and 47.2% increase in order value. Growth in Georgia continues to be a strategic focus for us, as this market demonstrates solid buyer demand and is one of the strongest homebuilding markets in the country. Accordingly, operations in Georgia continue to expand and provided 83 closings valued at \$27.5 million during the third quarter of 2016, 33.9% and 33.0% increases over prior year, respectively. Orders in Georgia grew by 26.9% or 18 units, largely attributable to a 22.0% increase in the orders pace during the quarter combined with a nominal increase in average communities. Total order value improved by \$5.7 million year over year. The South Carolina market provided 76 closings and \$22.7 million in home closing revenue during the third quarter of 2016, down 5.0% and 12.2% respectively from prior year, primarily due to a 16.2% decline in average communities. This decline also contributed to a 17 unit or 19.3% decline in orders during the third quarter compared to prior year.

The year-to-date East Region results through September 30, 2016 were similar to those of the third quarter, with 1,714 units closed, providing \$652.1 million in home closing revenue, 15.0% and 15.8% higher than the 2015 period. The number and value of orders also improved by 195 units and \$74.4 million, each representing increases of 10.8% over the prior year. The Region finished the third quarter of 2016 with 1,097 units in backlog with a value of \$435.9 million, 22.3% and 23.5% improvements over 2015, respectively.

#### Land Closing Revenue and Gross Profit

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 \$17.0 million and \$8.1 million for the three months ending September 30, 2016 and 2015, respectively and \$21.2 million and \$16.3 million for the nine months ended September 30, 2016 and 2015, respectively. For both years, modest profits were achieved on these land

sales, \$0.9 million and \$0.6 million for the three months ended September 30, 2016 and 2015, respectively and \$1.7 million and \$1.3 million for the nine months ended September 30, 2016 and 2015, respectively.

Other Operating Information (dollars in thousands)

|                                          | Three Months Ended September 30, |                                 |           |                                 | Nine Months Ended September 30, |                                 |           |                                 |
|------------------------------------------|----------------------------------|---------------------------------|-----------|---------------------------------|---------------------------------|---------------------------------|-----------|---------------------------------|
|                                          | 2016                             |                                 | 2015      |                                 | 2016                            |                                 | 2015      |                                 |
|                                          | Dollars                          | Percent of Home Closing Revenue | Dollars   | Percent of Home Closing Revenue | Dollars                         | Percent of Home Closing Revenue | Dollars   | Percent of Home Closing Revenue |
| Home Closing Gross Profit <sup>(1)</sup> |                                  |                                 |           |                                 |                                 |                                 |           |                                 |
| Total                                    | \$130,979                        | 17.8 %                          | \$125,617 | 19.0 %                          | \$372,072                       | 17.5 %                          | \$335,341 | 18.9 %                          |
| West                                     | \$56,381                         | 17.9 %                          | \$50,377  | 18.6 %                          | \$156,879                       | 17.3 %                          | \$126,274 | 18.1 %                          |
| Central                                  | \$39,546                         | 19.8 %                          | \$39,247  | 21.4 %                          | \$112,664                       | 19.9 %                          | \$109,973 | 21.5 %                          |
| East                                     | \$35,052                         | 15.9 %                          | \$35,993  | 17.3 %                          | \$102,529                       | 15.7 %                          | \$99,094  | 17.6 %                          |

(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 profit for the three and nine months ended September 30, 2016 was \$131.0 million and \$372.1 million, respectively, increases of \$5.4 million and \$36.7 million versus the respective periods in 2015 as a result of higher home closing revenue from more units closed and higher average sales prices. The 120 and 140 basis point declines in home closing gross margin for the three and nine months ended September 30, 2016, respectively, is primarily from a combination of higher labor, construction and land costs in the 2016 periods than in the comparable prior year periods, partially offset by increasing average sales prices. Labor costs have not yet normalized and land prices continue to place pressure on margins, as most of our markets continue to experience steadily increasing land prices. Despite the year over year decline, home closing gross margin improved sequentially from the second quarter of 2016 by 50 basis points, thanks in part to our success in achieving higher average sales prices in high demand markets.

West. Our West Region reported lower year-over-year home closing gross margin, 17.9% for the third quarter of 2016 compared to 18.6% in 2015, although improved sequentially by 70 basis points from the second quarter of 2016. The year-over-year margin decline is largely the result of higher land prices in the Region, as we are focused on building communities in highly sought-after submarkets, which demand high land prices. In particular, 2015 margins in the Southern California markets benefited from lower land prices in several communities that are now closed as compared to the replacement communities with closings in 2016. We are making concerted efforts to maximize margins in the Region and have been successful with raising average sales prices in certain markets that offset land and labor cost increases. Home closing gross margin for the nine months ended September 30, 2016 also declined from 18.1% in 2015 to 17.3% in 2016 for the same reasons noted for the third quarter.

Central. The Central Region produced the highest home closing gross margin in the company, although the third quarter margins declined year over year, with 19.8% in 2016 versus 21.4% in 2015. While we have experienced some pricing power with improved average sales prices, the increases are at a slower pace than that of rising labor, construction and land costs. In addition, several higher margin communities closed out, providing fewer 2016 closings than in the prior year. Year-to-date margins in this Region declined to 19.9% in 2016 versus 21.5% in 2015, also related to the circumstances described for the third quarter.

East. The East Region gross margins in the third quarter and first nine months of 2016 of 15.9% and 15.7%, respectively, declined from the 17.3% and 17.6% for the respective periods in 2015. Margins improved sequentially

from the second quarter by 50 basis points. A shift in product mix in Florida contributed to the decline in margin year over year, as several luxury communities that generated above-average margins with high closing volume in 2015 tapered off in 2016. This Region currently delivers our lowest gross margins, although our newer divisions are seeing improvements in terms of operational efficiencies, as their volumes are increasing and we continue to shift product mix as we expand our operations in these markets.



# Financial Services Profit (in thousands)

| Three Months Ended September 30, 2016 |      | Nine Months Ended September 30, 2015 |      |
|---------------------------------------|------|--------------------------------------|------|
| 2016                                  | 2015 | 2015                                 | 2014 |

Financial services profit \$5,956 \$5,601 \$15,765 \$13,517

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. The increase in financial services profit year over year is the result of the increases in home closings and revenue.

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

| Three Months Ended September 30, 2016 |      | Nine Months Ended September 30, 2015 |      |
|---------------------------------------|------|--------------------------------------|------|
| 2016                                  | 2015 | 2016                                 | 2015 |

### Commissions and Other Sales Costs

|                                 |             |             |              |              |
|---------------------------------|-------------|-------------|--------------|--------------|
| Dollars                         | \$ (52,478) | \$ (48,097) | \$ (155,034) | \$ (134,876) |
| Percent of home closing revenue | 7.1 %       | 7.3 %       | 7.3 %        | 7.6 %        |

### General and Administrative Expenses

|                                  |             |             |             |             |
|----------------------------------|-------------|-------------|-------------|-------------|
| Dollars                          | \$ (33,258) | \$ (28,774) | \$ (91,774) | \$ (86,074) |
| Percent of total closing revenue | 4.4 %       | 4.3 %       | 4.3 %       | 4.8 %       |

### Earnings/(Loss) from Other Unconsolidated Entities, Net

|         |        |          |        |          |
|---------|--------|----------|--------|----------|
| Dollars | \$ 440 | \$ (123) | \$ 856 | \$ (415) |
|---------|--------|----------|--------|----------|

### Interest Expense

|         |          |            |            |             |
|---------|----------|------------|------------|-------------|
| Dollars | \$ (167) | \$ (4,187) | \$ (5,127) | \$ (11,962) |
|---------|----------|------------|------------|-------------|

### Other Income, Net

|         |          |            |          |            |
|---------|----------|------------|----------|------------|
| Dollars | \$ 1,435 | \$ (3,996) | \$ 3,263 | \$ (3,445) |
|---------|----------|------------|----------|------------|

### Provision for Income Taxes

|         |             |             |             |             |
|---------|-------------|-------------|-------------|-------------|
| Dollars | \$ (16,915) | \$ (16,360) | \$ (43,989) | \$ (37,538) |
|---------|-------------|-------------|-------------|-------------|

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. As a result of the additional revenues on homes closed, these costs increased by \$4.4 million and \$20.2 million for the three and nine months ended September 30, 2016, respectively, versus the 2015 periods. As a percentage of home closing revenue, commissions and other sales costs declined by 20 basis points and 30 basis points, respectively, to 7.1% and 7.3% during the three and nine months ended September 30, 2016 compared to the respective 2015 periods as a result of improved overhead leverage on the additional revenue dollars. We have made concerted efforts to contain these costs and recently modified our internal commission structure as part of our cost-cutting initiatives.

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 September 30, 2016, general and administrative expenses were \$33.3 million compared to \$28.8 million in 2015. For the nine months ended September 30, 2015, we had \$91.8 million in expenses as compared to \$86.1 million for the same period in 2015. As a percentage of total closing revenue, these costs were relatively flat, increasing by 10 basis points for the three month period ending September 30, 2016 to 4.4% and declining by 50 basis points for the nine-month period ending September 30, 2016 to 4.3%. This improved leverage year to date is mainly attributable to the additional closing revenue in 2016 over 2015. We continually strive to optimize overhead leverage through cost control efforts at both corporate and divisional levels.

Earnings/(Loss) from Other Unconsolidated Entities, Net. Earnings/(loss) from other unconsolidated entities, net represents our portion of pre-tax earnings/(losses) from non-financial services joint ventures. Included in this amount is both the pass through of earnings/(losses) from the joint ventures' most recently available financial statements as well as any accrued expected earnings/(losses) for the periods presented that might not have been reflected in the joint

ventures' financial statements provided to us. The three- and nine-month periods ended September 30, 2016 reported earnings of \$0.4 million and \$0.9 million, respectively, compared to losses for the prior year periods of \$0.1 million and \$0.4 million, respectively. The 2016 earnings are the result of land sales recorded in our land joint ventures in 2016, with minimal comparable land sales in 2015.

**Interest Expense.** Interest expense is comprised of interest incurred, but not capitalized, on our senior notes, convertible senior notes and our Credit Facility. Interest expense decreased year over year for both the three- and nine-month periods, as we have more inventory under development that qualifies for interest capitalization. During the three months ended September 30, 2016 and September 30, 2015, our non-capitalizable interest expense was \$0.2 million and \$4.2 million, respectively. For the year-to-date results, our interest expense was \$5.1 million and \$12.0 million, respectively.

**Other Income/(Expense), Net.** Other income/(expense), net, primarily consists of (i) forfeited deposits from potential homebuyers who canceled their purchase contracts with us, (ii) sublease income, (iii) interest earned on our cash and cash equivalents, and (iv) payments and awards related to legal settlements. Other income/(expense), net was favorably impacted in 2016 both in the third quarter and year to date by interest income from municipalities related to reimbursable land development costs while a \$4.1 million adverse legal ruling unfavorably impacted the same periods in the prior year.

**Income Taxes.** Our effective tax rate was 31.4% and 35.1% for the three months ended September 30, 2016 and 2015, respectively, and 31.0% and 33.1% for the nine months ended September 30, 2016 and 2015, respectively. Our tax rate has been favorably impacted in both years by the homebuilding manufacturing deduction. Due to the timing of enabling legislation related to federal energy tax credits, the 2016 effective tax rate for both the three and nine months ended September 30, 2016 was reduced, whereas prior year rates were not impacted until the fourth quarter.

## Liquidity and Capital Resources

### Overview

Our principal uses of capital in 2016 were acquisition and development of new and strategic lot positions, operating expenses, home construction and the payment of routine liabilities. In the first nine months of 2016, 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 nine months ended September 30, 2016 and September 30, 2015, net cash used in operations totaled \$148.3 million and \$53.2 million, respectively. Operating cash flows in both 2016 and 2015 benefited from cash generated by net earnings of \$97.7 million and \$75.8 million, respectively, offset mainly by increases in real estate of \$318.5 million and \$198.5 million, respectively, reflecting increased land and land development spending.

### Investing Cash Flow Activities

During the nine months ended September 30, 2016, net cash used in investing activities totaled \$12.4 million as compared to \$12.5 million for the same period in 2015. Cash used in investing activities in 2016 and 2015 is mainly attributable to the purchases of property and equipment of \$12.3 million in both periods.

### Financing Cash Flow Activities

During the nine months ended September 30, 2016, net cash provided by financing activities totaled \$6.4 million as compared to \$197.9 million for the same period in 2015. The net cash provided by financing activities in 2016 is primarily the result of \$25.0 million in proceeds received from our Credit Facility offset partially by repayments of loans payable and other borrowings of \$18.3 million. Our 2015 results were mainly attributable to \$200.0 million in proceeds from the issuance of our 2025 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 statement of operations 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. As demand for new homes improves and we continue to expand our business, we expect cash outlays for land purchases, land development and home construction will continue to exceed our cash generated from operations in the near term.

During the nine months ended September 30, 2016, we closed 5,238 homes, purchased about 6,400 lots for \$478.7 million, spent \$188.5 million on land development, paid \$54.7 million in lot purchase and option deposits, and started approximately 6,142 homes. The opportunity to purchase substantially finished lots in desired locations continues to be more limited and competitive as compared to prior years. As a result, we are purchasing more undeveloped land and partially-finished lots than in recent years and subsequently incurring 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 third quarter of 2016 with \$107.9 million of cash and cash equivalents, a \$154.3 million decrease from December 31, 2015. We expect to generate cash from the sale of our inventory, but we intend to redeploy 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. Reference is made to Notes 5 and 6 in the accompanying unaudited consolidated financial statements.

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       |             |
|------------------------------------|-------------|-------------|
|                                    | September   | December    |
|                                    | 30, 2016    | 31, 2015    |
| Notes payable and other borrowings | \$1,139,815 | \$1,117,040 |
| Stockholders' equity               | 1,367,405   | 1,258,937   |
| Total capital                      | \$2,507,220 | \$2,375,977 |
| Debt-to-capital <sup>(1)</sup>     | 45.5 %      | 47.0 %      |
| Notes payable and other borrowings | \$1,139,815 | \$1,117,040 |
| Less: cash and cash equivalents    | (107,915 )  | (262,208 )  |
| Net debt                           | 1,031,900   | 854,832     |
| Stockholders' equity               | 1,367,405   | 1,258,937   |
| Total net capital                  | \$2,399,305 | \$2,113,769 |
| Net debt-to-capital <sup>(2)</sup> | 43.0 %      | 40.4 %      |

Debt-to-capital is computed as senior and convertible senior notes, net and loans payable and other borrowings (1)divided by the aggregate of total senior and convertible senior notes, net and loans payable and other borrowings and stockholders' equity.

Net debt-to-capital is computed as net debt divided by the aggregate of net debt and stockholders' equity. Net debt is total senior and convertible senior notes, net and loans payable and other borrowings, less cash and cash (2)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.

#### 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 \$670.3 million (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 September 30, 2016. Our actual financial covenant calculations as of September 30, 2016 are reflected in the table below.

| Financial Covenant (dollars in thousands):           | Covenant Requirement | Actual      |
|------------------------------------------------------|----------------------|-------------|
| Minimum Tangible Net Worth                           | > \$843,740          | \$1,330,036 |
| Leverage Ratio                                       | < 60%                | 42%         |
| Interest Coverage Ratio <sup>(1)</sup>               | > 1.50               | 4.51        |
| Minimum Liquidity <sup>(1)</sup>                     | > \$70,521           | \$550,540   |
| Investments other than defined permitted investments | < \$399,011          | \$11,831    |

(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, 4, and 15 in the accompanying Notes to the unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q. 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.

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#### 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 \$175.0 million in principal of our 4.50% senior notes, \$300.0 million in principal of our 7.15% senior notes, \$300.0 million in principal of our 7.00% senior notes, \$200.0 million in principal of our 6.00% senior notes and \$126.5 million in principal of our 1.875% convertible senior notes. Except in limited circumstances, or upon the occurrence of specific trigger events for our convertible notes, 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. Our Credit Facility is subject to interest rate changes as the borrowing rates are based on LIBOR or PRIME (see Note 5 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 Securities 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 Securities Exchange Act of 1934 (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, claims and litigation 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 legal proceedings, 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 the initiation of legal proceedings. We believe there are not any 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. Information related to pending legal proceedings is presented in Note 15 - Commitments on Contingencies, in the accompanying consolidated financial statements and is incorporated by reference herein.

### 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 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2015, 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

#### Issuer Purchases of Equity Securities:

We did not acquire any of our own equity securities during the three months ended September 30, 2016.

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, compliance with certain restrictive debt covenants, as well as other factors considered relevant by our Board of Directors.

## Item 6. Exhibits

| Exhibit Number | Description                                                                                                                                                                                                                                                                                                                                                                                                                     | Page or Method of Filing                                                                                                                        |
|----------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------|
| 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 November 24, 2014.                                                                   |
| 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                                                                                                                                                                                                                                                                                                                                               | Filed herewith.                                                                                                                                 |
| 101.0          | The following financial statements from Meritage Homes Corporation Quarterly Report on Form 10-Q for the quarter ended September 30, 2016, 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) the 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, this 28th day of October 2016.

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)

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- 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
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