Blackstone Group L.P.
Form S-1/A
May 21, 2007

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As filed with the Securities and Exchange Commission on May 21, 2007.

Registration No. 333-141504

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 2
to

FORM S-1

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

The Blackstone Group L.P.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**6282**	20-8875684
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

345 Park Avenue
New York, New York 10154
Telephone: (212) 583-5000

(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

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Approximate date of commencement of the proposed sale of the securities to the public: **As soon as practicable after the Registration Statement is declared effective.**

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. o

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

CALCULATION OF REGISTRATION FEE

Title Of Each Class Of Securities To Be Registered	Amount to be Registered(1)	Proposed Maximum Aggregate Offering Price Per Unit(2)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Common Units Representing Limited Partner Interests	153,333,334 common units	$31.00	$4,753,333,354	$145,927(3)

(1) Includes 20,000,000 common units subject to the underwriters' option to purchase additional common units.

(2) Estimated solely for the purpose of determining the amount of the registration fee in accordance with Rule 457(a) under the Securities Act of 1933.

(3) $122,800 of which has been previously paid.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED MAY 21, 2007

PRELIMINARY PROSPECTUS

133,333,334 Common Units
Representing Limited Partner Interests

The Blackstone Group L.P. is offering all of the 133,333,334 common units representing limited partner interests in this offering. This is our initial public offering of common units and no public market currently exists for our common units. We anticipate that the initial public offering price will be between $29.00 and $31.00 per common unit. We have applied to list the common units on the New York Stock Exchange under the symbol "BX."

We have entered into an agreement with an investment vehicle established by the People's Republic of China with respect to its foreign exchange reserve that we refer to as the "State Investment Company" pursuant to which we will sell to it $3 billion of non-voting common units at a purchase price per common unit equal to 95.5% of the initial public offering price in this offering. The number of non-voting common units purchased by the State Investment Company will be reduced if necessary so that its equity interest in Blackstone remains under 10%. The sale of non-voting common units to the State Investment Company is subject to, and will close concurrently with, the completion of this offering.

We intend to use a portion of the proceeds from this offering and the sale of non-voting common units to the State Investment Company to purchase interests in our business from our existing owners, including members of our senior management.

Our founders want to make these important observations:

Our corporate private equity and real estate businesses have benefited from high levels of activity in the last few years. These activity levels may continue, but could decline at any time because of factors we cannot control.

While we believe the long-term growth trends in our businesses are favorable, there may be significant fluctuations in our financial results from quarter to quarter. Our common units should only be purchased by investors who expect to remain unitholders for a number of years.

We intend to continue to follow the management approach that has served us well as a private firm of focusing on making the right decisions about purchasing and selling the right assets at the right time and at the right prices, without regard to how those decisions affect our financial results in any given quarter.

Investing in our common units involves risks. See "Risk Factors" beginning on page 32. These risks include the following:

The Blackstone Group L.P. is managed by our general partner, which is owned by our senior managing directors. Our common unitholders will have only limited voting rights and will have no right to elect our general partner or its directors.

Immediately following this offering, our existing owners will generally have sufficient voting power to determine the outcome of those few matters that may be submitted for a vote of our limited partners, including any attempt to remove our general partner.

The partnership agreement of The Blackstone Group L.P. limits the liability of, and reduces or eliminates the duties (including fiduciary duties) owed by, our general partner to our common unitholders and restricts the remedies available to common unitholders for actions that might otherwise constitute breaches of our general partner's duties.

We depend on our founders and other key senior managing directors, and our future success and growth depends to a substantial degree on our ability to retain and motivate our senior managing directors and other key personnel and to strategically recruit, retain and motivate new talented personnel.

We believe that The Blackstone Group L.P. will be treated as a partnership for U.S. federal income tax purposes and that you therefore will be required to take into account your allocable share of items of income, gain, loss and deduction of The Blackstone Group L.P. in computing your U.S. federal income tax liability. You may not receive cash distributions equal to your allocable share of our net taxable income or even the tax liability that results from that income.

PRICE $ A COMMON UNIT

	Price to Public	Underwriting Discounts	Proceeds to The Blackstone Group L.P.
Per Common Unit	$	$	$
Total	$	$	$

We have granted the underwriters the right to purchase up to an additional 20,000,000 common units to cover over-allotments.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the common units to purchasers on or about , 2007.

Morgan Stanley **Citi**

Merrill Lynch & Co. **Credit Suisse** **Lehman Brothers**

Deutsche Bank Securities

, 2007

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You should rely only on the information contained in this prospectus or in any free writing prospectus we may authorize to be delivered to you. Neither we nor the underwriters have authorized anyone to provide you with additional or different information. We and the underwriters are offering to sell, and seeking offers to buy, our common units only in jurisdictions where offers and sales are permitted. The information in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or any sale of our common units.

Until , 2007 (25 days after the date of this prospectus), all dealers that effect transactions in our common units, whether or not participating in this offering, may be required to deliver a prospectus. This delivery requirement is in addition to the obligation of dealers to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

Except where the context requires otherwise, references in this prospectus to "Blackstone," the "Company," "we," "us" or "our" refer (1) prior to the consummation of our reorganization into a holding partnership structure as described under "Organizational Structure", to Blackstone Group, which comprises certain consolidated and combined entities under the common control and ownership of (a) our two founders, Mr. Stephen A. Schwarzman and Mr. Peter G. Peterson, and our other senior managing directors, (b) selected other individuals engaged in some of our businesses and (c) American International Group, Inc., whom we refer to collectively as our "existing owners," and (2) after our reorganization, to The Blackstone Group L.P. and its consolidated subsidiaries. References in this prospectus to the ownership of our founders and other senior managing directors and of selected other individuals engaged in some of our businesses include the ownership of current and future personal planning vehicles of these individuals. Completion of our reorganization will occur prior to this offering.

"Blackstone funds," "our funds" and "our investment funds" refer to the corporate private equity funds, real estate opportunity funds, funds of hedge funds, mezzanine funds, senior debt vehicles, proprietary hedge funds and closed-end mutual funds that are managed by Blackstone. "Our carry funds" refer to the corporate private equity funds, real estate opportunity funds and mezzanine funds that are managed by Blackstone. "Our hedge funds" refer to the funds of hedge funds and proprietary hedge funds that are managed by Blackstone.

"Assets under management" refers to the assets we manage. Our assets under management equal the sum of:

(1) the fair market value of the investments held by our carry funds plus the capital that we are entitled to call from investors in those funds pursuant to the terms of their capital commitments to those funds (plus the fair market value of co-investments arranged by us that were made by limited partners of our corporate private equity and real estate opportunity funds in portfolio companies of such funds and as to which we receive fees or a carried interest allocation);

(2) the net asset value of our funds of hedge funds, proprietary hedge funds and closed-end mutual funds; and

(3) the amount of capital raised for our senior debt vehicles.

Our calculation of assets under management may differ from the calculations of other asset managers and as a result this measure may not be comparable to similar measures presented by other asset managers. Our definition of assets under management is not based on any definition of assets under management that is set forth in the agreements governing the investment funds that we manage. See "Business Structure and Operation of Our Investment Funds Incentive Arrangements / Fee Structure".

Unless indicated otherwise, the information included in this prospectus assumes no exercise by the underwriters of the option to purchase up to an additional 20,000,000 common units from us and that the common units to be sold in this offering are sold at $30.00 per common unit, which is the midpoint of the price range indicated on the front cover of this prospectus.

SUMMARY

This summary highlights information contained elsewhere in this prospectus and does not contain all the information you should consider before investing in our common units. You should read this entire prospectus carefully, including the section entitled "Risk Factors" and the financial statements and the related notes before you decide to invest in our common units.

Blackstone

We are a leading global alternative asset manager and provider of financial advisory services. We are one of the largest independent alternative asset managers in the world, with assets under management of approximately $88.4 billion as of May 1, 2007. Our alternative asset management businesses include the management of corporate private equity funds, real estate opportunity funds, funds of hedge funds, mezzanine funds, senior debt vehicles, proprietary hedge funds and closed-end mutual funds. We also provide various financial advisory services, including mergers and acquisitions advisory, restructuring and reorganization advisory and fund placement services.

We seek to deliver superior returns to investors in our funds through a disciplined, value-oriented investment approach. We believe that this investment approach, implemented across our broad and expanding range of alternative asset classes and investment strategies, helps provide stability and predictability to our business over different economic cycles. Since we were founded in 1985, we have cultivated strong relationships with clients in our financial advisory business, where we endeavor to provide objective and insightful solutions and advice that our clients can trust. We believe our scaled, diversified businesses, coupled with our long track record of investment performance, proven investment approach and strong client relationships, position us to continue to perform well in a variety of market conditions, expand our assets under management and add complementary businesses.

We currently have 57 senior managing directors and employ approximately 340 other investment and advisory professionals at our headquarters in New York and our offices in Atlanta, Boston, Chicago, Dallas, Los Angeles, San Francisco, London, Paris, Mumbai and Hong Kong. We believe that the depth and breadth of the intellectual capital and experience of our professionals are key reasons why we have generated exceptional returns over many years for the investors in our funds. This track record in turn has allowed us to successfully and repeatedly raise additional assets from an increasingly wide variety of sophisticated investors.

We generate our income from fees earned pursuant to contractual arrangements with the investment funds that we manage, with the investors in these funds and with these funds' portfolio companies (including management, transaction and monitoring fees), as well as from fees earned for the provision of mergers and acquisitions advisory services, restructuring and reorganization advisory services and fund placement services for alternative investment funds. In most cases, we receive a preferred allocation of income (a "carried interest") or an incentive fee from an investment fund in the event that specified investment returns are achieved by the fund. In the case of our carry funds, we are generally entitled to a carried interest equal to 20% of the net realized income and gains generated by these funds (subject to an annual preferred return for the limited partner investors in these funds ranging from 7% to 9% and a "catch-up" allocation to us). For example, if a carry fund were to sufficiently exceed the preferred return threshold and generate $500 million of profits net of allocable fees and expenses from a given investment, our carried interest would entitle us to receive $100 million of these net profits. Our ability to generate carried interest and incentive fees is an important element of our business and these items have historically accounted for a very significant portion of our income.

We have grown our assets under management significantly, from approximately $14.1 billion as of December 31, 2001 to approximately $88.4 billion as of May 1, 2007, representing compound annual growth of 41.1%. The following table sets forth our assets under management by segment and fund type as of May 1, 2007.

	Assets Under Management as of May 1, 2007	
	(in billions)	
Corporate private equity funds		$ 33.08
Real estate opportunity funds		19.95
Marketable alternative asset funds		35.34
Funds of hedge funds	$ 20.03	
Mezzanine funds	1.51	
Senior debt vehicles	8.43	
Distressed securities hedge fund	1.39	
Equity hedge fund	1.80	
Closed-end mutual funds	2.18	
Total		$ 88.37

Our business is organized into four business segments:

Corporate Private Equity. We are a world leader in private equity investing, having managed five general private equity funds as well as one specialized fund focusing on media and communications-related investments. We established this business in 1987. The corporate private equity fund we are currently investing is one of the largest funds of its kind ever raised, with aggregate capital commitments of over $19.6 billion as of May 1, 2007. We pursue transactions throughout the world, including not only typical leveraged buyout acquisitions of seasoned companies but also transactions involving start-up businesses in established industries, turnarounds, minority investments, corporate partnerships and industry consolidations. Our corporate private equity business has grown assets under management significantly, from approximately $7.6 billion as of December 31, 2001 to approximately $33.1 billion as of May 1, 2007, representing compound annual growth of 31.8%. Our corporate private equity segment generated income before taxes of $1,009.9 million for the year ended December 31, 2006 and $197.8 million for the three months ended March 31, 2007.

Real Estate. Since 1991, our real estate business has been a diversified, global operation, with investments in a variety of sectors and geographic locations. We have managed six general real estate opportunity funds and two internationally focused real estate opportunity funds. Taken together, the two real estate opportunity funds we are currently investing would represent one of the largest real estate funds ever raised, with aggregate capital commitments of over $7.2 billion as of May 1, 2007. Our real estate opportunity funds have made significant investments in lodging, major urban office buildings, residential properties, distribution and warehousing centers and a variety of real estate operating companies. Our real estate business has grown assets under management significantly, from approximately $3.0 billion as of December 31, 2001 to approximately $19.9 billion as of May 1, 2007, representing compound annual growth of 42.6%. Our real estate segment generated income before taxes of $902.7 million for the year ended December 31, 2006 and $762.0 million for the three months ended March 31, 2007.

Marketable Alternative Asset Management. Our marketable alternative asset management segment, established in 1990, comprises our management of funds of hedge funds, mezzanine funds, senior debt vehicles, proprietary hedge funds and publicly-traded closed-end mutual funds. Our marketable alternative asset management segment has grown assets under management significantly, from approximately $3.5 billion as of December 31, 2001 to approximately $35.3 billion as of May 1, 2007, representing compound annual growth of 54.2%. Our marketable alternative asset management segment generated income before taxes of

$191.7 million for the year ended December 31, 2006 and $113.2 million for the three months ended March 31, 2007.

Funds of hedge funds. We manage a variety of funds of hedge funds, which are investment funds that invest in third-party hedge funds. Our funds of hedge funds are designed as risk-mitigation products that are generally expected to have relatively low volatility and limited correlation with the equity markets. The funds of hedge funds that we manage comprise a wide range of different portfolios and investment strategies, including broadly diversified funds, strategy focused funds, opportunistic funds and client customized funds. We are one of the ten largest independent fund of hedge fund managers in the world with approximately $20.0 billion in aggregate assets under management as of May 1, 2007 in a variety of fund of hedge funds vehicles, which are invested with over 180 different hedge fund managers.

Mezzanine funds. We manage funds that invest primarily in the mezzanine debt of middle-market companies arranged through privately negotiated transactions. These investments are generally structured to earn current income through interest payments and may also include return enhancements including warrants or other equity-linked securities.

Senior debt vehicles. We manage vehicles that invest primarily in senior secured loans and other debt instruments. These vehicles are of the type commonly referred to as collateralized debt obligation or collateralized loan obligation funds.

Proprietary hedge funds. We have two proprietary hedge funds:

Distressed securities hedge fund. Our distressed securities hedge fund invests primarily in distressed and defaulted debt securities and related equities, with an emphasis on smaller, less efficiently traded issues.

Equity hedge fund. Our equity hedge fund invests primarily in equity investments on a long and short basis.

Closed-end mutual funds. We are the investment manager of two publicly-traded closed-end mutual funds The India Fund, Inc. and The Asia Tigers Fund, Inc. The India Fund's investment objective is long-term capital appreciation through investing primarily in the equity securities of Indian companies. The India Fund is the largest of the two India-focused closed-end mutual funds in the United States. The Asia Tigers Fund's investment objective is long-term capital appreciation through investing primarily in the equity securities of Asian companies.

Financial Advisory. Our financial advisory segment comprises our mergers and acquisitions advisory services, restructuring and reorganization advisory services and fund placement services for alternative investment funds. From January 1, 2002 to December 31, 2006, our financial advisory business revenues have grown at a compound annual rate of 22.7%. Our financial advisory segment generated income before taxes of $193.9 million for the year ended December 31, 2006 and $73.1 million for the three months ended March 31, 2007.

Mergers and Acquisitions Advisory. Since 1985, our mergers and acquisitions advisory services operation has advised on transactions with a total value of more than $275 billion. Professionals in this area have a wide array of specialized industry knowledge and experience and provide all types of corporate and financial advisory services with a wide range of transaction execution capability.

Restructuring and Reorganization Advisory. Our restructuring and reorganization advisory operation is one of the leading advisers to companies and creditors in restructurings and bankruptcies. Since 1991, we have advised on more than 150 distressed situations, both in and out of bankruptcy proceedings, involving more than $350 billion of total liabilities.

Park Hill Group. Park Hill Group is our fund placement business. Since its inception in 2005, Park Hill Group has assisted its clients in raising a total of $45.8 billion for 21 corporate private equity, real estate, venture capital and hedge funds.

Key Aspects of Our Organizational Structure and this Offering

Organizational Structure. Prior to this offering we will effect our reorganization into a holding partnership structure described in "Organizational Structure." Following the reorganization and this offering, The Blackstone Group L.P. will be a holding partnership and, through wholly-owned subsidiaries, will hold controlling equity interests in five Blackstone Holdings partnerships (which we refer to collectively as "Blackstone Holdings"), which in turn will with limited exceptions own each of the operating entities included in our historical combined financial statements.

Each of the Blackstone Holdings partnerships will have an identical number of partnership units outstanding, and we use the terms "Blackstone Holdings partnership unit" or "partnership unit in/of Blackstone Holdings" to refer collectively to a partnership unit in each of the Blackstone Holdings partnerships. The Blackstone Group L.P. will hold, through wholly-owned subsidiaries, a number of Blackstone Holdings partnership units equal to the number of common units that The Blackstone Group L.P. has issued. Immediately following this offering and the sale of non-voting common units to the State Investment Company as described below, The Blackstone Group L.P. will hold Blackstone Holdings partnership units representing 21.9% of the total number of partnership units of Blackstone Holdings, or 23.8% if the underwriters exercise in full their option to purchase additional common units, and our existing owners will hold Blackstone Holdings partnership units representing 78.1% of the total number of partnership units of Blackstone Holdings, or 76.2% if the underwriters exercise in full their option to purchase additional common units. The Blackstone Holdings partnership units that will be held by The Blackstone Group L.P.'s wholly-owned subsidiaries will be economically identical in all respects to the Blackstone Holdings partnership units that will be held by our existing owners, except that The Blackstone Group L.P.'s wholly-owned subsidiaries will be entitled to priority allocations of income through December 31, 2009 as described under "Cash Distribution Policy". Accordingly, the income of Blackstone Holdings will benefit The Blackstone Group L.P. to the extent of its equity interest in Blackstone Holdings.

Sale of Non-Voting Common Units to the State Investment Company

We have entered into an agreement with an investment vehicle established by the People's Republic of China with respect to its foreign exchange reserve that we refer to as the "State Investment Company", pursuant to which we will sell to it $3 billion of non-voting common units at a purchase price per common unit equal to 95.5% of the initial public offering price in this offering (or 104,712,041 common units, assuming an initial public offering price per unit of $30.00). The number of non-voting common units purchased by the State Investment Company will be reduced if necessary so that its equity interest in Blackstone immediately following this offering remains under 10%, and it will be restricted in the future from purchasing common units in excess of that amount. The State Investment Company has agreed to hold the purchased common units for four years, except in certain limited circumstances such as a change of control of us or a sale by our existing owners of a 51% equity interest in our business to a single person or group. After such four-year period, the State Investment Company may sell up to one-third of its common units over each of the subsequent three years and we have agreed to provide it with registration rights to effect such sales. Unaffiliated third-party transferees of common units from the State Investment Company or its affiliates will have the same limited voting rights with respect to such common units as the investors in this offering will have.

The sale of non-voting common units to the State Investment Company is subject to, and will close concurrently with, the completion of this offering.

The State Investment Company has agreed to explore in good faith potential arrangements pursuant to which it or its affiliates would invest in or commit to fund amounts to current and future investment funds managed by us and to evaluate in good faith and consider investing in any comparable funds or vehicles offered by us in connection with any investment they make in alternative asset funds or vehicles. In addition, the State Investment Company has agreed that it and its affiliates will obtain our written consent prior to making any investment in any other firm primarily engaged in the sponsorship or management of alternative asset funds or vehicles for a year following this offering. We have agreed that if we issue a 5% equity interest in our firm to an investor during the first year following this offering, we will modify the terms of the State Investment Company's investment in us to the extent necessary so that the terms of the new investor's investment, in the aggregate, are no more favorable than those of the State Investment Company's investment.

Distributions. Our intention is to distribute to our common unitholders on a quarterly basis, commencing in the quarter of 2007, substantially all of The Blackstone Group L.P.'s net after-tax share of our annual adjusted cash flow from operations in excess of amounts determined by our general partner to be necessary or appropriate to provide for the conduct of our business, to make appropriate investments in our business and our funds, to comply with applicable law, any of our debt instruments or other agreements or to provide for future distributions to our common unitholders for any one or more of the ensuing four quarters. Because we will not know what our available adjusted cash flow from operations will be for any year until the end of such year, we expect that our first three quarterly distributions in respect of any given year will generally be smaller than the final quarterly distribution in respect of such year. The declaration and payment of any distributions will be at the sole discretion of our general partner.

We intend to cause Blackstone Holdings to make distributions to its partners, including The Blackstone Group L.P.'s wholly-owned subsidiaries, in order to fund any distributions The Blackstone Group L.P. may declare on the common units. If Blackstone Holdings makes such distributions, our existing owners, as limited partners of Blackstone Holdings, will be entitled to receive equivalent distributions pro rata based on their partnership interests in Blackstone Holdings (except that The Blackstone Group L.P.'s wholly-owned subsidiaries will be entitled to priority allocations of income through December 31, 2009 as described under "Cash Distribution Policy"). In addition, with respect to our actively investing carry funds and proprietary hedge funds as well as any future carry funds and proprietary hedge funds and senior debt vehicles, we intend to continue to allocate to the senior managing directors, other professionals and selected other individuals who work in these operations a portion of the carried interest or incentive fees earned in relation to these funds in order to better align their interests with our own and with those of the investors in these funds.

Cash distributions to our existing owners in respect of the fiscal and tax year ended December 31, 2006 are expected to be approximately $ in the aggregate (of which approximately $ has been distributed to date). Cash distributions to our existing owners in respect of the current fiscal and tax year have aggregated approximately $ to date. In connection with the reorganization, prior to this offering, we intend to make one or more distributions to our existing owners representing all of the undistributed earnings generated by the businesses to be contributed to Blackstone Holdings prior to the date of the offering. If the offering had occurred on March 31, 2007, we estimate that the aggregate amount of such distributions would have been $610.4 million. However, the actual amount of such distributions will depend on the amount of earnings generated by the contributed businesses prior to the offering.

In addition, our existing owners will receive $3.90 billion of the proceeds from this offering and the sale of non-voting common units to the State Investment Company, or approximately $4.47 billion if the underwriters exercise in full their option to purchase additional common units, as a result of our purchase from them of interests in our business at the time of this offering.

Tax Consequences. Investors in this offering will become limited partners of The Blackstone Group L.P. We believe that The Blackstone Group L.P. will be treated as a partnership and not as a corporation for U.S. federal income tax purposes. An entity that is treated as a partnership for U.S. federal income tax purposes is not a taxable entity and incurs no U.S. federal income tax liability. Instead, each partner is required to take into account its allocable share of items of income, gain, loss and deduction of the partnership in computing its U.S. federal income tax liability, regardless of whether or not cash distributions are then made. Accordingly, an investor in this offering will generally be required to pay U.S. federal income taxes with respect to the income and gain of The Blackstone Group L.P. that is allocated to such investor, even if The Blackstone Group L.P. does not make cash distributions. See "Material U.S. Federal Tax Considerations" for a summary discussing certain United States federal income tax considerations related to the purchase, ownership and disposition of our common units as of the date of this prospectus.

Deconsolidation of Blackstone Funds. Investors in our common units should note that Blackstone's corporate private equity, real estate opportunity and mezzanine funds have historically been consolidated into Blackstone's financial statements, notwithstanding that Blackstone has only a minority interest in these funds. Consequently, our historical financial statements do not reflect the net asset value of our investments in such funds, but reflect rather on a gross basis the assets, liabilities, revenues, expenses and cash flows of these funds. We intend to deconsolidate all of our funds that have historically been consolidated in our financial statements with the exception of our proprietary hedge funds and four of our funds of hedge funds. Accordingly, we will no longer record the non-controlling interests' share of these fund's partners' capital and net income. These adjustments would have changed our March 31, 2007 financial statement items as follows (based on comparing our combined historical financial information for this period to our pro forma financial information for such period): assets decrease of 76%; liabilities decrease of 25%; revenues increase of 108%; expenses increase of 491%; and non-controlling interests in income of consolidated entities increase of 90%. We believe that the deconsolidation of these funds by means of granting investors in these funds general partner removal rights or liquidation rights, as the case may be, will result in our financial statements reflecting our alternative asset management business, including our management fee, incentive fee and performance fee revenues, in a manner that reflects both how our management evaluates our business and the risks of the assets and liabilities of our firm. Accordingly, we believe that deconsolidating these funds will provide investors reviewing our financial statements an enhanced understanding of our business. Because we are initiating these steps, we are not seeking or receiving any consideration from the investors in these funds for granting them these rights. There will be no change in either our equity or net income as a result of the deconsolidation. See "Unaudited Pro Forma Financial Information" for a more detailed description of the deconsolidation of our investment funds from our financial statements.

Competitive Strengths

World Leader in Alternative Asset Management. Alternative asset management is the fastest growing segment of the asset management industry, and we are one of the largest independent alternative asset managers in the world. From the time we entered the asset management business 20 years ago through May 1, 2007, we have raised approximately $61.4 billion of committed capital for our corporate private equity funds, real estate opportunity funds, mezzanine funds and senior debt vehicles, and we managed approximately $25.4 billion in our funds of hedge funds, proprietary hedge funds and closed-end mutual funds as of May 1, 2007. Our assets under management have grown from approximately $14.1 billion as of December 31, 2001 to approximately $88.4 billion as of May 1, 2007, representing compound annual growth of 41.1%. We believe that the strength and breadth of our franchise, supported by our people, investment approach and track record of success, provide a distinct advantage when raising capital, evaluating opportunities, making investments, building value and realizing returns.

One of the Largest Managers of Corporate Private Equity and Real Estate Opportunity Funds. We have been one of the largest private equity fund managers since we entered this business in 1987. From that time through May 1, 2007, we had invested total capital of $21.4 billion in 112 transactions with a total enterprise value of approximately $199 billion through our corporate private equity funds and total capital of $13.3 billion in 214 transactions with a total enterprise value of over $102 billion through our real estate opportunity funds. Both the corporate private equity fund and the two real estate opportunity funds (taken together) we are currently investing are among the largest funds ever raised in their respective sectors, with aggregate capital commitments of $19.6 billion and $7.2 billion, respectively, as of May 1, 2007. We believe that our long-term leadership in private equity has imbued the Blackstone brand with value that enhances all of our different businesses and facilitates our ability to expand into complementary new businesses.

Diversified, Global Investment Platform. Our asset management businesses are diversified across a broad variety of alternative asset classes and investment strategies and have global reach and scale. We benefit from substantial synergies across all of these businesses, including the ability to leverage the extensive intellectual capital that resides throughout our firm. We believe that the extensive investment review process that is conducted in all of our asset management businesses, involving active participation by Stephen A. Schwarzman and Hamilton E. James across all of our businesses, is not only a significant reason for our successful investment performance but also helps to maximize those synergies. In addition, we believe our financial advisory segment further increases the diversification of our business mix.

During our 21-year history, we have grown by entering new businesses that were complementary to our existing asset management and financial advisory businesses. For example, in 1988 we entered into a partnership with the founders of Blackrock, Inc. and helped those individuals develop an asset management business specializing in fixed income. We sold our interest in Blackrock in 1994. We have invested in complementary new areas because they offered opportunities to deploy our financial and intellectual capital and generate superior investment returns, attractive net income margins and substantial cash flow. We believe that our ability to identify and successfully enter new growth areas is a key competitive advantage, and we will continue to seek new opportunities to expand our asset management franchise and our advisory business.

Exceptional Investment Track Record. We have an exceptional record of generating attractive risk-adjusted returns across all of our asset management businesses, as shown in the table below. We believe that the superior investment returns we have generated for investors in our funds over many years across a broad and expanding range of alternative asset classes and through all types of economic conditions and all cycles of the equity and debt capital markets are a key reason why we have been able to successfully and consistently grow our assets under management across our alternative asset management platform.

	Year of Inception	Combined Fund Level Annualized IRR or Return Since Inception(1)	Annualized IRR or Return, Net of Fees, Since Inception(2)
Corporate private equity	1987	30.7%	22.6%
Real estate opportunity	1991	39.7%	31.0%
Funds of hedge funds	1990	13.0%	12.0
Mezzanine	1999	17.2%	10.6%
Senior debt vehicles:			
Equity tranches	2002	23.6%(3)	16.2%(3)
Distressed securities hedge	2005	11.5%	8.0%
Equity hedge	2006	26.1%(4)	20.0%(4)
Closed-end mutual funds:			
The India Fund	2005		30.1%(5)
The Asia Tigers Fund	2005		38.2%(5)

(1) Through March 31, 2007.

(2) Through March 31, 2007. The annualized IRR or return, net of fees, of an investment fund represents the gross annualized IRR or return applicable to limited partners net of management fees, incentive fees, organizational expenses, transaction costs, partnership expenses (including interest incurred by the fund itself) and the general partner's allocation of profits, if any.

(3) Our senior debt vehicles are typically capitalized with investment grade debt and tiers of subordinated debt and equity securities, the most subordinated of which benefit from residual amounts. These most subordinated securities typically represent approximately 10% of a vehicle's total capitalization. The gross annualized return for these subordinated securities represents the gross compound annual rate of return on such subordinated securities before management fees, but after deducting interest expense and administrative expenses.

(4) Reflects returns from October 1, 2006 (the date operations commenced) through March 31, 2007 only (in contrast to all other results in the table above, which are annualized).

(5) A subsidiary of ours has been the investment manager of The India Fund and The Asia Tigers Fund since December 5, 2005. The current portfolio manager has managed The India Fund since August 1, 1997 and has managed The Asia Tigers Fund since July 1, 1999. The net annualized returns, based on net asset value, have been calculated since December 5, 2005.

See "Business The Historical Investment Performance of Our Investment Funds" for information regarding the calculation of investment returns, valuation methodology and factors affecting our investment performance. The historical information presented above and elsewhere in this prospectus with respect to the investment performance of our funds is provided for illustrative purposes only. The historical investment performance of our funds is no guarantee of future performance of our current funds or any other fund we may manage in the future.

Diverse Base of Longstanding Investors. We have a long history of raising significant amounts of capital on a global basis across a broad range of asset classes, and we believe that the strength and breadth of our relationships with institutional investors provide us with a competitive advantage in raising capital for our investment funds. During our two decades of asset management activities, we have built long-term relationships with many of the largest institutional investors in the world, most of which invest in a number of different categories of our investment funds. For example, of those of the 50 largest corporate and public pension funds in the United States as measured by assets under management that to our knowledge invest in alternative assets, approximately 72% have invested in our funds. In addition, investors representing approximately 85% of the total capital invested in all of our carry funds since 1987 have invested in successive funds in the same category. Furthermore, our investor base is highly diversified, with no single unaffiliated investor in our current corporate private equity or real estate opportunity funds accounting for more than 9% of the total amount of capital raised for those funds. Our Park Hill Group business further enables us to grow our investor base

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through its expanding network of relationships with potential investors. We believe that our strong network of investor relationships, together with our long-term track record of providing investors in our funds with superior risk-adjusted investment returns, will enable us to continue to grow our assets under management across our investment platform.

Strong Industry and Corporate Relationships. We believe that the strength of our relationships with investment banking firms, other financial intermediaries and leading corporations and corporate executives provides us with competitive advantages in identifying transactions, securing investment opportunities and generating exceptional returns. We actively cultivate our relationships with major investment banking firms and other financial intermediaries and are among the most significant clients of many of these firms. For example, our investment professionals meet regularly with investment bankers and other personnel of all of the major investment banking firms regarding potential investment opportunities, and we will often seek to work with many of the same financial institutions that we have worked with on previous transactions when seeking financing arrangements for potential investment opportunities. We believe our repeated and consistent dealings with these firms over a long period of time have led to our being one of the first parties considered for potential investment ideas and have enhanced our ability to obtain financing on more favorable terms. We believe that our strong network of relationships with these firms provide us with a significant advantage in attracting deal flow and securing transactions, including a substantial number of exclusive investment opportunities and opportunities that are made available to only a very limited number of other private equity firms. We also have a broad range of relationships with senior-level business executives whom we use to generate investment opportunities, analyze prospective investments and act as directors of and advisers to our corporate private equity and real estate opportunity funds' portfolio companies. Moreover, private equity investing in partnership with leading corporations is a signature form of investing for us. Through May 1, 2007, we had invested in 42 corporate partnerships, including transactions with AT&T Inc., General Electric Company, Northrop Grumman Corporation, Sony Corporation, Time Warner Inc., Union Carbide Corporation, Union Pacific Corporation, USX Corporation and Vivendi SA. We believe that the depth and breadth of our corporate partnerships will lead to a significant number of opportunities for our corporate private equity and real estate opportunity funds over the next several years. As a result of these various relationships, we believe that we are less reliant on auction processes in making investments than many of our competitors, thereby providing us with a wider array of attractive investment opportunities.

Our People. We believe that our senior management and our talented and experienced professionals are the principal reason why we have achieved significant growth and success in all of our businesses. Since our firm's founding in 1985, Stephen A. Schwarzman has served as our firm's Chief Executive Officer and Peter G. Peterson has served as either Chairman or Senior Chairman. Hamilton E. James serves as our President and Chief Operating Officer, oversees our corporate private equity operation directly and, along with Mr. Schwarzman, oversees and serves on the investment committees or oversight committees for all of our other businesses. Jonathan D. Gray and Chad R. Pike are senior managing directors overseeing our real estate operation. J. Tomilson Hill is our Vice Chairman and the head of our fund of hedge funds business. Howard Gellis leads our corporate debt business, John D. Dionne manages our distressed securities hedge fund, Manish Mittal manages our equity hedge fund and Punita Kumar-Sinha manages our closed-end mutual funds. Our mergers and acquisitions advisory operation is led by John Studzinski, our restructuring and reorganization advisory operation is led by Arthur B. Newman and our fund placement business is overseen by Kenneth C. Whitney. Our 57 senior managing directors have an average of 22 years of relevant experience. This team is supported by approximately 340 other professionals with a variety of backgrounds in investment banking, leveraged finance, private equity, real estate and other disciplines. We believe that the extensive experience and financial acumen of our management and professionals provide us with a significant competitive advantage.

Alignment of Interests. One of our fundamental philosophies as a privately-owned firm has been to align our interests, and those of our senior managing directors and other professionals, with the interests of the investors in our funds. Since inception, Blackstone, its senior managing directors and other professionals have committed over $2.7 billion of their own capital to our carry funds and as of May 1, 2007, our hedge funds managed an additional $2.1 billion of Blackstone's senior managing director and employee capital. In structuring this offering, we have sought to achieve the same alignment of interests between our common unitholders and our senior managing directors and other employees through their significant and long-term ownership of our equity. Our senior managing directors and other existing owners who are our employees will own in excess of 78.1% of the equity in our business immediately following this offering. In addition, we intend to make equity awards to all of our employees at the time of this offering and to use appropriate equity-based compensation to motivate and retain our professionals in the future. The equity held by our senior managing directors and other employees will be subject to vesting and minimum retained ownership requirements and transfer restrictions as described in "Organizational Structure Reorganization Blackstone Holdings Formation", "Management IPO Date Equity Awards" and " Minimum Retained Ownership Requirements and Transfer Restrictions".

Distinct Advisory Perspective. We are not engaged in securities underwriting, research or other similar activities that might conflict with our role as a trusted financial advisor. We believe that this makes us particularly well-suited to represent boards and special committees in the increasing number of situations where they are looking to retain a financial advisor who is devoid of such conflicts. In addition, we believe that our ability to view financial advisory client assignments from both the client's and an owner's perspective often provides unique insights into how best to maximize value while also achieving our clients' strategic objectives.

Our Growth Strategy

We intend to create value for our common unitholders by:

- generating superior investment performance across our asset management platform;
- growing the assets under management in our existing investment fund operations;
- expanding our asset management base by raising new investment funds;
- increasing our investment of our own capital in our funds;
- expanding our advisory business; and
- entering into complementary new businesses.

Why We Are Going Public

We have decided to become a public company:

- to access new sources of capital that we can use to invest in our existing businesses, to expand into complementary new businesses and to further strengthen our development as an enduring institution;
- to enhance our firm's valuable brand;
- to provide us with a publicly-traded equity currency and to enhance our flexibility in pursuing future strategic acquisitions;

to expand the range of financial and retention incentives that we can provide to our existing and future employees through the issuance of equity-related securities representing an interest in the value and performance of our firm as a whole; and to permit the realization over time of the value of our equity held by our existing owners.

We Intend to be a Different Kind of Public Company

We have built a leading global alternative asset management and financial advisory firm that has achieved success and substantial growth. While we believe that becoming a publicly traded company will provide us with many benefits, it is our intention to preserve the elements of our culture that have contributed to our success as a privately-owned firm. In particular, as described below, we intend to continue to manage our business with a long-term perspective, to focus at all times on seeking to optimize returns to the limited partner investors in our investment funds and to retain our partnership management structure and culture of employee ownership of our business.

Management with a Long-Term Perspective. As a privately-owned firm, Blackstone has always been managed with a perspective of achieving successful growth over the long-term. Both in entering and building our various businesses over the years and in determining the types of investments to be made by our investment funds, our management has consistently sought to focus on the best outcomes for our businesses and investments over a period of years rather than on the short-term impact on our revenue, net income or cash flow. We intend to maintain this long-term focus after we become a public company even though this approach, together with the fact that our financial results will be significantly affected by the timing of new investments and realizations of gains, may result in significant and unpredictable variances in these items from quarter to quarter. In addition, while the management fees we receive from our investment funds are payable on a regular basis in contractually prescribed amounts over the life of each fund, transaction fees earned by our corporate private equity, real estate and mezzanine operations and fees earned by our advisory business are subject to greater variability from quarter to quarter.

Our largest businesses corporate private equity and real estate have benefited greatly in recent years from public companies accepting going-private acquisition offers in order, among other reasons, to avoid the public markets' focus on short-term earnings performance. As a public company we do not intend to permit the short-term perspective of the public markets to change our own focus on the long-term in making investment, operational and strategic decisions. Because our businesses can vary in significant and unpredictable ways from quarter to quarter and year to year, we do not plan to provide guidance regarding our expected quarterly and annual operating results to investors or analysts after we become a public company.

Continued Focus on Limited Partner Investors in Our Investment Funds. Serving the investors in our investment funds has been our guiding principle, and we remain fully committed to our fiduciary and contractual obligations to these investors. We do not intend to permit our status as a public company to change our focus on seeking at all times to optimize returns to investors in our investment funds. Accordingly, we expect to take actions regularly with respect to the purchase or sale of investments and the structuring of investment transactions for our investment funds to achieve this objective, even if these actions adversely affect our near-term results. We believe that optimizing returns for the investors in our funds will create the most value for our common unitholders over time.

Use of Leverage to Enhance Returns. In order to generate enhanced returns on equity for our owners, we have historically employed significant leverage on our balance sheet. As a public company, we intend to continue using leverage to create the most efficient capital structure for Blackstone and our public common unitholders. We do not anticipate approaching significant leverage levels during the first one or two years after this offering because the proceeds we will retain from this offering and the sale of non-voting common units to the State Investment Company are expected to be our principal source of financing for our business during that period. However, we anticipate that our debt-to-equity ratio will eventually rise to levels in the range of 3:1 to 4:1 as we attempt to increase o:inherit;font-size:10pt;">

Financial services profit

5,514

5,956

15,361

15,765

Commissions and other sales costs

(55,845
)

(52,478
)

(158,866
)

(155,034
)
General and administrative expenses

(31,636
)

(33,258
)

(90,849
)

(91,774
)
(Loss)/earnings from other unconsolidated entities, net

(91
)

440

852

856

Interest expense

(1,116
)

(167
)

(3,561
)

(5,127
)
Other income, net

2,028

1,435

5,218

3,263

Earnings before income taxes

63,455

53,802

163,429

141,723

Provision for income taxes

(20,905
)

(16,915
)

(55,727
)

(43,989
)

Net earnings

$
42,550

$
36,887

$
107,702

$
97,734

Earnings per common share:

Basic

$
1.06

$
0.92

$
2.67

$
2.45

Diluted

$
1.02

$
0.88

$
2.55

$
2.33

Weighted average number of shares:

Basic

40,323

40,022

40,273

39,958

Diluted

42,011

42,608

42,585

42,541

See accompanying notes to unaudited consolidated financial statements

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

	Nine Months Ended September 30,	
	2017	2016
Cash flows from operating activities:		
Net earnings	$107,702	$97,734
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	12,071	11,470
Stock-based compensation	9,898	11,042
Excess income tax provision from stock-based awards	—	540
Equity in earnings from unconsolidated entities	(10,525)	(11,658)
Distributions of earnings from unconsolidated entities	10,410	11,439
Other	1,265	4,942
Changes in assets and liabilities:		
Increase in real estate	(336,069)	(318,490)
Decrease/(increase) in deposits on real estate under option or contract	13,633	(3,160)
Increase in other receivables, prepaids and other assets	(15,207)	(14,201)
Increase in accounts payable and accrued liabilities	21,298	61,206
Increase in home sale deposits	11,098	791
Net cash used in operating activities	(174,426)	(148,345)
Cash flows from investing activities:		
Investments in unconsolidated entities	(404)	(242)
Distributions of capital from unconsolidated entities	1,250	—
Purchases of property and equipment	(12,038)	(12,256)
Proceeds from sales of property and equipment	251	144
Maturities/sales of investments and securities	1,297	645
Payments to purchase investments and securities	(1,297)	(645)
Net cash used in investing activities	(10,941)	(12,354)
Cash flows from financing activities:		
Proceeds from Credit Facility, net	10,000	25,000
Repayment of loans payable and other borrowings	(10,491)	(18,286)
Repurchase of convertible senior notes	(126,691)	—
Proceeds from issuance of senior notes	300,000	—
Payment of debt issuance costs	(3,986)	—
Excess income tax provision from stock-based awards	—	(540)
Proceeds from stock option exercises	—	232
Net cash provided by financing activities	168,832	6,406
Net decrease in cash and cash equivalents	(16,535)	(154,293)
Cash and cash equivalents, beginning of period	131,702	262,208
Cash and cash equivalents, end of period	$115,167	$107,915

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

MERITAGE HOMES CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — ORGANIZATION AND BASIS OF PRESENTATION

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

Our homebuilding and marketing activities are conducted under the name of Meritage Homes in each of our homebuilding markets. We also offer luxury homes under the brand name of Monterey Homes in some markets. At September 30, 2017, we were actively selling homes in 250 communities, with base prices ranging from approximately $170,000 to $1,390,000.

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, 2016. The consolidated financial statements include the accounts of Meritage Homes Corporation and those of our consolidated subsidiaries, partnerships and other entities in which we have a controlling financial interest, and of variable interest entities (see Note 3) in which we are deemed the primary beneficiary (collectively, “us”, “we”, “our” and “the Company”). Intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the accompanying unaudited financial statements include all adjustments (consisting only of normal recurring entries), necessary for the fair presentation of our results for the interim periods presented. Results for interim periods are not necessarily indicative of results to be expected for the full year.

Cash and Cash Equivalents. Liquid investments with an initial maturity of three months or less are classified as cash equivalents. Amounts in transit from title companies or closing agents for home closings of approximately $58.8 million and $75.3 million are included in cash and cash equivalents at September 30, 2017 and December 31, 2016, 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. Such an analysis is conducted if there is an indication of a decline in value of our land and real estate assets. The impairment of a community is allocated to each lot on a straight-line basis.

Deposits. Deposits paid related to land options and purchase contracts are recorded and classified as Deposits on real estate under option or contract until the related land is purchased. Deposits are reclassified as a component of real estate inventory at the time the deposit is applied to 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 contract is terminated or no longer considered probable. Since our acquisition contracts typically do not require specific performance, we do not consider such contracts to be contractual obligations to purchase the land and our total exposure under such contracts is limited to the loss of the non-refundable deposits and any ancillary capitalized costs. Our deposits on real estate under option or contract were $67.5 million and $85.6 million as of September 30, 2017 and December 31, 2016, respectively.

Goodwill. In accordance with ASC 350, Intangibles, Goodwill and Other ("ASC 350"), we analyze goodwill on an annual basis (or whenever indication of impairment exists) through a qualitative assessment to determine whether it is necessary to perform a two-step goodwill impairment test. ASC 350 states that an entity may first assess qualitative factors to determine whether it is necessary to perform a goodwill impairment test. Such qualitative factors include: (1) macroeconomic conditions, such as a deterioration in general economic conditions, (2) industry and market considerations such as deterioration in the environment in which the entity operates, (3) cost factors such as increases in raw materials and labor costs, and (4) overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings. If the qualitative analysis determines that additional impairment testing is required, 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.

Off-Balance Sheet Arrangements - Joint Ventures. We may participate in land development joint ventures as a means of accessing larger parcels of land and lot positions, expanding our market opportunities, managing our risk profile and leveraging our capital base. See Note 4 for additional discussion of our investments in unconsolidated entities.
Off-Balance Sheet Arrangements - Other. In the normal course of business, we may acquire lots from various development entities pursuant to option and purchase agreements. The purchase price generally approximates the market price at the date the contract is executed (with possible future escalators). See Note 3 for additional information on off-balance sheet arrangements.
Surety Bonds and Letters of Credit. We provide surety bonds or letters of credit in support of our obligations relating to the development of our projects and other corporate purposes. Surety bonds are generally posted in lieu of letters of credit or cash deposits. The amount of these obligations outstanding at any time varies depending on the stage and level of completion of our development activities. Bonds are generally not released until all development activities under the bond are complete. In the event a bond or letter of credit is drawn upon, we would be obligated to reimburse

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

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

	As of			
	September 30, 2017		December 31, 2016	
	Outstanding	Estimated work remaining to complete	Outstanding	Estimated work remaining to complete
Sureties:				
Sureties related to owned projects and lots under contract	$278,779	$ 123,970	$239,246	$ 85,706
Total Sureties	$278,779	$ 123,970	$239,246	$ 85,706
Letters of Credit (“LOCs”):				
LOCs in lieu of deposits for contracted lots	$250	N/A	$250	N/A
LOCs for land development	62,497	N/A	39,839	N/A
LOCs for general corporate operations	3,750	N/A	3,750	N/A
Total LOCs	$66,497	N/A	$43,839	N/A

Accrued Liabilities. Accrued liabilities at September 30, 2017 and December 31, 2016 consisted of the following (in thousands):

	As of	
	September 30, 2017	December 31, 2016
Accruals related to real estate development and construction activities	$63,227	$53,778
Payroll and other benefits	46,922	52,941
Accrued interest	30,722	15,017
Accrued taxes	11,847	9,637
Warranty reserves	24,432	22,660
Legal reserves (1)	600	673
Other accruals	15,352	16,146
Total	$193,102	$170,852

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

Warranty Reserves. We provide home purchasers with limited warranties against certain building defects and we have certain obligations related to those post-construction warranties for closed homes. The specific terms and conditions of these limited warranties vary by state, but overall the nature of the warranties include a complete workmanship and materials warranty typically during the first one to two years after the close of the home and a structural warranty that typically extends up to 10 years subsequent to the close of the home. With the assistance of an actuary, we have estimated the reserves for the structural warranty based on the number of homes still under warranty and historical data and trends for our communities. We also use industry data with respect to similar product types and geographic areas in markets where our experience is incomplete to draw a meaningful conclusion. We regularly review our warranty reserves and adjust them, as necessary, to reflect changes in trends as information becomes available. In the nine months ended September 30, 2016 we decreased our warranty reserve balance by $275,000, which decreased our cost of sales. A summary of changes in our warranty reserves follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Balance, beginning of period	$23,620	$22,699	$22,660	$21,615
Additions to reserve from new home deliveries	4,366	4,110	12,491	12,068
Warranty claims	(3,554)	(4,843)	(10,719)	(11,442)

Adjustments to pre-existing reserves	—	—	—	(275)
Balance, end of period	$24,432	$21,966	$24,432	$21,966

Warranty reserves are included in Accrued liabilities on the accompanying unaudited consolidated balance sheets, and additions and adjustments to the reserves, if any, are included in Cost of home closings within the accompanying unaudited

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consolidated income statements. These reserves are intended to cover costs associated with our contractual and statutory warranty obligations, which include, among other items, claims involving defective workmanship and materials. We believe that our total reserves, coupled with our contractual relationships and rights with our trades and the general liability insurance we maintain, are sufficient to cover our general warranty obligations. However, as unanticipated changes in legal, weather, environmental or other conditions could have an impact on our actual warranty costs, future costs could differ significantly from our estimates.

Recent Accounting Pronouncements.

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

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. In addition, ASU 2016-09 permits entities to make an election to either estimate forfeitures or recognize them as they occur. ASU 2016-09 was effective for us beginning January 1, 2017, and is reflected prospectively in the provision for income taxes in the accompanying unaudited consolidated income statement. The impact of the adoption was not material to our consolidated financial statements, including our prior year statement of cash flow, which was not revised. We continue to estimate forfeitures in calculating stock-based compensation expense and have not elected to recognize forfeitures as they occur.

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

In 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, and the guidance allows for full retrospective or modified retrospective methods of adoption. We have substantially completed our evaluation on the impact that the adoption of ASU 2014-09 will have on our financial statements. We do not expect it to have an impact on the amount or timing of our homebuilding revenues, although we expect there to be an immaterial impact to the timing of expense recognition related to ceasing the capitalization of certain selling costs we incur as part of the selling process.

NOTE 2 — REAL ESTATE AND CAPITALIZED INTEREST

Real estate consists of the following (in thousands):

	As of September 30, 2017	December 31, 2016
Homes under contract under construction (1)	$677,456	$508,927
Unsold homes, completed and under construction (1)	484,701	431,725
Model homes (1)	140,326	147,406
Finished home sites and home sites under development (2)	1,459,786	1,334,005
Total	$2,762,269	$2,422,063

(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 our real estate development and construction activities. Capitalized interest is allocated to active real estate when incurred and charged to cost of closings when the related property is delivered. A summary of our capitalized interest is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Capitalized interest, beginning of period	$72,327	$64,682	$68,196	$61,202
Interest incurred	21,024	17,372	58,199	52,644
Interest expensed	(1,116)	(167)	(3,561)	(5,127)
Interest amortized to cost of home and land closings	(15,462)	(14,256)	(46,061)	(41,088)
Capitalized interest, end of period	$76,773	$67,631	$76,773	$67,631

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

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

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

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

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

The table below presents a summary of our lots under option at September 30, 2017 (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	242	$39,793	$ 4,025	
Option contracts — non-refundable deposits, committed (1)	3,858	283,709	37,927	
Purchase contracts — non-refundable deposits, committed (1)	6,610	300,962	24,255	
Purchase and option contracts —refundable deposits, committed	560	17,669	902	
Total committed	11,270	642,133	67,109	
Purchase and option contracts — refundable deposits, uncommitted (2)	8,465	232,952	4,463	
Total lots under contract or option	19,735	$875,085	$ 71,572	
Total purchase and option contracts not recorded on balance sheet (3)	19,493	$835,292	$ 67,547	(4)

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

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

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

(4) Amount is reflected on our consolidated balance sheet in Deposits on real estate under option or contract as of September 30, 2017.

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

NOTE 4 - INVESTMENTS IN UNCONSOLIDATED ENTITIES

We may enter into land development joint ventures as a means of accessing larger parcels of land, expanding our market opportunities, managing our risk profile and leveraging our capital base. While purchasing land through a joint venture can be beneficial, currently we do not view joint ventures as critical to the success of our homebuilding operations. In 2016, we entered into our first new joint venture since 2008. Based on the structure of each joint venture, it may or may not be consolidated into our results. Our joint venture partners are generally other homebuilders, land sellers or other real estate investors. We generally do not have a controlling interest in these ventures, which means our joint venture partners could cause the venture to take actions we disagree with, or fail to take actions we believe should be undertaken, including the sale of the underlying property to repay debt or recoup all or part of the partners' investments. As of September 30, 2017, we had three active equity-method land ventures.

As of September 30, 2017, we also participated in one mortgage joint venture, which is engaged in mortgage activities and provides services to both our homebuyers as well as other buyers. Our investment in this mortgage joint venture as of September 30, 2017 and December 31, 2016 was $1.6 million and $2.3 million, respectively.

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

	As of September 30, 2017	December 31, 2016
Assets:		
Cash	$7,865	$ 7,446
Real estate	54,214	54,319
Other assets	4,151	6,461
Total assets	$66,230	$ 68,226
Liabilities and equity:		
Accounts payable and other liabilities	$6,072	$ 7,339
Notes and mortgages payable	24,304	23,000
Equity of:		
Meritage (1)	14,340	14,245
Other	21,514	23,642
Total liabilities and equity	$66,230	$ 68,226

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenue	$9,593	$13,374	$30,622	$34,875
Costs and expenses	(4,138)	(5,762)	(14,724)	(15,408)
Net earnings of unconsolidated entities	$5,455	$7,612	$15,898	$19,467
Meritage's share of pre-tax earnings(1) (2)	$3,398	$4,681	$10,648	$11,719

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

(2) Our share of pre-tax earnings is recorded in Earnings from financial services unconsolidated entities and other, net and (Loss)/earnings 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.

Our total investment in all of these joint ventures is $16.4 million and $17.1 million as of September 30, 2017 and December 31, 2016, respectively. We believe these ventures are in compliance with their respective debt agreements, if applicable, and such debt is non-recourse to us.

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NOTE 5 — LOANS PAYABLE AND OTHER BORROWINGS

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

	As of September 30, 2017	December 31, 2016
Other borrowings, real estate notes payable [1]	$13,082	$ 17,195
$625 million unsecured revolving credit facility with interest approximating LIBOR (approximately 1.23% at September 30, 2017) plus 1.75% or Prime (4.25% at September 30, 2017) plus 0.75%	25,000	15,000
Total	$38,082	$ 32,195

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

The Company has a $625.0 million unsecured revolving credit facility ("Credit Facility"), with an accordion feature that permits the size of the facility to increase to a maximum of $725.0 million. In May 2017, the maturity date of the credit facility was extended whereby $60.0 million matures in July 2019 with the remainder maturing in July 2021. 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 $987.4 million (which amount is subject to increase over time based on subsequent earnings and proceeds from equity offerings), and (b) a maximum leverage covenant that prohibits the leverage ratio (as defined therein) from exceeding 60%. In addition, we are required to maintain either (i) an interest coverage ratio (EBITDA to interest expense, as defined therein) of at least 1.50 to 1.00 or (ii) liquidity (as defined therein) of an amount not less than our consolidated interest incurred during the trailing 12 months.

We had $25.0 million of outstanding borrowings under the Credit Facility as of September 30, 2017 and $15.0 million in borrowings at December 31, 2016. During the nine months ended September 30, 2017 we had $320.0 million of gross borrowings and $310.0 million of repayments. During the nine months ended September 30, 2016 we had $106.0 million of gross borrowings and $81.0 million of repayments. As of September 30, 2017 we had outstanding letters of credit issued under the Credit Facility totaling $66.5 million, leaving $533.5 million available under the Credit Facility to be drawn.

NOTE 6 — SENIOR AND CONVERTIBLE SENIOR NOTES, NET

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

	As of September 30, 2017	December 31, 2016
4.50% senior notes due 2018	$175,000	$175,000
7.15% senior notes due 2020. At September 30, 2017 and December 31, 2016 there was approximately $1,422 and $1,849 in net unamortized premium, respectively	301,422	301,849
7.00% senior notes due 2022	300,000	300,000
6.00% senior notes due 2025	200,000	200,000
5.125% senior notes due 2027	300,000	—
1.875% convertible senior notes due 2032	—	126,500
Net debt issuance costs	(10,262)	(8,230)
Total	$1,266,160	$1,095,119

In June 2017, we completed an offering of $300.0 million aggregate principal amount of Senior Notes due 2027 (the "2027 Notes"). The 2027 Notes bear interest at 5.125% per annum, payable on June 6 and December 6 of each year, commencing on December 6, 2017.

Using the proceeds from the 2027 Notes offering, in June 2017 we repurchased in privately negotiated transactions $51.9 million of our convertible senior notes ("Convertible Notes") aggregate principal amount, incurring a loss on extinguishment of debt of $0.3 million included in Other income, net, in the accompanying consolidated income statements for the nine months ended September 30, 2017.

The Convertible Notes could be redeemed by the note-holders on the fifth, tenth and fifteenth anniversary dates of the Convertible Notes. The fifth anniversary of the Convertible Notes was on September 15, 2017. During September 2017, through a combination of holder redemptions and an exercise of our call option, we redeemed for cash all remaining Convertible Notes at a redemption price equal to 100% of the principal amount of the notes being redeemed, plus accrued and unpaid interest.

The indentures for all of our senior notes contain covenants including, among others, limitations on the amount of secured debt we may incur, and limitations on sale and leaseback transactions and mergers. We believe we are in compliance with all such covenants as of September 30, 2017.

Obligations to pay principal and interest on the senior (and previously our 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 non-guarantor subsidiaries are, individually and in the aggregate, minor.

NOTE 7 — FAIR VALUE DISCLOSURES

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

- Level 1 — Valuation is based on quoted prices in active markets for identical assets and liabilities.
- Level 2 — Valuation is determined from quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar instruments in markets that are not active, or by model-based techniques in which all significant inputs are observable in the market.
- Level 3 — Valuation is derived from model-based techniques in which at least one significant input is unobservable and based on the company's own estimates about the assumptions that market participants would use to value the asset or liability.

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

	As of			
	September 30, 2017		December 31, 2016	
	Aggregate Principal	Estimated Fair Value	Aggregate Principal	Estimated Fair Value
4.50% senior notes	$175,000	$175,875	$175,000	$177,625
7.15% senior notes	$300,000	$330,000	$300,000	$325,500
7.00% senior notes	$300,000	$342,750	$300,000	$324,750
6.00% senior notes	$200,000	$213,000	$200,000	$202,500
5.125% senior notes	$300,000	$300,750	$—	$—
1.875% convertible senior notes	$—	$—	$126,500	$126,105

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 September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Basic weighted average number of shares outstanding	40,323	40,022	40,273	39,958
Effect of dilutive securities:				
Convertible Notes (1)	1,105	2,176	1,754	2,176
Unvested restricted stock	583	410	558	407
Diluted average shares outstanding	42,011	42,608	42,585	42,541
Net earnings as reported	$42,550	$36,887	$107,702	$97,734
Interest attributable to Convertible Notes, net of income taxes	201	403	942	1,210
Net earnings for diluted earnings per share	$42,751	$37,290	$108,644	$98,944
Basic earnings per share	$1.06	$0.92	$2.67	$2.45
Diluted earnings per share (1)	$1.02	$0.88	$2.55	$2.33
Antidilutive stock not included in the calculation of diluted earnings per share	2	17	4	5

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

NOTE 9 — ACQUISITIONS AND GOODWILL

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

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

	West	Central	East	Financial Services	Corporate	Total
Balance at December 31, 2016	$ —	$ —	$32,962	$ —	$ —	$32,962
Additions	—	—	—	—	—	—
Impairments	—	—	—	—	—	—
Balance at September 30, 2017	$ —	$ —	$32,962	$ —	$ —	$32,962

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NOTE 10 — STOCKHOLDERS' EQUITY

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

	Nine Months Ended September 30, 2017 (In thousands)				
	Number of Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Total
Balance at December 31, 2016	40,031	$ 400	$572,506	$848,589	$1,421,495
Net earnings	—	—	—	107,702	107,702
Exercise/vesting of stock-based awards	295	3	(3)	—	—
Stock-based compensation expense	—	—	9,911	—	9,911
Balance at September 30, 2017	40,326	$ 403	$582,414	$956,291	$1,539,108

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

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NOTE 11 — STOCK BASED AND DEFERRED COMPENSATION

We have a stock-based compensation plan, the Amended and Restated 2006 Stock Incentive Plan (the “Plan”), that was adopted in 2006 and has been amended or restated from time to time. The Plan was approved by our stockholders and is administered by our Board of Directors. The provisions of the Plan allow for the grant of stock appreciation rights, restricted stock awards, restricted stock units, performance share awards and performance-based awards in addition to non-qualified and incentive stock options. The Plan authorizes awards to officers, key employees, non-employee directors and consultants for up to 5,350,000 shares of common stock, of which 1,131,155 shares remain available for grant at September 30, 2017. The available shares include shares from expired, terminated or forfeited awards under prior plans that have since expired and are thus available for grant under the Plan. We believe that such awards provide a means of performance-based compensation to attract and retain qualified employees and better align the interests of our employees with those of our stockholders. Non-vested stock awards are usually granted with a five-year ratable vesting period for employees and with a three-year cliff vesting for both non-vested stock and performance-based awards granted to certain senior executive officers and non-employee directors.

Compensation cost related to time-based restricted stock awards is measured as of the closing price on the date of grant and is expensed on a straight-line basis over the vesting period of the award. Compensation cost related to performance-based restricted stock awards is also measured as of the closing price on the date of grant but is expensed in accordance with ASC 718-10-25-20, Compensation – Stock Compensation ("ASC 718"), which requires an assessment of probability of attainment of the performance target. As our performance targets are dependent on performance over a specified measurement period, once we determine that the performance target outcome is probable, the cumulative expense is recorded immediately with the remaining expense recorded on a straight-line basis through the end of the award vesting period. Beginning with grants in 2014, a portion of the performance-based restricted stock awards granted contain market conditions as defined by ASC 718. The guidance in ASC 718 requires that compensation expense for stock awards with market conditions be expensed based on a derived grant date fair value and expensed over the service period. We engaged a third party to perform a valuation analysis on the awards containing market conditions and our associated expense with those awards is based on the derived fair value from that analysis and is being expensed straight-line over the service period of the awards. Below is a summary of compensation expense and stock award activity (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Stock-based compensation expense	$4,113	$3,729	$9,898	$11,042
Non-vested shares granted	14,075	3,500	430,575	497,365
Performance-based non-vested shares granted	—	—	154,120	66,698
Stock options exercised [1]	—	—	—	14,400
Restricted stock awards vested (includes performance-based awards)	5,780	6,940	295,544	341,490

(1) As of December 31, 2016, we have no remaining unexercised stock options.

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

	As of September 30, 2017	December 31, 2016
Unrecognized stock-based compensation cost	$21,920	$ 18,528
Weighted average years expense recognition period	2.75	2.56
Total stock-based awards outstanding [1]	1,302,176	1,147,271

(1)

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

We also offer a non-qualified deferred compensation plan ("deferred compensation plan") to highly compensated employees in order to allow them additional pre-tax income deferrals above and beyond the limits that qualified plans, such as 401k plans, impose on highly compensated employees. We do not currently offer a contribution match on the deferred compensation plan. All contributions to the plan to date have been funded by the employees and, therefore, we have no associated expense related to the deferred compensation plan for the three and nine months ended September 30, 2017 or 2016, other than minor administrative costs.

NOTE 12 — INCOME TAXES
Components of the income tax provision are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Federal	$18,890	$15,032	$49,678	$38,141
State	2,015	1,883	6,049	5,848
Total	$20,905	$16,915	$55,727	$43,989

The effective tax rate for the three and nine months ended September 30, 2017 was 32.9% and 34.1%, respectively, and for the three and nine months ended September 30, 2016 was 31.4% and 31.0%, respectively. Our tax rate has been favorably impacted in both years by the homebuilding manufacturing deduction. The lower 2016 effective tax rate reflects the benefit of federal energy credits for homes sold in both 2016 and in prior periods as a result of the Protecting Americans from Tax Hikes (PATH) Act of 2015. The PATH Act was the enabling legislation for claiming federal energy tax credits on homes qualifying in 2015 and 2016. This legislation has expired and has not been renewed for 2017. Accordingly, our effective tax rate for 2017 does not reflect a tax benefit from federal energy credits for homes sold in 2017.

At September 30, 2017 and December 31, 2016, we have no unrecognized tax benefits. We believe that our current income tax filing positions and deductions will be sustained on audit and do not anticipate any adjustments that will result in a material change. Our policy is to accrue interest and penalties on unrecognized tax benefits and include them in federal income tax expense.

We determine our deferred tax assets and liabilities in accordance with ASC 740-10, Income Taxes. We evaluate our deferred tax assets, including the benefit from net operating losses ("NOLs"), by jurisdiction to determine if a valuation allowance is required. Companies must assess whether a valuation allowance should be established based on the consideration of all available evidence using a "more likely than not" standard with significant weight being given to evidence that can be objectively verified. This assessment considers, among other matters, the nature, frequency and severity of cumulative losses, forecasts of future profitability, the length of statutory carry forward periods, experiences with operating losses and experiences of utilizing tax credit carry forwards and tax planning alternatives. We have no valuation allowance on our deferred tax assets and NOL carryovers at September 30, 2017.

At September 30, 2017, we had no remaining federal NOL carry forward or un-utilized federal tax credits. At September 30, 2017, and December 31, 2016 we had tax benefits for state NOL carry forwards of $1.4 million, net of federal benefit, that begin to expire in 2028.

At September 30, 2017, we have income taxes payable of $5.7 million, which primarily consists of current federal and state tax accruals, net of estimated tax payments and tax credits. This amount is recorded in Accrued liabilities on the accompanying unaudited balance sheet at September 30, 2017. At September 30, 2017, we have an income tax receivable of $2.0 million from amending prior year tax returns to claim additional federal energy tax credits which is included in Other receivables on the accompanying unaudited balance sheet.

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

The tax benefits from NOLs, built-in losses, and tax credits would be materially reduced or potentially eliminated if we experience an "ownership change" as defined under Internal Revenue Code §382. Based on our analysis performed as of September 30, 2017 we do not believe that we have experienced an ownership change. As a protective measure, our stockholders held a Special Meeting of Stockholders on February 16, 2009 and approved an amendment to our Articles of Incorporation that restricts certain transfers of our common stock. The amendment is intended to help us avoid an unintended ownership change and thereby preserve the value of any tax benefit for future utilization.

NOTE 13 — SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION
The following table presents certain supplemental cash flow information (in thousands):

	Nine Months Ended September 30,	
	2017	2016
Interest capitalized, net	$(14,454)	$(9,053)
Income taxes paid	$61,034	$43,860
Non-cash operating activities:		
Real estate not owned increase	$39,793	$—
Real estate acquired through notes payable	$6,378	$14,199

NOTE 14 — OPERATING AND REPORTING SEGMENTS
We operate with two principal business segments: homebuilding and financial services. As defined in ASC 280-10, Segment Reporting, we have nine homebuilding operating segments. The homebuilding segments are engaged in the business of acquiring and developing land, constructing homes, marketing and selling those homes and providing warranty and customer services. We aggregate our homebuilding operating segments into reporting segments based on similar long-term economic characteristics and geographical proximity. Our current reportable homebuilding segments are as follows:

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

Management's evaluation of segment performance is based on segment operating income, which we define as 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 September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Homebuilding revenue [1]:				
West	$373,708	$330,805	$1,055,086	$924,494
Central	236,884	200,446	637,394	571,036
East	195,005	221,606	587,867	652,989
Consolidated total	$805,597	$752,857	$2,280,347	$2,148,519
Homebuilding segment operating income:				
West	$35,026	$27,829	$94,169	$71,387
Central	26,404	18,635	63,524	52,313
East	4,954	9,737	12,675	27,918
Total homebuilding segment operating income	66,384	56,201	170,368	151,618
Financial services segment profit	5,514	5,956	15,361	15,765
Corporate and unallocated costs [2]	(9,264)	(10,063)	(24,809)	(24,652)
(Loss)/earnings from other unconsolidated entities, net	(91)	440	852	856
Interest expense	(1,116)	(167)	(3,561)	(5,127)
Other income, net	2,028	1,435	5,218	3,263
Net earnings before income taxes	$63,455	$53,802	$163,429	$141,723

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Land closing revenue:				
West	$—	$15,543	$11,800	$15,608
Central	125	947	247	4,659
East	464	497	4,895	920
Total	$589	$16,987	$16,942	$21,187

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

	At September 30, 2017					
	West	Central	East	Financial Services	Corporate and Unallocated	Total
Deposits on real estate under option or contract	$21,275	$23,237	$23,035	$ —	$—	$67,547
Real estate	1,183,953	701,516	876,800	—	—	2,762,269
Investments in unconsolidated entities	7,660	7,158	—	—	1,560	16,378
Other assets	47,648	(1) 104,063	(2) 117,411	(3) 615	136,227	(4) 405,964
Total assets	$1,260,536	$835,974	$1,017,246	$ 615	$ 137,787	$3,252,158

(1) Balance consists primarily of cash and property and equipment.
(2) Balance consists primarily of development reimbursements from local municipalities and cash.
(3) Balance consists primarily of real estate not owned and goodwill (see Note 9).
(4) Balance consists primarily of our deferred tax asset and cash.

	At December 31, 2016					
	West	Central	East	Financial Services	Corporate and Unallocated	Total
Deposits on real estate under option or contract	$25,863	$27,669	$32,024	$ —	$—	$85,556
Real estate	1,120,038	595,485	706,540	—	—	2,422,063
Investments in unconsolidated entities	7,362	7,450	—	—	2,285	17,097
Other assets	45,624	(1) 94,299	(2) 93,245	(3) 812	129,995	(4) 363,975
Total assets	$1,198,887	$724,903	$831,809	$ 812	$ 132,280	$2,888,691

(1) Balance consists primarily of cash and property and equipment.
(2) Balance consists primarily of development reimbursements from local municipalities and cash.
(3) Balance consists primarily of goodwill (see Note 9), prepaid permits and fees to local municipalities and cash.
(4) Balance consists primarily of cash and our deferred tax asset.

NOTE 15 — COMMITMENTS AND CONTINGENCIES

We are involved in various routine legal and regulatory proceedings, including, without limitation, warranty claims and litigation and arbitration proceedings alleging construction defects. In general, the proceedings are incidental to our business, and most exposure is subject to and should be covered by warranty and indemnity obligations of our consultants and subcontractors. Additionally, some such claims are also covered by insurance. With respect to the majority of such legal proceedings, our ultimate legal and financial responsibility, if any, cannot be estimated with certainty and, in most cases, any potential losses related to these matters are not considered probable. Historically, most disputes regarding warranty claims are resolved without the initiation of legal proceedings. We believe there are not any pending legal or warranty matters that could have a material adverse impact upon our consolidated financial condition, results of operations or cash flows that have not been sufficiently reserved.

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 similar expressions identify forward-looking statements, which speak only as of the date the statement was made. All statements we make other than statements of historical fact are forward-looking statements within the meaning of that term in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

Forward-looking statements in this Quarterly Report include: statements concerning trends in the homebuilding industry in general, and our markets and results specifically; our operating strategy and initiatives, including our strategy to expand the number of communities that target the first-time buyer segment; demand and pricing trends in the short-term throughout our geographies; that we may opportunistically repurchase our debt and equity securities; the benefits of our land acquisition strategy and structures, including the use and the benefits of option contracts and joint ventures; that we expect to redeploy cash generated from operations to acquire and develop lot positions; management estimates regarding joint venture exposure; our expectation that existing guarantees, letters of credit and performance and surety bonds will not be drawn on; the adequacy of our insurance coverage and warranty reserves; the expected outcome of legal proceedings we are involved in and the sufficiency of our reserves relating thereto; the sufficiency of our liquidity and capital resources to support our business strategy; our ability and willingness to acquire land under option or contract; our strategy and trends and expectations concerning sales prices, sales pace, closings, orders, cancellations, material and labor costs for land development and home construction, gross margins, gross profit, revenues, net earnings, operating leverage, backlog, land prices, changes in and location of active communities, seasonality and the amount, type and timing of new community openings; our future cash needs; that we may seek to raise additional debt and equity capital; and our intentions regarding the payment of dividends and the use of derivative contracts; our perceptions about the importance of joint ventures to our business; and the impact of 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: potential adverse impacts on our Houston and Florida orders, closings, revenue and costs due to Hurricanes Harvey and Irma; growth in first-time homebuyers; the availability and cost of finished lots and undeveloped land; changes in interest rates and the availability and pricing of residential mortgages; the success of our strategic initiatives; shortages in the availability and cost of labor; changes in tax laws that adversely impact us or our homebuyers; the ability of our potential buyers to sell their existing homes; cancellation rates; inflation in the cost of materials used to develop communities and construct homes; the adverse effect of slower order absorption rates; impairments of our real estate inventory; a change to the feasibility of projects under option or contract that could result in the write-down or write-off of option deposits; our potential exposure to natural disasters or severe weather conditions; competition; construction defect and home warranty claims; failures in health and safety performance; our success in prevailing on contested tax positions; our ability to obtain performance and surety bonds in connection with our development work; the loss of key personnel; enactment of new regulations or our failure to comply with laws and regulations; our limited geographic diversification; fluctuations in quarterly operating results; our level of indebtedness; our ability to obtain financing; our ability to successfully integrate acquired companies and achieve anticipated benefits from these acquisitions; our compliance with government regulations; the effect of legislative and other government actions, orders, policies or initiatives that impact housing, labor availability, construction, mortgage availability, our access to capital, the cost of capital or the economy in general, or other initiatives that seek to restrain growth of new housing construction or similar measures; legislation relating to energy and climate change; the replication of our energy-efficient technologies by our competitors; our exposure to information technology failures and security breaches; 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, 2016 under the caption “Risk Factors,” which can be found on our website.

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

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

Overview and Outlook

The housing market has continued to improve throughout the first nine months of 2017 as evidenced by a favorable demand environment assisted by historically low interest rates and strong consumer confidence combined with a limited supply of resale homes. While these dynamics have translated to rising average sales prices in some markets, the increase in demand has also resulted in rising land and construction material costs limiting the potential expansion in gross margins. Unprecedented devastation hit two of our key markets in the third quarter with the recent hurricanes in Houston and Florida. While we were fortunate to incur minimal physical damage, we have been impacted with delays in orders and closings, as many communities were closed, some up to several weeks, due to the storms. We are working to quantify what, if any, impact the storms will have on our future cycle times and margins as a result of labor shortages and/or material price increases.

The desire for new homes continues to be healthy across most of our markets, especially for our entry-level and LiVE.NOW communities that target the first-time homebuyer who has returned to the market in a meaningful way in recent years. We expect first-time buyers to continue to grow as a percentage of total homebuyers. Our entry-level product is also attracting some move-down buyers with select floor plans that appeal to an age targeted audience. We continue to focus on strategic initiatives that are designed to position us for further growth and improve our margins, while pivoting to increase our focus on the first-time buyer. We remain committed to expanding our presence in our markets by increasing our community count and offering homes with energy-efficient features and appealing designs for today's homebuyer.

Summary Company Results

Total home closing revenue was $805.0 million for the three months ended September 30, 2017, an increase of $69.1 million over the corresponding prior year period due to the 169 additional homes closed. The 9.4% increase in home closing revenue and 30-basis-point improvement in home closing gross margin provided $14.7 million in additional home closing gross profit which, combined with reduced general and administrative costs of $1.6 million, helped to offset higher interest expense and contributed to our improved net income of $42.6 million for the three months ended September 30, 2017 versus $36.9 million for the 2016 period. Third quarter 2017 results reflect a higher provision for income taxes due to a higher effective tax rate of 32.9% versus 2016 of 31.4%. The lower 2016 effective tax rate is inclusive of the benefit of federal energy credits for homes sold in both 2016 and in prior periods, as the legislation providing for these credits expired in 2016 and has not been renewed for 2017. Year-to-date results reflect $136.1 million in additional home closing revenue and $21.8 million higher home closing gross profit versus the nine months ended September 30, 2016. Higher gross profit combined with lower year-over-year general and administrative costs, lower interest expense and an increase in other income, partially offset by the increased tax rate, led to net income of $107.7 million for the nine months ended September 30, 2017 compared to $97.7 million in 2016.

On a consolidated basis, we experienced year over year growth in closings and orders, both in units and value, for the three and nine months ended September 30, 2017. We ended the third quarter of 2017 with 3,333 homes in backlog, 2.5% higher than 2016 providing a backlog value of $1.4 billion, a 2.4% increase over September 30, 2016. The slight growth in year over year backlog is primarily the result of the increase in the number of average communities at September 30, 2017 compared to prior year combined with consistent year-over-year orders pace.

Company Positioning

We believe that the investments in our new communities, particularly those designed for the first-time homebuyer, and industry-leading innovation in energy-efficient product offerings and automation create a differentiated strategy that has aided us in our growth in the highly competitive new home market. We remain focused on our main goals of growing our orders, revenue and profit, and maintaining a strong balance sheet. To help meet these goals, we continue to focus on the following initiatives:

- Continuing to actively acquire and develop land in key markets in order to maintain and grow our lot supply and active community count;
- Expanding the number of 'entry-level plus' communities that target the growing first-time homebuyer segment;
- Introducing newly designed plan offerings to meet homebuyers changing preferences in our markets, most recently an entire new product library in our East Region;

- Expanding market share in our smaller markets;
- Managing construction efficiencies and cost increases through national and regional vendor relationships with a focus on quality construction and warranty management;
- Growing revenue while managing costs, allowing us to improve overhead operating leverage;

- Generating additional working capital and maintaining adequate liquidity, most recently through a $300 million senior note debt issuance, the pay-off of our Convertible Notes, and expansion of our Credit Facility capacity;
- Increasing orders pace through the use of our consumer and market research to build homes that offer our buyers their desired features and amenities;
- Continuing to innovate and promote our energy efficiency program and our recently announced M. Connected™ Automation Suite to drive sales;
- Adapting sales and marketing efforts to increase traffic and allow us to favorably compete with both resale and new homes;
- Actively monitoring and adjusting our sales, construction and closing processes to incorporate enhancements identified through customer satisfaction surveys; and
- Promoting a positive environment for our employees in order to develop and motivate them and to minimize turnover.

Critical Accounting Policies

The accounting policies we deem most critical to us and that involve the most difficult, subjective or complex judgments include revenue recognition, valuation of real estate, goodwill, deferred tax assets and warranty reserves as well as the calculation of compensation cost relating to share-based payments. There have been no significant changes to our critical accounting policies during the nine months ended September 30, 2017 compared to those disclosed in Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations, included in our 2016 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 September 30,		Quarter over Quarter	
	2017	2016	Change $	Change %
Home Closing Revenue				
Total				
Dollars	$805,008	$735,870	$69,138	9.4 %
Homes closed	1,969	1,800	169	9.4 %
Average sales price	$408.8	$408.8	$—	— %
West Region				
Arizona				
Dollars	$141,249	$89,092	$52,157	58.5 %
Homes closed	424	253	171	67.6 %
Average sales price	$333.1	$352.1	$(19.0)	(5.4)%
California				
Dollars	$154,731	$142,056	$12,675	8.9 %
Homes closed	261	251	10	4.0 %
Average sales price	$592.8	$566.0	$26.9	4.7 %
Colorado				
Dollars	$77,728	$84,114	$(6,386)	(7.6)%
Homes closed	135	167	(32)	(19.2)%
Average sales price	$575.8	$503.7	$72.1	14.3 %
West Region Totals				
Dollars	$373,708	$315,262	$58,446	18.5 %
Homes closed	820	671	149	22.2 %
Average sales price	$455.7	$469.8	$(14.1)	(3.0)%
Central Region - Texas				
Central Region Totals				
Dollars	$236,759	$199,499	$37,260	18.7 %
Homes closed	647	542	105	19.4 %
Average sales price	$365.9	$368.1	$(2.1)	(0.6)%
East Region				
Florida				
Dollars	$77,652	$85,647	$(7,995)	(9.3)%
Homes closed	185	206	(21)	(10.2)%
Average sales price	$419.7	$415.8	$4.0	1.0 %
Georgia				
Dollars	$29,019	$27,477	$1,542	5.6 %
Homes closed	95	83	12	14.5 %
Average sales price	$305.5	$331.0	$(25.6)	(7.7)%
North Carolina				

Dollars	$48,129	$71,641	$(23,512)	(32.8)%
Homes closed	107	177	(70)	(39.5)%
Average sales price	$449.8	$404.8	$45.1	11.1 %
South Carolina				
Dollars	$25,164	$22,658	$2,506	11.1 %
Homes closed	74	76	(2)	(2.6)%
Average sales price	$340.1	$298.1	$41.9	14.1 %
Tennessee				
Dollars	$14,577	$13,686	$891	6.5 %
Homes closed	41	45	(4)	(8.9)%
Average sales price	$355.5	$304.1	$51.4	16.9 %
East Region Totals				
Dollars	$194,541	$221,109	$(26,568)	(12.0)%
Homes closed	502	587	(85)	(14.5)%
Average sales price	$387.5	$376.7	$10.9	2.9 %

	Nine Months Ended September 30,		Quarter over Quarter	
	2017	2016	Chg $	Chg %
Home Closing Revenue				
Total				
Dollars	$2,263,405	$2,127,332	$136,073	6.4 %
Homes closed	5,456	5,238	218	4.2 %
Average sales price	$414.8	$406.1	$8.7	2.1 %
West Region				
Arizona				
Dollars	$382,814	$258,139	$124,675	48.3 %
Homes closed	1,139	749	390	52.1 %
Average sales price	$336.1	$344.6	$(8.5)	(2.5)%
California				
Dollars	$427,095	$418,834	$8,261	2.0 %
Homes closed	702	738	(36)	(4.9)%
Average sales price	$608.4	$567.5	$40.9	7.2 %
Colorado				
Dollars	$233,377	$231,913	$1,464	0.6 %
Homes closed	417	474	(57)	(12.0)%
Average sales price	$559.7	$489.3	$70.4	14.4 %
West Region Totals				
Dollars	$1,043,286	$908,886	$134,400	14.8 %
Homes closed	2,258	1,961	297	15.1 %
Average sales price	$462.0	$463.5	$(1.4)	(0.3)%
Central Region - Texas				
Central Region Totals				
Dollars	$637,147	$566,377	$70,770	12.5 %
Homes closed	1,752	1,563	189	12.1 %
Average sales price	$363.7	$362.4	$1.3	0.4 %
East Region				
Florida				
Dollars	$225,674	$252,311	$(26,637)	(10.6)%
Homes closed	518	619	(101)	(16.3)%
Average sales price	$435.7	$407.6	$28.1	6.9 %
Georgia				
Dollars	$74,860	$76,874	$(2,014)	(2.6)%
Homes closed	223	229	(6)	(2.6)%
Average sales price	$335.7	$335.7	$—	0.0 %
North Carolina				
Dollars	$164,596	$198,525	$(33,929)	(17.1)%
Homes closed	370	474	(104)	(21.9)%
Average sales price	$444.9	$418.8	$26.0	6.2 %
South Carolina				
Dollars	$75,085	$71,577	$3,508	4.9 %
Homes closed	217	231	(14)	(6.1)%
Average sales price	$346.0	$309.9	$36.2	11.7 %
Tennessee				
Dollars	$42,757	$52,782	$(10,025)	(19.0)%

Homes closed	118	161	(43)	(26.7)%
Average sales price	$362.3	$327.8	$34.5	10.5 %
East Region Totals				
Dollars	$582,972	$652,069	$(69,097)	(10.6)%
Homes closed	1,446	1,714	(268)	(15.6)%
Average sales price	$403.2	$380.4	$22.7	6.0 %

	Three Months Ended September 30,		Quarter over Quarter	
	2017	2016	Change $	Change %
Home Orders [1]				
Total				
Dollars	$765,027	$715,562	$49,465	6.9 %
Homes ordered	1,874	1,737	137	7.9 %
Average sales price	$408.2	$412.0	$(3.7)	(0.9)%
West Region				
Arizona				
Dollars	$116,757	$116,815	$(58)	0.0 %
Homes ordered	348	345	3	0.9 %
Average sales price	$335.5	$338.6	$(3.1)	(0.9)%
California				
Dollars	$124,339	$125,920	$(1,581)	(1.3)%
Homes ordered	200	216	(16)	(7.4)%
Average sales price	$621.7	$583.0	$38.7	6.6 %
Colorado				
Dollars	$55,459	$66,213	$(10,754)	(16.2)%
Homes ordered	92	121	(29)	(24.0)%
Average sales price	$602.8	$547.2	$55.6	10.2 %
West Region Totals				
Dollars	$296,555	$308,948	$(12,393)	(4.0)%
Homes ordered	640	682	(42)	(6.2)%
Average sales price	$463.4	$453.0	$10.4	2.3 %
Central Region - Texas				
Central Region Totals				
Dollars	$213,241	$178,934	$34,307	19.2 %
Homes ordered	593	488	105	21.5 %
Average sales price	$359.6	$366.7	$(7.1)	(1.9)%
East Region				
Florida				
Dollars	$120,243	$95,946	$24,297	25.3 %
Homes ordered	269	208	61	29.3 %
Average sales price	$447.0	$461.3	$(14.3)	(3.1)%
Georgia				
Dollars	$33,039	$28,841	$4,198	14.6 %
Homes ordered	102	85	17	20.0 %
Average sales price	$323.9	$339.3	$(15.4)	(4.5)%
North Carolina				
Dollars	$59,976	$61,537	$(1,561)	(2.5)%
Homes ordered	147	149	(2)	(1.3)%
Average sales price	$408.0	$413.0	$(5.0)	(1.2)%
South Carolina				
Dollars	$28,449	$22,434	$6,015	26.8 %
Homes ordered	86	71	15	21.1 %
Average sales price	$330.8	$316.0	$14.8	4.7 %
Tennessee				

Dollars	$13,524	$18,922	$(5,398)	(28.5)%
Homes ordered	37	54	(17)	(31.5)%
Average sales price	$365.5	$350.4	$15.1	4.3 %
East Region Totals				
Dollars	$255,231	$227,680	$27,551	12.1 %
Homes ordered	641	567	74	13.1 %
Average sales price	$398.2	$401.6	$(3.4)	(0.8)%

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

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	Nine Months Ended September 30,		Quarter over Quarter	
	2017	2016	Chg $	Chg %
Home Orders [1]				
Total				
Dollars	$2,536,448	$2,365,508	$170,940	7.2 %
Homes ordered	6,162	5,797	365	6.3 %
Average sales price	$411.6	$408.1	$3.6	0.9 %
West Region				
Arizona				
Dollars	$380,459	$322,807	$57,652	17.9 %
Homes ordered	1,148	935	213	22.8 %
Average sales price	$331.4	$345.2	$(13.8)	(4.0)%
California				
Dollars	$480,694	$442,863	$37,831	8.5 %
Homes ordered	802	775	27	3.5 %
Average sales price	$599.4	$571.4	$27.9	4.9 %
Colorado				
Dollars	$214,532	$237,237	$(22,705)	(9.6)%
Homes ordered	368	459	(91)	(19.8)%
Average sales price	$583.0	$516.9	$66.1	12.8 %
West Region Totals				
Dollars	$1,075,685	$1,002,907	$72,778	7.3 %
Homes ordered	2,318	2,169	149	6.9 %
Average sales price	$464.1	$462.4	$1.7	0.4 %
Central Region - Texas				
Central Region Totals				
Dollars	$719,656	$597,947	$121,709	20.4 %
Homes ordered	2,000	1,629	371	22.8 %
Average sales price	$359.8	$367.1	$(7.2)	(2.0)%
East Region				
Florida				
Dollars	$342,754	$295,453	$47,301	16.0 %
Homes ordered	791	702	89	12.7 %
Average sales price	$433.3	$420.9	$12.4	2.9 %
Georgia				
Dollars	$88,306	$102,392	$(14,086)	(13.8)%
Homes ordered	270	305	(35)	(11.5)%
Average sales price	$327.1	$335.7	$(8.7)	(2.6)%
North Carolina				
Dollars	$187,683	$205,562	$(17,879)	(8.7)%
Homes ordered	440	497	(57)	(11.5)%
Average sales price	$426.6	$413.6	$12.9	3.1 %
South Carolina				
Dollars	$76,827	$95,123	$(18,296)	(19.2)%
Homes ordered	224	296	(72)	(24.3)%
Average sales price	$343.0	$321.4	$21.6	6.7 %
Tennessee				
Dollars	$45,537	$66,124	$(20,587)	(31.1)%

Homes ordered	119	199	(80)	(40.2)%
Average sales price	$382.7	$332.3	$50.4	15.2 %
East Region Totals				
Dollars	$741,107	$764,654	$(23,547)	(3.1)%
Homes ordered	1,844	1,999	(155)	(7.8)%
Average sales price	$401.9	$382.5	$19.4	5.1 %

	Three Months Ended September 30,			
	2017		2016	
	Ending	Average	Ending	Average
Active Communities				
Total	250	253.5	237	239.0
West Region				
Arizona	40	39.5	40	41.5
California	24	25.0	29	27.0
Colorado	9	9.5	10	11.0
West Region Totals	73	74.0	79	79.5
Central Region - Texas				
Central Region Totals	93	92.5	74	73.5
East Region				
Florida	29	29.5	26	26.0
Georgia	17	18.0	17	17.0
North Carolina	18	19.0	19	20.5
South Carolina	14	14.0	15	15.5
Tennessee	6	6.5	7	7.0
East Region Totals	84	87.0	84	86.0

	Nine Months Ended September 30,			
	2017		2016	
	Ending	Average	Ending	Average
Active Communities				
Total	250	246.5	237	245.5
West Region				
Arizona	40	41.0	40	40.5
California	24	26.0	29	26.5
Colorado	9	9.5	10	13.0
West Region Totals	73	76.5	79	80.0
Central Region - Texas				
Central Region Totals	93	86.5	74	73.0
East Region				
Florida	29	28.0	26	28.5
Georgia	17	17.0	17	17.0
North Carolina	18	17.5	19	22.5
South Carolina	14	14.5	15	16.5
Tennessee	6	6.5	7	8.0
East Region Totals	84	83.5	84	92.5

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Cancellation Rates [1]				
Total	13 %	14 %	13 %	12 %
West Region				
Arizona	12 %	12 %	12 %	12 %
California	19 %	19 %	14 %	13 %
Colorado	8 %	13 %	10 %	10 %
West Region Totals	14 %	14 %	13 %	12 %
Central Region - Texas				
Central Region Totals	14 %	16 %	14 %	15 %
East Region				
Florida	9 %	13 %	11 %	11 %
Georgia	12 %	12 %	16 %	13 %
North Carolina	8 %	10 %	8 %	8 %
South Carolina	11 %	15 %	11 %	8 %
Tennessee	14 %	7 %	13 %	8 %
East Region Totals	10 %	12 %	11 %	10 %

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

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	At September 30,		Quarter over Quarter	
	2017	2016	Change $	Change %
Order Backlog [1]				
Total				
Dollars	$1,408,801	$1,375,857	$32,944	2.4 %
Homes in backlog	3,333	3,251	82	2.5 %
Average sales price	$422.7	$423.2	$(0.5)	(0.1)%
West Region				
Arizona				
Dollars	$158,988	$182,574	$(23,586)	(12.9)%
Homes in backlog	453	503	(50)	(9.9)%
Average sales price	$351.0	$363.0	$(12.0)	(3.3)%
California				
Dollars	$207,237	$208,175	$(938)	(0.5)%
Homes in backlog	331	326	5	1.5 %
Average sales price	$626.1	$638.6	$(12.5)	(2.0)%
Colorado				
Dollars	$135,239	$167,475	$(32,236)	(19.2)%
Homes in backlog	224	317	(93)	(29.3)%
Average sales price	$603.7	$528.3	$75.4	14.3 %
West Region Totals				
Dollars	$501,464	$558,224	$(56,760)	(10.2)%
Homes in backlog	1,008	1,146	(138)	(12.0)%
Average sales price	$497.5	$487.1	$10.4	2.1 %
Central Region - Texas				
Central Region Totals				
Dollars	$437,243	$381,764	$55,479	14.5 %
Homes in backlog	1,179	1,008	171	17.0 %
Average sales price	$370.9	$378.7	$(7.9)	(2.1)%
East Region				
Florida				
Dollars	$233,534	$161,148	$72,386	44.9 %
Homes in backlog	526	370	156	42.2 %
Average sales price	$444.0	$435.5	$8.4	1.9 %
Georgia				
Dollars	$46,809	$58,944	$(12,135)	(20.6)%
Homes in backlog	138	171	(33)	(19.3)%
Average sales price	$339.2	$344.7	$(5.5)	(1.6)%
North Carolina				
Dollars	$110,339	$118,515	$(8,176)	(6.9)%
Homes in backlog	263	283	(20)	(7.1)%
Average sales price	$419.5	$418.8	$0.8	0.2 %
South Carolina				
Dollars	$42,378	$53,657	$(11,279)	(21.0)%
Homes in backlog	123	153	(30)	(19.6)%
Average sales price	$344.5	$350.7	$(6.2)	(1.8)%
Tennessee				
Dollars	$37,034	$43,605	$(6,571)	(15.1)%
Homes in backlog	96	120	(24)	(20.0)%

Average sales price	$385.8	$363.4	$22.4	6.2	%
East Region Totals					
Dollars	$470,094	$435,869	$34,225	7.9	%
Homes in backlog	1,146	1,097	49	4.5	%
Average sales price	$410.2	$397.3	$12.9	3.2	%

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

Operating Results

Companywide. Home closing revenue increased by 9.4% to $805.0 million on 1,969 closings for the three months ended September 30, 2017 compared to $735.9 million from 1,800 closings during the same quarter of the prior year, driven entirely by increased closing volume. Average sales prices on home closings were consistent with the prior year, as price increases in some markets are being fully offset by a higher percentage of entry-level homes in our closing mix. Home orders also improved year-over-year, with order value growing by 6.9% to $765.0 million on 1,874 homes in the third quarter of 2017 as compared to $715.6 million on 1,737 homes in the third quarter of 2016. We ended the quarter with 250 actively selling communities, a 5.5% improvement over prior year and maintained a relatively flat company-wide orders pace of 7.4 homes ordered per average community in the third quarter of 2017 compared to 7.3 in the comparable 2016 quarter. For the nine months ended September 30, 2017, home closing units and revenue grew by 218 units and $136.1 million for total home closing revenue of $2.3 billion, 6.4% higher than the nine month period in 2016. Orders for the nine months ended September 30, 2017 were up 6.3% from the prior year resulting in order value of $2.5 billion, a 7.2% increase from the 2016 period. We ended the quarter with 3,333 homes in backlog, reflecting a $32.9 million, or 2.4%, increase from 2016 driven entirely by volume as average sales prices are beginning to temper as we shift toward a higher percentage of backlog from entry-level homes.

West. During the three months ended September 30, 2017, the West region led the company in home closing units and revenue in addition to contributing the largest growth in closing volume year over year. Home closing revenue rose 18.5% over the 2016 period, due to a 22.2% increase in homes closed partially offset by a slight decline in average sales prices, resulting in 820 closings valued at $373.7 million for the three months ended September 30, 2017. Average community count in the West region was down 6.9%, although orders pace was consistent at 8.6, resulting in order units and value declining by 6.2% and 4.0%, respectively. The region ended the third quarter of 2017 with 640 orders valued at $296.6 million and a 2.3% increase in average sales prices. Average sales prices in the Region are starting to temper as Arizona is contributing a larger percentage to the Region's results and is shifting to a higher number of lower priced, faster selling communities aimed to first-time buyers. Strong demand is evident in all markets in the region where our orders pace continues to outpace the rest of the company. As a result, communities are selling out faster than anticipated. We are actively working to open additional communities throughout the region and we anticipate over forty new community openings in the next twelve months, with over half of those targeted toward the first-time homebuyer where we are experiencing particularly strong demand.

For the nine months ended September 30, 2017, similar to the third quarter results, the number and value of units closed versus prior year improved by 15.1% and 14.8%, respectively, driven by significant growth in Arizona. Orders in Arizona were also the driver for the Region's 6.9% higher orders year to date. The Region ended the nine-month period with overall growth in order value of $72.8 million on 149 additional units and ending backlog of $501.5 million on 1,008 units.

Central. In the third quarter of 2017, the Central Region, made up of our Texas markets, closed 647 homes and generated $236.8 million in home closing revenue, improvements of 19.4% and 18.7%, respectively, leading to year over year home closing revenue growth of $37.3 million despite some delays in deliveries and construction cycle times from the hurricane that impacted the Houston market. Orders grew by 21.5% to a total of 593 units valued at $213.2 million at September 30, 2017 as compared to 488 units valued at $178.9 million in the prior year. We continue to see improved demand trends in the Central Region, evidenced by the rising orders in the third quarter of 2017 aided by a 25.9% increase in average communities. Third quarter orders pace dipped slightly partially due to sales office closures from the hurricane and related flooding. We are responding to the entry-level demand in this Region with a strong transition to first-time buyer product offerings, as evidenced in the marginally decreasing average sales prices year over year on both closings and orders.

Year-to-date saw overall improvements in the Region as well. Home closings and home closing revenue results were similar to the third quarter with increases of 12.1% and 12.5%, respectively, compared to prior year. Orders and order value were up year over year by 22.8% and 20.4%, respectively, aided by a 18.5% increase in average active communities and a 3.6% increase in orders pace. The Region ended the quarter with 1,179 homes in backlog valued at $437.2 million, 17.0% and 14.5% improvements, respectively.

East. Our East region generated 502 closings and $194.5 million in home closing revenue in the third quarter of 2017, declines of 14.5% and 12.0%, respectively, from the prior year. The decline in closing volume was partially offset with a 2.9% or $10,900 increase in average sales price, as nearly all markets in the Region experienced higher average sales prices on their third quarter closings versus prior year. Order volume increased by 13.1% compared to prior year which led to a 12.1% increase in order value, ending the third quarter of 2017 with 641 units valued at $255.2 million. New community openings in high-demand sub-markets is a strategic focus for us in the East Region. We held back some community openings until the roll-out of our new product offering throughout the majority of the region which impacted orders in the first several months of the year and accordingly third quarter closings. While certain markets have seen community count growth thus far, we still have a significant number of additional new communities anticipated to open in the next several months in the region. In the third quarter of 2017, orders pace in the East region improved by 12.1% which we believe demonstrates the desirability of our updated plan offerings in newer community locations. Both closing and order volumes in the third quarter of 2017 were impacted by the hurricane-related delays as sales offices in certain areas of Florida were closed for several weeks and construction cycle times have been slowed due primarily to utility and municipal delays in the area.

The year-to-date closing results of the East Region were similar to those of the third quarter, with 1,446 units closed, providing $583.0 million in home closing revenue, 15.6% and 10.6% lower than the 2016 period, respectively. The region ended the nine month period of 2017 with a 7.8% decrease in orders and a 3.1% decrease in order value compared to prior year, attributable to a 9.7% decline in average communities related to the delay in community openings pending the introduction of our new product offering. Similar to the third quarter of 2017, year-to-date orders pace improved by 2.3% over the comparable 2016 period. Backlog units and value improved in the region by 4.5% and 7.9%, respectively, to end the quarter with 1,146 units in backlog valued at $470.1 million.

Land Closing Revenue and Gross Profit

From time to time, we may sell certain lots or land parcels to other homebuilders, developers or investors if we feel the sale will provide a greater economic benefit to us than continuing home construction or where we are looking to diversify our land positions in the specific geography. As a result of such sales, we recognized land closing revenue of $0.6 million and $17.0 million for the three months ending September 30, 2017 and 2016, respectively, and $16.9 and $21.2 million for the nine months ended September 30, 2017 and 2016, respectively. We recognized a loss of $1.1 million for the three months ended September 30, 2017 compared to a nominal profit of $0.9 million in the third quarter of the prior year. For the nine months ended September 30, both periods recognized land closing gross profits of $1.4 million and $1.7 million, respectively.

Other Operating Information (dollars in thousands)

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017		2016		2017		2016	
	Dollars	Percent of Home Closing Revenue	Dollars	Percent of Home Closing Revenue	Dollars	Percent of Home Closing Revenue	Dollars	Percent of Home Closing Revenue
Home Closing Gross Profit (1)								
Total	$145,658	18.1 %	$130,979	17.8 %	$393,836	17.4 %	$372,072	17.5 %
West	$67,225	18.0 %	$56,381	17.9 %	$181,692	17.4 %	$156,879	17.3 %
Central	$49,746	21.0 %	$39,546	19.8 %	$128,878	20.2 %	$112,664	19.9 %
East	$28,687	14.7 %	$35,052	15.9 %	$83,266	14.3 %	$102,529	15.7 %

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

zoning costs), interest, sales tax, impact fees, warranty, construction overhead and closing costs.
Companywide. Home closing gross margin for the third quarter of 2017 increased by 30 basis points over the prior year, combined with higher home closing revenue, resulted in a $14.7 million increase in home closing gross profit. With improved demand and pricing power, we have been successful in some markets in minimizing the impact of rising costs and improving our leverage of construction overhead costs on increased revenues. Charges incurred on asset write-offs in the third quarter of 2017 of approximately $1.8 million impacted gross margin by 20 basis points as compared to the third quarter of 2016 with a

10 basis point impact on home closing gross margin. Home closing gross margin has improved sequentially throughout 2017. Accordingly, combined with higher home closing revenue, for the nine months ended September 30, 2017 home closing gross profit increased by $21.8 million over the 2016 period with margins of 17.4% in 2017 compared to 17.5% in 2016.

West. Our West Region reported slightly higher year-over-year home closing gross margin for the third quarter of 2017 of 18.0% compared to 17.9% in 2016, and 17.4% versus 17.3% for the nine months ended September 30, 2017 and 2016, respectively. We are making concerted efforts to maximize margins in the Region and have been successful with raising average sales prices in certain markets to offset land and labor cost increases. Higher volume and simplified product, particularly in markets with a face paced, entry-level focus, has also helped with leveraging construction overhead costs and improving home closing gross margin.

Central. The Central Region produced the highest home closing gross margin in the company and improved 120 basis points year over year, with 21.0% in 2017 versus 19.8% in 2016. In the third quarter of 2017, we were successful in maintaining pricing in alignment with labor, construction and land cost increases. The increased volume of closings and higher revenue in the Central region helped leverage construction overhead costs, resulting in an improved home closing gross margin both in the third quarter and year to date. Year to date, the Region's margins improved by 30 basis points, increasing from 19.9% in 2016 to 20.2% in 2017.

East. The East Region experienced lower year-over-year gross margins in both the three and nine months ended September 30, 2017 of 14.7% and 14.3%, respectively, versus 15.9% and 15.7% for the same periods in 2016. A primary contributor to the decline was impairment charges partially stemming from terminated land contracts. These charges impacted third quarter margins by 90 basis points as compared to the third quarter of 2016 where impairment charges negatively impacted margins by 10 basis points. The lower gross margin was also partially driven by reduced leverage of construction overhead costs due to the decrease in closing volume compared to prior year. We have experienced sequential home closing gross margin improvement throughout the year and as we remain in a period of growth in several of the markets in this Region, we expect that our new product offerings in high demand areas will continue to provide us with pricing power opportunities as well as greater leverage of overhead costs.

Financial Services Profit (in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Financial services profit	$5,514	$5,956	$15,361	$15,765

Financial services profit represents the net profit of our financial services operations, including the operating profit generated by our wholly-owned title company, Carefree Title, as well as our portion of earnings from a mortgage joint venture. The decline is the result of a decline in the capture rate of homebuyers by our mortgage joint venture in the East region.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Commissions and Other Sales Costs				
Dollars	$(55,845)	$(52,478)	$(158,866)	$(155,034)
Percent of home closing revenue	6.9 %	7.1 %	7.0 %	7.3 %
General and Administrative Expenses				
Dollars	$(31,636)	$(33,258)	$(90,849)	$(91,774)
Percent of home closing revenue	3.9 %	4.5 %	4.0 %	4.3 %
(Loss)/Earnings from Other Unconsolidated Entities, Net				
Dollars	$(91)	$440	$852	$856
Interest Expense				
Dollars	$(1,116)	$(167)	$(3,561)	$(5,127)

Other Income, Net				
Dollars	$2,028	$1,435	$5,218	$3,263
Provision for Income Taxes				
Dollars	$(20,905)	$(16,915)	$(55,727)	$(43,989)

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Commissions and Other Sales Costs. Commissions and other sales costs are comprised of internal and external commissions and related sales and marketing expenses such as advertising and sales office costs. These costs increased by $3.4 million for the three months ended September 30, 2017 versus 2016 and increased $3.8 million year to date as a result of increased closing volume. As a percentage of home closing revenue, commissions and other sales costs declined by 20 basis points to 6.9% during the three months ended September 30, 2017, and by 30 basis points to 7.0% for the nine months ended September 30, 2017. This is the result of improved overhead leverage on higher revenues and the revised commission structure we implemented in the latter half of 2016.

General and Administrative Expenses. General and administrative expenses represent corporate and divisional overhead expenses such as salaries and bonuses, occupancy, insurance and travel expenses. For the three months ended September 30, 2017, general and administrative expenses were $31.6 million as compared to $33.3 million for the 2016 period. This decrease is primarily related to our focus on various cost cutting initiatives throughout the company as we continually strive to optimize overhead leverage through cost control efforts at both corporate and divisional levels. For the nine months ended September 30, 2017, these costs were $90.8 million versus $91.8 million in 2016. As a percentage of home closing revenue, general and administrative expenses decreased by 60 basis points for the three-month period ending September 30, 2017 to 3.9% and decreased by 30 basis points to 4.0% year to date. The improved leverage year to date is mainly attributable to the additional closing revenue in 2017 over 2016 in addition to lower costs overall.

(Loss)/Earnings from Other Unconsolidated Entities, Net. Earnings from other unconsolidated entities, net represents our portion of pre-tax earnings/(losses) from non-financial services joint ventures. Included in this amount is both the pass through of earnings/(losses) from the joint ventures' most recently available financial statements as well as any accrued expected earnings/(losses) for the periods presented that might not have been reflected in the joint ventures' financial statements provided to us. The three-month period ended September 30, 2017 reported a slight loss of $0.1 million compared to earnings of $0.4 million in the respective 2016 period. The nine-month periods ended September 30, 2017 and 2016 both reported earnings of $0.9 million.

Interest Expense. Interest expense is comprised of interest incurred, but not capitalized, on our senior notes, Convertible Notes, other borrowings, and our Credit Facility. Interest expense increased year over year in the third quarter to $1.1 million for 2017 compared to $0.2 million in 2016 as we had a higher amount of outstanding debt and associated interest charges from our 5.125% senior notes entered into in June 2017. Our non-capitalizable interest expense was $3.6 million for the nine months ended September 30, 2017 compared to $5.1 million for the 2016 period due to a higher balance of inventory under development that qualifies for interest capitalization.

Other Income, Net. Other income, net, primarily consists of (i) forfeited deposits from potential homebuyers who canceled their purchase contracts with us, (ii) sublease income, (iii) interest earned on our cash and cash equivalents, and (iv) payments and awards related to legal settlements. Other income, net was favorably impacted in 2017 both in the third quarter and year to date primarily by additional interest income from municipalities related to reimbursable land development costs and forfeited buyer deposits compared to the prior year periods.

Income Taxes. Our effective tax rate was 32.9% and 31.4% for the three months ended September 30, 2017 and 2016, respectively, and 34.1% and 31.0% for the nine months ended September 30, 2017 and 2016, respectively. Our tax rate has been favorably impacted in both years by the homebuilding manufacturing deduction and federal energy tax credits. Although the legislation related to federal energy tax credits has expired for tax years after 2016, we continue to claim and recognize a benefit in 2017 and later years for additional energy tax credits from years prior to 2017.

Liquidity and Capital Resources

Overview

Our principal uses of capital in the first nine months of 2017 were acquisition and development of new and strategic lot positions, operating expenses, home construction and the payment of routine liabilities. We used funds generated by operations, our new senior notes, and borrowings under our Credit Facility to meet our short-term working capital requirements and to pay off our Convertible Notes. We remain focused on acquiring desirable land positions, generating increasing margins in our homebuilding operations and maintaining a strong balance sheet to support future needs and growth, while leveraging land options where possible.

Operating Cash Flow Activities

During the nine months ended September 30, 2017 and September 30, 2016, net cash used in operations totaled $174.4 million and $148.3 million, respectively. Operating cash flows in both 2017 and 2016 benefited from cash generated by net earnings of $107.7 million and $97.7 million, respectively, offset mainly by increases in real estate of $336.1 million and $318.5 million, respectively, reflecting increased land and land development spending.

Investing Cash Flow Activities

During the nine months ended September 30, 2017, net cash used in investing activities totaled $10.9 million as compared to $12.4 million for the same period in 2016. Cash used in investing activities in the first nine months of 2017 and 2016 is mainly attributable to the purchases of property and equipment of $12.0 million and $12.3 million for the 2017 and 2016 periods, respectively.

Financing Cash Flow Activities

During the nine months ended September 30, 2017, net cash provided by financing activities totaled $168.8 million as compared to $6.4 million for the same period in 2016. The net cash provided by financing activities in 2017 is primarily the result of $300.0 million in net proceeds received from our 5.125% bond issuance offset partially by the redemption of our Convertible Notes. Our 2016 results were mainly attributable to $25.0 million in proceeds from our Credit Facility partially offset by $18.3 million in payments of loans payable and other borrowings.

Overview of Cash Management

Cash flows for each of our communities depend on their stage of the development cycle, and can differ substantially from reported earnings. Early stages of development or expansion require significant cash outlays for land acquisitions, zoning plat and other approvals, community and lot development, and construction of model homes, roads, utilities, landscape and other amenities. Because these costs are a component of our inventory and not recognized in our statement of operations until a home closes, we incur significant cash outlays prior to recognition of earnings. In the later stages of a community, cash inflows may significantly exceed earnings reported for financial statement purposes, as the cash outflow associated with home and land construction was previously incurred. From a liquidity standpoint, we are currently actively acquiring and developing lots in our markets to maintain and grow our lot supply and active community count. We are also using our cash on hand and draws under our Credit Facility, as needed, to fund operations in newer markets. As demand for new homes improves and we continue to expand our business, we expect cash outlays for land purchases, land development and home construction will continue to exceed our cash generated from operations in the near term.

During the nine months ended September 30, 2017, we closed 5,456 homes, purchased about 9,000 lots for $477.8 million, spent $247.5 million on land development, paid $45.8 million in lot purchase and option deposits, and started construction on 6,416 homes. The opportunity to purchase substantially finished lots in desired locations continues to be more limited and competitive as compared to prior years. As a result, we are purchasing more undeveloped land and partially-finished lots than in recent years and subsequently incurring development dollars in order to bring them to a finished status ready for home construction. We exercise strict controls and believe we have a prudent strategy for Company-wide cash management, including those related to cash outlays for land and inventory acquisition and development. We ended the third quarter of 2017 with $115.2 million of cash and cash equivalents, a $16.5 million decrease from December 31, 2016.

We expect to generate cash from the sale of our inventory, but we intend to redeploy that cash to acquire and develop strategic and well-positioned lots to grow our business. We believe that we currently have strong liquidity.

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

In May 2017, we entered into an amendment to our Credit Facility, which among other things, increased the total commitments available from $540.0 million to $625.0 million and extended the maturity date of a substantial portion of the Credit Facility. Of the total commitments, $60.0 million matures in July 2019 and the remaining $565.0 million matures in July 2021. In June 2017, we completed an offering of $300 million aggregate principal amount of Senior Notes due 2027, bearing interest at 5.125%. In addition, in June 2017 we redeemed $51.9 million of aggregate principal amount of our Convertible Notes in privately negotiated transactions. In September of 2017, on the fifth anniversary of the Convertible Notes, the remaining $74.6 million of our Convertible Notes was redeemed for cash through a combination of holder redemptions and an exercise of our call option, in each case at a redemption price equal to 100% of the principal amount of the notes redeemed, plus accrued and unpaid interest. Reference is made to Notes 5 and 6 in the accompanying unaudited consolidated financial statements.

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

	As of September 30, 2017	December 31, 2016
Notes payable and other borrowings	$1,304,242	$1,127,314
Stockholders’ equity	1,539,108	1,421,495
Total capital	$2,843,350	$2,548,809
Debt-to-capital [1]	45.9 %	44.2 %
Notes payable and other borrowings	$1,304,242	$1,127,314
Less: cash and cash equivalents	(115,167)	(131,702)
Net debt	1,189,075	995,612
Stockholders’ equity	1,539,108	1,421,495
Total net capital	$2,728,183	$2,417,107
Net debt-to-capital [2]	43.6 %	41.2 %

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

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

Credit Facility Covenants

Borrowings under the Credit Facility are unsecured but availability is subject to, among other things, a borrowing base. The Credit Facility also contains certain financial covenants, including (a) a minimum tangible net worth requirement of $987.4 million (which amount is subject to increase over time based on subsequent earnings and proceeds from equity offerings), and (b) a maximum leverage covenant that prohibits the leverage ratio (as defined therein) from exceeding 60%. In addition, we are required to maintain either (i) an interest coverage ratio (EBITDA to interest expense, as defined therein) of at least 1.50 to 1.00 or (ii) liquidity (as defined therein) of an amount not less than our consolidated interest incurred during the trailing 12 months. We were in compliance with all Credit Facility covenants as of September 30, 2017. Our actual financial covenant calculations as of September 30, 2017 are reflected in the table below.

Financial Covenant (dollars in thousands):	Covenant Requirement	Actual
Minimum Tangible Net Worth	> $1,029,472	$1,499,496
Leverage Ratio	< 60%	43%
Interest Coverage Ratio (1)	> 1.50	4.49
Minimum Liquidity (1)	> $75,903	$648,670
Investments other than defined permitted investments	< $449,849	$16,378

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

Off-Balance Sheet Arrangements

Reference is made to Notes 1, 3, 4, and 15 in the accompanying Notes to the unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q, which are incorporated by reference herein. These Notes discuss our off-balance sheet arrangements with respect to land acquisition contracts and option agreements, and land development joint ventures, including the nature and amounts of financial obligations relating to these items. In addition, these Notes discuss the nature and amounts of certain types of commitments that arise in connection with the ordinary course of our land development and homebuilding operations, including commitments of land development joint ventures for which we might be obligated.

Seasonality

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

Recently Issued Accounting Pronouncements

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our fixed rate debt is made up primarily of $175.0 million in principal of our 4.50% senior notes, $300.0 million in principal of our 7.15% senior notes, $300.0 million in principal of our 7.00% senior notes, $200.0 million in principal of our 6.00% senior notes, and $300.0 million of our 5.125% senior notes. Except in limited circumstances, we do not have an obligation to prepay our fixed-rate debt prior to maturity and, as a result, interest rate risk and changes in fair value should not have a significant impact on our fixed rate borrowings until we would be required to repay such debt.
Our Credit Facility is subject to interest rate changes as the borrowing rates are based on LIBOR or PRIME (see Note 5 in the accompanying notes to the unaudited consolidated financial statements included in this Form 10-Q).
Our operations are interest rate sensitive. As overall housing demand is adversely affected by increases in interest rates, a significant increase in mortgage interest rates may negatively affect the ability of homebuyers to secure adequate financing. Higher interest rates could adversely affect our revenues, gross margins and net income and would also increase our variable rate borrowing costs. We do not enter into, or intend to enter into, derivative financial instruments for trading or speculative purposes.

Item 4. Controls and Procedures

In order to ensure that the information we must disclose in our filings with the SEC is recorded, processed, summarized and reported on a timely basis, we have developed and implemented disclosure controls and procedures. Our management, with the participation of our chief executive officer and chief financial officer, has reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e), as of the end of the period covered by this Form 10-Q (the “Evaluation Date”). Based on such evaluation, management has concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective at a reasonable assurance level in ensuring that information that is required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934 (the “Exchange Act”) is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms, and that information required to be disclosed in our reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.
During the fiscal quarter covered by this Form 10-Q, there has not been any change in our internal control over financial reporting that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are involved in various routine legal and regulatory proceedings, including, without limitation, claims and litigation alleging construction defects. In general, the proceedings are incidental to our business, and most exposure is subject to and should be covered by warranty and indemnity obligations of our consultants and subcontractors. Additionally, some such claims are also covered by insurance. With respect to the majority of pending legal proceedings, our ultimate legal and financial responsibility, if any, cannot be estimated with certainty and, in most cases, any potential losses related to these matters are not considered probable. Historically, most disputes regarding warranty claims are resolved prior to the initiation of legal proceedings. We believe there are not any pending legal or warranty matters that could have a material adverse impact upon our consolidated financial condition, results of operations or cash flows that have not been sufficiently reserved. Information related to pending legal proceedings is presented in Note 15 - Commitments on Contingencies, in the accompanying consolidated financial statements and is incorporated by reference herein.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may eventually prove to materially adversely affect our business, financial condition and/or operating results.

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

Issuer Purchases of Equity Securities:

A summary of the Company's repurchase activity for the three months ended September 30, 2017 is as follows:

Period	Total Number of Shares Purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs (2)
July 1, 2017 - July 31, 2017	—	$ ——	—	$130,202,650
August 1, 2017 - August 31, 2017	—	$ ——	—	$130,202,650
September 1, 2017 - September 30, 2017	—	$ ——	—	$130,202,650
Total	—		—	

(1) During the third quarter of 2017, the Company (i) repurchased $26.0 million in aggregate principal amount of its Convertible Notes pursuant to the noteholder's exercise of their put provision of the Convertible Notes and (ii) called the remaining $48.6 million of outstanding Convertible Notes pursuant to our exercise of the call provision of the Convertible Notes, in each case at a price of 100% of the principal amount of the Convertible Notes, plus accrued interest (See Note 6 - Senior and Convertible Senior Notes, Net in the Notes to the Consolidated Financial Statements in Item I of this Form 10-Q for additional details).

(2) On February 21, 2006, we announced that our Board of Directors approved a stock repurchase program, authorizing the expenditure of up to $100 million to repurchase shares of our common stock, in open market or

privately negotiated transactions, based on market conditions and subject to certain price parameters. On August 15, 2006, the Board of Directors authorized an additional $100 million under this program. There is no stated expiration date for this program. As of September 30, 2017, we had approximately $130.2 million of the authorized amount available to repurchase shares under this program.

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

Item 6. Exhibits

Exhibit Number	Description	Page or Method of Filing
3.1	Restated Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Exhibit 3 of Form 8-K dated June 20, 2002
3.1.1	Amendment to Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Exhibit 3.1 of Form 8-K dated September 15, 2004
3.1.2	Amendment to Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Appendix A of the Proxy Statement for the Registrant's 2006 Annual Meeting of Stockholders
3.1.3	Amendment to Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Appendix B of Proxy Statement for the Registrant's 2008 Annual Meeting of Stockholders
3.1.4	Amendment to Articles of Incorporation of Meritage Homes Corporation	Incorporated by reference to Appendix A of the Definitive Proxy Statement filed with the Securities and Exchange Commission on January 9, 2009
3.2	Amended and Restated Bylaws of Meritage Homes Corporation	Incorporated by reference to Exhibit 3.1 of Form 8-K dated May 10, 2017
31.1	Rule 13a-14(a)/15d-14(a) Certification of Steven J. Hilton, Chief Executive Officer	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Hilla Sferruzza, Chief Financial Officer	Filed herewith
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer	Furnished herewith
101.0	The following financial statements from the Meritage Homes Corporation Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2017, were formatted in XBRL (Extensible Business Reporting Language); (i) Unaudited Consolidated Balance Sheets, (ii) Unaudited Consolidated Income Statements, (iii) Unaudited Consolidated Statements of Cash Flows, and (iv) Notes to Unaudited Consolidated Financial Statements.	

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SIGNATURES

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

MERITAGE HOMES CORPORATION,
a Maryland Corporation

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

Date: October 30, 2017

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