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Meritage Homes CORP
Form 10-Q
July 31, 2015

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 June 30, 2015

OR

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

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

(Exact Name of Registrant as Specified in its Charter)

Maryland 86-0611231
(State or Other Jurisdiction of (IRS Employer
Incorporation or Organization) Identification No.)

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

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

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

Indicate by a checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive 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 x No

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

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

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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 July 29, 2015: 39,660,997

MERITAGE HOMES CORPORATION
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2015
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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

| | June 30, 2015 | December 31, 2014 |
|---|---------------|----------------------|
| Assets | | |
| Cash and cash equivalents | \$217,021 | \$103,333 |
| Other receivables | 64,659 | 56,763 |
| Real estate | 2,027,064 | 1,877,682 |
| Real estate not owned | — | 4,999 |
| Deposits on real estate under option or contract | 92,085 | 94,989 |
| Investments in unconsolidated entities | 10,303 | 10,780 |
| Property and equipment, net | 33,741 | 32,403 |
| Deferred tax asset | 65,651 | 64,137 |
| Prepays, other assets and goodwill | 76,145 | 71,052 |
| Total assets | \$2,586,669 | \$2,316,138 |
| Liabilities | | |
| Accounts payable | \$103,145 | \$83,619 |
| Accrued liabilities | 137,602 | 154,144 |
| Home sale deposits | 38,728 | 29,379 |
| Liabilities related to real estate not owned | — | 4,299 |
| Loans payable and other borrowings | 34,654 | 30,722 |
| Senior and convertible senior notes | 1,104,202 | 904,486 |
| Total liabilities | 1,418,331 | 1,206,649 |
| Stockholders' Equity | | |
| Preferred stock, par value \$0.01. Authorized 10,000,000 shares; none issued and outstanding at June 30, 2015 and December 31, 2014 | — | — |
| Common stock, par value \$0.01. Authorized 125,000,000 shares; issued 39,660,997 and 39,147,153 shares at June 30, 2015 and December 31, 2014, respectively | 397 | 391 |
| Additional paid-in capital | 552,098 | 538,788 |
| Retained earnings | 615,843 | 570,310 |
| Total stockholders' equity | 1,168,338 | 1,109,489 |
| Total liabilities and stockholders' equity | \$2,586,669 | \$2,316,138 |
| See accompanying notes to unaudited consolidated financial statements | | |

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|------------|---------------------------|------------|
| | 2015 | 2014 | 2015 | 2014 |
| Homebuilding: | | | | |
| Home closing revenue | \$591,027 | \$502,800 | \$1,108,300 | \$908,579 |
| Land closing revenue | 6,774 | 2,804 | 8,213 | 5,370 |
| Total closing revenue | 597,801 | 505,604 | 1,116,513 | 913,949 |
| Cost of home closings | (476,790) | (392,839) | (898,576) | (706,019) |
| Cost of land closings | (6,262) | (2,762) | (7,547) | (6,355) |
| Total cost of closings | (483,052) | (395,601) | (906,123) | (712,374) |
| Home closing gross profit | 114,237 | 109,961 | 209,724 | 202,560 |
| Land closing gross profit/(loss) | 512 | 42 | 666 | (985) |
| Total closing gross profit | 114,749 | 110,003 | 210,390 | 201,575 |
| Financial Services: | | | | |
| Revenue | 2,741 | 2,451 | 5,276 | 4,350 |
| Expense | (1,362) | (1,131) | (2,661) | (2,206) |
| Earnings from financial services unconsolidated entities and other, net | 2,757 | 2,297 | 5,301 | 4,498 |
| Financial services profit | 4,136 | 3,617 | 7,916 | 6,642 |
| Commissions and other sales costs | (45,167) | (36,105) | (86,779) | (67,039) |
| General and administrative expenses | (27,650) | (24,571) | (57,300) | (46,242) |
| Loss from other unconsolidated entities, net | (169) | (61) | (292) | (230) |
| Interest expense | (4,621) | (1,396) | (7,775) | (4,109) |
| Other income, net | 136 | 3,749 | 551 | 4,397 |
| Earnings before income taxes | 41,414 | 55,236 | 66,711 | 94,994 |
| Provision for income taxes | (12,281) | (20,157) | (21,178) | (34,538) |
| Net earnings | \$29,133 | \$35,079 | \$45,533 | \$60,456 |
| Earnings per common share: | | | | |
| Basic | \$0.73 | \$0.90 | \$1.15 | \$1.55 |
| Diluted | \$0.70 | \$0.85 | \$1.10 | \$1.48 |
| Weighted average number of shares: | | | | |
| Basic | 39,648 | 39,118 | 39,520 | 38,904 |
| Diluted | 42,145 | 41,598 | 42,079 | 41,487 |
| See accompanying notes to unaudited consolidated financial statements | | | | |

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

| | Six Months Ended June 30, | |
|---|---------------------------|-----------|
| | 2015 | 2014 |
| Cash flows from operating activities: | | |
| Net earnings | \$45,533 | \$60,456 |
| Adjustments to reconcile net earnings to net cash used in operating activities: | | |
| Depreciation and amortization | 6,729 | 5,182 |
| Stock-based compensation | 8,465 | 5,264 |
| Excess income tax benefit from stock-based awards | (2,012) | (2,194) |
| Equity in earnings from unconsolidated entities | (5,009) | (4,268) |
| Distributions of earnings from unconsolidated entities | 5,769 | 6,119 |
| Other | 424 | 3,955 |
| Changes in assets and liabilities: | | |
| Increase in real estate | (144,450) | (229,805) |
| Decrease/(increase) in deposits on real estate under option or contract | 3,604 | (7,986) |
| Increase in receivables, prepaids and other assets | (10,346) | (15,121) |
| Increase in accounts payable and accrued liabilities | 4,996 | 2,247 |
| Increase in home sale deposits | 9,349 | 5,537 |
| Net cash used in operating activities | (76,948) | (170,614) |
| Cash flows from investing activities: | | |
| Investments in unconsolidated entities | (282) | (233) |
| Purchases of property and equipment | (7,829) | (11,864) |
| Proceeds from sales of property and equipment | 62 | 146 |
| Maturities of investments and securities | — | 65,388 |
| Payments to purchase investments and securities | — | (35,614) |
| Net cash (used in)/provided by investing activities | (8,049) | 17,823 |
| Cash flows from financing activities: | | |
| Proceeds from Credit Facility, net | — | — |
| Repayment of loans payable and other borrowings | (3,211) | (4,036) |
| Proceeds from issuance of senior notes | 200,000 | — |
| Debt issuance costs | (2,955) | — |
| Excess income tax benefit from stock-based awards | 2,012 | 2,194 |
| Proceeds from issuance of common stock, net | — | 110,420 |
| Proceeds from stock option exercises | 2,839 | 707 |
| Net cash provided by financing activities | 198,685 | 109,285 |
| Net increase/(decrease) in cash and cash equivalents | 113,688 | (43,506) |
| Cash and cash equivalents, beginning of period | 103,333 | 274,136 |
| Cash and cash equivalents, end of period | \$217,021 | \$230,630 |

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 detached homes. We primarily build in historically high-growth regions of the United States and offer a variety of homes that are designed to appeal to a wide range of homebuyers, including first-time, move-up, active adult and luxury. We have homebuilding operations in three regions: West, Central and East, which are comprised of nine states: Arizona, California, Colorado, Texas, Florida, Georgia, North Carolina, South Carolina and Tennessee. In August 2014, we entered the Atlanta, Georgia and Greenville, South Carolina markets through the acquisition of the homebuilding assets and operations of Legendary Communities ("Legendary Communities"). We also operate a wholly-owned title company, Carefree Title Agency, Inc. ("Carefree Title"). Carefree Title's core business includes title insurance and closing/settlement services we offer to our homebuyers. Through our predecessors, we commenced our homebuilding operations in 1985. Meritage Homes Corporation was incorporated in 1988 in the state of Maryland.

Our homebuilding and marketing activities are conducted under the name of Meritage Homes in each of our homebuilding markets, other than Tennessee, where we currently operate under the name of Phillips Builders, and in the Atlanta and Greenville markets where we currently operate under the Legendary Communities brand. We also offer luxury homes in some markets under the brand name of Monterey Homes. At June 30, 2015, we were actively selling homes in 240 communities, with base prices ranging from approximately \$122,000 to \$1,315,000.

Basis of Presentation. The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2014. The consolidated financial statements include the accounts of Meritage Homes Corporation and those of our consolidated subsidiaries, partnerships and other entities in which we have a controlling financial interest, and of variable interest entities (see Note 3) in which we are deemed the primary beneficiary (collectively, "us", "we", "our" and "the Company"). Intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the accompanying unaudited financial statements include all adjustments (consisting only of normal recurring entries), necessary for the fair presentation of our results for the interim periods presented. Results for interim periods are not necessarily indicative of results to be expected for the full year. Certain reclassifications have been made to prior year results to conform to current year presentation. Cash and Cash Equivalents. Liquid investments with an initial maturity of three months or less are classified as cash equivalents. Amounts in transit from title companies or closing agents for home closings of approximately \$57.5 million and \$59.2 million are included in cash and cash equivalents at June 30, 2015 and December 31, 2014, respectively.

Real Estate. Real estate is stated at cost unless the asset is determined to be impaired, at which point the inventory is written down to fair value as required by Accounting Standards Codification ("ASC") 360-10, Property, Plant and Equipment ("ASC 360-10"). Inventory includes the costs of land acquisition, land development, home construction, capitalized interest, real estate taxes, capitalized direct overhead costs incurred during development and home construction that benefit the entire community, less impairments, if any. Land and development costs are typically allocated and transferred to homes under construction when construction begins. Home construction costs are accumulated on a per-home basis, while selling costs are expensed as incurred. Cost of home closings includes the specific construction costs of the home and all related allocated land acquisition, land development and other common costs (both incurred and estimated to be incurred) that are allocated based upon the total number of homes expected to be closed in each community or phase. Any changes to the estimated total development costs of a community or phase are allocated to the remaining homes in the community or phase. When a home closes, we may have incurred costs for

goods and services that have not yet been paid. An accrued liability to capture such obligations is recorded in connection with the home closing and charged directly to cost of sales.

We rely on certain estimates to determine our construction and land development costs. Construction and land costs are comprised of direct and allocated costs, including estimated future costs. In determining these costs, we compile project budgets that are based on a variety of assumptions, including future construction schedules and costs to be incurred. It is possible that actual results could differ from budgeted amounts for various reasons, including construction delays, labor or material shortages, increases in costs that have not yet been committed, changes in governmental requirements, or other

unanticipated issues encountered during construction and development and other factors beyond our control. To address uncertainty in these budgets, we assess, update and revise project budgets on a regular basis, utilizing the most current information available to estimate construction and land costs.

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

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

Deposits. Deposits paid related to land options and purchase contracts are recorded and classified as Deposits on real estate under option or contract until the related land is purchased. Deposits are reclassified as a component of real estate inventory at the time the deposit is used to offset the acquisition price of the lots based on the terms of the underlying agreements. To the extent they are non-refundable, deposits are charged to expense if the land acquisition is terminated or no longer considered probable. Since our acquisition contracts typically do not require specific performance, we do not consider such contracts to be contractual obligations to purchase the land and our total exposure under such contracts is limited to the loss of the non-refundable deposits and any ancillary capitalized costs. Our deposits were \$92.1 million and \$95.0 million as of June 30, 2015 and December 31, 2014, respectively.

Goodwill. In accordance with ASC 350, Intangibles, Goodwill and Other ("ASC 350"), we analyze goodwill on at least an annual basis to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. ASC 350 states that an entity may assess qualitative factors first to determine whether it is necessary to perform a two-step goodwill impairment test. Such qualitative factors include: (1) macroeconomic conditions, such as a deterioration in general economic conditions, (2) industry and market considerations such as deterioration in the environment in which the entity operates, (3) cost factors such as increases in raw materials and labor costs, and (4) overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings. If the qualitative analysis determines that additional impairment testing is required, the two-step impairment testing in accordance with ASC 350 would be initiated. We continually evaluate our qualitative inputs to assess whether events and circumstances have occurred that indicate the goodwill balance may not be recoverable. See Note 9 for additional information related to goodwill.

Off-Balance Sheet Arrangements - Joint Ventures. In the past, we have participated in land development joint ventures as a means of accessing larger parcels of land and lot positions, expanding our market opportunities, managing our risk profile and leveraging our capital base; however, in recent years, such ventures have not been a significant avenue for us to access lots. See Note 4 for additional discussion of our investments in unconsolidated entities.

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

information on off-balance sheet arrangements.

Surety Bonds and Letters of Credit. We provide letters of credit in support of our obligations relating to the development of our projects and other corporate purposes. For some projects, surety bonds may be posted in lieu of letters of credit or cash deposits. The amount of these obligations outstanding at any time varies depending on the stage and level of our development activities. Bonds are generally not released until all development activities under the bond are complete. In the event a bond or letter of credit is drawn upon, we would be obligated to reimburse the issuer for any amounts advanced under the bond. We believe it is unlikely that any significant amounts of these bonds or letters of credit will be drawn upon. The table below outlines our surety bond and letter of credit obligations (in thousands):

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| | At June 30, 2015 | | At December 31, 2014 | |
|--|------------------|--------------------------------------|----------------------|--------------------------------------|
| | Outstanding | Estimated work remaining to complete | Outstanding | Estimated work remaining to complete |
| Sureties: | | | | |
| Sureties related to joint ventures | \$87 | \$ 87 | \$87 | \$ 87 |
| Sureties related to owned projects and lots under contract | 241,805 | 93,313 | 230,079 | 93,667 |
| Total Sureties | \$241,892 | \$ 93,400 | \$230,166 | \$ 93,754 |
| Letters of Credit (“LOCs”): | | | | |
| LOCs in lieu of deposits for contracted lots | \$— | N/A | \$1,200 | N/A |
| LOCs for land development | 13,091 | N/A | 13,789 | N/A |
| LOCs for general corporate operations | 4,500 | N/A | 4,500 | N/A |
| Total LOCs | \$17,591 | N/A | \$19,489 | N/A |

Accrued Liabilities. Accrued liabilities at June 30, 2015 and December 31, 2014 consisted of the following (in thousands):

| | June 30, 2015 | December 31, 2014 |
|---|------------------|-------------------|
| Accruals related to real estate development and construction activities | \$40,187 | \$34,975 |
| Payroll and other benefits | 29,592 | 44,107 |
| Accrued taxes | 4,637 | 11,096 |
| Warranty reserves | 21,993 | 22,080 |
| Legal reserves | 15,484 | 16,499 |
| Other accruals | 25,709 | 25,387 |
| Total | \$137,602 | \$154,144 |

Warranty Reserves. We provide home purchasers with limited warranties against certain building defects and 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, we increased our warranty reserve balance by \$750,000 and \$500,000 in the three and six months ended June 30, 2015 and 2014, respectively, which increased our cost of sales. A summary of changes in our warranty reserves follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-----------------|---------------------------|-----------------|
| | 2015 | 2014 | 2015 | 2014 |
| Balance, beginning of period | \$21,839 | \$21,482 | \$22,080 | \$21,971 |
| Additions to reserve from new home deliveries | 2,996 | 2,759 | 5,624 | 5,035 |
| Warranty claims | (3,592) | (3,859) | (6,461) | (6,624) |
| Adjustments to pre-existing reserves | 750 | 500 | 750 | 500 |
| Balance, end of period | \$21,993 | \$20,882 | \$21,993 | \$20,882 |

Warranty reserves are included in Accrued liabilities on the accompanying unaudited consolidated balance sheets, and additions and adjustments to the reserves 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 April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 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 in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. ASU 2015-03 is effective for us for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. ASU 2015-03 is to be applied on a retrospective basis and represents a change in accounting principle. The adoption of ASU 2015-03 will result in a retrospective reclassification of our debt costs as described above, but we do not expect the resulting changes to be material.

In February 2015, the FASB issued ASU 2015-02, Consolidation: Amendments to the Consolidation Analysis ("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 is effective for us beginning January 1, 2016. Early adoption is permitted. We do not anticipate the adoption of ASU 2015-02 will have a material effect on our consolidated financial statements.

In January 2015, the FASB issued ASU 2015-01, Income Statement - Extraordinary and Unusual Items ("ASU 2015-01"). ASU 2015-01 eliminates the concept of extraordinary items from GAAP but retains the presentation and disclosure guidance for items that are unusual in nature or occur infrequently and expands the guidance to include items that are both unusual and infrequently occurring. ASU 2015-01 is effective for us on January 1, 2016. A reporting entity may apply ASU 2015-01 prospectively or retrospectively to all periods presented in the financial statements. We do not anticipate the adoption of ASU 2015-01 will have a material effect on our consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"), which provides guidance on determining when and how to disclose going-concern uncertainties in the financial statements. The new standard requires management to perform assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued. An entity must provide certain disclosures if conditions or events raise substantial doubt about the entity's ability to continue as a going concern. We will be required to perform the going concern assessment under ASU 2014-15 beginning with the year ending December 31, 2016. We do not anticipate the adoption of ASU 2014-15 will have a material effect on our consolidated financial statements or disclosures.

In June 2014, the FASB issued ASU 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period ("ASU 2014-12"). ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in ASC 718, Compensation - Stock Compensation, as it relates to awards with performance conditions that affect vesting to account for such awards. The amendments in ASU 2014-12 are effective for us on January 1, 2016. Early adoption is permitted. We do not anticipate the adoption of ASU 2014-12 will have a material effect on our consolidated financial statements or disclosures.

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. ASU 2014-09 is effective for us on January 1, 2018. Early adoption is not permitted. We are currently evaluating the potential impact of adopting this guidance on our consolidated

financial statements.

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NOTE 2 — REAL ESTATE AND CAPITALIZED INTEREST

Real estate consists of the following (in thousands):

| | June 30, 2015 | December 31, 2014 |
|--|---------------|----------------------|
| Homes under contract under construction (1) | \$506,004 | \$328,931 |
| Unsold homes, completed and under construction (1) | 251,067 | 302,288 |
| Model homes (1) | 120,981 | 109,614 |
| Finished home sites and home sites under development (2) | 1,149,012 | 1,136,849 |
| | \$2,027,064 | \$1,877,682 |

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

(2) Includes raw land, land held for development and land held for sale. 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 the development and construction of real estate. Capitalized interest is allocated to active real estate when incurred and charged to cost of closings when the related property is delivered. A summary of our capitalized interest is as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|----------|---------------------------|----------|
| | 2015 | 2014 | 2015 | 2014 |
| Capitalized interest, beginning of period | \$56,843 | \$38,701 | \$54,060 | \$32,992 |
| Interest incurred | 16,526 | 14,382 | 31,808 | 28,638 |
| Interest expensed | (4,621) | (1,396) | (7,775) | (4,109) |
| Interest amortized to cost of home and land closings | (9,878) | (7,332) | (19,223) | (13,166) |
| Capitalized interest, end of period (1) | \$58,870 | \$44,355 | \$58,870 | \$44,355 |

Approximately \$490,000 of the capitalized interest is related to our joint venture investments and is a component (1) of Investments in unconsolidated entities in our consolidated balance sheet as of June 30, 2015 and December 31, 2014.

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

In the normal course of business, we enter into purchase and option agreements for land or lots. 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 holdings 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 option and purchase 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 we are, we 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 to acquire additional land into the VIE or dispose of land in the VIE 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 deemed to be in line with current marking pricing on behalf of the land owner and any budget savings or shortfalls are borne by us. Some of our option deposits may be refundable to us if certain contractual conditions are not performed by the party selling the lots.

The table below presents a summary of our lots under option at June 30, 2015 (dollars in thousands):

| | Projected Number of Lots | Purchase Price | Option/ Earnest Money Deposits—Cash | |
|--|--------------------------------|-------------------|---|-----|
| Purchase and option contracts recorded on balance sheet as Real estate not owned | — | \$— | \$— | |
| Option contracts not recorded on balance sheet — non-refundable deposits, committed (1) | 6,706 | 537,038 | 73,925 | |
| Purchase contracts not recorded on balance sheet — non-refundable deposits, committed (1) | 2,516 | 125,952 | 13,321 | |
| Purchase contracts not recorded on balance sheet —refundable deposits, committed | 907 | 31,835 | 748 | |
| Total committed (on and off balance sheet) | 10,129 | 694,825 | 87,994 | |
| Total purchase and option contracts not recorded on balance sheet — refundable deposits, uncommitted (2) | 5,576 | 281,864 | 4,091 | |
| Total lots under contract or option | 15,705 | \$976,689 | \$92,085 | |
| Total purchase and option contracts not recorded on balance sheet (3) | 15,705 | \$976,689 | \$92,085 | (4) |

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

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

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

(4) Amount is reflected in our consolidated balance sheet in the line item Deposits on real estate under option or contract as of June 30, 2015.

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, or in situations where we may encounter development or construction delays, we may purchase lots at an absorption level that exceeds our sales and home starts pace.

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, currently we do not view joint ventures as critical to the success of our homebuilding operations and have not entered into any new land joint ventures since 2008. 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 June 30, 2015, we had two active equity-method land ventures.

We have outstanding litigation reserves related to a minority ownership in one of our inactive joint ventures, the South Edge joint venture. There is pending litigation with the venture's lender group regarding our \$13.2 million guarantee related to that venture and, separate pending arbitration proceedings regarding a dispute we have with certain members of the joint venture. See Note 15 regarding the outstanding litigation related to this joint venture and the corresponding reserves and charges we have recorded relating thereto.

As of June 30, 2015, we also participated in one mortgage joint venture, which is engaged in mortgage activities and provides services to both our homebuyers as well as other buyers. Our investment in this mortgage joint venture as of June 30, 2015 and December 31, 2014 was \$1.5 million and \$2.0 million, respectively.

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

| | At June 30, 2015 | At December 31, 2014 |
|--|------------------|-------------------------|
| Assets: | | |
| Cash | \$5,743 | \$6,471 |
| Real estate | 33,902 | 34,435 |
| Other assets | 3,947 | 2,990 |
| Total assets | \$43,592 | \$43,896 |
| Liabilities and equity: | | |
| Accounts payable and other liabilities | \$5,609 | \$5,994 |
| Notes and mortgages payable | 13,345 | 13,346 |
| Equity of: | | |
| Meritage (1) | 7,980 | 7,735 |
| Other | 16,658 | 16,821 |
| Total liabilities and equity | \$43,592 | \$43,896 |

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|----------|---------------------------|----------|
| | 2015 | 2014 | 2015 | 2014 |
| Revenue | \$8,413 | \$6,614 | \$15,154 | \$11,923 |
| Costs and expenses | (4,213 |) (3,112 |) (7,408 |) (5,865 |
| Net earnings of unconsolidated entities | \$4,200 | \$3,502 | \$7,746 | \$6,058 |
| Meritage's share of pre-tax earnings (1) (2) | \$2,588 | \$2,236 | \$5,009 | \$4,268 |

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

(1) Our share of pre-tax earnings is recorded in Earnings from financial services unconsolidated entities and other, net and Loss from other unconsolidated entities, net on our consolidated income statements and excludes 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.

(2)

The joint venture assets and liabilities noted in the table above primarily represent the active land ventures, one mortgage venture and various inactive ventures. Our total investment in all of these joint ventures is \$10.3 million and \$10.8 million as of June 30, 2015 and December 31, 2014, respectively. As of June 30, 2015, 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):

| | At June 30, 2015 | At December 31, 2014 |
|---|------------------|-------------------------|
| Other borrowings, real estate note payable (1) | \$34,654 | \$30,722 |
| \$500 million unsecured revolving credit facility, maturing July 2019, with interest approximating LIBOR (approximately 0.19% at June 30, 2015) plus 1.75% or Prime (3.25% at June 30, 2015) plus 0.75% | — | — |
| Total | \$34,654 | \$30,722 |

(1) Reflects balance of non-recourse notes payable in connection with land purchases, with interest rates ranging from 0% to 6%.

In July 2012, we entered into an unsecured revolving \$125.0 million credit facility ("Credit Facility"). In 2014, we amended and restated the Credit Facility, increasing the capacity as of December 31, 2014 to \$400.0 million, increasing the amount available for letters of credit to \$200.0 million and extending the maturity date to June 2018. In the first quarter of 2015, we further increased the capacity to \$500.0 million. In July 2015, the maturity date of the credit facility was extended to July 9, 2019 and the accordion feature was amended to permit the size of the facility to be increased by \$100.0 million up to a maximum of \$600.0 million. In addition to the extended maturity date, various terms including interest rates and commitment fees were reduced. 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. During the second quarter of 2015, our maximum borrowings under the Credit Facility were \$110.0 million, all of which was repaid as of June 30, 2015. As of June 30, 2015 we had outstanding letters of credit issued under the Credit Facility totaling \$17.6 million, leaving \$482.4 million available under the Credit Facility to be drawn.

NOTE 6 — SENIOR AND CONVERTIBLE SENIOR NOTES

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

| | At June 30, 2015 | At December 31, 2014 |
|--|------------------|-------------------------|
| 4.50% senior notes due 2018 | \$175,000 | \$175,000 |
| 7.15% senior notes due 2020. At June 30, 2015 and December 31, 2014 there was approximately \$2,702 and \$2,986 in net unamortized premium, respectively | 302,702 | 302,986 |
| 7.00% senior notes due 2022 | 300,000 | 300,000 |
| 6.00% senior notes due 2025 | 200,000 | — |
| 1.875% convertible senior notes due 2032 (1) | 126,500 | 126,500 |
| Total | \$1,104,202 | \$904,486 |

(1) The Convertible Notes may be redeemed by the note-holders on the fifth, tenth and fifteenth anniversary dates of the issuance date of the Convertible Notes.

On June 2, 2015, we completed an offering of \$200.0 million aggregate principal amount of Senior Notes due 2025 ("2025 Notes"). The 2025 Notes bear interest at 6.00% per annum, payable on June 1 and December 1 of each year, commencing on December 1, 2015.

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. 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 represents a 47.5% conversion premium based on the closing price of our common stock on September 12, 2012.

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. This guidance defines fair value, establishes a framework for measuring fair value and addresses required disclosures about fair value measurements. This standard establishes a three-level hierarchy for fair value measurements based upon the significant inputs used to determine fair value. Observable inputs are those which are obtained from market participants external to the company while unobservable inputs are generally developed internally, utilizing management’s estimates, assumptions and specific knowledge of the assets/liabilities and related markets. The three levels are defined as follows:

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

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

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

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. Except as discussed in Note 1, we do not value any other non-financial assets at fair value.

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):

| | June 30, 2015 | | December 31, 2014 | |
|---------------------------------|------------------------|-------------------------|------------------------|-------------------------|
| | Aggregate Principal | Estimated Fair Value | Aggregate Principal | Estimated Fair Value |
| 4.50% senior notes | \$175,000 | \$178,500 | \$175,000 | \$175,000 |
| 7.15% senior notes | \$300,000 | \$323,250 | \$300,000 | \$322,500 |
| 7.00% senior notes | \$300,000 | \$320,250 | \$300,000 | \$318,000 |
| 6.00% senior notes | \$200,000 | \$201,000 | N/A | N/A |
| 1.875% convertible senior notes | \$126,500 | \$133,299 | \$126,500 | \$124,444 |

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 Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|----------|---------------------------|----------|
| | 2015 | 2014 | 2015 | 2014 |
| Basic weighted average number of shares outstanding | 39,648 | 39,118 | 39,520 | 38,904 |
| Effect of dilutive securities: | | | | |
| Convertible debt (1) | 2,176 | 2,176 | 2,176 | 2,176 |
| Stock options and unvested restricted stock | 321 | 304 | 383 | 407 |
| Diluted average shares outstanding | 42,145 | 41,598 | 42,079 | 41,487 |
| Net earnings as reported | \$29,133 | \$35,079 | \$45,533 | \$60,456 |
| Interest attributable to convertible senior notes, net of income taxes | 386 | 378 | 771 | 757 |
| Net earnings for diluted earnings per share | \$29,519 | \$35,457 | \$46,304 | \$61,213 |
| Basic earnings per share | \$0.73 | \$0.90 | \$1.15 | \$1.55 |
| Diluted earnings per share (1) | \$0.70 | \$0.85 | \$1.10 | \$1.48 |
| Antidilutive stock options not included in the calculation of diluted earnings per share | 14 | 254 | 7 | 20 |

(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

Legendary Communities. In August 2014, we entered the Atlanta, Georgia and Greenville, South Carolina markets as well as increased our existing Charlotte, North Carolina presence through the acquisition of the homebuilding assets and operations of Legendary Communities. The purchase price was approximately \$130.7 million in cash. The results of operations of Legendary Communities have been included in our financial statements since August 1, 2014, the effective date of the acquisition. As a result of the transaction, we recorded approximately \$22.7 million of goodwill (all of which is tax deductible) which relates to expected synergies from establishing a market presence in Georgia and South Carolina, the experience and knowledge of the acquired workforce and the capital efficient operating structure of the business acquired. The remaining basis of the \$108.0 million is almost entirely comprised of the fair value of the acquired inventory with limited other assets and liabilities.

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 included in our consolidated balance sheet in Prepaids, other assets and goodwill.

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

| | West | Central | East | Financial Services | Corporate | Total |
|------------------------------|------|---------|----------|--------------------|-----------|----------|
| Balance at December 31, 2014 | — | — | 32,962 | — | — | 32,962 |
| Additions | — | — | — | — | — | — |
| Impairments | — | — | — | — | — | — |
| Balance at June 30, 2015 | \$— | \$— | \$32,962 | \$— | \$— | \$32,962 |

NOTE 10 — STOCKHOLDERS' EQUITY

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

| | Six Months Ended June 30, 2015 (In thousands) | | | | |
|---|--|-----------------|----------------------------------|----------------------|-------------|
| | Number of Shares | Common Stock | Additional Paid-In Capital | Retained Earnings | Total |
| Balance at December 31, 2014 | 39,147 | \$391 | \$538,788 | \$570,310 | \$1,109,489 |
| Net earnings | — | — | — | 45,533 | 45,533 |
| Exercise/vesting of equity awards | 514 | 6 | 2,833 | — | 2,839 |
| Excess income tax benefit from stock-based awards | — | — | 2,012 | — | 2,012 |
| Equity award compensation expense | — | — | 8,465 | — | 8,465 |
| Balance at June 30, 2015 | 39,661 | \$397 | \$552,098 | \$615,843 | \$1,168,338 |
| | | | | | |
| | Six Months Ended June 30, 2014 (In thousands) | | | | |
| | Number of Shares | Common Stock | Additional Paid-In Capital | Retained Earnings | Total |
| Balance at December 31, 2013 | 36,244 | \$362 | \$412,961 | \$428,069 | \$841,392 |
| Net earnings | — | — | — | 60,456 | 60,456 |
| Exercise/vesting of equity awards | 348 | 4 | 703 | — | 707 |
| Excess income tax benefit from stock-based awards | — | — | 2,194 | — | 2,194 |
| Equity award compensation expense | — | — | 5,264 | — | 5,264 |
| Issuance of stock (1) | 2,530 | 25 | 110,395 | — | 110,420 |
| Other | — | \$— | \$(114) | \$— | \$(114) |
| Balance at June 30, 2014 | 39,122 | \$391 | \$531,403 | \$488,525 | \$1,020,319 |

(1) In January 2014, we issued 2,530,000 shares of common stock in a secondary public offering, par value \$0.01 per share, at a price of \$45.75 per share.

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 was amended and restated effective May 2014. 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 10,050,000 shares of common stock, of which 1,076,123 shares remain available for grant at June 30, 2015. 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, with a three-year cliff vesting for 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 and recorded on a straight-line basis through the end of the award's 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 (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|---------|---------------------------|---------|
| | 2015 | 2014 | 2015 | 2014 |
| Stock-based compensation expense | 3,835 | \$2,853 | \$8,465 | \$5,264 |
| Non-vested shares granted | 15,000 | 19,400 | 403,787 | 374,683 |
| Performance-based non-vested shares granted | — | — | 66,187 | 52,083 |
| Stock options exercised | 200 | — | 143,640 | 40,245 |
| Restricted stock awards vested (includes performance-based awards) | 44,134 | 7,220 | 370,204 | 307,390 |

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

| | As of | |
|---|---------------|-------------------|
| | June 30, 2015 | December 31, 2014 |
| Unrecognized stock-based compensation cost | \$25,868 | \$20,577 |
| Weighted average years expense recognition period | 2.68 | 2.11 |
| Total equity awards outstanding (1) | 1,137,554 | 1,255,714 |

(1) Includes options outstanding and unvested restricted stock and performance-based awards 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 deferral opportunities 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 or six months ended June 30, 2015 or 2014.

NOTE 12 — INCOME TAXES

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------|-----------------------------|----------|---------------------------|----------|
| | 2015 | 2014 | 2015 | 2014 |
| Federal | \$11,767 | \$17,976 | \$19,427 | \$30,858 |
| State | 514 | 2,181 | 1,751 | 3,680 |
| Total | \$12,281 | \$20,157 | \$21,178 | \$34,538 |

The effective tax rate for the three and six months ended June 30, 2015 was 29.7% and 31.7%, respectively, and for the three and six months ended June 30, 2014 was 36.5% and 36.4%, respectively. Our tax rate has been favorably impacted in both periods by the homebuilding manufacturing deduction and in 2015 there was a favorable impact from additional estimated federal energy tax credits related to prior tax years. The 2014 impact from such credits was fully recognized in the fourth quarter of 2014. In the second quarter of 2015, there was also a favorable impact from a state tax rate reduction in Texas due to a change in law.

At June 30, 2015 and December 31, 2014, we have no unrecognized tax benefits due to the lapse of the statute 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. In accordance with ASC 740-10, Income Taxes ("ASC 740"), we determine our deferred tax assets and liabilities by taxing jurisdiction. 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 carryforward periods, experiences with operating losses and experiences of utilizing tax credit carryforwards and tax planning alternatives. We have no valuation allowance on our deferred tax assets and NOL carryovers at June 30, 2015.

At June 30, 2015, we had no remaining federal NOL carryforward or federal tax credits. At June 30, 2015, we had tax benefits for state NOL carryforwards of \$4.6 million, unchanged from December 31, 2014, that begin to expire in 2015 depending on the state jurisdiction.

At June 30, 2015, we have income taxes payable of \$0.4 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 in the accompanying unaudited balance sheet at June 30, 2015.

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 2010. We have one state income tax examination pending resolution at this time.

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 June 30, 2015 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):

| | Six Months Ended June 30, | |
|--|---------------------------|-----------|
| | 2015 | 2014 |
| Cash paid during the period for: | | |
| Interest, net of interest capitalized | \$4,061 | \$2,413 |
| Income taxes | \$27,227 | \$41,519 |
| Non-cash operating activities: | | |
| Real estate not owned (decrease)/increase | \$(4,999 |) \$4,710 |
| Real estate acquired through notes payable | \$7,143 | \$1,043 |

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 a reporting segment based on similar long-term economic characteristics and geographical proximity. Our current reportable homebuilding segments are as follows:

| | |
|----------|--|
| West: | Arizona, California and Colorado |
| Central: | Texas |
| East: | Florida, Georgia, North Carolina, South Carolina and Tennessee |

Management's evaluation of segment performance is based on segment operating income, which we define as 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 June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-----------|---------------------------|-----------|
| | 2015 | 2014 | 2015 | 2014 |
| Homebuilding revenue (1): | | | | |
| West | \$219,774 | \$231,965 | \$426,652 | \$424,646 |
| Central | 179,475 | 160,143 | 333,501 | 279,858 |
| East | 198,552 | 113,496 | 356,360 | 209,445 |
| Consolidated total | \$597,801 | \$505,604 | \$1,116,513 | \$913,949 |
| Homebuilding segment operating income: | | | | |
| West | \$15,256 | \$27,384 | \$29,453 | \$52,194 |
| Central | 21,053 | 18,720 | 35,158 | 28,189 |
| East | 15,959 | 10,580 | 21,578 | 21,244 |
| Total homebuilding segment operating income | 52,268 | 56,684 | 86,189 | 101,627 |
| Financial services segment profit | 4,136 | 3,617 | 7,916 | 6,642 |
| Corporate and unallocated costs (2) | (10,336 |) (7,357 |) (19,878 |) (13,333 |
| Loss from unconsolidated entities, net | (169 |) (61 |) (292 |) (230 |
| Interest expense | (4,621 |) (1,396 |) (7,775 |) (4,109 |
| Other income, net | 136 | 3,749 | 551 | 4,397 |
| Net earnings before income taxes | \$41,414 | \$55,236 | \$66,711 | \$94,994 |

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------|-----------------------------|---------|---------------------------|---------|
| | 2015 | 2014 | 2015 | 2014 |
| Land closing revenue: | | | | |
| West | \$— | \$— | \$— | \$1,050 |
| Central | 5,078 | 581 | 6,517 | 2,097 |
| East | 1,696 | 2,223 | 1,696 | 2,223 |
| Total | \$6,774 | \$2,804 | \$8,213 | \$5,370 |

(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 June 30, 2015 | | | | | |
|--|----------------------|-----------|------------|--------------------|---------------------------|-------------|
| | West | Central | East | Financial Services | Corporate and Unallocated | Total |
| Deposits on real estate under option or contract | \$31,983 | \$33,510 | \$26,592 | \$— | \$— | \$92,085 |
| Real estate | 1,008,212 | 480,194 | 538,658 | — | — | 2,027,064 |
| Investments in unconsolidated entities | 204 | 8,552 | — | — | 1,547 | 10,303 |
| Other assets | 45,621 | 75,576 | (1) 83,185 | (2) 1,033 | 251,802 | (3) 457,217 |
| Total assets | \$1,086,020 | \$597,832 | \$648,435 | \$1,033 | \$253,349 | \$2,586,669 |
| | At December 31, 2014 | | | | | |
| | West | Central | East | Financial Services | Corporate and Unallocated | Total |
| Deposits on real estate under option or contract | \$34,622 | \$31,317 | \$29,050 | \$— | \$— | \$94,989 |
| Real estate | 943,600 | 446,208 | 487,874 | — | — | 1,877,682 |
| Investments in unconsolidated entities | 204 | 8,561 | — | — | 2,015 | 10,780 |
| Other assets | 48,120 | 80,689 | (1) 70,036 | (2) 958 | 132,884 | (3) 332,687 |
| Total assets | \$1,026,546 | \$566,775 | \$586,960 | \$958 | \$134,899 | \$2,316,138 |

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

(2) Balance consists primarily of goodwill (see Note 9) and cash.

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

NOTE 15 — COMMITMENTS AND CONTINGENCIES

We are involved in various routine legal proceedings incidental to our business, some of which are covered by insurance. With respect to most pending litigation matters, our ultimate legal and financial responsibility, if any, cannot be estimated with certainty and our actual future expenditure to resolve those matters could prove to be different from the amount that we accrued or reserved. On a quarterly basis, our senior management and legal team conduct an in-depth review of all active legal claims and litigation matters and we record a legal or warranty accrual representing the estimated total expense required to resolve each such matter. As of June 30, 2015, we have reserved approximately \$15.5 million related to non-warranty related litigation and asserted claims. In addition, our \$22.0 million warranty reserve includes accruals for all warranty and construction defect claims that are similarly recorded in an amount we believe will be necessary to resolve those warranty and construction defect claims. Except as may be specifically disclosed herein, we currently believe that any reasonably possible additional losses from existing claims and litigation in excess of our existing reserves and accruals would be immaterial, individually and in the aggregate, to our financial results.

Joint Venture Litigation

Since 2008, we have been involved in litigation initiated by the lender group for a large Nevada-based land acquisition and unconsolidated development joint venture in which the lenders were seeking damages in two separate actions on the basis of enforcement of completion guarantees and other related claims (JP Morgan Chase Bank, N.A. v. KB HOME Nevada, et al., U.S. District Court, District of Nevada (Case No. 08-CV-01711 PMP Consolidated)). Our interest in this joint venture is comparatively small, totaling 3.53%, but we have vigorously defended and otherwise sought resolution of these actions. We are 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 we contend, 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. Pursuant to the lenders' request and stipulation of the parties, on January 23, 2012, the Court dismissed without prejudice all of the lenders' claims against Meritage in this consolidated lawsuit.

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 claim that the involuntary bankruptcy filed by three of the co-lenders triggered the springing repayment guarantee. We do not believe the lenders have an enforceable position associated with their \$13.2 million claim and do not believe we should be required to pay such amount because, among other reasons, 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 and we do not believe the repayment guarantee was triggered by the lenders' filing of the involuntary bankruptcy. As a result, on August 19, 2011, we filed a lawsuit against JP Morgan Chase Bank, NA ("JP Morgan") in the Court of Common Pleas in Franklin County, Ohio (Case No. 11CVH0810353) regarding the repayment guarantee. In reaction to that lawsuit, on August 25, 2011, JP Morgan filed a lawsuit against us in the US District Court of Nevada, which is currently being prosecuted in the name of JP Morgan's agent, ISG Insolvency Group, Inc. regarding most of the same issues addressed in the Ohio litigation (Case No. 2:11-CV-01364-PMP). The Ohio and the Nevada actions have been consolidated into a single action. On October 26, 2011, the Bankruptcy Court approved a Plan pursuant to which (i) the lenders have received all payments to which they are entitled, (ii) the project has been conveyed to Inspirada Builders, LLC, which is an entity owned by four of the co-venturers in the South Edge entity (KB Home, Toll Brothers, Pardee Homes and Beazer Homes), and (iii) the four co-venturer builders claim to have succeeded to the lenders' repayment guarantee claim against Meritage.

On September 4, 2012, the Court ruled on a motion for summary judgment that JP Morgan has standing to pursue its repayment guarantee claims against Meritage, and that Meritage was liable thereunder to JP Morgan and that the parties should be permitted to conduct discovery with respect to the amount of damages to which JP Morgan is entitled under the repayment guarantee. Following limited discovery, JP Morgan filed a motion for summary judgment with respect to damages, and on June 17, 2013 the Court granted the motion, ruling that Meritage owes JP Morgan \$15,053,857. Later, on July 8, 2013, the Court entered Judgment in favor of JP Morgan in the amount of \$15,753,344, which included an additional \$699,487 for prejudgment interest that accrued between December 6, 2012 and the date of the judgment. We immediately appealed the Court's rulings, which is still currently pending and on July 17, 2013 we posted a supersedeas bond in the amount of \$16,050,604 staying enforcement of the judgment. Pursuant to a stipulation between the parties, the bond amount included the amount of the judgment and additional sums for a potential award of post-judgment interest and attorneys' fees on appeal. On February 14, 2014, the Court awarded JP Morgan an additional \$877,241 for pre-judgment attorneys' fees. Meritage has appealed this judgment as well, and per stipulation of the parties, has posted an amended bond in the total amount of \$16,930,477 covering both judgments. We disagree with many of the conclusions and findings contained in the Court's order and have appealed the ruling, which appeal is currently pending. In addition, we believe that the four co-venturers in the South Edge entity (KB Home, Toll Brothers, Pardee Homes and Beazer Homes) are liable to Meritage for any amounts that Meritage may ultimately be required to pay under the repayment guarantee, and we have filed claims against those builders to, among other things, recover from them any such amounts.

In March 2012, Inspirada Builders, LLC, (an entity owned by the above named four co-venturers) as Estate Representative of bankrupt South Edge, LLC (the original joint venture) filed demand for arbitration in the United States Bankruptcy Court in the District of Nevada against Meritage Homes of Nevada, Inc. There were two main demands against us contained in this filing. The first is a demand for \$13.5 million, relating to alleged breaches of the Operating Agreement of South Edge, LLC, for not paying the amounts Meritage fully tendered but South Edge (at the direction of, or as a result of acts or of the failure to perform by, the above named co-venture members) rejected in 2008. The second demand was for \$9.8 million relating to our supposed pro rata share of alleged future infrastructure improvement costs to be incurred by Inspirada Builders, LLC (which is the new owner of the project and which is owned by the four builders identified above) having purchased it through bankruptcy proceedings. The second demand was dismissed on June 27, 2013. The \$13.5 million claim identified above represents the same alleged obligation that is the subject of the repayment guarantee litigation between us and JP Morgan that is described above. Meritage has filed a response to Inspirada Builders' arbitration claims denying liability, and we have asserted cross-claims against the four above-named co-venture builders for breach of contract, breach of the implied covenant of good faith and fair dealing, and indemnity. The balance of the parties' arbitration claims are currently pending but pursuant to a stipulation of the parties have been stayed pending resolution of our pending appeal of the Court's rulings in favor of JP Morgan in the federal court action. We do not believe there is any additional exposure to us related to this arbitration claim beyond that already disclosed and discussed above.

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; that closings may be delayed due to recent severe weather; 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, including our exposure to joint ventures that are in default of their debt or guarantee agreements; expectations regarding our industry and our business for the remainder of 2015 and beyond; that we anticipate growth in new communities in 2015; the impact on gross margins of purchase price adjustments relating to the Legendary acquisition; demographic and other trends related to the homebuilding industry in general; 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 (including the joint venture litigation relating to the South Edge/Inspirada joint venture) 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, construction costs and gross margins, gross profit, revenues, net earnings, operating leverage, backlog, 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; the impact of new accounting standards and changes in accounting estimates; 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 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 our homebuyers; the ability of our potential buyers to sell their existing homes; cancellation rates and home prices in our markets; weakness in the homebuilding market resulting from an unexpected setback in the current economic recovery due to lower oil prices and other factors; inflation in the cost of materials used to develop communities and construct homes; the adverse effect of slower order absorption rates; potential write-downs or write-offs of assets; changes in tax laws; 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 ability to successfully integrate acquired companies and achieve anticipated benefits from these acquisitions; our potential exposure to natural disasters or severe weather conditions; competition; construction defect and home warranty claims; adverse legal rulings; 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; changes in or our failure to comply with laws and regulations; limitations of geographic diversification; fluctuations in quarterly operating results; our financial leverage and level of indebtedness and our ability to take certain actions because of restrictions contained in the indentures for our senior notes and our ability to raise additional capital when and if needed; our credit ratings; successful integration of future acquisitions; our compliance with government regulations and the effect of legislative or other initiatives that seek to restrain growth or new housing construction or similar measures; acts of war; the replication of our "Green" 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, 2014 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.

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

Overview and Outlook

During the three months ended June 30, 2015, the new home market has continued to benefit from job growth, increasing consumer confidence and historically low interest rates. We have been successful over the past several quarters in capitalizing on this environment by broadening our position across many of the top housing markets in the country both through acquisitions and through organic expansion of our existing operations. We remain committed to our plan of strategically positioning ourselves and actively sourcing land in well-located communities within those top markets.

Summary Company Results

Total home closing revenue was \$591.0 million and \$1.1 billion for the three and six months ended June 30, 2015, respectively representing 17.5% and 22.0% increases over the respective prior year periods. This revenue growth helped partially offset lower margins and increased overhead expenses, generating net income of \$29.1 million and \$45.5 million for the three and six months ended June 30, 2015, respectively as compared to \$35.1 million and \$60.5 million for the same periods in 2014. While home closing revenues were boosted from more closing units and higher average sales prices, the lower net income for both the three and six months ended June 30, 2015 was partially due to higher land costs leading to lower gross margins on closings versus the prior year. In addition, as the East Region has increased its relative contribution to our consolidated results its lower margins are impacting our 2015 gross margins and net income to a greater degree as compared to the prior year periods. Our East Region is primarily comprised of newly-acquired or start up divisions that have not yet achieved the benefits of reaching full operating scale and overhead leverage, generally earning lower margins compared to our established divisions. Additionally, our West region has experienced a year-over-year decline for both the three and six months ended June 30, 2015 in gross margin largely due to rising land costs. The Region is also still feeling the impact of the 2014 slowdown in the Arizona market. That slow down led to a temporary reduction in demand and average sales prices, therefore temporarily reducing margins as we close the homes that were sold during that 2014 period.

We experienced consolidated year-over-year growth in closings, orders and backlog, in both units and value for both the three and six months ended June 30, 2015. The overall unit increases are largely attributable to our market expansion through our recent acquisitions in Georgia and South Carolina, where we have no comparable prior year results. We ended the second quarter of 2015 with 3,188 homes in backlog, valued at \$1.3 billion, 25.1% and 36.3% increases over June 30, 2014, respectively. Increased community count that generated 8.5 orders per average community for the three months ended June 30, 2015, combined with higher average sales prices are largely responsible for the increases in ending backlog. Our average sales price for homes in backlog increased 8.9% to \$406,800 at June 30, 2015 from \$373,500 at June 30, 2014, primarily due to overall strong market conditions as well growth in markets that generally demand higher prices such as Florida, California and Colorado. Those three states experienced 60.0%, 28.1% and 23.1% average community count increases quarter over quarter, respectively. Our cancellation rate on sales orders as a percentage of gross sales in the second quarter of 2015 remains below historical levels at 11% as compared to 13% for the second quarter of 2014, reflecting a high quality backlog and increased consumer confidence in the homebuilding market.

Company Positioning

We remain focused on our main goals of growing our orders and gross margin while controlling overhead costs and maintaining a strong balance sheet. To help meet these goals, we continue to focus on the following initiatives:

- Expanding market share in our smaller markets;
- Fully integrating newly acquired divisions into our operating model;
- Generating additional revenue and improving overhead operating leverage in all of our markets;
- Generating additional working capital and maintaining adequate liquidity;
- Continuing to actively acquire and develop lots in key markets in order to maintain and grow our lot supply and active community count;
-

Increasing orders pace through the use of our consumer and market research to build homes that offer our buyers their desired features and amenities;

• Managing cost increases through national and regional vendor relationships with a focus on quality construction and warranty management;

• Continuing to innovate and promote the Meritage Green energy efficiency program to drive sales;

• Adapting sales and marketing efforts to increase traffic and compete with both resale and new homes;

•Actively monitoring our sales, construction and closing processes through customer satisfaction survey scores; and
•Promoting a positive environment for our employees in order to minimize turnover and retain our employees.

We believe that our investments in new communities in strategic locations and new markets and our industry leading energy efficient product offerings create a differentiated strategy that has aided us in our growth. During the first six months of 2015, we opened 27 new communities while closing out 16 communities, ending the quarter with 240 active communities, up from prior year end and the first quarter of 2015. In addition, we grew active community count year-over-year by 28.8%, largely the result of our acquisition of Legendary Communities. We anticipate continued growth in the number of new communities coming on line as we move forward throughout 2015.

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 three and six months ended June 30, 2015 compared to those disclosed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our 2014 Annual Report on Form 10-K.

Home Closing Revenue, Home Orders and Order Backlog

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

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

| | Three Months Ended June | | Quarter over Quarter | | |
|------------------------|-------------------------|-----------|----------------------|--------|---|
| | 30, 2015 | 2014 | Chg \$ | Chg % | |
| Home Closing Revenue | | | | | |
| Total | | | | | |
| Dollars | \$591,027 | \$502,800 | \$88,227 | 17.5 | % |
| Homes closed | 1,556 | 1,368 | 188 | 13.7 | % |
| Average sales price | \$379.8 | \$367.5 | \$12.3 | 3.3 | % |
| West Region | | | | | |
| Arizona | | | | | |
| Dollars | \$71,878 | \$84,606 | \$(12,728) | (15.0) | % |
| Homes closed | 229 | 252 | (23) | (9.1) | % |
| Average sales price | \$313.9 | \$335.7 | \$(21.8) | (6.5) | % |
| California | | | | | |
| Dollars | \$95,763 | \$95,067 | \$696 | 0.7 | % |
| Homes closed | 176 | 185 | (9) | (4.9) | % |
| Average sales price | \$544.1 | \$513.9 | \$30.2 | 5.9 | % |
| Colorado | | | | | |
| Dollars | \$52,133 | \$52,292 | \$(159) | (0.3) | % |
| Homes closed | 113 | 115 | (2) | (1.7) | % |
| Average sales price | \$461.4 | \$454.7 | \$6.7 | 1.5 | % |
| West Region Totals | | | | | |
| Dollars | \$219,774 | \$231,965 | \$(12,191) | (5.3) | % |
| Homes closed | 518 | 552 | (34) | (6.2) | % |
| Average sales price | \$424.3 | \$420.2 | \$4.1 | 1.0 | % |
| Central Region - Texas | | | | | |
| Central Region Totals | | | | | |
| Dollars | \$174,397 | \$159,562 | \$14,835 | 9.3 | % |
| Homes closed | 509 | 524 | (15) | (2.9) | % |
| Average sales price | \$342.6 | \$304.5 | \$38.1 | 12.5 | % |
| East Region | | | | | |
| Florida | | | | | |
| Dollars | \$91,491 | \$60,732 | \$30,759 | 50.6 | % |
| Homes closed | 210 | 155 | 55 | 35.5 | % |
| Average sales price | \$435.7 | \$391.8 | \$43.9 | 11.2 | % |
| Georgia | | | | | |
| Dollars | \$13,057 | N/A | N/M | N/M | |
| Homes closed | 42 | N/A | N/M | N/M | |
| Average sales price | \$310.9 | N/A | N/M | N/M | |
| North Carolina | | | | | |
| Dollars | \$50,214 | \$36,127 | \$14,087 | 39.0 | % |

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| | | | | | |
|----------------------|----------------------|-----------|----------|--------|----|
| Homes closed | 135 | 89 | 46 | 51.7 | % |
| Average sales price | \$372.0 | \$405.9 | \$(33.9 |) (8.4 |)% |
| South Carolina | | | | | |
| Dollars | \$27,258 | N/A | N/M | N/M | |
| Homes closed | 91 | N/A | N/M | N/M | |
| Average sales price | \$299.5 | N/A | N/M | N/M | |
| Tennessee | | | | | |
| Dollars | \$14,836 | \$14,414 | \$422 | 2.9 | % |
| Homes closed | 51 | 48 | 3 | 6.3 | % |
| Average sales price | \$290.9 | \$300.3 | \$(9.4 |) (3.1 |)% |
| East Region Totals | | | | | |
| Dollars | \$196,856 | \$111,273 | \$85,583 | 76.9 | % |
| Homes closed | 529 | 292 | 237 | 81.2 | % |
| Average sales price | \$372.1 | \$381.1 | \$(9.0 |) (2.4 |)% |
| N/A – Not Applicable | N/M - Not Meaningful | | | | |

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| | Six Months Ended June 30, | | Quarter over Quarter | | |
|------------------------|---------------------------|-----------|----------------------|--------|----|
| | 2015 | 2014 | Chg \$ | Chg % | |
| Home Closing Revenue | | | | | |
| Total | | | | | |
| Dollars | \$1,108,300 | \$908,579 | \$199,721 | 22.0 | % |
| Homes closed | 2,891 | 2,477 | 414 | 16.7 | % |
| Average sales price | \$383.4 | \$366.8 | \$16.6 | 4.5 | % |
| West Region | | | | | |
| Arizona | | | | | |
| Dollars | \$134,479 | \$156,388 | \$(21,909) | (14.0) |)% |
| Homes closed | 415 | 463 | (48) | (10.4) |)% |
| Average sales price | \$324.0 | \$337.8 | \$(13.8) | (4.1) |)% |
| California | | | | | |
| Dollars | \$182,186 | \$174,994 | \$7,192 | 4.1 | % |
| Homes closed | 329 | 350 | (21) | (6.0) |)% |
| Average sales price | \$553.8 | \$500.0 | \$53.8 | 10.8 | % |
| Colorado | | | | | |
| Dollars | \$109,987 | \$92,214 | \$17,773 | 19.3 | % |
| Homes closed | 241 | 204 | 37 | 18.1 | % |
| Average sales price | \$456.4 | \$452.0 | \$4.4 | 1.0 | % |
| West Region Totals | | | | | |
| Dollars | \$426,652 | \$423,596 | \$3,056 | 0.7 | % |
| Homes closed | 985 | 1,017 | (32) | (3.1) |)% |
| Average sales price | \$433.1 | \$416.5 | \$16.6 | 4.0 | % |
| Central Region - Texas | | | | | |
| Central Region Totals | | | | | |
| Dollars | \$326,984 | \$277,761 | \$49,223 | 17.7 | % |
| Homes closed | 949 | 927 | 22 | 2.4 | % |
| Average sales price | \$344.6 | \$299.6 | \$45.0 | 15.0 | % |
| East Region | | | | | |
| Florida | | | | | |
| Dollars | \$164,322 | \$127,829 | \$36,493 | 28.5 | % |
| Homes closed | 387 | 318 | 69 | 21.7 | % |
| Average sales price | \$424.6 | \$402.0 | \$22.6 | 5.6 | % |
| Georgia | | | | | |
| Dollars | \$28,515 | N/A | N/M | N/M | |
| Homes closed | 94 | N/A | N/M | N/M | |
| Average sales price | \$303.4 | N/A | N/M | N/M | |
| North Carolina | | | | | |
| Dollars | \$85,189 | \$58,706 | \$26,483 | 45.1 | % |
| Homes closed | 224 | 144 | 80 | 55.6 | % |
| Average sales price | \$380.3 | \$407.7 | \$(27.4) | (6.7) |)% |
| South Carolina | | | | | |
| Dollars | \$51,818 | N/A | N/M | N/M | |
| Homes closed | 167 | N/A | N/M | N/M | |
| Average sales price | \$310.3 | N/A | N/M | N/M | |
| Tennessee | | | | | |
| Dollars | \$24,820 | \$20,687 | \$4,133 | 20.0 | % |

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| | | | | | |
|----------------------|----------------------|-----------|-----------|-------|----|
| Homes closed | 85 | 71 | 14 | 19.7 | % |
| Average sales price | \$292.0 | \$291.4 | \$0.6 | 0.2 | % |
| East Region Totals | | | | | |
| Dollars | \$354,664 | \$207,222 | \$147,442 | 71.2 | % |
| Homes closed | 957 | 533 | 424 | 79.5 | % |
| Average sales price | \$370.6 | \$388.8 | \$(18.2) | (4.7) |)% |
| N/A – Not Applicable | N/M - Not Meaningful | | | | |

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| | Three Months Ended June | | Quarter over Quarter | | |
|------------------------|-------------------------|-----------|----------------------|--------|----|
| | 30, 2015 | 2014 | Chg \$ | Chg % | |
| Home Orders (1) | | | | | |
| Total | | | | | |
| Dollars | \$775,815 | \$618,435 | \$157,380 | 25.4 | % |
| Homes ordered | 1,986 | 1,647 | 339 | 20.6 | % |
| Average sales price | \$390.6 | \$375.5 | \$15.1 | 4.0 | % |
| West Region | | | | | |
| Arizona | | | | | |
| Dollars | \$102,714 | \$77,372 | \$25,342 | 32.8 | % |
| Homes ordered | 320 | 239 | 81 | 33.9 | % |
| Average sales price | \$321.0 | \$323.7 | \$(2.7) | (0.8) |)% |
| California | | | | | |
| Dollars | \$131,814 | \$107,608 | \$24,206 | 22.5 | % |
| Homes ordered | 237 | 205 | 32 | 15.6 | % |
| Average sales price | \$556.2 | \$524.9 | \$31.3 | 6.0 | % |
| Colorado | | | | | |
| Dollars | \$84,421 | \$64,491 | \$19,930 | 30.9 | % |
| Homes ordered | 181 | 140 | 41 | 29.3 | % |
| Average sales price | \$466.4 | \$460.7 | \$5.7 | 1.2 | % |
| West Region Totals | | | | | |
| Dollars | \$318,949 | \$249,471 | \$69,478 | 27.9 | % |
| Homes ordered | 738 | 584 | 154 | 26.4 | % |
| Average sales price | \$432.2 | \$427.2 | \$5.0 | 1.2 | % |
| Central Region - Texas | | | | | |
| Central Region Totals | | | | | |
| Dollars | \$224,195 | \$240,463 | \$(16,268) | (6.8) |)% |
| Homes ordered | 635 | 718 | (83) | (11.6) |)% |
| Average sales price | \$353.1 | \$334.9 | \$18.2 | 5.4 | % |
| East Region | | | | | |
| Florida | | | | | |
| Dollars | \$92,663 | \$67,891 | \$24,772 | 36.5 | % |
| Homes ordered | 218 | 180 | 38 | 21.1 | % |
| Average sales price | \$425.1 | \$377.2 | \$47.9 | 12.7 | % |
| Georgia | | | | | |
| Dollars | \$16,690 | N/A | N/M | N/M | |
| Homes ordered | 53 | N/A | N/M | N/M | |
| Average sales price | \$314.9 | N/A | N/M | N/M | |
| North Carolina | | | | | |
| Dollars | \$72,667 | \$43,062 | \$29,605 | 68.7 | % |
| Homes ordered | 181 | 102 | 79 | 77.5 | % |
| Average sales price | \$401.5 | \$422.2 | \$(20.7) | (4.9) |)% |
| South Carolina | | | | | |
| Dollars | \$29,473 | N/A | N/M | N/M | |
| Homes ordered | 99 | N/A | N/M | N/M | |
| Average sales price | \$297.7 | N/A | N/M | N/M | |

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| | | | | | |
|----------------------|----------------------|-----------|-----------|--------|----|
| Tennessee | | | | | |
| Dollars | \$21,178 | \$17,548 | \$3,630 | 20.7 | % |
| Homes ordered | 62 | 63 | (1 |) (1.6 |)% |
| Average sales price | \$341.6 | \$278.5 | \$63.1 | 22.7 | % |
| East Region Totals | | | | | |
| Dollars | \$232,671 | \$128,501 | \$104,170 | 81.1 | % |
| Homes ordered | 613 | 345 | 268 | 77.7 | % |
| Average sales price | \$379.6 | \$372.5 | \$7.1 | 1.9 | % |
| N/A – Not Applicable | N/M - Not Meaningful | | | | |

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| | Six Months Ended June 30, | | Quarter over Quarter | | |
|------------------------|---------------------------|-------------|----------------------|--------|----|
| | 2015 | 2014 | Chg \$ | Chg % | |
| Home Orders (1) | | | | | |
| Total | | | | | |
| Dollars | \$1,558,627 | \$1,173,475 | \$385,152 | 32.8 | % |
| Homes ordered | 3,965 | 3,172 | 793 | 25.0 | % |
| Average sales price | \$393.1 | \$369.9 | \$23.2 | 6.3 | % |
| West Region | | | | | |
| Arizona | | | | | |
| Dollars | \$193,305 | \$153,019 | \$40,286 | 26.3 | % |
| Homes ordered | 608 | 467 | 141 | 30.2 | % |
| Average sales price | \$317.9 | \$327.7 | \$(9.8) | (3.0) |)% |
| California | | | | | |
| Dollars | \$309,911 | \$227,660 | \$82,251 | 36.1 | % |
| Homes ordered | 547 | 442 | 105 | 23.8 | % |
| Average sales price | \$566.6 | \$515.1 | \$51.5 | 10.0 | % |
| Colorado | | | | | |
| Dollars | \$169,828 | \$119,249 | \$50,579 | 42.4 | % |
| Homes ordered | 370 | 264 | 106 | 40.2 | % |
| Average sales price | \$459.0 | \$451.7 | \$7.3 | 1.6 | % |
| West Region Totals | | | | | |
| Dollars | \$673,044 | \$499,928 | \$173,116 | 34.6 | % |
| Homes ordered | 1,525 | 1,173 | 352 | 30.0 | % |
| Average sales price | \$441.3 | \$426.2 | \$15.1 | 3.5 | % |
| Central Region - Texas | | | | | |
| Central Region Totals | | | | | |
| Dollars | \$409,327 | \$432,694 | \$(23,367) | (5.4) |)% |
| Homes ordered | 1,192 | 1,352 | (160) | (11.8) |)% |
| Average sales price | \$343.4 | \$320.0 | \$23.4 | 7.3 | % |
| East Region | | | | | |
| Florida | | | | | |
| Dollars | \$201,520 | \$132,506 | \$69,014 | 52.1 | % |
| Homes ordered | 466 | 353 | | | |