Forestar Group Inc.
Form 10-Q
May 08, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2015

or

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

For the transition period from to

Commission File Number: 001-33662

FORESTAR GROUP INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	26-1336998
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

6300 Bee Cave Road, Building Two, Suite 500, Austin, Texas 78746
(Address of Principal Executive Offices, Including Zip Code)
(512) 433-5200
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title of Each Class	Number of Shares Outstanding as of May 4, 2015
Common Stock, par value $1.00 per share	33,618,526

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PART I—FINANCIAL INFORMATION
Item 1. Financial Statements
FORESTAR GROUP INC.
Consolidated Balance Sheets
(Unaudited)

	First Quarter-End 2015	Year-End 2014
	(In thousands, except share data)	
ASSETS		
Cash and cash equivalents	$126,262	$170,127
Real estate, net	596,284	575,756
Oil and gas properties and equipment, net	279,954	263,493
Investment in unconsolidated ventures	65,381	65,005
Timber	8,430	8,315
Receivables, net	15,785	24,589
Income taxes receivable	2,092	7,503
Prepaid expenses	3,379	6,000
Property and equipment, net	11,104	11,627
Deferred tax asset, net	44,583	40,624
Goodwill and other intangible assets	65,891	66,131
Other assets	17,826	19,029
TOTAL ASSETS	$1,236,971	$1,258,199
LIABILITIES AND EQUITY		
Accounts payable	$11,123	$20,400
Accrued employee compensation and benefits	2,807	8,323
Accrued property taxes	3,092	5,966
Accrued interest	7,551	3,451
Earnest money deposits	10,113	10,045
Other accrued expenses	33,964	35,729
Other liabilities	30,519	31,799
Debt	434,413	432,744
TOTAL LIABILITIES	533,582	548,457
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Forestar Group Inc. shareholders' equity:		
Common stock, par value $1.00 per share, 200,000,000 authorized shares, 36,946,603 issued at first quarter-end 2015 and year-end 2014	36,947	36,947
Additional paid-in capital	558,600	558,945
Retained earnings	158,843	167,001
Treasury stock, at cost, 3,328,077 shares at first quarter-end 2015 and 3,485,278 shares at year-end 2014	(53,124)	(55,691)
Total Forestar Group Inc. shareholders' equity	701,266	707,202
Noncontrolling interests	2,123	2,540
TOTAL EQUITY	703,389	709,742
TOTAL LIABILITIES AND EQUITY	$1,236,971	$1,258,199

Please read the notes to consolidated financial statements.

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FORESTAR GROUP INC.
Consolidated Statements of Income and Comprehensive Income
(Unaudited)

	First Quarter 2015	First Quarter 2014
	(In thousands, except per share amounts)	
REVENUES		
Real estate sales and other	$21,961	$55,547
Commercial and income producing properties	10,869	9,933
Real estate	32,830	65,480
Oil and gas	13,185	17,554
Other natural resources	1,790	1,571
	47,805	84,605
COSTS AND EXPENSES		
Cost of real estate sales and other	(10,362)	(26,064)
Cost of commercial and income producing properties	(7,692)	(10,120)
Cost of oil and gas producing activities	(11,542)	(12,620)
Cost of other natural resources	(920)	(776)
Other operating	(18,060)	(13,997)
General and administrative	(8,142)	(5,145)
	(56,718)	(68,722)
GAIN ON SALE OF ASSETS	1,176	—
OPERATING INCOME (LOSS)	(7,737)	15,883
Equity in earnings of unconsolidated ventures	3,045	991
Interest expense	(8,821)	(5,503)
Other non-operating income	917	2,294
INCOME (LOSS) BEFORE TAXES	(12,596)	13,665
Income tax benefit (expense)	4,359	(4,658)
CONSOLIDATED NET INCOME (LOSS)	(8,237)	9,007
Less: Net (income) loss attributable to noncontrolling interests	79	(673)
NET INCOME (LOSS) ATTRIBUTABLE TO FORESTAR GROUP INC.	$(8,158)	$8,334
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING		
Basic	34,168	35,576
Diluted	34,168	43,913
NET INCOME (LOSS) PER COMMON SHARE		
Basic	$(0.24)	$0.20
Diluted	$(0.24)	$0.19
TOTAL COMPREHENSIVE INCOME (LOSS)	$(8,158)	$8,334

Please read the notes to consolidated financial statements.

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FORESTAR GROUP INC.
Consolidated Statements of Cash Flows
(Unaudited)

	First Quarter 2015	2014
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Consolidated net income (loss)	$(8,237)	$9,007
Adjustments:		
Depreciation, depletion and amortization	11,325	7,439
Change in deferred income taxes	(4,359)	2,976
Equity in earnings of unconsolidated ventures	(3,045)	(991)
Distributions of earnings of unconsolidated ventures	2,845	1,018
Share-based compensation	3,342	313
Real estate cost of sales	9,884	24,812
Dry hole and leasehold abandonment costs	86	2,381
Real estate development and acquisition expenditures, net	(34,769)	(35,035)
Reimbursements from utility and improvement districts	4,130	1,536
Other changes in real estate	667	652
Changes in deferred income	81	(132)
Gain on sale of assets	(1,176)	—
Other	982	615
Changes in:		
Notes and accounts receivable	7,016	7,433
Prepaid expenses and other	2,695	790
Accounts payable and other accrued liabilities	(15,644)	(15,104)
Income taxes	5,411	(2,167)
Net cash provided by (used for) operating activities	(18,766)	5,543
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property, equipment, software, reforestation and other	(2,809)	(4,699)
Oil and gas properties and equipment	(23,718)	(19,357)
Investment in unconsolidated ventures	(831)	(4,293)
Proceeds from sales of oil and gas properties, net	2,000	—
Return of investment in unconsolidated ventures	655	155
Net cash used for investing activities	(24,703)	(28,194)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments of debt	(2,463)	(15,711)
Additions to debt	3,119	2,608
Deferred financing fees	(6)	—
Distributions to noncontrolling interests, net	(338)	(498)
Purchase of noncontrolling interests	—	(7,971)
Exercise of stock options	14	754
Payroll taxes on issuance of stock-based awards	(723)	(879)
Excess income tax benefit from share-based compensation	1	20
Net cash used for financing activities	(396)	(21,677)
Net decrease in cash and cash equivalents	(43,865)	(44,328)
Cash and cash equivalents at beginning of period	170,127	192,307
Cash and cash equivalents at end of period	$126,262	$147,979

Please read the notes to consolidated financial statements.

FORESTAR GROUP INC.
Notes to Consolidated Financial Statements
(Unaudited)

Note 1—Basis of Presentation

Our consolidated financial statements include the accounts of Forestar Group Inc., all subsidiaries, ventures and other entities in which we have a controlling interest. We account for our investment in other entities in which we have significant influence over operations and financial policies using the equity method. We eliminate all material intercompany accounts and transactions. Noncontrolling interests in consolidated pass-through entities are recognized before income taxes.

We prepare our unaudited interim financial statements in accordance with U.S. generally accepted accounting principles and Securities and Exchange Commission requirements for interim financial statements. As a result, they do not include all the information and disclosures required for complete financial statements. However, in our opinion, all adjustments considered necessary for a fair presentation have been included. Such adjustments consist only of normal recurring items unless otherwise noted. We make estimates and assumptions about future events. Actual results can, and probably will, differ from those we currently estimate including those principally related to allocating costs to real estate, measuring long-lived assets for impairment, oil and gas revenue accruals, capital expenditure and lease operating expense accruals associated with our oil and gas production activities, oil and gas reserves and depletion of our oil and gas properties. These interim operating results are not necessarily indicative of the results that may be expected for the entire year. For further information, please read the financial statements included in our 2014 Annual Report on Form 10-K.

Note 2—New and Pending Accounting Pronouncements

Pending Accounting Standards

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606), requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. Early adoption is not permitted. The updated standard becomes effective for annual and interim periods beginning after December 15, 2016. On April 1, the FASB voted to propose a deferral of the effective date of the new standard by one year. This proposed deferral would result in the new standard being effective after December 15, 2017. We have not yet selected a transition method and we are currently evaluating the effect that the updated standard will have on our earnings, financial position and disclosures.

In February 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis, requiring entities to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The revised consolidation model: (1) modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities, (2) eliminates the presumption that a general partner should consolidate a limited partnership, (3) affects the consolidation analysis of reporting entities that are involved with VIEs, and (4) provides a scope exception from consolidation guidance for reporting entities with interests in certain legal entities. The updated standard is effective for financial statements issued for annual and interim periods beginning after December 15, 2015. Early adoption is permitted. The updated standard may be applied retrospectively or using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption. We are currently evaluating the effect that the updated standard will have on our earnings, financial position and disclosures.

In April 2015, the FASB issued ASU 2015-03, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, as part of its initiative to reduce complexity in accounting standards. To simplify presentation of debt issuance costs, the amendments in this Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The updated standard is effective for financial statements issued for annual and interim periods beginning after December 15, 2015. We are currently evaluating the effect that the updated standard will have on our financial position and disclosures.

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Note 3—Real Estate

Real estate consists of:

	First Quarter-End 2015	Year-End 2014
	(In thousands)	
Entitled, developed and under development projects	$338,607	$321,273
Undeveloped land (includes land in entitlement)	93,458	93,182
Commercial and income producing properties		
Carrying value	196,348	192,678
Less: accumulated depreciation	(32,129)	(31,377)
Net carrying value	164,219	161,301
	$596,284	$575,756

Our estimated costs of assets for which we expect to be reimbursed by utility and improvement districts were $90,506,000 at first quarter-end 2015 and $65,212,000 at year-end 2014, including $47,075,000 at first quarter-end 2015 and $31,913,000 at year-end 2014 related to our Cibolo Canyons project near San Antonio, Texas. At first quarter-end 2015,$47,075,000 of reimbursable costs for the Cibolo Canyons project were related to submitted and approved reimbursements of $65,438,000 net of collections totaling $33,552,000 plus $15,189,000 of additional reimbursable costs we incurred which we plan to submit for approval from the district. At year-end 2014, $31,913,000 of reimbursable costs for the Cibolo Canyons project were related to costs of $65,465,000 that were submitted, net of collections totaling $33,552,000. These costs are principally for water, sewer and other infrastructure assets that we have incurred and submitted or will submit to utility or improvement districts for approval and reimbursement. We expect to be reimbursed by utility and improvement districts when these districts achieve adequate tax basis or otherwise have funds available to support payment. In first quarter 2015, our submitted reimbursements to these districts for all real estate projects excluding Cibolo Canyons project were $1,520,000 and we have collected and $4,130,000 in reimbursements that were previously submitted to these districts.

At first quarter-end 2015, commercial and income producing properties represents our investment of $78,566,000 in multifamily development sites located in Austin, Charlotte, Dallas and Nashville, $52,742,000 investment in a 257-unit multifamily project in Austin, $32,505,000 investment in a 413 guest room hotel in Austin and $406,000 investment in a golf course and a country club property located near Fort Worth.

Note 4—Oil and Gas Properties and Equipment, net

Net capitalized costs, utilizing the successful efforts method of accounting, related to our oil and gas producing activities follows:

	First Quarter-End 2015	Year-End 2014
	(In thousands)	
Unproved oil and gas properties	$85,771	$90,446
Proved oil and gas properties	249,601	221,299
Total costs	335,372	311,745
Less: accumulated depreciation, depletion and amortization	(55,418)	(48,252)
	$279,954	$263,493

In first quarter 2015, we recorded a gain of $1,176,000 related to the sale of 290 net mineral acres leased from others in North Dakota for $2,000,000.

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Note 5—Goodwill and Other Intangible Assets

Carrying value of goodwill and other intangible assets follows:

	First Quarter-End 2015	Year-End 2014
	(In thousands)	
Goodwill	$63,423	$63,423
Identified intangibles, net	2,468	2,708
	$65,891	$66,131

At first quarter-end 2015, goodwill related to our oil and gas properties is $59,549,000 and $3,874,000 is associated with a water resources company acquired in 2010.

Identified intangibles include $1,681,000 in indefinite lived groundwater leases associated with a water resources company acquired in 2010, $433,000 related to in-place tenant leases with definite lives associated with the purchase of our partner's interest in the Eleven venture and $354,000 related to patents with definite lives associated with the Calliope Gas Recovery System, a process to increase natural gas production.

Note 6—Equity

A reconciliation of changes in equity at first quarter-end 2015 follows:

	Forestar Group Inc.	Noncontrolling Interests	Total
	(In thousands)		
Balance at year-end 2014	$707,202	$2,540	$709,742
Net income (loss)	(8,158)	(79)	(8,237)
Distributions to noncontrolling interests	—	(338)	(338)
Other (primarily share-based compensation)	2,222	—	2,222
	$701,266	$2,123	$703,389

Note 7—Investment in Unconsolidated Ventures

At first quarter-end 2015, we have ownership interests in 15 ventures that we account for using the equity method. Combined summarized balance sheet information for our ventures accounted for using the equity method follows:

	Venture Assets		Venture Borrowings[a]		Venture Equity		Our Investment	
	First Quarter-End 2015	Year-End 2014	First Quarter-End 2015	Year-End 2014	First Quarter-End 2015	Year-End 2014	First Quarter-End 2015	Year-End 2014
	(In thousands)							
242, LLC [b]	$35,556	$33,021	$9,328	$6,940	$22,253	$21,789	$10,363	$10,098
CL Ashton Woods, LP [c]	12,649	13,269	—	—	9,479	11,453	4,693	6,015
CL Realty, LLC	7,965	7,960	—	—	7,899	7,738	3,950	3,869
CREA FMF Nashville LLC [b]	50,251	40,014	40,648	29,660	5,874	5,987	5,403	5,516
Elan 99, LLC	12,060	10,070	1	1	10,333	9,643	9,299	8,679
FMF Littleton LLC	32,765	26,953	3,912	—	24,737	24,435	6,362	6,287
FMF Peakview LLC	45,457	43,638	24,774	23,070	17,462	17,464	3,574	3,575
HM Stonewall Estates, Ltd [c]	3,629	3,750	33	669	3,596	3,081	1,982	1,752
LM Land Holdings, LP [c]	30,487	25,561	8,505	4,448	19,750	18,500	9,686	9,322
PSW Communities, LP	18,964	16,045	12,870	10,515	4,610	4,415	4,097	3,924

Temco Associates, LLC	11,734	11,756	—	—	11,556	11,556	5,778	5,778
Other ventures [d]	4,837	8,453	23,437	26,944	(25,752)	(25,614)	194	190
	$266,354	$240,490	$123,508	$102,247	$111,797	$110,447	$65,381	$65,005

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Combined summarized income statement information for our ventures accounted for using the equity method follows:

	Venture Revenues		Venture Earnings (Loss)		Our Share of Earnings (Loss)	
	First Quarter					
	2015	2014	2015	2014	2015	2014
	(In thousands)					
242, LLC [(b)]	$5,331	$1,475	$3,464	$533	$1,766	$277
CL Ashton Woods, LP [(c)]	1,350	708	527	220	678	318
CL Realty, LLC	279	368	160	230	80	115
CREA FMF Nashville LLC [(b)]	6	—	(113)	(25)	(113)	(25)
Elan 99, LLC	—	—	(2)	—	(2)	—
FMF Peakview LLC	186	—	(482)	(73)	(96)	(15)
HM Stonewall Estates, Ltd [(c)]	1,058	1,001	515	352	230	141
LM Land Holdings, LP [(c)]	1,976	4,898	1,250	2,927	364	677
PSW Communities, LP	2,427	—	195	(216)	173	(189)
Temco Associates, LLC	58	60	(1)	(18)	—	(9)
Other ventures [(d)]	3,701	385	(203)	(261)	(35)	(299)
	$16,372	$8,895	$5,310	$3,669	$3,045	$991

(a) Total includes current maturities of $78,947,000 at first quarter-end 2015, of which $51,788,000 is non-recourse to us, and $65,795,000 at year-end 2014, of which $42,566,000 is non-recourse to us.

(b) Includes unamortized deferred gains on real estate contributed by us to ventures. We recognize deferred gains as income as real estate is sold to third parties. Deferred gains of $1,587,000 are reflected as a reduction to our investment in unconsolidated ventures at first quarter-end 2015.

(c) Includes unrecognized basis difference of $1,373,000 which is reflected as a reduction of our investment in unconsolidated ventures at first quarter-end 2015. The difference will be accreted as income or expense over the life of the investment and included in our share of earnings (loss) from the respective ventures.

(d) Our investment in other ventures reflects our ownership interests, excluding venture losses that exceed our investment where we are not obligated to fund those losses. Please read Note 16—Variable Interest Entities for additional information.

In first quarter 2015, we invested $831,000 in these ventures and received $3,500,000 in distributions. In first quarter 2014, we invested $4,293,000 in these ventures and received $1,173,000 in distributions. Distributions include both return of investments and distribution of earnings.

Note 8—Receivables

Receivables consist of:

	First Quarter-End	Year-End
	2015	2014
	(In thousands)	
Oil and gas revenue accruals	6,811	7,293
Other receivables and accrued interest	4,696	6,505
Oil and gas joint interest billing receivables	2,657	5,738
Other loans secured by real estate, average interest rates of 9.90% at first quarter-end 2015 and 4.41% at year-end 2014	1,879	1,737
Loan secured by real estate	$—	$3,574
	16,043	24,847
Allowance for bad debts	(258)	(258)
	$15,785	$24,589

In second quarter 2011, we acquired a non-performing loan that was secured by a lien on developed and undeveloped real estate located near Houston designated for single-family residential and commercial development. In first quarter

2015, the loan was paid in full and we received principal payments of $4,394,000 and interest payments of $49,000.

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Estimated accretable yield follows:

	First Quarter-End 2015
	(In thousands)
Beginning of period (year-end 2014)	$839
Change in accretable yield due to change in timing of estimated cash flows	30
Interest income recognized (in first quarter 2015)	(869)
End of period	$—

Other loans secured by real estate generally are secured by a deed of trust and due within three years.

Note 9—Debt

Debt consists of:

	First Quarter-End 2015	Year-End 2014
	(In thousands)	
8.50% senior secured notes due 2022	250,000	250,000
3.75% convertible senior notes due 2020, net of discount	104,020	103,194
6.00% tangible equity unit notes, net of discount	15,092	17,154
Secured promissory notes — average interest rates of 3.18% at first quarter-end 2015 and 3.17% at year-end 2014	15,400	15,400
Other indebtedness — interest rates ranging from 2.19% to 5.50% at first quarter-end 2015	49,901	46,996
	$434,413	$432,744

Our debt agreements contain financial covenants customary for such agreements including minimum levels of interest coverage and limitations on leverage. At first quarter-end 2015, we were in compliance with the financial covenants of these agreements.

At first quarter-end 2015, our senior secured credit facility provides for a $300,000,000 revolving line of credit maturing May 15, 2017. The revolving line of credit may be prepaid at any time without penalty. The revolving line of credit includes a $100,000,000 sublimit for letters of credit, of which $15,459,000 is outstanding at first quarter-end 2015. Total borrowings under our senior secured credit facility (including the face amount of letters of credit) may not exceed a borrowing base formula. At first quarter-end 2015, we had $284,541,000 in net unused borrowing capacity under our senior secured credit facility.

Under the terms of our senior secured credit facility, at our option we can borrow at LIBOR plus 4.0 percent or at the alternate base rate plus 3.0 percent. The alternate base rate is the highest of (i) KeyBank National Association’s base rate, (ii) the federal funds effective rate plus 0.5 percent or (iii) 30 day LIBOR plus 1 percent. Borrowings under the senior secured credit facility are or may be secured by (a) mortgages on the timberland, high value timberland and portions of raw entitled land, as well as pledges of other rights including certain oil and gas operating properties, (b) assignments of current and future leases, rents and contracts, (c) a security interest in our primary operating account, (d) a pledge of the equity interests in current and future material operating subsidiaries and most of our majority-owned joint venture interests, or if such pledge is not permitted, a pledge of the right to distributions from such entities, and (e) a pledge of certain reimbursements payable to us from special improvement district tax collections in connection with our Cibolo Canyons project. The senior secured credit facility provides for releases of real estate and other collateral provided that borrowing base compliance is maintained.

At first quarter-end 2015, secured promissory notes represent a $15,400,000 loan collateralized by a 413 guest room hotel located in Austin with a carrying value of $32,505,000. Other indebtedness principally represents $45,714,000 of senior secured loans for two multifamily properties, our 257-unit multifamily project in Austin and our 354-unit multifamily property in Dallas. The combined carrying value of these two multifamily properties is $87,012,000 at first quarter-end 2015.

At first quarter-end 2015 and year-end 2014, we have $14,276,000 and $15,168,000 in unamortized deferred financing fees which are included in other assets. Amortization of deferred financing fees was $1,156,000 and $901,000 in first quarter 2015 and 2014 and is included in interest expense.

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Note 10—Fair Value

Fair value is the exchange price that would be the amount received for an asset or paid to transfer a liability in an orderly transaction between market participants. In arriving at a fair value measurement, we use a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable. The three levels of inputs used to establish fair value are the following:

- Level 1 — Quoted prices in active markets for identical assets or liabilities;
- Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Non-financial assets measured at fair value on a non-recurring basis principally include real estate assets, oil and gas properties, assets held for sale, goodwill and other intangible assets, which are measured for impairment. In first quarter 2015, we recognized non-cash asset impairment charges of $504,000 associated with a residential development with golf course and country club property located near Fort Worth. We had no non-cash impairment charges of proved oil and gas properties in first quarter 2015.

	First Quarter-End 2015				Year-End 2014			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	(In thousands)							
Non-Financial Assets and Liabilities:								
Real estate	$—	$1,948	$—	$1,948	$—	$970	$—	$970
Proved oil and gas properties	$—	$—	$—	$—	$—	$—	$3,655	$3,655

We elected not to use the fair value option for cash and cash equivalents, accounts receivable, other current assets, variable debt, accounts payable and other current liabilities. The carrying amounts of these financial instruments approximate their fair values due to their short-term nature or variable interest rates. We determine the fair value of fixed rate financial instruments using quoted prices for similar instruments in active markets.

Information about our fixed rate financial instruments not measured at fair value follows:

	First Quarter-End 2015		Year-End 2014		
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Valuation Technique
	(In thousands)				
Loan secured by real estate	$—	$—	$3,574	$4,859	Level 2
Fixed rate debt	$(369,112)	$(357,342)	$(370,348)	$(359,131)	Level 2

Note 11—Capital Stock

In first quarter 2015, we accelerated the expiration date of our shareholder rights plan from December 11, 2017 to March 13, 2015, resulting in termination of the plan.

Please read Note 17—Share-Based and Long-Term Incentive Compensation for information about additional shares of common stock that could be issued under terms of our share-based compensation plans.

At first quarter-end 2015, personnel of former affiliates held options to purchase 510,000 shares of our common stock. The options have a weighted average exercise price of $28.42 and a weighted average remaining contractual term of one year. At first quarter-end 2015, the options have an aggregate intrinsic value of $24,600.

Note 12—Net Income (Loss) per Share

Basic and diluted earnings per share is computed using the two-class method. The two-class method is an earnings allocation formula that determines net income per share for each class of common stock and participating security. We have determined that our 6.00% tangible equity units (Units) are participating securities. Per share amounts are computed by dividing earnings available to common shareholders by the weighted average shares outstanding during each period. In periods

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with a net loss, no such adjustment is made to earnings as the holders of the participating securities have no obligation to fund losses.

Due to a net loss in first quarter 2015, as the effect of potentially dilutive securities would be anti-dilutive, basic and diluted loss per share are the same. The computations of basic and diluted earnings per share are as follows:

	First Quarter	
	2015	2014
	(In thousands)	
Numerator:		
Consolidated net income (loss)	$(8,237)	$9,007
Less: Net loss (income) attributable to noncontrolling interest	79	(673)
Earnings (loss) available for diluted earnings per share	$(8,158)	$8,334
Less: Undistributed net income allocated to participating securities	—	(1,295)
Earnings (loss) available to common shareholders for basic earnings per share	$(8,158)	$7,039
Denominator:		
Weighted average common shares outstanding — basic	34,168	35,576
Weighted average common shares upon conversion of participating securities [(a)]	—	7,857
Dilutive effect of stock options, restricted stock and equity-settled awards	—	480
Total weighted average shares outstanding — diluted	34,168	43,913
Anti-dilutive awards excluded from diluted weighted average shares	10,743	2,051

(a) Our earnings per share calculation reflects the weighted average shares issuable upon settlement of the prepaid stock purchase contract component of our 6.00% tangible equity units, issued November 27, 2013.

The actual number of shares we may issue upon settlement of the stock purchase contract will be between 6,547,800 shares (the minimum settlement rate) and 7,857,000 shares (the maximum settlement rate) based on the applicable market value, as defined in the purchase contract agreement associated with issuance of the Units.

We intend to settle the principal amount of our convertible senior notes (Convertible Notes) in cash upon conversion with only the amount in excess of par value of the Convertible Notes to be settled in shares of our common stock. Therefore, our calculation of diluted net income per share using the treasury stock method includes only the amount, if any, in excess of par value of the Convertible Notes. As such, the Convertible Notes have no impact on diluted net income per share until the price of our common stock exceeds the $24.49 conversion price of the Convertible Notes. The average price of our common stock in first quarter 2015 did not exceed the conversion price which resulted in no additional diluted outstanding shares.

Note 13—Income Taxes

Our effective tax rate was 35 percent in first quarter 2015, which includes a two percent benefit for noncontrolling interests and a two percent detriment for share-based compensation benefits that will not be realized. Our effective tax rate was 34 percent in first quarter 2014, which included a two percent benefit for noncontrolling interests. Our effective tax rates also include the effect of state income taxes, nondeductible items and benefits of percentage depletion.

We have not provided a valuation allowance for our federal deferred tax asset because we believe it is likely it will be recoverable in future periods.

Note 14—Commitments and Contingencies

Litigation

We are involved in various legal proceedings that arise from time to time in the ordinary course of doing business and believe that adequate reserves have been established for any probable losses. We do not believe that the outcome of any of these proceedings should have a significant adverse effect on our financial position, long-term results of operations or cash flows. However, it is possible that charges related to these matters could be significant to our results or cash flows in any one accounting period.

Environmental

Environmental remediation liabilities arise from time to time in the ordinary course of doing business, and we believe we have established adequate reserves for any probable losses that we can reasonably estimate. We own 288 acres near Antioch,

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California, portions of which were sites of a former paper manufacturing operation that are in remediation. We have received certificates of completion on all but one 80 acre tract, a portion of which includes subsurface contamination. We estimate the remaining cost to complete remediation activities will be approximately $451,000, which is included in other accrued expenses. It is possible that remediation or monitoring activities could be required in addition to those included within our estimate, but we are unable to determine the scope, timing or extent of such activities.

We have asset retirement obligations related to the abandonment and site restoration requirements that result from the acquisition, construction and development of oil and gas properties. We record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Accretion expense related to the asset retirement obligation and depletion expense related to capitalized asset retirement cost is included in cost of oil and gas producing activities on our consolidated statements of income and comprehensive income. At first quarter-end 2015 and year-end 2014, our asset retirement obligation was $1,877,000 and $1,807,000, which is included in other liabilities.

Oil and Gas Restructuring Costs

In connection with review of strategic alternatives with respect to our oil and gas business that was announced in December 2014, we offered retention bonuses aggregating $1,519,000 to key personnel provided they remain our employees through December 2015. We are expensing retention bonus costs over the retention period. In first quarter 2015, we incurred severance expenses related to staff reductions, paid a portion of the December 2014 accrual under written severance agreements and incurred costs associated with closure of our Fort Worth office. Office closure costs include a $1,750,000 lease termination charge and $391,000 for write off of leasehold improvements which were partially offset by a deferred lease credit of $364,000. These restructuring costs are included in other operating expense on our consolidated statements of income and comprehensive income. We may incur additional costs related to our review of strategic alternatives associated with our oil and gas business.

The following table summarizes activity related to liabilities associated with our oil and gas restructuring activities in first quarter 2015:

	Employee-Related Costs	Facility Closure	Total
	(In thousands)		
Balance at year-end 2014	$(2,367)	$—	$(2,367)
Additions	(1,068)	(1,750)	(2,818)
Payments	1,894	1,750	3,644
Balance at first quarter-end 2015	$(1,541)	$—	$(1,541)

Note 15—Segment Information

We manage our operations through three segments: real estate, oil and gas and other natural resources. Real estate secures entitlements and develops infrastructure on our lands for single-family residential and mixed-use communities, and manages our undeveloped land, commercial and income producing properties, primarily a hotel and our multifamily investments. Oil and gas is an independent oil and gas exploration, development and production operation and manages our owned and leased mineral interests. Other natural resources manages our timber, recreational leases and water resource initiatives.

Total assets allocated by segment are as follows:

	First Quarter-End 2015	Year-End 2014
	(In thousands)	
Real estate	$670,067	$654,774
Oil and gas	352,695	342,703
Other natural resources	20,077	22,531
Assets not allocated to segments [(a)]	194,132	238,191
	$1,236,971	$1,258,199

(a) Assets not allocated to segments at first quarter-end 2015 principally consist of cash and cash equivalents of $126,262,000 and a net deferred tax asset of $44,583,000. Assets not allocated to segments at year-end 2014 principally consist of cash and cash equivalents of $170,127,000 and a net deferred tax asset of $40,624,000.

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We evaluate performance based on segment earnings (loss) before unallocated items and income taxes. Segment earnings (loss) consist of operating income, equity in earnings (loss) of unconsolidated ventures, gain on sales of assets, interest income on loans secured by real estate and net (income) loss attributable to noncontrolling interests. Items not allocated to our business segments consist of general and administrative expense, share-based and long-term incentive compensation, gain on sale of strategic timberland, interest expense and other corporate non-operating income and expense. The accounting policies of the segments are the same as those described in Note 1—Basis of Presentation. Our revenues are derived from U.S. operations and all of our assets are located in the U.S. In first quarter 2015, no single customer accounted for more than ten percent of our total revenues.
Segment revenues and earnings are as follows:

	First Quarter	
	2015	2014
	(In thousands)	
Revenues:		
Real estate	$32,830	$65,480
Oil and gas	13,185	17,554
Other natural resources	1,790	1,571
Total revenues	$47,805	$84,605
Segment earnings (loss):		
Real estate	$9,066	$23,575
Oil and gas	(2,941)	807
Other natural resources	(391)	(528)
Total segment earnings	5,734	23,854
Items not allocated to segments [(a)]	(18,251)	(10,862)
Income (loss) before taxes attributable to Forestar Group Inc.	$(12,517)	$12,992

[(a)] Items not allocated to segments consist of:

	First Quarter	
	2015	2014
	(In thousands)	
General and administrative expense	$(6,020)	$(5,168)
Shared-based and long-term incentive compensation expense	(3,458)	(313)
Interest expense	(8,821)	(5,503)
Other corporate non-operating income	48	122
	$(18,251)	$(10,862)

Note 16—Variable Interest Entities

We participate in real estate ventures for the purpose of acquiring and developing residential, multifamily and mixed-use communities in which we may or may not have a controlling financial interest. Generally accepted accounting principles require consolidation of VIEs in which an enterprise has a controlling financial interest and is the primary beneficiary. A controlling financial interest will have both of the following characteristics: (a) the power to direct the VIE activities that most significantly impact economic performance and (b) the obligation to absorb the VIE losses and right to receive benefits that are significant to the VIE. We examine specific criteria and use judgment when determining whether we are the primary beneficiary and must consolidate a VIE. We perform this review initially at the time we enter into venture agreements and continuously reassess to see if we are the primary beneficiary of a VIE.

At first quarter-end 2015, we have four VIEs. We account for these VIEs using the equity method and we are not the primary beneficiary. Although we have certain rights regarding major decisions, we do not have the power to direct the activities that are most significant to the economic performance of these VIEs. At first quarter-end 2015, these VIEs have total assets of $73,855,000, substantially all of which represent developed and undeveloped real estate, and total liabilities of $89,317,000, which includes $36,306,000 of borrowings classified as current maturities. These amounts are included in the summarized balance sheet information for ventures accounted for using the equity method in Note 7—Investment in Unconsolidated Ventures. At first quarter-end 2015, our investment in these VIEs is $9,567,000 and is included in investment in unconsolidated ventures. In first quarter 2015, we contributed $37,000 to these VIEs. Our maximum exposure to loss related to one of these VIEs is estimated at $3,561,000, which exceeds our investment as we have a nominal general partner interest

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and could be held responsible for its liabilities. The maximum exposure to loss represents the maximum loss that we could be required to recognize assuming all the ventures' assets (principally real estate) are worthless, without consideration of the probability of a loss or of any actions we may take to mitigate any such loss.

Note 17—Share-Based and Long-Term Incentive Compensation

Share-based and long-term incentive compensation expense consists of:

	First Quarter	
	2015	2014
	(In thousands)	
Cash-settled awards	296	(2,683)
Equity-settled awards	1,997	2,349
Restricted stock	17	46
Stock options	1,032	601
Total share-based compensation	3,342	313
Deferred cash	116	—
	$3,458	$313

Share-based and long-term incentive compensation expense is included in:

	First Quarter	
	2015	2014
	(In thousands)	
General and administrative expense	$2,122	$(23)
Other operating expense	1,336	336
	$3,458	$313

Share-Based Compensation

In first quarter 2015, we granted 89,900 cash-settled stock appreciation rights awards and 598,600 equity-settled awards. Cash-settled stock appreciation rights have a ten-year term, generally become exercisable ratably over four years and provide for accelerated or continued vesting upon retirement, death, or disability or if there is a change in control. Equity-settled awards granted to employees in the first quarter 2015 include market-leveraged stock units (MSUs) and stock options. Equity-settled MSUs will be settled in common stock based upon our stock price performance over 3 years years from the date of grant. Stock options have a ten-year term, generally become exercisable ratably over four years and provide for accelerated or continued vesting upon retirement, death, or disability or if there is a change in control. Equity-settled awards in the form of restricted stock units granted to our directors are fully vested at the time of grant and are issued upon retirement.

The fair value of awards granted to retirement eligible employees and expensed at the date of grant was $517,000 and $760,000 in first quarter 2015 and 2014. Unrecognized share-based compensation expense related to non-vested equity-settled awards, restricted stock and stock options is $10,177,000 at first quarter-end 2015.

In first quarter 2015 and 2014, we issued 157,201 and 167,747 shares out of our treasury stock associated with vesting of stock-based awards or exercise of stock options, net of 48,636 and 46,314 shares withheld having a value of $723,000 and $879,000 for payroll taxes in connection with vesting of stock-based awards or exercise of stock options.

Long-Term Incentive Compensation

In first quarter 2015, we granted $587,000 of long-term incentive compensation in the form of deferred cash compensation. Deferred cash will be paid out after the earlier of three years or the employee's retirement eligibility date and the expense is recognized ratably over the vesting period. The accrued liability was $116,000 at first quarter-end 2015 and is included in other liabilities.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2014 Annual Report on Form 10-K. Unless otherwise indicated, information is presented as of first quarter-end 2015, and references to acreage owned includes all acres owned by ventures regardless of our ownership interest in a venture.

Forward-Looking Statements

This Quarterly Report on Form 10-Q and other materials we have filed or may file with the Securities and Exchange Commission contain "forward-looking statements" within the meaning of the federal securities laws. These forward-looking statements are identified by their use of terms and phrases such as "believe," "anticipate," "could," "estimate," "likely," "intend," "may," "plan," "expect," and similar expressions, including references to assumptions. These statements reflect our current views with respect to future events and are subject to risks and uncertainties. We note that a variety of factors and uncertainties could cause our actual results to differ significantly from the results discussed in the forward-looking statements. Factors and uncertainties that might cause such differences include, but are not limited to:

- general economic, market or business conditions in Texas or Georgia, where our real estate activities are concentrated, or on a national or global scale;
- our ability to achieve some or all of our strategic initiatives;
- the opportunities (or lack thereof) that may be presented to us and that we may pursue;
- our ability to hire and retain key personnel;
- significant customer concentration;
- future residential, multifamily or commercial entitlements, development approvals and the ability to obtain such approvals;
- obtaining approvals of reimbursements and other payments from special improvement districts and the timing of such payments;
- accuracy of estimates and other assumptions related to investment in and development of real estate, the expected timing and pricing of land and lot sales and related cost of real estate sales, impairment of long-lived assets, income taxes, share-based compensation, oil and gas reserves, revenues, capital expenditures and lease operating expense accruals associated with our oil and gas working interests, and depletion of our oil and gas properties;
- the levels of resale housing inventory and potential impact of foreclosures in our mixed-use development projects and the regions in which they are located;
- fluctuations in costs and expenses, including impacts from shortages in materials or labor;
- demand for new housing, which can be affected by a number of factors including the availability of mortgage credit, job growth and fluctuations in commodity prices;
- demand for multifamily communities, which can be affected by a number of factors including local markets and economic conditions;
- competitive actions by other companies;
- changes in governmental policies, laws or regulations and actions or restrictions of regulatory agencies;
- risks associated with oil and gas exploration, drilling and production activities;
- fluctuations in oil and gas commodity prices;
- government regulation of exploration and production technology, including hydraulic fracturing;
- the results of financing efforts, including our ability to obtain financing with favorable terms, or at all;
- our ability to make interest and principal payments on our debt and satisfy the other covenants contained in our senior secured credit facility, indentures and other debt agreements;
- our partners' ability to fund their capital commitments and otherwise fulfill their operating and financial obligations;
- the effect of limitations, restrictions and natural events on our ability to harvest and deliver timber;
- inability to obtain permits for, or changes in laws, governmental policies or regulations affecting, water withdrawal or usage;

- the final resolutions or outcomes with respect to our contingent and other liabilities related to our business; and
- our ability to execute our growth strategy and deliver acceptable returns from acquisitions and other investments.

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Other factors, including the risk factors described in Item 1A of our 2014 Annual Report on Form 10-K, may also cause actual results to differ materially from those projected by our forward-looking statements. New factors emerge from time to time and it is not possible for us to predict all such factors, nor can we assess the impact of any such factor on our business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.

Any forward-looking statement speaks only as of the date on which such statement is made, and, except as required by law, we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

Strategy

Our strategy is:

- Recognizing and responsibly delivering the greatest value from every acre; and
- Growing through strategic and disciplined investments.

On December 8, 2014, we announced that our Board of Directors, working together with our management team and financial advisor, is exploring strategic alternatives to enhance shareholder value. This analysis includes a review of alternatives with respect to our oil and gas business. There is no assurance that exploration of strategic alternatives will result in any transaction being pursued or consummated.

Results of Operations

A summary of our consolidated results by business segment follows:

First Quarter