
THIS ANNUAL REPORT IS BEING PREPARED PURSUANT TO REQUIREMENTS CONTAINED IN THE INDENTURE,
DATED AS OF FEBRUARY 6, 2013 GOVERNING THE 6.875% SENIOR NOTES DUE 2021 ISSUED BY
ASHTON WOODS USA L.L.C.

ANNUAL REPORT

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

For the fiscal year ended May 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 _____.

Ashton Woods USA L.L.C.

(Exact Name of Registrant as Specified in Its Charter)

Commission file Number: N/A

Nevada

(State or Other Jurisdiction of
Incorporation or Organization)

37-1590746

(I.R.S. Employer Identification No.)

1405 Old Alabama Road Suite 200
Roswell, GA

(Address of Principal Executive Offices)

30076

(Zip Code)

(770) 998-9663

Registrant's telephone number, including area code

Securities registered pursuant to Section
12(b) of the Act:

Title of Each Class

NONE

Securities registered pursuant to Section
12(g) of the Act:

Title of Each Class

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ___ No X

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.
Yes X No ___

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ___ No ___ N/A X

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 definition of “accelerated filer,” “large accelerated filer” and smaller company: in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ___ Accelerated filer ___ Non-accelerated filer X 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 ___ No X

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PART I.

Item 1. *Business*

Our company

Headquartered in Atlanta, Georgia, Ashton Woods USA L.L.C., together with its subsidiaries (collectively, the “Company” or “Ashton Woods”), is one of the largest private homebuilders in the United States (based on the number of home closings). We design, build and market high-quality attached and detached single-family homes under the Ashton Woods Homes brand name. We serve a broad customer base and focus on achieving the highest standards in design, quality and customer satisfaction. We finished calendar year 2014 ranked sixth among private builders and were ranked 22nd among all builders (private and public) in the U.S. based on home closings, according to Builder Magazine.

Our homebuilding operations started in Dallas, Texas in 1989. We have delivered over 31,000 homes in the more than 25 years we have been in business and have grown organically through the formation of homebuilding and land development operations in select strategic markets with strong long-term housing and employment growth characteristics.

The Company's homes are marketed in two major geographic regions or segments: East and Central. The Company operated in the following operating divisions as of May 31, 2015:

East: Raleigh, Charleston, Atlanta, Orlando, and Southwest Florida (Tampa, Sarasota and Naples)

Central: Houston, Dallas, Central Texas (Austin and Killeen), San Antonio, and Phoenix

During the fiscal year ended May 31, 2015, the Company sold 218 lots in Denver for a total purchase price of \$7.5 million and a commercial tract in Orlando for a total purchase price of \$4.4 million. In addition, the Company owns a commercial parcel in Dallas.

Our strategy

Provide superior customer experience through design, quality and service

We believe that our rigorous focus on design, quality and customer service represents a critical differentiator relative to our competitors. According to surveys completed during fiscal year 2015 by GuildQuality, a third party measuring customer satisfaction for homebuilders and home services companies, 82% of Ashton Woods’ buyers are likely to recommend Ashton Woods to family and friends, one year after closing on their home purchase. We will continue to focus on building and selling homes that combine high-quality craftsmanship with design characteristics that ultimately reflect the various lifestyles and aspirations of our broad customer base.

We differentiate ourselves through a combination of high-style architecture and design, high-quality materials and construction, and a dedication to homeowner satisfaction. Our product offerings are designed to enhance efficiency and livability, update technology and align with modern tastes, and our product offerings continue to evolve as we commit to delivering innovative designs.

We are committed to achieving the highest level of customer service during the sales process and after a home is closed through our 1-5-11 customer care program which provides us an opportunity to address any warranty matters with our customers during the warranty period. We have a variety of programs and services in place that seek to ensure customer satisfaction and help us improve production efficiency and reduce warranty costs.

Preserve and build on leading market position and selectively pursue growth opportunities

We believe the markets in which we operate exhibit positive demographic trends and offer attractive long-term growth opportunities. Maintaining and growing our share of those markets enables us to achieve economies of scale by leveraging our reputation as the preferred builder of choice by developers, land brokers, trade partners and municipalities, and source attractive acquisition opportunities.

We pursue growth within our current markets, and potentially new markets, to the extent we believe such growth is consistent with our integrated operating and land acquisition strategies, and commitment to best-in-class quality and superior customer experience. We have historically accessed new markets through organic growth. Since fiscal year 2010, we have opened new operations in Raleigh, Central Texas, San Antonio, Charleston, and Naples. We will continue to evaluate new market opportunities and, in the future, may also grow our business through select opportunistic acquisitions, joint ventures and other strategic transactions.

Our Business

Operating divisions and products

As previously discussed, we currently operate in Raleigh, Charleston, Atlanta, Orlando, Southwest Florida, Houston, Dallas, Central Texas, San Antonio and Phoenix. We evaluate a number of factors in determining which geographic markets to enter. We analyze economic and real estate conditions by evaluating statistical information such as the historical and projected population growth, the number of new jobs created and projected to be created, the number of housing starts in previous periods, building lot availability and price, housing inventory, competitive environment, and home sale absorption rates.

We generally seek to maintain the flexibility to alter our product mix within a given market depending on market conditions and consumer preferences. In determining our product mix in each market, we consider demographic trends, demand for a particular type of product, margins, timing and the economic strength of the market. We have focused, and intend to continue to focus, on our broad customer base who value style and design.

We build and sell detached single-family homes in all of our markets. Attached single-family homes are currently offered in all of our operating segments except Houston, Phoenix and San Antonio. For the year ended May 31, 2015, our homebuilding revenues were derived from closings of 1,891 detached single-family homes (80% of closings) and 469 attached single-family homes (20% of closings).

The base prices of our detached single-family homes range from \$149,000 to over \$945,000, and the base prices of our attached single-family homes range from \$189,000 to over \$549,000.

As of May 31, 2015, we had 106 active communities, comprised of 96 detached single-family home communities and 10 attached single-family home communities, and additionally had 108 start-up communities and 26 close-out communities. Active communities are defined as communities that have sold at least five homes and have at least five homes left to sell. Start-up communities are defined as communities that have not yet achieved five home sales, and close-out communities are defined as communities that have less than five homes left to sell.

Home design and design studios

We are dedicated to providing high-quality, well-designed homes in desirable locations while endeavoring to meet the demands of today's homebuyers. The product lines offered in a particular community depend upon many factors, including the supply of existing housing and the demand for new housing in the general area. In an effort to greater meet the demand in the marketplace, we conduct in-depth qualitative and quantitative market research including consumer focus groups. This research enables us to meet the specific lifestyle demands of our targeted homebuyers and create synergies between the design of our homes and the community development.

We seek to ensure that our home designs provide maximum utilization of space for our product offerings. To supplement our internal resources, we use external architectural consultants who we believe are experts in their field to help enhance our designs, often using professionals with knowledge in specific regional architecture, exterior finishes and selections, and floor plan solutions that give our product an added edge. Additionally, we do not believe that one house plan can meet the demands of multiple markets, but instead should be tailored to the individual community.

Our aim is to provide each home with features that appeal to a specific lifestyle segment, while giving the plan flexibility through options and elevation varieties selected by our homeowners. This allows our homebuyers to feel as if we designed the home just for them.

We generally maintain at least one fully decorated model home in each of our active communities merchandised to provide our homebuyers with the ability to view the completed home as part of their buying decision. In addition, we utilize our Design Studios to provide homebuyers the ability to personalize their homes. The Design Studios are staffed with in-house designers who can help homebuyers make selections from an extensive array of options, including carpets, tiles, cabinets, light fixtures and countertops, among others.

Land acquisition and development

We endeavor to achieve a balance between land owned and developed for our own use, and additional lots controlled through option contracts. We believe that our attractive land positions in our markets will enable us to continue to maintain market share in the current homebuilding environment. As of May 31, 2015 and based on the last twelve months closings, we had land supply for use in our homebuilding operations of approximately 5.7 years, consisting of a 1.8 year supply of owned land and lots and homes available to close, and a 3.9 year supply of land and lots controlled through contracts.

We typically purchase land only after necessary entitlements have been obtained so that development or construction may begin as soon as market conditions dictate. The term “entitlements” refers to development agreements, tentative maps or recorded plats, as applicable, since the types of entitlements will vary depending on the jurisdiction within which the land is located. Even though entitlements are usually obtained before we purchase land, we are often required to secure a variety of other governmental approvals and permits during the land development phase. The process of obtaining such approvals and permits can substantially lengthen the development process.

We select land and lots to purchase based upon a variety of factors, including:

- in-depth market studies to confirm pricing and pace assumptions;
- competition analysis to establish competitive positioning;
- suitability for development, generally within a one to three-year time period from the beginning of the development process to the delivery of the last home;
- financial review as to the feasibility of the proposed project, including projected profit margins, return on capital employed and the capital payback period;
- results of environmental and legal due diligence;
- proximity to local traffic corridors and amenities;
- management’s judgment on the state of the real estate market and the economic trends; and
- our experience in a particular market.

We acquire land through purchase and option contracts, as well as through joint ventures with other builders or developers. A portion of our land is acquired through option contracts, which allows us to control lots and land without incurring the risks of land ownership or financial commitments other than non-refundable deposits. We generally enter into option contracts with third parties to purchase finished lots as home construction begins. These contracts are generally non-recourse and require non-refundable deposits. At May 31, 2015, we had \$64.6 million in non-refundable deposits on real estate under option or contract. We had 13,522 total lots and homes under control for use in our homebuilding operations. Of the 13,522 lots and homes controlled, we owned 30.9% or 4,177 lots and homes, and 69.1% or 9,345 lots were under contract. At May 31, 2015, we had one lot purchase agreement which could result in a specific performance obligation to purchase 208 lots in the amount of \$42.2 million. Once we acquire land, we

generally initiate development and construction through contractual agreements with local subcontractors. These activities include site planning, engineering and home construction, as well as development activities to provide roads, sewerage, water supply, other utilities, drainage, recreation facilities and other refinements.

Land joint ventures

Occasionally, we use partnerships or joint ventures to purchase and develop land where these arrangements are economically advantageous. As of May 31, 2015, we controlled 86 lots for future use by our homebuilding operations through one joint venture with an unrelated third party and 186 lots through one joint venture with a related party. We will consider forming new partnerships or joint ventures in the future where economically advantageous.

Letters of credit and surety bonds

In the ordinary course of business, we provide letters of credit and surety bonds to third parties to secure performance and provide deposits under various contracts and commitments. The amount of such obligations outstanding at any time varies in accordance with our development activities and commitments. In the event any letters of credit or surety bonds are drawn upon, we would be obligated to reimburse the issuer of such letter of credit or surety bond. At May 31, 2015, we had outstanding letters of credit of \$3.2 million and surety bonds outstanding of \$20.7 million. As of May 31, 2015, we had \$41.8 million of unused letter of credit capacity under our senior secured revolving credit facility.

Marketing and sales

We believe that we have established a reputation for building high quality homes, which helps to generate interest in each new community. We market our products through a variety of means ranging from fully decorated model homes in our communities to print advertising and increasingly through internet exposure via our website and social media. We focus on continually improving upon our brand awareness and maintaining consistency across our various operating divisions by applying standardized sales office designs and national marketing communications guidelines, while customizing by operating division to address the needs and wants of local homebuyers.

We typically build, decorate, furnish and landscape between one and two model homes for each community and maintain on-site sales offices. As of May 31, 2015, we maintained 151 model homes in all stages of construction. We believe that model homes play a particularly important role in our marketing efforts, helping homebuyers to imagine the possibilities of an Ashton Woods home. Consequently, we expend significant effort in creating an attractive atmosphere at our model homes. Generally, interior decorations are undertaken by select third-party design firms, as well as an internal design firm, and vary among our models based upon the lifestyles of targeted homebuyers. Structural changes in design from the model homes are generally permitted within certain guidelines, and homebuyers may select various options through our Design Studios, which allow our homebuyers to personalize their new home.

Our sales counselors are available to assist prospective homebuyers by providing them with floor plans, price information and tours of model homes and to assist them with the selections for their new homes. The selection of interior features is a principal component of our marketing and sales efforts. Sales counselors are trained by us and attend periodic meetings to be updated on sales techniques, competitive products in the area, the availability of financing, construction schedules and marketing and advertising plans, which management believes results in a sales force with extensive knowledge of our operating practices and housing products.

We use various sales incentives in order to attract homebuyers, including sales price reductions, reductions in the prices of certain options or upgrades and the payment of certain closing costs. The decision to offer incentives and the type of incentives offered at any point in time are driven by market forces and vary by location.

Sales of our homes are made pursuant to home sale contracts, the terms of which vary according to market practices and to the legal requirements of the states in which they are used. Typically, each contract requires a deposit from the homebuyer. In addition, the home sale contract typically contains a financing contingency that generally provides homebuyers with the right to cancel in the event they are unable to obtain financing at a prevailing interest rate within a specified time period after the execution of the home sales contract.

Title services

We offer title services to our homebuyers in Dallas and Houston through minority ownership interests in two title joint ventures. The joint ventures are managed by and all underwriting risks associated with the title insurance reside with the majority owner of each of these entities. The earnings from our investments in each of these title joint ventures are recorded using the equity method of accounting, and the earnings are a component of the line item "Equity in earnings in unconsolidated entities" in our consolidated statements of operations. During the year ended May 31, 2014, we formed a wholly-owned title agency which began offering title services in our Southwest Florida, Orlando, and Atlanta operating divisions in fiscal year 2015.

Construction

We act as the general contractor for the construction of our homes. Subcontractors are typically engaged to complete construction of each home at a negotiated price. Agreements with our subcontractors and material suppliers are generally entered into after competitive bidding. Our operating division personnel supervise the construction of each project, coordinate the activities of subcontractors and suppliers, subject their work to quality and cost controls and assure compliance with zoning and building codes.

We specify that quality, durable materials be used in the construction of our homes. We have numerous suppliers of raw materials and services, and such materials and services have been and continue to be available. From time to time, we enter into regional and national supply contracts with certain vendors to leverage our purchasing power and our size in order to control our costs. However, we do not have any material long-term contractual commitments with any of our subcontractors or suppliers. We do not maintain inventories of construction materials except for materials being utilized for homes under construction. Prices of materials may fluctuate due to various factors, including demand or supply shortages, which may be beyond the control of our vendors. We believe that our relationships with our suppliers and subcontractors are good.

Construction time for our homes depends on the availability of labor, materials and supplies, the type and size of the home, location and weather conditions. Our homes are designed to promote efficient use of space and materials, and to minimize construction costs and time. In all of our markets, construction of a home is typically completed within four to six months following commencement of construction.

Warranty program

We offer a standard one, two and ten-year warranty to our homebuyers. The one-year limited warranty covers workmanship and materials and includes home inspection visits with the homebuyer. We subcontract our homebuilding work to subcontractors who typically provide us with an indemnity and a certificate of insurance and, therefore, claims relating to workmanship and materials are generally the primary responsibility of our subcontractors. In addition, the first and second years of our warranty cover construction defects and certain defects in plumbing, electrical, heating, cooling and ventilation systems. The remaining years of protection cover only structural defects. We contract with an independent third party company that assist in administering our structural warranty program.

We record a liability of approximately 0.6% to 1.2% of the sales price of a home to cover warranty expenses, although this estimate is subject to adjustment in certain circumstances. Our historical experience is that warranty expenses generally fall within the amount established for such estimate.

Corporate operations

We perform the following functions at a centralized level:

- the evaluation and selection of geographic markets;
- the allocation of capital resources to particular markets, including final approval of all land acquisitions;
- the consolidation of operating division and segment financial information;
- the capitalization of the Company;

- the maintenance of centralized information systems; and
- the monitoring of the decentralized operations of our operating divisions.

We allocate the capital resources necessary for new projects in a manner consistent with our overall operating strategy. We utilize gross margins, net income margins and inventory turnover as the primary criteria for our allocation of capital resources. We will vary the capital allocation based on market conditions, results of operations and other factors. Capital commitments are determined through consultation among certain corporate and operational management, who play an important role in ensuring that new communities are consistent with our strategy. Centralized financial controls are also maintained through the standardization of accounting and financial policies and procedures.

We operate through separate operating divisions, which are located within the market in which they operate. Each operating division generally is managed by professionals with substantial experience in the operating division's market. In addition, each established operating division is equipped with the skills to complete the functions of land acquisition, land development, construction, marketing, sales, product service and accounting.

Competition and market factors

The development and sale of residential properties is highly competitive and fragmented. We compete with numerous small and large residential builders for sales on the basis of a number of interrelated factors, including location, reputation, amenities, design, quality and price. We compete with new home sales, re-sales of existing homes and available rental housing.

We believe that we compare favorably to other builders in the markets in which we operate due primarily to:

- our experience within our geographic markets and the breadth of our product line, which allows us to vary our product offerings to reflect changing conditions within a market;
- our responsiveness to market conditions, which enables us to capitalize on the opportunities for attractive land acquisitions in desirable locations; and
- our reputation for quality design, construction and service.

Notwithstanding our perceived advantages relative to other builders, some of our competitors have significantly greater financial resources or lower cost structures than we do. Because some of our competitors are larger than us, they may possess certain advantages over us, such as the ability to raise money at lower cost and the ability to negotiate better prices on materials and services with subcontractors. Certain of our smaller competitors may have an advantage over us based on length of operation in the market compared to us or better name recognition than us. Furthermore, many custom homebuilders may have an advantage over us because purchasers of custom homes tend to want a level of flexibility in the design and construction of their homes that we do not offer.

The demand for new housing is directly related to consumer confidence levels and general economic conditions, including employment and interest rate levels. Other factors are also believed to affect the housing industry and the demand for new homes. Such other factors include:

- the availability of labor and materials and increases in the costs thereof;
- changes in costs associated with home ownership such as increases in property taxes and energy costs;
- changes in consumer preferences;
- demographic trends;
- the amount of resale housing inventory available in the market; and
- the availability of and changes in mortgage financing programs.

Government regulation and environmental matters

Substantially all of our land is purchased with entitlements, giving us the right to obtain building permits upon compliance with specified conditions, which generally are within our control. Upon compliance with such conditions, we must obtain building permits. The length of time necessary to obtain such permits and approvals affects the carrying

costs of unimproved property acquired for the purpose of development and construction. In addition, the continued effectiveness of permits already granted is subject to factors such as changes in policies, rules and regulations and their interpretation and application. Several governmental authorities have imposed impact fees as a means of defraying the cost of providing certain governmental services to developing areas. To date, the governmental approval processes discussed above have not had a material adverse effect on our development activities and have not had a material effect on our capital expenditures, earnings and competitive position, and indeed all homebuilders in a given market face the same fees and restrictions. There can be no assurance, however, that these and other restrictions will not adversely affect us in the future.

We may also be subject to periodic delays or may be precluded entirely from developing communities due to building moratoriums or “slow-growth” or “no-growth” initiatives or building permit allocation ordinances which could be implemented in the future in the states and markets in which we operate. Substantially all of our land is entitled and, therefore, other than delays in the delivery of land and lots to us caused by such delays, the moratoriums generally would only adversely affect us if they arose from health, safety and welfare issues such as insufficient water or sewerage facilities. Local and state governments also have broad discretion regarding the imposition of development fees for projects in their jurisdiction. These fees are normally established, however, when we receive recorded final maps and building permits. We are also subject to a variety of local, state and federal statutes, ordinances, rules and regulations concerning the protection of health and the environment. Although in the future these laws may result in delays, cause us to incur substantial compliance and other costs, and prohibit or severely restrict development in certain environmentally sensitive regions or areas, these laws have not had a material effect on our capital expenditures, earnings and competitive position to date.

Employees and subcontractors

As of May 31, 2015, we employed 691 employees, of whom 206 were sales and marketing personnel, 283 were executive, management and administrative personnel and 202 were construction personnel. Although our employees are not covered by collective bargaining agreements, subcontractors may be represented by labor unions or may be subject to collective bargaining arrangements. We believe that our relations with our employees and subcontractors are good.

Item 1A. Risk Factors

Risks related to our business

You should read the discussion of our business, included elsewhere in this annual report, in conjunction with the risks included below. We are or could become subject to the risks and uncertainties set forth below and/or those referenced elsewhere in this annual report. If we are negatively affected by any or a combination of such risks and uncertainties, our results of operations, cash flows, financial position or business prospects could be severely and negatively impacted.

Downward changes in general economic, real estate construction, or other business conditions could adversely affect our business or our financial results.

The residential homebuilding industry is sensitive to changes in economic conditions and other factors, such as the level of employment, consumer confidence, consumer income, availability of financing, and interest rate levels. Adverse changes in any of these conditions generally, or in the markets where we operate, could decrease demand and pricing for new homes in these areas or result in customer cancellations of pending contracts, which could adversely affect the number of home deliveries we make or reduce the prices we can charge for homes, either of which could result in a decrease in our revenues and earnings and would adversely affect our financial condition.

The housing industry has, in the past, experienced significant downturns and our home sales and operating revenues could again decline due to macroeconomic and other factors outside of our control, such as changes in consumer confidence and declines in employment levels.

In the years prior to 2006, land and housing prices increased significantly in many of our markets. Beginning in 2006 through 2011, the U.S. homebuilding industry was negatively impacted by declining consumer confidence, restrictive mortgage standards and decreased availability of financing, and large supplies of foreclosure, resale and new homes, among other factors. When combined with a prolonged economic downturn, high unemployment levels, increases in the rate of inflation and uncertainty in the U.S. economy, these conditions contributed to a decreased demand for housing, declining sales prices, and increasing pricing pressures, which had hindered our ability to attract new homebuyers. These factors in turn, contributed to declines in our revenues, increased impairment charges and reduced profitability. Since 2012, conditions in the homebuilding market have improved; however, knowledge of the recent downturn and continuing economic uncertainty in the U.S. may result in more caution on the part of potential homebuyers, which could adversely affect consumer demand for and the pricing of our homes, which could, in turn, impact our operating performance and cause our operating revenues to decline. If the homebuilding and mortgage lending industries were to slow again, or if the national economy weakens further or goes back into recession, we could experience declines in the market value of our inventory and demand for our homes, which could have a significant negative impact on our gross margins and financial and operating results. Overall demand for new homes continues to remain below historical levels. Accordingly, the adjustments we have made in our operating strategy may not be sufficient to support continued improvement in our operating results or to protect us from fluctuating demand or other market factors.

Fluctuations and declines in the market value of land may have an adverse effect on the value of our inventory resulting in impairment charges, which could adversely affect our business and results of operations.

We regularly acquire land for replacement and expansion of land inventory within our existing and new markets. The market value of land, building lots and housing inventories can fluctuate significantly as a result of changing market conditions and the measures we employ to manage inventory risk may not be adequate to insulate our operations from a severe drop in inventory values. Further, as a result of these fluctuations, the book value of our real estate assets may not reflect current or future market value of these assets. When market conditions are such that land values are not appreciating, previously entered into option agreements may become less desirable, at which time we may elect to forgo deposits and pre-acquisition costs and terminate the agreements. At times in the past years, as a result of the negative impact of economic conditions in our markets on land values, we have had to recognize inventory impairment charges and have also, at times, chosen to write-off deposits on land. If these conditions recur or worsen, we may have to incur additional and larger inventory impairment charges which would adversely affect our financial condition and results of operation and our ability to comply with certain covenants in our debt instruments linked to tangible net worth.

Certain undue or unforeseen delays in our business activities could have material adverse effects on our operating results.

The timing of land acquisitions, zoning and other regulatory approvals impacts our ability to pursue the development of new housing projects in accordance with our business plan. If the timing of land acquisitions, zonings or regulatory approvals is delayed, we will be delayed in our ability to develop housing projects, which would likely decrease our backlog. Furthermore, a delay could result in a decrease in our revenues and earnings for the periods in which the delays occur and possibly subsequent periods until the planned housing projects can be completed. A delay in the development of one or more communities or in a significant number of home closings or land sales due to acts of God, adverse weather, subcontractor unavailability, strikes or other unforeseen factors could have a similar impact on revenues and earnings for the periods in which the delays occur and, possibly, subsequent periods.

A substantial increase in mortgage interest rates or the unavailability of mortgage financing may reduce consumer demand for our homes.

A substantial number of purchasers of our homes finance their home purchase with mortgage financing. Housing demand is adversely affected by reduced availability of mortgage financing and factors that increase the upfront or monthly cost of financing a home such as increases in interest rates or insurance premiums. The decrease in the willingness and ability of lenders to make residential mortgage loans over the last few years, the tightening of lending standards and the limitation of financing product options, have made it more difficult for homebuyers to obtain acceptable financing in spite of attractive mortgage interest rates. Any substantial increase in mortgage interest rates or

unavailability of mortgage financing may adversely affect the ability of prospective homebuyers to obtain financing for our homes, as well as adversely affect the ability of prospective homebuyers to sell their current homes. Following the 2008 financial crisis, the tightening of lending standards and the decline in investor demand for mortgage loans and mortgage-backed securities have adversely affected our business financial condition, results of operations and cash flows as compared to prior periods.

Even if potential new homebuyers do not need financing, changes in interest rates could make it harder for them to sell their existing homes to potential buyers who need financing. Where potential homebuyers must sell their existing homes in order to buy a home, increases in mortgage costs, lack of availability of mortgages and/or regulatory changes could prevent the buyers of potential homebuyers' existing homes from obtaining mortgage financing, which would result in our potential homebuyers' inability to buy a new home. All these factors could prevent or limit our ability to attract new buyers as well as our ability to fully realize our backlog because our sales contracts frequently include a financing contingency. Financing contingencies permit the buyer to cancel the sales contract in the event that mortgage financing at prevailing interest rates is unobtainable within the period specified in the contract. Our homebuyers' need for mortgage financing and our exposure to such financing contingencies render us vulnerable to changes in prevailing interest rates and lending standards.

Certain changes to tax laws could reduce the incentives of homeownership.

Our current tax laws permit certain expenses of owning a home to be deducted by an individual in determining individual federal taxable, and in many cases, state taxable income. Such deductions include mortgage interest and real estate taxes. If these tax deductions were to be eliminated or limited, this could reduce the incentives to buy a home and make home buying more expensive which, in turn, could adversely affect our sales and earnings. Increases in real estate taxes by local governments also increase the cost of owning a home and accordingly any such increases could affect the demand for and sale of our homes.

An increase in unemployment or underemployment may lead to a slower sales pace, an increase in the number of loan delinquencies and property repossessions and may have an adverse impact on us.

In the United States, the unemployment rate was 5.5% in May 2015, according to the U.S. Bureau of Labor Statistics. People who are not employed or are underemployed or are concerned about the loss, or potential loss, of their jobs are less likely to purchase new homes, may be forced to try to sell the homes they own and may face difficulties in making required mortgage payments. Therefore, any increase in unemployment or underemployment may lead to a decrease in sales pace or an increase in the number of loan delinquencies and property repossessions and may have an adverse impact on us both by reducing demand for the homes we build and by increasing the supply of homes for sale.

Increases in our cancellation rates could have a negative impact on our home sales revenue and home building gross margins.

During the recent economic downturn, homebuilders experienced increases in cancellation rates. Cancellations negatively impact the number of closed homes, net new home orders, home sales revenue and results of operations, as well as the number of homes in backlog. Home order cancellations can result from a number of factors, including declines or slow appreciation in the market value of homes, increases in the supply of homes available to be purchased, increased competition, higher mortgage interest rates, homebuyers' inability to sell their existing homes, homebuyers' inability to obtain suitable financing, including providing sufficient down payments, and adverse changes in economic conditions. While our cancellation rates have been relatively low compared to certain of our competitors, high levels of home order cancellations in any of our markets would have a negative impact on our home sales revenue and financial and operating results.

In cases of cancellation after construction of the home has started, we remarket the home and may retain any deposits we are holding, depending upon the circumstances. Nevertheless, the deposits retained, if any, may not cover the additional costs involved in remarketing the home, any difference in the sales price at which the home ultimately closes and carrying of higher inventory. Significant numbers of cancellations could adversely affect our business, financial condition and results of operations.

Our business is seasonal and our operating results can fluctuate.

We have historically experienced, and in the future expect to continue to experience, variability in our operating results on a quarterly and an annual basis. Factors expected to contribute to this variability include, among other things:

- the timing of land acquisitions and zoning and other regulatory approvals;
- the timing of home closings, land sales and level and timing of home sales;
- our product mix;
- our ability to continue to acquire additional land and lots or options thereon on acceptable terms;
- the condition of the real estate market and the general economy;
- delays in construction due to acts of God, adverse weather, reduced subcontractor availability and strikes;
- changes in prevailing interests rates and the availability of mortgage financing; and
- employment levels.

Adverse changes in these conditions may affect our business or may be more prevalent or concentrated in particular regions or localities in which we operate. In the past several years, unfavorable changes in many of these factors negatively affected all of the markets we serve. Economic conditions in certain of our markets continue to be characterized by levels of uncertainty. Any deterioration in economic conditions or continuation of uncertain economic conditions would likely worsen the unfavorable trends the housing market experienced in prior years, which could have a material adverse effect on our business.

Adverse changes in economic conditions can cause demand and prices for our homes to decrease or cause us to take longer to build our homes and make it more costly for us to do so. We may not be able to recover these increased costs by raising prices because of weak market conditions and because the price of each home we sell is usually set several months before the home is delivered, as many homebuyers sign their home purchase contracts before construction begins. The potential difficulties described above could impact our homebuyers' ability to obtain suitable financing and cause some homebuyers to cancel or refuse to honor their home purchase contracts altogether.

As market conditions permit, we intend to continue to consider growth or expansion of our operations, which could have a material adverse effect on our cash flows or profitability and our ability to service our debt and meet our working capital requirements.

We intend to continue to consider growth or expansion of our operations in our current operating divisions or in other markets, which will require substantial capital expenditures. The magnitude, timing and nature of any future expansion will depend on a number of factors, including the identification of suitable markets, our financial capabilities, the availability of qualified personnel in the target market and general economic and business conditions. Our expansion into new markets or existing operating divisions could have a material adverse effect on our cash flows and profitability.

Before a new community generates revenues, we invest significant time and material expenditures to acquire the land, obtain approvals, construct large portions of the community's infrastructure, put certain amenities in place, build model homes and arrange sales facilities.

Historically, our strategy has been to enter new markets through the start-up of company-developed operating divisions, rather than the acquisition of existing homebuilding companies. Because we typically do not acquire existing homebuilders when entering a new market, we do not have the advantage of the experience and goodwill of an established local homebuilding company. As a result, we incur substantial start-up costs in establishing our operations in new markets, and we may not be successful in such new markets. If we are unsuccessful in developing profitable operations in new markets or are unsuccessful in generating positive cash flows in a timely manner, we may not be able to recover our investment, our financial results could suffer and we may not be able to service our debt and meet our working capital requirements.

Furthermore, in the future, we may choose to enter new markets or expand operations in existing operating divisions through acquisitions, and these acquisitions may result in the incurrence of additional debt, some of which could be secured or unsecured senior debt. Acquisitions also involve numerous risks, including difficulties in the assimilation of the acquired company's operations, the incurrence of unanticipated liabilities or expenses, the diversion of management's attention from other business concerns, risks of entering markets in which we have limited or no direct experience, and the potential loss of key employees of the acquired company.

Our future success is highly dependent on the availability of undeveloped land and improved lots at prices acceptable to us, as well as adequate liquidity to acquire such properties.

Our success in land development and in the building and sale of homes depends in large part upon the continued availability of undeveloped land and improved lots at prices acceptable to us and with terms that meet our underwriting criteria. The availability of undeveloped land and improved lots at favorable prices depends on a number of factors

that are beyond our control. Such factors include the risks of competitive over-bidding on land sites, restrictive governmental regulations that limit housing density, deterioration in market conditions, availability of financing to acquire land and other market conditions. If the availability of suitable land opportunities is negatively affected, the number of homes we may be able to build and sell could decline. Further, increased demand for such land could cause prices to rise and we may not be able to pass the increased costs onto homebuyers. Such factors would negatively affect our revenues and profits. In addition, our ability to purchase land will depend upon us having satisfactory liquidity to fund these purchases. Because such land purchases involve significant cash investments, we may be at a competitive disadvantage for these land purchases due to differences in levels of debt between us and other homebuilders and due to differing access to capital between us and other homebuilders.

To the extent that we are unable to purchase land timely or enter into new contracts for the purchase of land at reasonable prices, our home sales revenue and results of operations could be negatively impacted and/or we could be required to scale back our operations in a given market.

Lack of greater geographic diversification could expose our business to increased risks if there are economic downturns in our markets.

We have homebuilding operations in the following markets:

East: Raleigh, Charleston, Atlanta, Orlando, and Southwest Florida (Tampa, Sarasota and Naples)
Central: Houston, Dallas, Central Texas (Austin and Killeen), San Antonio, and Phoenix

Some or all of these regions could be affected by:

- severe weather;
- natural disasters;
- shortages in the availability or increased costs in obtaining land, equipment, labor or building supplies;
- changes to the population growth rates and therefore the demand for homes in these regions; or
- changes in the regulatory and fiscal environment.

Four of the ten markets in which we have homebuilding operations are in the State of Texas. Failure to be more geographically diversified could impact us severely if the homebuilding business in one or more of our current markets should decline.

We could experience a reduction in the number of homes sold, revenues or reduced cash flows if we are unable to obtain reasonably priced financing to support our homebuilding and land development activities.

The homebuilding industry is capital intensive, and homebuilding operations require significant up-front expenditures to acquire land and begin development. Accordingly, we use significant amounts of capital to finance our homebuilding and land development activities. If, in the future, internally generated funds and other funds available to us are not sufficient to finance our capital needs (including capital required to fund land acquisition, development and construction activities), we would seek additional capital in the form of debt or equity financing from a variety of potential sources, including additional bank financing and/or securities offerings. The amount and types of indebtedness that we may incur are limited by the terms of our senior secured credit facility and the indenture governing our 6.875% Senior Notes due 2021 (the "6.875% Notes"). In addition, the availability of borrowed funds to be utilized for land acquisition, development and construction, may be greatly reduced and the lending community may require increased amounts of equity to be invested in a project by borrowers in connection with both new loans and the extension of existing loans. Any shortage of financing, increased cost of such financing, unwillingness of third parties to engage in joint ventures, failure to obtain capital to fund our planned capital and other expenditures and/or delays in obtaining such capital could have a material adverse effect on our business, cause project delays and result in increased costs.

Any downgrade of our credit ratings could adversely affect our access to capital, the cost of obtaining such capital and have other adverse effects on us.

Our credit ratings, ratings on our outstanding indebtedness and our current credit condition, among other factors, can impact our ability to access capital and any negative changes in these ratings may also result in more stringent covenants and higher interest rates. Our credit ratings could be downgraded in the future or credit agencies could issue negative commentaries about us in the future, any of which could adversely impact our business, financial condition,

results of operations or liquidity. Any weakening of our financial condition, increase in leverage and/or decrease in profitability or cash flows could adversely affect our ability to access capital, cause a credit downgrade or result in a change in outlook or increase our cost of borrowing.

Difficulty in obtaining sufficient capital to fund our liquidity needs could result in increased costs and delays in completion of projects.

The homebuilding industry is capital intensive and requires significant up-front expenditures to acquire land and begin development and construction. Land acquisition, development and construction activities may be adversely affected by any shortage or increased cost of financing or the unwillingness of third parties to engage in joint ventures. Any difficulty in obtaining sufficient capital for planned development expenditures could cause project delays, and any such delay could result in cost increases and may adversely affect our sales and future results of operations and cash flows.

Governmental regulations and environmental matters could increase the cost, limit the availability of our development and homebuilding projects and adversely affect our business or financial results.

We are subject to extensive and complex regulations that affect land development and home construction, including zoning, density restrictions, building design and building standards. These regulations often provide broad discretion to the administering governmental authorities as to the conditions we must meet prior to development or construction being approved, if approved at all. We are subject to determinations by these authorities as to the adequacy of water or sewage facilities, roads or other local services. New housing developments may also be subject to various assessments for schools, parks, streets and other public improvements. In addition, in many markets government authorities have implemented no growth or growth control initiatives. Any of these and changes in any of these regulations can limit, delay or increase the costs of development or home construction.

We are subject to a variety of local, state and federal laws and regulations concerning protection of health, safety and the environment, including those regulating the emission or discharge of materials into the environment, the handling, use, storage and disposal of hazardous substances, impacts to wetlands and other sensitive environments, and the remediation of contamination at properties that we have owned. Noncompliance with these laws and regulations could result in fines or penalties, claims for personal injury or property damage, obligations to remediate, permit revocations or other sanctions. The impact of environmental laws varies depending upon the prior uses of the building site or adjoining properties and may be greater in areas with less supply where undeveloped land or desirable alternatives are less available. These matters may result in delays, may cause us to incur substantial compliance, remediation, mitigation and other costs, and can prohibit or severely restrict development and homebuilding activity in environmentally sensitive regions or areas.

We are also subject to other local, state and federal laws and regulations in other aspects of our business, which are subject to evolving interpretation. Failure to comply with such laws and regulations could increase our costs or adversely affect our business or financial results.

A major health and safety incident relating to our business could be costly in terms of potential liabilities and reputational damage.

Building sites are inherently dangerous, and operating in the homebuilding industry poses certain inherent health and safety risks. Due to health and safety regulatory requirements and the number of projects we work on, health and safety performance is critical to the success of all areas of our business. Any failure in health and safety performance may result in penalties for non-compliance with relevant regulatory requirements, and a failure that results in a major or significant health and safety incident is likely to be costly in terms of potential liabilities incurred as a result. Such a failure could generate significant negative publicity and have a corresponding impact on our reputation, our relationships with relevant regulatory agencies or governmental authorities, and our ability to win new business, which in turn could have a material adverse effect on our business, financial condition and operating results.

Homebuilding is subject to home warranty and construction defect claims and litigation and other litigation in the ordinary course of business that can be significant. Our operating expenses could increase if we are required to pay higher insurance premiums or incur substantial litigation costs with respect to such claims and risks.

As a homebuilder, we are subject to home warranty and construction defect claims and litigation and other types of claims and litigation arising in the ordinary course of business. There can be no assurance that any developments

we undertake will be free from defects once completed or will generate the expected levels of return. Construction defects may occur on projects and developments and may arise a significant period of time after completion. Defects arising on a development attributable to us may lead to significant contractual or other liabilities.

As a consequence, we maintain products and completed operations liability insurance, generally obtain indemnities and certificates of insurance from subcontractors generally covering claims related to damages resulting from faulty workmanship and materials, and create warranty and other reserves for the homes we sell based on historical experience in our markets and our judgment of the risks associated with the types of homes built. Although we actively monitor our insurance reserves and coverage, because of the uncertainties inherent in these matters, we cannot provide assurance that our insurance coverage, our subcontractor arrangements and our reserves will be adequate to address all of our warranty and construction defect claims in the future. We generally confirm subcontractor insurance coverage; however, it is possible that the limits disclosed have been reduced or exhausted by other claims or losses or existing coverage is canceled or not renewed. Contractual indemnities can be difficult to enforce. We may also be responsible for applicable self-insured retentions and some types of claims may not be covered by insurance or may exceed applicable coverage limits. Additionally, the coverage offered by and the availability of products and completed operations liability insurance for construction defects are currently limited and costly. This coverage may be further restricted or become more costly in the future, or may be canceled, denied or rescinded.

Unexpected expenditures attributable to defects or previously unknown sub-surface or other conditions arising in a community may have a material adverse effect on the levels of return generated from a particular community. In addition, severe or widespread incidence of defects giving rise to unexpected levels of expenditure, to the extent not covered by insurance or redress against subcontractors, may adversely affect our business, financial condition and operating results.

Increasingly in recent years, individual and class action lawsuits have been filed against homebuilders asserting claims of personal injury and property damage caused by a variety of issues, including mold in residential dwellings or the use of faulty or hazardous materials in such dwellings. Furthermore, decreases in home values as a result of general economic conditions may result in an increase in both non-meritorious and meritorious claims, including those relating to construction defects and marketing and sales practices or other theories of liability. Our insurance may not cover all of the claims arising from such issues, or such coverage may become prohibitively expensive. If we are not able to obtain or retain adequate insurance against these claims or if our insurance does not cover all the types of claims made against us, we may experience litigation costs and losses that could reduce our net income. Even if we are successful in defending such claims, we may incur significant costs.

We are dependent on the services of certain key employees, and the loss of their services could hurt our business.

Our future success depends upon our ability to attract, train, assimilate and retain skilled personnel. If we are unable to retain our key employees, or attract, train, assimilate or retain other skilled personnel in the future, it could hinder the execution of our business strategy. Competition for qualified personnel in all of our operating markets is intense, and it could be difficult for us to find experienced personnel to replace our current employees, many of whom have significant homebuilding experience. Furthermore, a significant increase in the number of our active communities would necessitate the hiring of a significant number of additional skilled personnel, who are in short supply in our markets.

We are dependent on the continued availability and satisfactory performance of our subcontractors and our business could be materially and adversely impacted if qualified subcontractors are not available.

We conduct our construction operations only as a general contractor. Virtually all construction work is performed by unaffiliated third party subcontractors. Consequently, we depend on the continued availability of and satisfactory performance by these subcontractors for the construction of our homes. There may not be sufficient availability of and satisfactory performance by these unaffiliated third party subcontractors. In addition, inadequate subcontractor resources could have a material adverse effect on our business.

We can be injured by failures of persons who act on our behalf to comply with applicable regulations and guidelines.

Although we expect all of our employees, officers and directors to comply at all times with all applicable laws, rules and regulations, there may be instances in which employees, subcontractors or others with whom we conduct business engage in practices that do not comply with applicable regulations or guidelines. When we learn of practices relating to homes we build that do not comply with applicable regulations or guidelines, we promptly move actively to stop the

non-complying practices and will take appropriate disciplinary action with regard to employees of ours who were aware of the practices and did not take steps to address them through and including termination of their employment. However, regardless of the steps we take after we learn of practices that do not comply with applicable regulations or guidelines, we can in some instances be subject to fines or other governmental penalties, and our reputation can be injured, due to the practices having taken place.

Supply risks and shortages relating to labor and materials can harm our business by delaying construction and increasing costs.

The homebuilding industry has, from time to time, experienced significant difficulties with respect to:

- shortages of qualified trades people and other labor;
- shortages of materials;
- volatile increases in the cost of certain materials, including lumber, framing and cement, which are significant components of home construction costs;
- work stoppages;
- labor disputes;
- changes in laws related to unionizing activity;
- increases in subcontractor and professional service costs; and
- lack of availability of adequate utility infrastructure and services.

These difficulties can, and often do, cause unexpected short-term increases in construction costs and cause construction delays. We are generally unable to pass on any unexpected increases in construction costs to those homebuyers who have already entered into sales contracts, as those contracts generally fix the price of the home at the time the contract is signed, which may be up to one year in advance of the delivery of the home. Furthermore, sustained increases in construction costs may, over time, erode our profit margins. In the future, pricing competition may restrict our ability to pass on any additional costs, and we may not be able to achieve sufficient operating efficiencies to maintain our current profit margins.

Our business and operating results could be adversely affected by adverse weather conditions and natural disasters.

Adverse weather conditions, such as extended periods of rain, snow or cold temperatures, and natural disasters, such as hurricanes, tornadoes, floods and fires, can reduce the availability of materials, delay land development and community openings, delay completion and sale of homes, damage partially complete or other unsold homes in our inventory and/or decrease the demand for homes or increase the cost of building homes. To the extent that natural disasters or adverse weather events occur, our business and results may be adversely affected. To the extent our insurance is not adequate to cover business interruption losses or repair costs resulting from these events, our revenues, earnings, liquidity and capital resources could be adversely affected.

If we are unsuccessful in competing against our competitors, our market share could decline or our growth could be impaired and, as a result, our financial results could be adversely affected.

The homebuilding industry is highly competitive. Homebuilders compete for, among other things, desirable land, financing, raw materials, skilled labor and purchasers. We compete for residential sales on the basis of a number of interrelated factors, including location, reputation, community amenities, design, quality and price, with numerous large and small homebuilders, including some homebuilders with nationwide operations and greater financial resources and/or lower costs than us. Any consolidation of homebuilding companies may create competitors that have greater financial, marketing and sales resources than we do and may also create competitors that are able to compete more effectively against us. In addition, there may be new entrants into the markets in which we currently conduct business. We also compete for sales with the resale market for existing and foreclosed homes, with real estate speculators and with available rental housing. If we are unable to successfully compete, our financial results could be adversely affected and the value of, or our ability to service, our debt could be adversely affected.

Reduced numbers of homes sold may force us to absorb additional costs, which could have an adverse impact on our operating results and financial condition.

We incur many costs even before we begin to build homes in a community. These include costs related to developing land and installing roads, sewage and other utilities, as well as taxes and other costs related to ownership of the land on which we plan to build homes. Reducing the rate at which we build homes, which is related to the number of home

sales, extends the length of time it takes us to recover these costs, which could have an adverse impact on our operating results and financial condition.

We enter into unconsolidated joint ventures in which we do not have a controlling interest and we could be adversely impacted if our joint venture partners fail to fulfill their obligations.

We enter into land development joint ventures from time to time as a means of accessing larger parcels of land and lot positions, while managing our risk profile and leveraging our capital base. At May 31, 2015, we had equity investments of less than 50% in three land development joint ventures and did not have a controlling interest in these unconsolidated entities. Our partners in our land development joint ventures are both related parties and unrelated homebuilders, land developers or other real estate entities. Our joint venture partners generally share profits and losses in accordance with their respective ownership interests.

The land development joint ventures from time to time obtain secured acquisition and development financing. We or our joint venture partners, may, from time to time, provide varying levels of guarantees associated with the debt of these unconsolidated entities. These guarantees may require the partners to repay their share of the debt of the unconsolidated joint venture entity in the event the entity defaults on its obligations under the borrowings, or may require the completion of development of the land owned by the joint venture. With respect to the one joint venture with a related party with outstanding debt, we have provided the lender with a performance guarantee for the substantial completion of the first phase of development with the cost of the development funded by the lender. In the event that we pay any money or perform any services pursuant to the guarantee, the joint venture has agreed to indemnify and reimburse us for any costs incurred; however, should the joint venture be required to indemnify or reimburse us for any such costs incurred, the joint venture may not have sufficient funds to fulfill its indemnity and reimbursement obligations.

Our investments in joint ventures are considered illiquid since we do not have a controlling interest and therefore are limited in buy/sell decisions of joint venture assets. In addition, we may not necessarily agree with decisions made by our joint venture partners or our joint venture partners may fail to take actions that we would take if we had a controlling interest. Further, our financial condition and results of operations could be negatively impacted if any debt guarantees that we provide are drawn upon.

We are a community based homebuilding company and our ability to maintain our reputation is critical to the success of our business and the failure to do so may materially adversely affect our performance.

Our business as a homebuilding company depends on our relationship to the communities we build and serve, and our reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior products to our homebuyers and caring about our homebuyers and employees. Further, residents of communities we develop rely on us to resolve issues or disputes that may arise in connection with the operation or development of their communities. Efforts made by us to resolve these issues or disputes could be deemed unsatisfactory by the affected residents and have a negative impact on our reputation. If our reputation is negatively affected by the actions of our subcontractors, employees or otherwise, our business and, therefore, our operating results may be materially adversely affected.

Failure in our financial and commercial controls could result in significant cost overruns or errors in valuing sites.

We own and purchase a large number of sites each year and are therefore dependent on our ability to process a very large number of transactions (which include, among other things, evaluating the site purchase, designing the layout of the community, sourcing materials and subcontractors and managing contractual commitments) efficiently and accurately. Errors by employees, failure to comply with regulatory requirements and conduct of business rules, failings or inadequacies in internal control processes, equipment failures, natural disasters or the failure of external systems, including those of our suppliers, subcontractors, or counterparties, could result in operational losses that could adversely affect our business, financial condition and operating results and our relationships with our homebuyers.

We may be unable to obtain adequate surety bonding for the development of our communities.

We provide surety bonds to governmental authorities and others to ensure the completion of our projects. If we are unable to provide required surety bonds for our projects, our business operations and revenues could be adversely

affected. If we are unable to obtain required surety bonds in the future or are required to provide credit enhancements with respect to our current or future surety bonds, our liquidity could be negatively impacted.

Future terrorist attacks against the United States or increased domestic or international political or economic instability could have an adverse effect on our operations.

Adverse developments in the war on terrorism, future terrorist attacks against the United States, or any outbreak or escalation of hostilities between the United States and any foreign power or economic instability in Europe or elsewhere may cause disruption to the economy, our Company, our employees and our homebuyers, which could adversely affect our revenues, operating expenses and financial condition.

Inflation could cause our costs to rise and we may not be able to recover such costs if there is a decline in demand for our homes.

Inflation could have a long-term negative effect on our business due to gradual or not so gradual cost increases in land, labor and materials, which we may or may not be able to pass on to our home buyers in the form of higher home prices. Further, inflation is generally accompanied by higher interest rates, which may prove to be a disincentive to home ownership, thereby affecting demand for homes and our ability to pass on increased costs in the form of higher home prices and/or lower incentives. As a result, inflation could cause our margins to decline.

Information technology failures could harm our business.

We use information technology and other computer resources to carry out important operational activities and to maintain our financial and business records. Our computer systems, including our back-up systems, are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, catastrophic events such as fires, tornadoes and hurricanes, and usage errors by our employees or independent contractors. If our computer systems and our back-up systems are damaged, or cease to function properly, we could suffer interruptions in our operations or unintentionally allow misappropriation of proprietary or confidential information (including information about our homebuyers and business partners), which could require us to incur significant costs to remediate or otherwise resolve these issues.

Databases containing the Company's proprietary information and personal or proprietary information of our homebuyers, employees and business partners could be breached, which could subject us to adverse publicity, costly government enforcement actions or private litigation, and expenses.

As part of our business and operation of our technology, we maintain proprietary information electronically and electronically receive, process, store and transmit homebuyer information and confidential and sensitive business information of our homebuyers, employees and business partners. We rely on the security of our networks, databases, systems and processes and, in certain circumstances, those of third parties, such as vendors, to protect our proprietary information and information about our homebuyers, employees and business partners. Criminals and other wrongdoers are constantly devising schemes to circumvent information technology security safeguards and other large companies have recently suffered serious data security breaches. If unauthorized parties gain access to our networks or databases, or those of our vendors, they may be able to steal, publish, delete, or modify our sensitive proprietary information and sensitive third party information, including personally identifiable information. In addition, employees may intentionally or inadvertently cause data or security breaches that result in unauthorized release of such personal or confidential information. In such circumstances, our business could suffer and we could be held liable to our homebuyers, employees or other parties, as well as be subject to regulatory or other actions for breaching privacy law or failing to adequately protect such information. This could result in costly investigations and litigation, civil or criminal penalties, operational changes or other response measures, loss of consumer confidence in our security measures and negative publicity that could adversely affect our financial condition, results of operations, and reputation. Furthermore, Congress or individual states could enact new laws regulating electronic commerce that could adversely affect us and our results of operations.

If we were subjected to a material amount of additional entity-level taxation by individual states and localities, it would negatively impact our operating results.

Because of widespread state budget deficits and other reasons, several states are evaluating ways to subject partnerships and limited liability companies to entity-level taxation through the imposition of state income, franchise and other forms of taxation. Changes in current state law may subject us to additional entity-level taxation by individual states and localities, reducing our available cash.

Risks associated with our indebtedness

Our indebtedness could adversely affect our financial condition, limit our growth and make it more difficult for us to satisfy our debt obligations.

As of May 31, 2015, we had \$350.0 million of indebtedness outstanding (excluding accrued interest and discount) and \$185.8 million available for borrowing under our senior secured revolving credit facility, after applying a borrowing base formula and the level of pledged assets. Our indebtedness could have important consequences for us. Such indebtedness could, among other things:

- cause us to be unable to satisfy our obligations under our debt agreements;
- make us more vulnerable to adverse general economic and industry conditions;
- make it difficult to fund future working capital, land acquisition and development, home construction, acquisitions and general corporate needs;
- cause us to be limited in our flexibility in planning for, or reacting to, changes in our business; or
- cause us to be less competitive than other companies with less indebtedness.

In addition, subject to restrictions in our debt instruments, we may incur additional indebtedness. If new debt is added to our current debt levels, the related risks that we now face could intensify.

Despite current indebtedness levels, we may still be able to incur substantially more debt. This could further exacerbate the risks associated with our substantial leverage.

We may be able to incur substantial additional indebtedness, including additional secured indebtedness and other senior unsecured indebtedness, in the future. Although the indenture governing our 6.875% Notes and the agreement governing our senior secured revolving credit facility contain restrictions on the incurrence of additional indebtedness, these restrictions are subject to a number of significant qualifications and exceptions and, under certain circumstances, the amount of indebtedness that could be incurred in compliance with these restrictions could be substantial. Any secured indebtedness, including draws under our senior secured revolving credit facility, would be effectively senior to the 6.875% Notes to the extent of the value of the assets securing such indebtedness. As of May 31, 2015, we had \$185.8 million of availability under our senior secured revolving credit facility, based on a borrowing base formula and the level of pledged assets, and \$3.2 million of outstanding letters of credit, all of which would be effectively senior to the 6.875% Notes. If we incur additional indebtedness, the related risks that we now face would intensify and could further exacerbate the risks associated with our substantial leverage.

We may be unable to generate sufficient cash to service our debt obligations.

Our ability to pay our expenses and to pay the principal and interest on the 6.875% Notes and our other debt depends on our ability to generate positive cash flows in the future. Our operations may not generate cash flows in an amount sufficient to enable us to pay the principal and interest on our debt or to fund our other liquidity needs.

If we do not have sufficient cash flows from operations, we may be required to incur additional indebtedness, refinance all or part of our existing debt, or sell assets. Our ability to borrow funds under our senior credit facility in the future will depend on our meeting the financial covenants of such senior credit facility, and sufficient borrowings may not be available to us. In addition, the terms of existing or future debt agreements may restrict us from effecting any of these alternatives. Any inability to generate sufficient cash flows or refinance our debt on favorable terms could significantly and adversely affect our financial condition.

The families and family trusts that are majority owners of our equity interests have the right to select our board members, can influence our business operations, including all matters subject to membership approval, and may have interests that conflict with the interests of our Note holders.

As of May 31, 2015, entities directly or indirectly owned by five families or family trusts beneficially own 87.8% of our equity interests. Except as may be limited by our debt agreements, these members, by virtue of their majority equity ownership, have the ability to:

- elect the entire membership of our board of directors;

- control all of our management policies, including decisions regarding payments to our members or other affiliates, whether by way of dividend, compensation or otherwise or entering into other transactions with entities affiliated with the families and trusts comprising the majority ownership group; and
- determine the outcome of corporate matters or transactions, including mergers, joint ventures, consolidations, asset sales, equity issuances or debt incurrences.

Of our five directors, three are affiliated with our majority ownership group.

Other affiliates of our majority ownership group operate businesses that derive revenue from homebuilding and land development. Some affiliates of such entities have engaged, and will in the future continue to engage, in transactions with us. In particular, we are party to a service and software license agreement with an affiliate of this group pursuant to which we are provided with a license to use software critical to our business. The initial term of the services and software license agreement was two years and it automatically renews for successive one-year terms unless either party gives notice that the agreement will not be renewed. From time to time, we are also party to agreements whereby we purchase finished lots or undeveloped land from affiliates of our majority ownership group. In addition, we have one joint venture with an affiliate of our majority ownership group that is accounted for as an equity method investment. The families and family trusts comprising our majority ownership group are not restricted from engaging in homebuilding or land development activities in the United States through entities unrelated to us.

Any guarantees of the 6.875% Notes by our subsidiaries may be voidable, subordinated or limited in scope under laws governing fraudulent transfers and insolvency.

Under federal bankruptcy laws and comparable provisions of state fraudulent transfer laws, a guarantee of the 6.875% Notes by any subsidiary guarantor could be voided, subordinated, or limited in scope if, among other things, at the time the guarantor issued its guarantee, the applicable guarantor:

- intended to hinder, delay or defraud any present or future creditor; or
- received less than reasonably equivalent value or fair consideration for the incurrence of such guarantee; and
- was insolvent or rendered insolvent by reason of such incurrence; or
- was engaged in a business or transaction for which such guarantor's remaining assets constituted unreasonably small capital; or
- intended to incur, or believed that it would incur, debts beyond its ability to pay such debts as they mature.

The measures of insolvency for purposes of the foregoing considerations will vary depending upon the law applied in any proceeding with respect to the foregoing. Generally, however, a guarantor in the United States would be considered insolvent if:

- the sum of its debts, including contingent liabilities, was greater than the saleable value of all of its assets;
- the present fair saleable value of its assets was less than the amount that would be required to pay its probable liabilities on its existing debts, including contingent liabilities, as they become absolute and mature; or
- it could not pay its debts as they become due.

We cannot be sure what standard a court would use to determine whether or not a guarantor was solvent at the relevant time, or, regardless of the standard that the court uses, that the issuance of the guarantee would not be avoided or the guarantee would not be subordinated to the guarantors' other debt. If such a case were to occur, the guarantee could also be subject to the claim that, since the guarantee was incurred for the benefit of the issuer of the 6.875% Notes, and only indirectly for the benefit of the guarantor, the obligations of the applicable guarantor were incurred for less than fair consideration.

Our senior secured revolving credit facility and the indenture governing the 6.875% Notes contain a variety of covenants imposing significant operating and financial restrictions, which may limit our ability to operate our business. Our failure to comply with these covenants could result in an event of default under the senior secured revolving credit facility or the indenture relating to the 6.875% Notes.

Our senior secured revolving credit facility requires us to maintain specified financial ratios and tests, among other obligations, including a minimum tangible net worth test and a maximum leverage ratio. In addition, our senior secured credit facility and the indenture governing the 6.875% Notes have affirmative and negative covenants customary for financings of those types, which limit our ability to, among other things, borrow money, make investments and extend credit, engage in transactions with our affiliates, consummate certain asset sales, consolidate or merge with another entity or sell, transfer, lease or otherwise dispose of all or substantially all of our assets, and create liens on our assets. It is possible that these covenants could adversely impact our ability to finance our future operations or capital needs or to pursue available business opportunities. Additionally, a failure to comply with any of these covenants could lead to an event of default under our senior secured credit facility, which could result in an acceleration of the indebtedness under the senior secured credit facility. Acceleration of the indebtedness under our senior secured credit facility or other senior indebtedness would constitute an event of default under the indenture.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We lease 16,200 square feet of office space in Roswell, Georgia for our corporate offices. This lease expires in May 2019. In addition, we lease a total of approximately 216,000 square feet of space for our operating divisions under leases expiring at various times through December 2023. Periods under lease range from 12 months to 91 months, with various commencement dates and renewal options.

During the first quarter of fiscal year 2015, the Company entered into a lease as a lessee with an affiliate of the Investors (as defined in Item 7) to rent approximately 8,000 square feet of commercial space in Dallas, Texas. The term of the lease is 66 months. The Company has the option to renew the lease for one additional five-year term. Total minimum lease payments due under the lease were \$0.5 million as of May 31, 2015.

Item 3. Legal Proceedings

We are involved in lawsuits and other contingencies in the ordinary course of business. Management believes that, while the ultimate outcome of the contingencies cannot be predicted with certainty, the ultimate liability, if any, net of anticipated recoveries including from any insurance, will not have a material adverse effect on our financial condition, results of operations or cash flows.

Item 4. Mine Safety Disclosures

Not applicable.

PART II.

Item 5. Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

We are a limited liability company, and the majority of our membership interests are owned indirectly through Little Shots Nevada, L.L.C. by five families or family trusts related to the following individuals: Elly Reisman, Norman Reisman, Bruce Freeman, Seymour Joffe and Harry Rosenbaum. See Item 12 “*Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*” for additional information about the ownership of our membership interests. There is no established public trading market for our membership interests.

We periodically make distributions to our Members for the payment of federal and state income taxes. We made distributions of \$14.7 million and \$11.8 million during the year ended May 31, 2015 and 2014, respectively. No distributions were made to our Members during the year ended May 31, 2013. We are restricted in our ability to pay distributions under various covenants of our debt agreements.

Item 6. Selected Financial Data

	Year ended May 31,		
	2015	2014	2013
	(in thousands)		
Revenues:			
Home sales	\$ 949,267	\$ 808,547	\$ 650,234
Land sales	12,192	2,210	7,806
	<u>\$ 961,459</u>	<u>\$ 810,757</u>	<u>\$ 658,040</u>
Gross profit:			
Home sales	\$ 181,793	\$ 155,710	\$ 118,982
Land sales	685	103	210
	<u>\$ 182,478</u>	<u>\$ 155,813</u>	<u>\$ 119,192</u>
Selling, general and administrative	\$ 130,891	\$ 108,911	\$ 85,070
Net income ⁽¹⁾	\$ 34,272	\$ 32,387	\$ 32,362

- (1) Because we are structured as a limited liability company, income tax obligations are paid by our Members and are not borne by us. Therefore, our net income is higher than it would be if we were structured as a corporation. However, as a limited liability company, we periodically make distributions to our Members. The Company made distributions of \$14.7 million and \$11.8 million during the year ended May 31, 2015 and 2014, respectively. The Company made no distributions during the year ended May 31, 2013.

	Year ended May 31,		
	2015	2014	2013
	(\$ in thousands)		
Supplemental data :			
Active communities at end of period	106	83	69
Net new home orders (in units)	2,567	2,356	2,267
Homes closed (in units) ⁽²⁾	2,360	2,298	2,080
Average sales price per home closed	\$ 402	\$ 352	\$ 313
Backlog at end of period (in units)	1,213	1,006	948
Sales value of backlog at end of period	\$ 544,073	\$ 406,666	\$ 334,711
Home gross margin ⁽³⁾	19.2%	19.3%	18.3%
Adjusted home gross margin ⁽⁴⁾	21.4%	21.6%	21.4%
Ratio of selling, general and administrative expenses to home sales revenue	13.8%	13.5%	13.1%
Interest incurred ⁽⁵⁾	\$ 30,563	\$ 26,404	\$ 22,627
EBITDA ⁽⁶⁾	\$ 76,611	\$ 68,360	\$ 61,535
EBITDA margin ⁽⁶⁾	8.0%	8.4%	9.4%
Total debt to total capitalization	58.5%	61.5%	64.1%
Total net debt to net capitalization	58.5%	56.3%	54.2%
Cancellation rate (as a percentage of gross sales)	12.1%	11.8%	12.6%

- (2) A home is included in “homes closed” when title is transferred to the buyer. Revenues and cost of sales for a home are recognized at the date of closing.
- (3) Home gross margin is defined as the difference between home sales revenues and cost of sales—homes, expressed as a percentage of home sales revenues. Cost of sales—homes includes the land costs, home construction costs, indirect costs of construction, previously capitalized interest, a reserve for warranty expense, architecture fee amortization, impairment charges, closing costs, and pre-acquisition costs related to real estate purchases that are no longer probable.
- (4) Adjusted home gross margin is not a financial measure under GAAP and should not be considered an alternative to home gross margin determined in accordance with GAAP as an indicator of operating performance. We use this measure to evaluate our performance against other companies in the homebuilding industry and believe it is also relevant and useful to investors. Adjusted home gross margin is home gross margin that is adjusted for inventory impairments and interest amortized to cost of sales. The following is a reconciliation of home gross margin to adjusted home gross margin, which is the most directly comparable GAAP measure:

	Year ended May 31,		
	2015	2014	2013
	(in thousands)		
Home sales revenues	\$ 949,267	\$ 808,547	\$ 650,234
Cost of sales - homes	767,474	652,837	531,252
Home gross margin	181,793	155,710	118,982
Add: Inventory impairments	298	452	492
Interest amortized to cost of sales	20,587	18,441	19,458
Adjusted home gross margin	<u>\$ 202,678</u>	<u>\$ 174,603</u>	<u>\$ 138,932</u>
Ratio of home gross margin to home sales revenue	19.2%	19.3%	18.3%
Ratio of adjusted home gross margin to home sales revenue	21.4%	21.6%	21.4%

- (5) Interest incurred for any period is the aggregate amount of interest that is capitalized or charged directly to general and administrative expenses during such period. The following table summarizes interest costs incurred, amortized to cost of sales, and expensed during the year ended May 31, 2015, 2014, and 2013:

	Year ended May 31,		
	2015	2014	2013
	(in thousands)		
Capitalized interest, beginning of period	\$ 10,592	\$ 10,678	\$ 10,263
Interest incurred	30,563	26,404	22,627
Interest amortized to cost of sales	(20,587)	(18,441)	(19,458)
Interest expensed	(10,327)	(8,049)	(2,754)
Capitalized interest, end of period	<u>\$ 10,241</u>	<u>\$ 10,592</u>	<u>\$ 10,678</u>

- (6) EBITDA (earnings before interest, taxes, depreciation and amortization) is a measure commonly used in the homebuilding industry and is presented as a useful adjunct to net income/loss and other measurements under GAAP because it is a meaningful measure of a company's performance, as interest expense, taxes, depreciation and amortization expense can vary significantly between companies due, in part, to differences in structure, levels of indebtedness, capital purchasing practices and interest rates. EBITDA is not a financial measure under GAAP and should not be considered an alternative to net income/loss determined in accordance with GAAP as an indicator of operating performance, nor an alternative to cash flows from operating activities determined in accordance with GAAP as a measure of liquidity. Because some analysts and companies may not calculate EBITDA in the same manner as us, the EBITDA information in this report may not be comparable to similar presentations by others.

EBITDA margin is calculated by dividing EBITDA by total revenues.

The following is a reconciliation of EBITDA to net income, which is the most directly comparable GAAP measure:

	Year ended May 31,		
	2015	2014	2013
	(in thousands)		
Net income	\$ 34,272	\$ 32,387	\$ 32,362
Depreciation and amortization	11,425	9,483	6,961
Interest amortized to cost of sales	20,587	18,441	19,458
Interest expensed	10,327	8,049	2,754
EBITDA	<u>\$ 76,611</u>	<u>\$ 68,360</u>	<u>\$ 61,535</u>

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following management's discussion and analysis is intended to assist the reader in understanding the Company's business and is provided as a supplement to, and should be read in conjunction with, the Company's consolidated financial statements and accompanying notes. The Company's results of operations discussed below are presented in conformity with U.S. GAAP.

Forward-Looking Statements

Certain statements included in this report contain forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995, which represent our expectations or beliefs concerning future events, and no assurance can be given that the results described in this report will be achieved. These forward-looking statements can generally be identified by the use of statements that include words such as "estimate," "project," "believe," "expect," "anticipate," "intend," "plan," "foresee," "likely," "will," "target," "could," "seek" or other similar words or phrases. All forward-looking statements are based upon information available to us as of the date of this report.

A forward-looking statement speaks only as of the date on which such statement is made, and, except as required by law, we undertake no obligation to update or revise 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 or new information, even if future events make it clear that any expected results that we have expressed or implied will not be realized. Though we are of the view that such forward-looking statements are reasonable, the results or savings or benefits in the forward-looking statement may not be achieved. New factors emerge from time to time and it is not possible for management to predict all such factors.

These forward-looking statements reflect our best estimates and are subject to risks, uncertainties and other factors, many of which are outside of our control, which could cause actual results to differ materially from the results discussed in the forward-looking statements. These factors include, but are not limited to, the following:

- Fluctuations in mortgage interest rates and the availability of mortgage financing;
- The availability of high quality undeveloped land and improved lots at suitable prices;
- The volatility of the capital markets and the banking industry;
- An ownership change which could have unfavorable implications for our debt instruments;
- The availability of qualified employees, skilled labor, qualified subcontractors and raw materials;
- The competitive nature of the homebuilding industry;
- Deterioration of the economic climate either nationally or in the regions in which we operate, which could impact growth and expansion opportunities, impact the price of labor and materials, impact the value of our inventory and impact inflation, consumer confidence and consumer preferences;
- Government regulatory actions, which could affect tax laws and result in delays or increased costs in obtaining necessary permits and complying with environmental laws;
- Timing of permits and other regulatory approvals;
- Our substantial indebtedness and our ability to comply with the related financial and other covenants and our ability to obtain replacement financing as these instruments mature;
- The cost and availability of insurance and the level of warranty claims;
- Changes in accounting guidelines or our interpretation of those guidelines;
- Adverse weather conditions and acts of war or terror; and
- Other factors over which the Company has little or no control.

Results of operations

The consolidated financial statements included herein have been prepared in accordance with GAAP and in accordance with Article 10 of Regulation S-X. We will discuss our results of operations under the following two major sub-headings:

- Results of operations—Consolidated discussion; and
- Results of operations—Segment discussion.

Results of operations—Consolidated discussion

Year Ended May 31, 2015 Compared to Year Ended May 31, 2014

Home sales revenues

Home sales revenues increased by 17.4% (\$140.7 million) for the year ended May 31, 2015 to \$949.3 million, from \$808.5 million for the year ended May 31, 2014. The increase in revenues for the year was due to increases in both the average sales price of homes closed and in the number of homes closed. The average sales price of homes closed increased 14.2% in the year ended May 31, 2015 to an average of \$402,232, from an average of \$351,848 for the year ended May 31, 2014. The number of homes closed increased 2.7% in the year ended May 31, 2015 to 2,360, from 2,298 for the year ended May 31, 2014.

Many of the Company's newer communities target move-up buyers, with starting sales prices higher than our more mature communities. As we begin to see closings in these communities, our average sales prices may continue to increase quarter over quarter. Additionally, we were able to increase sales prices and/or reduce incentives in certain communities throughout our divisions as market conditions allowed. Increase in sales revenue was also attributable to an increase in our active community count from 83 at May 31, 2014 to 106 at May 31, 2015, an increase of 27.7% or 23 additional active communities.

Land sales

We had land sales of \$12.2 million for the year ended May 31, 2015, compared to \$2.2 million for the year ended May 31, 2014. During the fiscal year, the Company sold all of its land in Denver and a commercial tract in Orlando (See Note 4). No significant profits were realized from the sales of land, as the land parcels were sold at prices that were substantially equivalent to their cost basis.

Net new home orders and backlog

Net new home orders and backlog do not have a current effect on our revenues; however, both provide important information about our future revenues and business prospects. New home orders are converted to revenues at the time of home closing, which is generally within nine months of the date the home is sold. Net new home orders increased 9.0% (211 homes) during the year ended May 31, 2015, compared to the year ended May 31, 2014. These new home orders contributed to a backlog at May 31, 2015 of 1,213 homes, which is a 20.6% increase from the 1,006 homes in backlog at May 31, 2014. The sales value of backlog at May 31, 2015 was \$544.1 million, a 33.8% increase over the sales value of backlog at May 31, 2014 of \$406.7 million. The average sales price of homes in backlog increased 11.1% from \$404,000 at May 31, 2014 to \$449,000 at May 31, 2015. The increase in the average sales price of homes in backlog was primarily driven by higher sales prices in our newer communities, as well as our ability to increase sales prices and/or reduce incentives in certain communities throughout our divisions as market conditions allowed.

Gross margins

During the early stages of a community's life cycle, the average gross margin is typically lower and increases over the life of a community as we are able to raise prices and/or reduce incentives. The average gross margin from homes closed for the year ended May 31, 2015 remained relatively unchanged at 19.2%, compared to 19.3% for the year ended May 31, 2014. Adjusted home gross margin also remained relatively unchanged at 21.4% for the year ended May 31, 2015, compared to 21.6% for the year ended May 31, 2014.

Selling, general and administrative expenses

Selling, general and administrative expenses totaled \$130.9 million for the year ended May 31, 2015, compared to \$108.9 million for the year ended May 31, 2014. The increase of \$22.0 million was due primarily to an increase in sales and marketing costs, commission expense and compensation expense.

Sales and marketing costs increased \$9.0 million for the year ended May 31, 2015 due to a 22.2% increase in start-up communities with selling activity, from 18 communities as of May 31, 2014 to 22 communities as of May 31, 2015. While commissions as a percentage of revenues remained relatively flat at 3.9% of home sales revenue, commission expense increased \$4.8 million for the year ended May 31, 2015, due to a 14.2% increase in average sales price and a 2.7% increase in homes closed for the year ended May 31, 2015. Compensation expense increased \$8.2 million for the year ended May 31, 2015 as a result of an increase in employee count due to overall growth in our operations.

Net income

Net income for the year ended May 31, 2015 was \$34.3 million compared to net income of \$32.4 million for the year ended May 31, 2014. The increase in net income for the year ended May 31, 2015 is attributable to an increase in the average sales price of homes closed and an increase in the number of homes closed, offset by a 20.2% increase in selling, general and administrative expenses which was primarily driven by increases in sales and marketing costs, commissions, and compensation expense related to the increase in start-up communities.

Year Ended May 31, 2014 Compared to Year Ended May 31, 2013

Home sales revenues

Home sales revenues increased by 24.3% (\$158.3 million) for the year ended May 31, 2014 to \$808.5 million, from \$650.2 million for the year ended May 31, 2013. The increase in revenues for the year was due to increases in both the average sales price of homes closed and the number of homes closed. The average sales price of homes closed increased 12.5% in the year ended May 31, 2014 to an average of \$352,000, from an average of \$313,000 for the year ended May 31, 2013. The number of homes closed during the year ended May 31, 2014 increased 10.5% (218 homes) compared to year ended May 31, 2013.

The increase in average sales price of homes closed was primarily due to a decrease in entry-level homes closed. Of the homes that closed during the year ended May 31, 2014, 16.9% were entry-level homes compared to 27.5% for the year ended May 31, 2013. In all markets, we were able to increase sales prices and/or reduce incentives, which not only contributed to an increase in the average sales price but also resulted in improved margins. The increase in closings was due to an increase in demand for new homes as a result of a limited supply of resale inventory in our markets, which tends to increase the demand for new homes by reducing competition (resale inventory in most of our markets was below the six-month supply level). Increase in sales revenue was also attributable to an increase in our active community count from 69 at May 31, 2013 compared to 83 at May 31, 2014, an increase of 20.3% or 14 additional active communities.

Land sales

We had land sales of \$2.2 million for the year ended May 31, 2014, compared to \$7.8 million for the year ended May 31, 2013. No significant profit was realized from the sale of land for the years ended May 31, 2014 and 2013 as the land parcels were sold at prices that were substantially equivalent to their cost basis.

Net new home orders and backlog

Net new home orders increased 3.9% (89 homes) during the year ended May 31, 2014, compared to the year ended May 31, 2013. This increase contributed to a backlog at May 31, 2014 of 1,006 homes, which is a 6.1% increase from the 948 homes in backlog at May 31, 2013. The sales value of the backlog at May 31, 2014 was \$406.7 million, a 21.5% increase over the sales value of the backlog at May 31, 2013 of \$334.7 million.

Gross margins

The average gross margin from homes closed for the year ended May 31, 2014 was 19.4% compared to 18.4% for the year ended May 31, 2013. The improved average gross margin was due to a number of factors, including a reduction

in interest amortized through cost of sales, both in absolute terms and as a percentage of revenues. For the year ended May 31, 2014, interest amortized through cost of sales averaged 2.3% of housing revenue, compared to 3.0% for fiscal year 2013. The interest amortized through cost of sales decreased due to lower borrowing costs for the Company after the issuance of the 6.875% Notes and related repayments of certain higher-rate debt. Additional factors also included increased sales prices and/or reduced incentives in our divisions, offset in part by an increase in labor and material costs.

The average adjusted gross margin from homes closed for the year ended May 31, 2014 was 21.7%, compared to 21.5% for the year ended May 31, 2013. The improved adjusted gross margin was primarily due to increased sales prices and/or reduced incentives in our divisions, offset in part by an increase in labor and material costs.

Selling, general and administrative expenses

Selling, general and administrative expenses totaled \$110.1 million for the year ended May 31, 2014, compared to \$85.6 million for the year ended May 31, 2013. A substantial portion of that increase was due to an increase in compensation expense of \$10.0 million as a result of an increase in headcount of 31% or 143 employees, from 458 employees as of May 31, 2013 to 601 employees as of May 31, 2014, due to overall growth in the business. A smaller portion of the increase was also due to additional commission expense. While commissions as a percentage of revenues remained flat at 4.1% of housing revenue, commission expense increased \$6.4 million or 24.0%, due to a 10.5% increase in additional home closings and a 12.5% increase in the average sales prices of homes closed. Fixed sales and marketing costs increased due to a 100% increase in start-up communities with selling activity, from 9 communities as May 31, 2013 to 18 communities as of May 31, 2014.

Net income

Net income for the years ended May 31, 2014 and 2013 was \$32.4 million. Included in net income for the year ended May 31, 2014 is additional interest directly expensed of \$5.3 million, additional depreciation expense of \$2.5 million, and additional selling, general and administrative expenses of \$24.5 million, offset by improved gross margin. In addition, included in net income for the year ended May 31, 2013 was a \$1.4 million gain on the cash settlement of a paid-in-kind interest option on the 11% Notes and a \$3.4 million gain on early extinguishment of debt, which is more fully discussed in Debt Obligations below.

Results of operations—Homebuilding segments discussion

We have grouped our homebuilding operating divisions into two reportable segments, East and Central. At May 31, 2015, our reportable homebuilding segments consisted of homebuilding operating divisions located in the following areas:

- 1) East:** Raleigh, Charleston, Atlanta, Orlando, and Southwest Florida (Tampa, Sarasota and Naples)
- 2) Central:** Houston, Dallas, Central Texas (Austin and Killeen), San Antonio, and Phoenix

Presented below are certain operating and other data for our segments:

Net new home orders (units):

	Year ended May 31,		
	2015	2014	2013
East	1,313	1,174	1,144
Central	1,254	1,182	1,123
Company total	2,567	2,356	2,267

Homes closed (units):

	Year ended May 31,		
	2015	2014	2013
East	1,151	1,188	1,039
Central	1,209	1,110	1,041
Company total	2,360	2,298	2,080

Average sales price per home closed:

	Year ended May 31,		
	2015	2014	2013
	(in thousands)		
East	\$ 445	\$ 372	\$ 320
Central	361	330	306
Company average	402	352	313

Backlog (units) at end of period:

	As of May 31,		
	2015	2014	2013
East	631	469	483
Central	582	537	465
Company total	1,213	1,006	948

Sales value of backlog at end of period:

	As of May 31,		
	2015	2014	2013
	(in thousands)		
East	\$ 310,817	\$ 217,375	\$ 178,716
Central	233,256	189,291	155,995
Company total	\$ 544,073	\$ 406,666	\$ 334,711

Active communities:

	As of May 31,		
	2015	2014	2013
East	55	40	31
Central	51	43	38
Company total	106	83	69

Total communities:

	As of May 31, 2015			
	Active ⁽¹⁾	Start-up ⁽²⁾	Close-out ⁽³⁾	Total
East	55	66	12	133
Central	51	42	14	107
Company total	106	108	26	240

	As of May 31, 2014			
	Active ⁽¹⁾	Start-up ⁽²⁾	Close-out ⁽³⁾	Total
East	40	69	17	126
Central	43	49	10	102
Company total	83	118	27	228

(1) Active communities are defined as communities that have sold at least 5 homes and have at least 5 homes left to sell.

(2) Start-up communities are defined as communities that have not yet achieved 5 sales.

(3) Close-out communities are defined as communities that have less than 5 homes left to sell.

Homebuilding—East

	Year ended May 31,		
	2015	2014	2013
	(\$ in thousands)		
Homebuilding East:			
Home sales revenues	\$ 512,714	\$ 441,833	\$ 331,997
Home closed (in units)	1,151	1,188	1,039
Average sales price per home closed	\$ 445	\$ 372	\$ 320
Home gross margin	19.8%	18.7%	18.8%
Adjusted home gross margin ⁽¹⁾	21.9%	20.9%	21.7%

(1) Adjusted home gross margin is a non-GAAP measure. The following is a reconciliation of home gross margin to adjusted home gross margin, which is the most directly comparable U.S. GAAP measure:

	Year ended May 31,		
	2015	2014	2013
	(in thousands)		
Home sales revenues	\$ 512,714	\$ 441,833	\$ 331,997
Cost of sales - homes	411,395	359,366	269,615
Home gross margin	101,319	82,467	62,382
Add: Inventory impairments	97	71	197
Interest amortized to cost of sales	10,752	10,016	9,518
Adjusted home gross margin	<u>\$ 112,168</u>	<u>\$ 92,554</u>	<u>\$ 72,097</u>
Ratio of home gross margin to home sales revenues	19.8%	18.7%	18.8%
Ratio of adjusted home gross margin to home sales revenues	21.9%	20.9%	21.7%

Year Ended May 31, 2015 Compared to Year Ended May 31, 2014 - East

Home sales revenues

Revenues for the eastern segment increased by 16.0% (\$70.9 million) for the year ended May 31, 2015 to \$512.7 million, from \$441.8 million for the year ended May 31, 2014. The increase in revenues for the year ended May 31, 2015 was due to an increase in the average price of homes closed and offset slightly by a decrease in the number of homes closed. The average sales price of homes closed increased 19.6% in the year ended May 31, 2015 to an average of \$445,000, from an average of \$372,000 for the year ended May 31, 2014. The number of homes closed during the year ended May 31, 2015 decreased 3.1% (37 homes), compared to the year ended May 31, 2014.

Many of the Company's newer communities target move-up buyers, with starting sales prices higher than our more mature communities. As we begin to see closings in these communities, our average sales prices may continue to increase quarter over quarter. Additionally, we were able to increase sales prices and/or reduce incentives in certain communities throughout our divisions as market conditions allowed.

Gross margins

During the early stages of a community's life cycle, the average gross margin is typically lower and increases over the life of a community as we are able to raise prices and/or reduce incentives. The average gross margin from homes closed for the year ended May 31, 2015 was 19.8% compared to 18.7% for the year ended May 31, 2014. The improved average gross margin for the year ended May 31, 2015 as compared to the year ended May 31, 2014 was primarily due to a decrease in construction costs as a percent of revenue. The reductions in construction costs as a percentage of revenue were primarily due to our ability to increase sales prices and/or reduce incentives in certain communities throughout our divisions as market conditions allowed.

Net new home orders and backlog

Net new home orders increased 11.8% (139 homes) during the year ended May 31, 2015, compared to the year ended May 31, 2014. These new home orders contributed to a backlog at May 31, 2015 of 631 homes, which is a 34.5% increase from the 469 homes in backlog at May 31, 2014. The sales value of backlog at May 31, 2015 was \$310.8 million, a 43.0% increase over the sales value of backlog at May 31, 2014 of \$217.4 million. The average sales price of homes in backlog increased 6.5% from \$463,000 at May 31, 2014 to \$493,000 at May 31, 2015. The increase in net new home orders and backlog units was primarily due to an increase in active communities of 37.5% from 40 communities at May 31, 2014 to 55 communities at May 31, 2015. The increase in the sales value of backlog was primarily driven by higher sales prices in many of our newer communities, as well as our ability to increase sales prices and/or reduce incentives in certain communities throughout our divisions as the market allowed.

Year Ended May 31, 2014 Compared to Year Ended May 31, 2013 - East

Home sales revenues

Revenues for the eastern segment increased by 33.1% (\$109.8 million) for the year ended May 31, 2014 to \$441.8 million, from \$332.0 million for the year ended May 31, 2013. The increase in revenues for the year ended May 31, 2014 was due to increases in both the number of homes closed and the average price of homes closed. The number of homes closed during the year ended May 31, 2014 increased 14.3% (149 homes), compared to the year ended May 31, 2013. The average sales price of homes closed increased 16.3% for the year ended May 31, 2014 to an average of \$372,000, from an average of \$320,000 for the year ended May 31, 2013.

The increase in the number of homes closed in the eastern segment in the year ended May 31, 2014 was primarily due to a decrease in resale inventory in those markets and a 29.0% increase in our active communities. The increase in the average sales price of homes closed in the eastern segment for the year ended May 31, 2014 was due, in part, to strategically positioning ourselves during the last several fiscal years in better located communities, targeting the multi-move-up buyer, to achieve closings at higher sales prices and margins. Also, we were able to increase sales prices and/or reduce incentives in all of these markets, which contributed to an increase in the average sales price.

Gross margins

The average gross margin from homes closed for the year ended May 31, 2014 was 18.9%, compared to 18.9% for the year ended May 31, 2013. The average adjusted gross margin from homes closed for the year ended May 31, 2014 was 21.2%, compared to 21.9% for the year ended May 31, 2013. The decrease in adjusted gross margin was primarily due to increased costs of land, materials and labor.

Net new home orders and backlog

Net new home orders increased 2.6% (30 homes) during the year ended May 31, 2014, compared to the year ended May 31, 2013. These new home orders contributed to a backlog at May 31, 2014 of 469 homes, which is a 2.9% decrease from the 483 homes in backlog at May 31, 2013. The sales value of backlog at May 31, 2014 was \$217.4 million, a 21.6% increase over the sales value of backlog at May 31, 2013 of \$178.7 million. The average sales price of homes in backlog increased 25.1% from \$370,000 at May 31, 2013 to \$463,000 at May 31, 2014. The increase in net new home orders was primarily due to an increase in active communities of 29.0% from 31 communities at May 31, 2013 to 40 communities at May 31, 2014. The increase in the sales value of backlog was primarily driven by higher sales prices in many of our newer communities, as well as our ability to increase sales prices and/or reduce incentives in certain communities throughout our divisions as the market allowed.

Homebuilding—Central

	Year ended May 31,		
	2015	2014	2013
	(\$ in thousands)		
Homebuilding Central:			
Home sales revenues	\$ 436,553	\$ 366,714	\$ 318,237
Home closed (in units)	1,209	1,110	1,041
Average sales price per home closed	\$ 361	\$ 330	\$ 306
Home gross margin	18.4%	20.0%	17.8%
Adjusted home gross margin ⁽¹⁾	20.7%	22.4%	21.0%

(1) Adjusted home gross margin is a non-GAAP measure. The following is a reconciliation of home gross margin to adjusted home gross margin, which is the most directly comparable U.S. GAAP measure:

	Year ended May 31,		
	2015	2014	2013
	(in thousands)		
Home sales revenues	\$ 436,553	\$ 366,714	\$ 318,237
Cost of sales - homes	356,079	293,471	261,637
Home gross margin	80,474	73,243	56,600
Add: Inventory Impairments	201	381	295
Interest amortized to cost of sales	9,835	8,425	9,940
Adjusted home gross margin	<u>\$ 90,510</u>	<u>\$ 82,049</u>	<u>\$ 66,835</u>
Ratio of home gross margin to home sales revenues	18.4%	20.0%	17.8%
Ratio of adjusted home gross margin to home sales revenues	20.7%	22.4%	21.0%

Year Ended May 31, 2015 Compared to Year Ended May 31, 2014 - Central

Home sales revenues

Revenues for the central segment increased by 19.0% (\$69.8 million) for the year ended May 31, 2015 to \$436.6 million, from \$366.7 million for the year ended May 31, 2014. The increase in revenues for the year ended May 31, 2015 was due to increases in both the average price of homes closed and the number of homes closed. The average sales price of homes closed increased 9.4% in the year ended May 31, 2015 to an average of \$361,000, from an average of \$330,000 for the year ended May 31, 2014. The number of homes closed increased 8.9% in the year ended May 31, 2015 to 1,209 from 1,110 for the year ended May 31, 2014.

Many of the Company's newer communities target move-up buyers, with starting sales prices higher than our more mature communities. As we begin to see closings in these communities, our average sales prices may continue to increase quarter over quarter. Additionally, we were able to increase sales prices and/or reduce incentives in certain communities throughout our divisions as market conditions allowed.

Gross margins

During the early stages of a community's life cycle, the average gross margin is typically lower and increases over the life of a community as we are able to raise prices and/or reduce incentives. The average gross margin from homes closed for the year ended May 31, 2015 was 18.4%, compared to 20.0% for the year ended May 31, 2014. The reduction in average gross margin for the year ended May 31, 2015 as compared to the year ended May 31, 2014 was primarily due to an increase in closings in newer communities with lower average gross margins in the year ended May 31, 2015 as compared to the year ended May 31, 2014, while the gross margins in the more mature communities remained relatively flat, year over year.

Net new home orders and backlog

Net new home orders increased 6.1% (72 homes) during the year ended May 31, 2015, compared to the year ended May 31, 2014. These new home orders contributed to a backlog at May 31, 2015 of 582 homes, which is an 8.4% increase from the 537 homes in backlog at May 31, 2014. The sales value of backlog at May 31, 2015 was \$233.3 million, a 23.2% increase over the sales value of backlog at May 31, 2014 of \$189.3 million. The average sales price of homes in backlog increased 13.9% from \$352,000 at May 31, 2014 to \$401,000 at May 31, 2015. The increase in net new home orders and backlog units was primarily due to an increase in active communities of 18.6% from 43 communities at May 31, 2014 to 51 communities at May 31, 2015. The increase in the sales value of backlog was primarily driven by higher sales prices in our newer communities, as well as our ability to increase sales prices and/or reduce incentives in certain communities throughout our divisions as the market allowed.

Year Ended May 31, 2014 Compared to Year Ended May 31, 2013 - Central

Home sales revenues

Revenues for the central segment increased by 15.2% (\$48.5 million) for the year ended May 31, 2014 to \$366.7 million, from \$318.2 million for the year ended May 31, 2013. The increase in revenues for the year ended May 31, 2014 was due to increases in both the average price of homes closed and the number of homes closed. The average sales price of homes closed increased 7.8% for the year ended May 31, 2014 to an average of \$330,000, from an average of \$306,000 for the year ended May 31, 2013. The number of homes closed during the year ended May 31, 2014 increased 6.6% (69 homes), compared to the year ended May 31, 2013.

The increase in the number of homes closed in the central segment in the year ended May 31, 2014 occurred primarily due to a decrease in resale inventory in each market. The increase in the average sales price of homes that closed in the central segment for the year ended May 31, 2014 was due, in part, to an increase in the percentage of move-up closings. Of the homes that closed in the central segment during the year ended May 31, 2014, 80% were move-up homes compared to 76% for the year ended May 31, 2013. Also, in all of these markets, we were able to increase sales prices and/or reduce incentives, which not only contributed to an increase in the average sales price but also resulted in improved margins.

Gross margins

The average gross margin from homes closed for the year ended May 31, 2014 was 20.0%, compared to 17.8% for the year ended May 31, 2013. The improved gross margin was due in part to a decrease in interest amortized through cost of sales. For the year ended May 31, 2014, interest amortized through cost of sales averaged 2.3% of housing revenue versus 3.1% for the year ended May 31, 2013. The improved gross margin was also due to additional move-up closings as discussed above. Also, as previously discussed, we were able to increase sales prices and/or reduce incentives in all of our markets.

The average adjusted gross margin from homes closed for the year ended May 31, 2014 was 22.4% compared to 21.0% for the year ended May 31, 2013. The improved adjusted gross margin was primarily due to an increase in additional move-up closings and an increase in sales prices and/or reduced incentives in all of our markets.

Net new home orders and backlog

Net new home orders increased 5.3% (59 homes) during the year ended May 31, 2014, compared to the year ended May 31, 2013. These new home orders contributed to a backlog at May 31, 2014 of 537 homes, which is a 15.5% increase from the 465 homes in backlog at May 31, 2013. The sales value of backlog at May 31, 2014 was \$189.3 million, a 21.3% increase over the sales value of backlog at May 31, 2013 of \$156.0 million. The average sales price of homes in backlog increased 5.1% from \$335,000 at May 31, 2013 to \$352,000 at May 31, 2014. The increase in net new home orders and backlog units was primarily due to an increase in active communities of 13.2% from 38 communities at May 31, 2013 to 43 communities at May 31, 2014. The increase in the sales value of backlog was primarily driven by higher sales prices in our newer communities, as well as our ability to increase sales prices and/or reduce incentives in certain communities throughout our divisions as market conditions allowed.

Liquidity and capital resources

Our principal uses of cash are land and lot purchases, land development, home construction, interest costs and overhead. We currently fund our operations with cash flows from operating activities, borrowings under our senior secured revolving credit facility, long-term financing and equity investments. As we utilize our capital resources and liquidity to fund the growth of our business, we monitor our balance sheet leverage ratios to ensure that we maintain reasonable levels. We also monitor current and expected operational requirements, as well as financial market conditions, to evaluate accessing other available financing sources. Based on our existing financial condition and credit relationships, we believe that our operations and capital resources are sufficient to provide for our current and foreseeable capital needs. However, we continue to evaluate the impact of market conditions on our liquidity and will consider, as appropriate, additional funding opportunities.

Operating cash flows

Net cash used in operating activities for the year ended May 31, 2015 was \$41.7 million compared to \$77.5 million for the year ended May 31, 2014. The primary source of operating funds was the sale of homes, and we primarily used these funds to buy land, build homes, pay interest and fund overhead expenses. We increased our deposits on future land purchases by \$19.8 million during the year ended May 31, 2015. The increase in cash used in operating activities was also due to an increase in homes under construction from 858 (589 sold and 269 unsold) at May 31, 2014 to 867 (614 sold and 253 unsold) at May 31, 2015.

Net cash used in operating activities for the year ended May 31, 2014 was \$77.5 million compared to \$62.4 million for the year ended May 31, 2013. The primary source of operating funds was the sale of homes, and we primarily used these funds to buy land, build homes, pay interest and fund overhead expenses. We increased our deposits on future land purchases by \$27.6 million during the year ended May 31, 2014. The increase in cash used in operating activities was also due to an increase in homes under construction from 680 (506 sold and 174 unsold) at May 31, 2013 to 858 (589 sold and 269 unsold) at May 31, 2014.

Investing cash flows

Net cash used in investing activities was \$16.4 million for the year ended May 31, 2015 compared to \$20.0 million for the year ended May 31, 2014. Net cash used in investing activities for the year ended May 31, 2015 included \$14.7 million for model home furnishings and sales offices, and \$5.1 million for new Design Studios. The cash outflows were partially offset by a \$1.5 million return on investment from an unconsolidated entity and the release of \$3.1 million in restricted cash used to cash collateralize letters of credit (see Note 1(d)).

Net cash used in investing activities was \$20.0 million for the year ended May 31, 2014 compared to \$16.0 million for the year ended May 31, 2013. Net cash used in investing activities included an \$8.0 million investment in an unconsolidated entity offset by a \$1.0 million return on investment from an unconsolidated entity and expenditures of \$11.0 million for model home furnishings and sales offices and \$2.1 million for new design studios. The cash outflows were partially offset by the release of \$2.3 million in restricted cash used to cash collateralize letters of credit.

Financing cash flows

Net cash used in financing activities was \$6.0 million for the year ended May 31, 2015, compared to \$66.1 million for the year ended May 31, 2014 and \$145.1 million for the year ended May 31, 2013. The funds used in financing activities during the year ended May 31, 2015 consisted of \$439.3 million of borrowings from the Fourth Amended and Restated Credit Agreement as amended by that certain First Amendment to the Fourth Amended and Restated Credit Agreement (the "Restated Revolver") repaid in full during the fiscal year, \$10.0 million received from the sale of Class C membership interests to our Members in May 2015, which was offset by distributions of \$14.7 million to our Members, and \$1.3 million of debt issuance costs paid in connection with the Restated Revolver. The funds provided by financing activities during the year ended May 31, 2014 consisted of \$49.1 million received from the issuance of \$50 million in principal amount of additional 6.875% Notes in December 2013 and \$30.3 million received from the sale of Class C membership interests to our Members offset in part by \$11.8 million of distributions to our Members and \$1.3 million of debt issuance costs paid in connection with the issuance of the additional 6.875% Notes. As of May 31, 2015, we had no outstanding borrowings under our Restated Revolver and available additional borrowing capacity of \$185.8 million based on outstanding borrowings, outstanding letters of credit, and the value of collateral pledged to secure the facility.

As of May 31, 2014, we did not have any outstanding borrowings under our Restated Revolver.

The total debt to total capitalization ratio consists of total debt divided by total capitalization (debt plus members' equity). Our ratio of total debt to total capitalization decreased to 58.5% as of May 31, 2015 from 61.5% as of May 31, 2014. Our ratio of net debt to net capitalization increased to 58.5% as of May 31, 2015 from 56.3% as of May 31, 2014. The net debt to net capitalization ratio consists of total debt, net of cash and restricted cash, divided by net capitalization (debt plus members' equity), net of cash and restricted cash.

Inventory

As of May 31, 2015, we had the following owned homes in our reportable segments (in units):

	Homes Under Construction			Completed Homes			Total Homes
	Unsold	Models	Sold	Unsold	Models	Sold	
East	126	8	287	45	69	34	569
Central	109	10	327	57	64	47	614
Company total	235	18	614	102	133	81	1,183

As of May 31, 2015 we controlled the following residential homes and lots (in units):

	Total Homes	Finished Lots	Land Under Development	Residential Land Held for Future Development	Total Owned	Total Under Option	Total Controlled
East	569	1,432	323	89	2,413	4,488	6,901
Central	614	982	168	—	1,764	4,857	6,621
Total Company	1,183	2,414	491	89	4,177	9,345	13,522
Percentage of total controlled	8.7%	17.9%	3.6%	0.7%	30.9%	69.1%	100.0%

In addition to the lots in the table above, the Company owned a commercial tract of land in Dallas with a book value of \$1.3 million at May 31, 2015 and 2014. This land is not being actively marketed and is included in commercial land.

During the fiscal year, the Company sold 218 lots in Denver for a total purchase price of \$7.5 million and a commercial tract in Orlando for a total purchase price of \$4.4 million.

In addition to the 4,177 lots we owned, we controlled, through the use of purchase and option agreements, 9,345 lots at May 31, 2015. Purchase and option agreements that did not require consolidation under ASC Subtopic 810, *Consolidations*, ASC Subtopic 360-20, *Property, Plant, and Equipment ("ASC 360-20")*, or ASC Subtopic 470-40, *Product Financing Arrangements ("ASC 470-40")* at May 31, 2015 had an aggregate purchase price of \$742.1 million. In connection with these agreements, we had cash deposits of \$73.4 million at May 31, 2015. With respect to these purchase and option agreements, there was one agreement that could result in a specific performance agreement to purchase 208 lots as of May 31, 2015 with an aggregate remaining purchase price of \$42.2 million. In addition, we had purchase and option agreements consolidated under ASC 360-20, or ASC 470-40 with an aggregate purchase price of \$42.5 million and cash deposits of \$7.8 million. (See Note 5)

During the year ended May 31, 2015, we acquired 2,430 lots for a total purchase price of \$184.5 million. We spent \$55.6 million on land development for the year ended May 31, 2015. Additionally, we spent \$21.0 million during the year ended May 31, 2015, to furnish model homes and sales offices, to build and furnish Design Studios and to update furnishings in existing communities.

Debt Obligations

Our debt obligations, which are more fully discussed in our audited consolidated financial statements as of May 31, 2015 and 2014, and for the years ended May 31, 2015, 2014, and 2013, are summarized below.

Senior Secured Revolving Credit Facility

On August 21, 2014, the Company amended its senior secured revolving credit facility by entering into a First Amendment to Fourth Amended and Restated Credit Agreement (the “First Amendment”), providing for, among other things, an aggregate revolving loan commitment of \$195.0 million with up to \$45.0 million available for the issuance of letters of credit and extending the maturity date to February 21, 2018. The Fourth Amended and Restated Credit Agreement as amended by the First Amendment is referred to herein as the “Restated Revolver.”

Interest accrues on borrowings under the Restated Revolver at the London Interbank Offered Rate (LIBOR) plus an applicable margin that ranges from 325 to 385 basis points. Letters of credit may be issued under the Restated Revolver at a rate of 100 basis points if secured by cash, or at a rate of 325 to 385 basis points if not secured by cash. The Restated Revolver has a maturity date of February 21, 2018, subject to an extension in accordance with the terms set forth therein. The Restated Revolver is secured by a continuing first priority security interest in the real property of certain operating divisions selected by the Company for inclusion in the borrowing base, and the personal property of the Company and its subsidiaries affixed to, placed upon, used in connection with, arising from or appropriated for use on the pledged real property and the continuing guarantee of substantially all of its subsidiaries. The Company may pledge additional collateral as needed to increase the borrowing base consistent with the maximum availability under the Restated Revolver.

The Restated Revolver contains the following material financial covenants:

- A minimum level of Tangible Net Worth;
- A maximum Leverage Ratio;
- A minimum Interest Coverage Ratio;
- Minimum liquidity;
- Maximum level of land supply; and
- Maximum level of Speculative Housing Units and Model Housing Units.

Availability under the Restated Revolver is based upon a borrowing base formula. Additionally, the Restated Revolver contains covenants in addition to the financial covenants noted above. The Restated Revolver permits sales and transfers of ownership interests so long as no change of control, as defined in the Restated Revolver, occurs and permits certain tax distributions to Members and certain other distributions to Members if certain Leverage Ratio and other conditions are met. As of May 31, 2015, the Company was in compliance with the covenants in the Restated Revolver.

At May 31, 2015, there were no borrowings outstanding under the Restated Revolver and \$3.2 million of letters of credit outstanding. As of May 31, 2015, and subject to a borrowing base formula, the Company had available additional borrowing capacity of \$185.8 million under the Restated Revolver based on outstanding borrowings on the Restated Revolver, outstanding letters of credit, and the value of collateral pledged to secure the facility.

At May 31, 2014, there were no borrowings outstanding under the Restated Revolver and \$3.0 million of letters of credit outstanding. The Company has elected to cash collateralize all letters of credits in restricted accounts. As of May 31, 2014, the Company had \$116.8 million available for borrowings under the Restated Revolver.

The 6.875% Notes

The Company has issued and outstanding \$350 million principal amount of 6.875% Senior Notes due February 15, 2021 (the “6.875% Notes”).

Interest is payable on the 6.875% Notes on February 15 and August 15 of each year. The 6.875% Notes are senior, unsecured obligations of the Company and rank equally in right of payment to all of the Company’s existing and future senior debt and senior in right of payment to the Company’s existing and future subordinated debt. The 6.875% Notes are effectively subordinated to any of the Company’s existing and future secured debt, including the Restated Revolver, to the extent of the value of the assets securing such debt. The obligations under the 6.875% Notes are jointly and severally guaranteed by each Restricted Subsidiary, as defined, that has assets with a book value of more than \$2.0 million.

The Company has the option to redeem the 6.875% Notes at any time or from time to time, in whole or in part, (a) until February 15, 2017, at a redemption price equal to 100% of their principal amount, together with accrued and unpaid interest thereon, if any, to and excluding the redemption date, plus a make-whole premium as defined in the indenture governing the 6.875% Notes, (b) on or after February 15, 2017, at certain redemption prices set forth in the indenture governing the 6.875% Notes together with accrued and unpaid interest thereon, if any, to and excluding the redemption date, and (c) on or after February 15, 2019, at 100% of the principal amount to be redeemed, together with accrued and unpaid interest thereon, if any, to and excluding the redemption date. At any time before February 15, 2016, the Company may redeem up to 35% of the aggregate principal amount of the 6.875% Notes with the net cash proceeds of certain equity offerings, at a redemption price equal to 106.875% of the aggregate principal amount of the notes plus accrued and unpaid interest, if any, to and excluding the redemption date.

The indenture governing the 6.875% Notes contains a number of covenants, including covenants relating to the following:

- Limitations on indebtedness;
- Limitations on restricted payments;
- Limitations on dividends;
- Limitations on transactions with affiliates;
- Limitations on liens;
- Limitations on asset sales;
- Limitations on designation of unrestricted subsidiaries; and
- Limitations on mergers.

As of May 31, 2015, the Company was in compliance with the covenants in the indenture governing the 6.875% Notes.

Senior Secured Second Lien Credit Facility

Prior to repayment with the proceeds of the 6.875% Notes on February 6, 2013, the Company was a party to a Senior Secured Second Lien Credit Agreement dated July 6, 2010 under which a \$115 million term loan was outstanding (the “Term Loan”). The Term Loan bore interest at an annual rate of 11.75% payable on January 2 and July 1 of each year, commencing on January 2, 2011. The lenders under the Term Loan had a second priority security interest in the same assets securing the Restated Revolver and the Term Loan was guaranteed by the Company’s subsidiaries.

The 11.0% Notes and the 9.5% Notes (together, the “Notes”)

Prior to redemption with the proceeds of the 6.875% Notes on February 6, 2013, the Company had outstanding \$64.1 million principal amount of 11.0% Notes due 2015 and \$1.7 million principal amount of 9.5% Notes due 2015 (collectively the “Notes”).

The 11.0% Notes did not bear interest during the first three years following their issuance on February 23, 2009. From and after February 23, 2012, the 11.0% Notes bore interest at the rate of 11.0% per year, payable on June 30 and December 30 of each year. For the period commencing February 23, 2012 until and including the first interest payment date of June 30, 2012, interest was required to be paid in cash only to the extent that the Consolidated Fixed Charge Coverage Ratio, as defined, calculated assuming the payment of such interest in cash, exceeded 1.75 to 1.00. If the Consolidated Fixed Charge Coverage Ratio, as defined, did not exceed 1.75 to 1.00, the first interest payment was payable, at the Company’s option, in kind based on an annual rate of 13.05% for such interest payment period only. The Company settled the interest payment obligation in cash on its due date and recorded a \$1.4 million gain on paid-in-kind option settlement during the year ended May 31, 2013. The gain arose because the accrued interest of \$25.1 million that was recorded in fiscal year 2009, pursuant to ASC Subtopic 470-60, included an assumption that the first interest payment would be paid-in-kind.

The 9.5% Notes bore interest at a rate of 9.5% per annum, payable semiannually on October 1 and April 1 of each year.

The Notes were unsecured and subordinated in right of payment to all of the Company’s existing and future senior debt. The obligations under the Notes were jointly and severally guaranteed by each Restricted Subsidiary, as defined. All of the Company’s subsidiaries were Restricted Subsidiaries with respect to the Notes.

Aggregate contractual commitments and off-balance sheet arrangements

Our contractual obligations under our debt agreements, specific performance lot purchase contracts, and lease payments under operating leases as of May 31, 2015 are presented below (in thousands):

	Due in				Total
	Less than 1 year	2 to 3 years	4 to 5 years	More than 5 years	
6.875% senior notes ⁽¹⁾	\$ —	\$ —	\$ —	\$ 350,000	\$350,000
Lot option agreement with specific performance ⁽²⁾	—	42,200	—	—	42,200
Operating leases	3,167	3,117	3,060	7,072	16,416
	<u>\$ 3,167</u>	<u>\$ 45,317</u>	<u>\$ 3,060</u>	<u>\$ 357,072</u>	<u>\$408,616</u>

(1) Excludes interest obligations.

(2) We have one lot purchase agreement which could result in a specific performance obligation to purchase a total of 208 lots.

In the ordinary course of business, we provide letters of credit and surety bonds to third parties to secure performance and provide deposits under various contracts and commitments. At May 31, 2015, we had letters of credit and surety bonds outstanding of \$3.2 million and \$20.7 million, respectively. As of May 31, 2015, we had \$41.8 million of unused letters of credit capacity under the Restated Revolver.

At May 31, 2015, we controlled 13,522 lots and homes available to close. Of the 13,522 lots and homes controlled, we owned 30.9%, or 4,177 lots and homes, and 69.1%, or 9,345 lots were under contract. In the ordinary course of business, we enter into purchase and option agreements in order to procure land for the construction of homes in the future. At May 31, 2015, these agreements had an aggregate remaining purchase price of \$742.1 million, net of deposits

of \$73.4 million. In addition, we had purchase and option agreements recorded under ASC 360-20 or ASC 470-40 with an aggregate purchase price of \$42.5 million and cash deposits of \$7.8 million. Pursuant to these land purchase and land option agreements, we generally provide a deposit to the seller as consideration for the right, but not the obligation, to purchase land at different times in the future, usually at predetermined prices. In certain instances, we are required to record the land under option as if we own it. With respect to these purchase agreements, there was one purchase agreement as of May 31, 2015 which could result in a specific performance agreement under which the Company had a \$1.4 million deposit and an aggregate purchase price of \$42.2 million.

As of May 31, 2015, we recorded real estate not owned of \$38.3 million for six lot purchase agreements. As of May 31, 2015, we participated in three land development joint ventures in which we have less than a controlling interest. We account for our interests in these joint ventures under the equity method. Our share of profits from lots we purchase from these entities is deferred and treated as a reduction of the cost basis of land purchased from the entity. Our share of profits from lots purchased by other parties is recognized immediately and included within equity in earnings in unconsolidated entities on the consolidated statements of operations.

As of May 31, 2014, we recorded real estate not owned of \$23.3 million for four lot purchase agreements, three with unaffiliated investors and one with an investor group that was comprised of certain beneficial owners of our equity or their affiliates.

Seasonality and inflation

Our historical quarterly results of operations have tended to be variable due to the seasonal nature of the homebuilding industry. We have historically experienced increases in revenues and cash flow from operations during the calendar second quarter based on the timing of home closings. Any period of high inflation is likely to have an adverse effect on us and the homebuilding industry in general since it may contribute to higher land, financing, labor and construction costs. Further, higher mortgage interest rates may accompany inflation and affect the affordability of mortgage financing for homebuyers. We have, in the past, attempted to pass on at least a portion of the cost increases to our homebuyers via increased sales prices; however, we may be limited in our ability to increase our prices. If we are unable to increase our sales prices to compensate for any increased costs, or if mortgage interest rates increase significantly, thereby affecting the ability of potential homebuyers to adequately finance home purchases, our results of operations will likely be adversely affected.

Our operations are also affected by seasonality in cash use. Our cash needs are generally higher from January to April each year as we complete the spring building cycle.

Critical accounting policies and estimates

General

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. GAAP requires us to make decisions based upon estimates, assumptions, and factors we consider relevant to the circumstances. Such decisions include the selection of applicable accounting principles and the use of judgment in their application, the results of which impact reported amounts and disclosures. Some of our critical accounting policies require the use of judgment in their application or require estimates of inherently uncertain matters. Changes in future economic conditions or other business circumstances may affect the outcomes of our estimates and assumptions. Accordingly actual results could differ materially from those anticipated. In instances where alternative methods of accounting are permissible under GAAP, we have chosen the method that most appropriately reflects the nature of our business, the results of our operations and our financial condition, and have consistently applied those methods over each of the periods presented in the financial statements.

A summary of the significant accounting policies followed in the preparation of the financial statements is contained in our audited Consolidated Financial Statements for the three year period ended May 31, 2015. Other footnotes in those financial statements describe various elements of the financial statements and the assumptions on which specific

amounts were determined. Listed below are those accounting policies and underlying estimates and judgments that we believe are critical and require the use of complex judgment in their application.

Revenue recognition

We recognize homebuilding revenues when a home closes and title to the property transfers to the buyer. Substantially all of our revenues are received in cash within a day or two of closing. We include amounts in transit from title companies at the end of each reporting period in accounts receivable. When we execute sales contracts with our homebuyers, or when we require advance payment from homebuyers for upgrades or options related to their homes, we record the cash deposits received as liabilities until the homes are closed or the contracts are canceled. We either retain or refund to the homebuyer deposits on canceled sales contracts, depending upon the applicable provisions of the contract.

Inventories and cost of sales

In addition to the costs of direct land acquisition, land development and home construction, inventory costs include interest, real estate taxes and indirect overhead costs incurred during development and home construction. The Company uses the specific identification method for the purpose of accumulating home construction costs. Cost of sales for homes closed includes the specific construction costs of each home (both incurred and estimated to be incurred) and all applicable land acquisition, land development and related costs based upon the total number of homes expected to be closed in each community. Any changes to the estimated total development costs subsequent to the initial home closings in a community are allocated to the remaining homes in the community.

When a home is closed, the Company generally has not yet paid and recorded all incurred costs necessary to complete the home. Each month, the Company records as a liability, and a charge to cost of sales, the amount it estimates will ultimately be paid related to completed homes that have been closed as of the end of that month. The Company compares its updated home construction budgets to actual recorded costs to estimate the additional costs remaining to be paid on each closed home. The Company monitors the accuracy of each month's accrual by comparing actual costs paid on closed homes in subsequent months to the amount accrued. Actual costs to be paid on closed homes in the future could differ from the current estimate.

Inventory is stated at cost, unless the carrying amount is determined not to be recoverable, in which case the inventory is written down to fair value in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standard Codification ("ASC") Subtopic 360-10, *Property, Plant and Equipment*. The Company reviews its inventory in accordance with ASC Subtopic 360-10, which requires long-lived assets to be assessed for impairment when facts and circumstances indicate an impairment may exist. The Company utilizes an undiscounted future cash flow model in this assessment. When the results of the undiscounted future cash flows are less than the carrying value of the community (asset group), an asset impairment must be recognized in the consolidated financial statements as a component of cost of sales. The amount of the impairment is calculated by subtracting the estimated fair value, less cost to sell, of the community from the carrying value. ASC Subtopic 360-10 also requires that assets held for sale be stated at the lower of cost or fair value less costs to sell. Accordingly, land held for sale is stated at the lower of accumulated cost or fair value less costs to sell.

In order for management to assess the fair value of its real estate assets, certain assumptions must be made which are highly subjective and susceptible to change. Management evaluates, among other things, the actual gross margins for homes closed and the gross margins for homes sold in backlog (representing the number or value of sales orders that have not yet closed, net of cancellations). This evaluation also includes assumptions with respect to future home sales prices, cost of sales, including levels of sales incentives, the monthly rate of sale, discount rates, profit margins, and potential buyers, which are critical in determining the fair value of the Company's real estate assets. If events and circumstances indicate that the carrying value of a real estate asset is not expected to be recoverable, then it is written down to its estimated fair value. Given the historical variability in the homebuilding industry cycle, the Company is of the view that the valuation of homebuilding inventories is sensitive to changes in economic conditions, such as interest rates, the availability of credit and unemployment levels. Changes in these economic conditions could materially affect the projected home sales prices, the level of sales incentives, the costs to develop land and construct homes and the monthly rate of sales. Because of these potential changes in economic and market conditions in conjunction with

the assumptions and estimates required of management in valuing homebuilding inventory, actual results could differ materially from management's assumptions and may require material inventory impairments to be recorded in the future.

Deposits and pre-acquisition costs paid related to purchase agreements are capitalized when paid and initially classified as as deposits (for deposits) and other assets (for pre-acquisition costs). These costs are transferred to inventory at the time the land or lots are acquired. Nonrefundable deposits and pre-acquisition costs are charged to expense when the real estate purchase is no longer considered probable. If the Company intends to terminate a purchase agreement, it records a charge to earnings for these costs associated with the purchase agreement in the period such a decision is made. This expense is included as a component of cost of sales expense in the consolidated statements of income and was \$0.9 million, \$1.2 million, and \$0.6 million for the year ended May 31, 2015, 2014, and 2013, respectively.

Warranty liabilities

We establish warranty liabilities by charging cost of sales and crediting a warranty liability for each home closed. We estimate the amounts charged to expense that we believe are adequate to cover expected warranty-related costs. Our warranty cost accruals are based upon our historical warranty cost experience in each market in which we operate and are adjusted as appropriate to reflect qualitative risks associated with the type of homes we build and the geographic areas in which we build them. Actual future warranty costs could differ significantly from our currently estimated amounts.

Transactions with related parties

A services agreement with a related party provides the Company with a license, as well as development and support, for the Company's computer systems and certain administrative services. The Company pays \$800 per home closing quarterly, in arrears, for these services, which are included in selling, general and administrative expenses in the consolidated statements of income. During the year ended May 31, 2015, 2014, and 2013, the Company incurred fees of \$1.9 million, \$1.8 million, and \$1.7 million, respectively, under the services agreement. As of May 31, 2015 and 2014, the balance due to the related party was \$0.7 million and \$0.7 million, respectively.

During the first quarter of fiscal year 2015, the Company entered into a lease as a lessee with an affiliate of the Investors (as defined in Item 7) to rent approximately 8,000 square feet of commercial space in Dallas, Texas. The term of the lease is 66 months. The Company has the option to renew the lease for one additional five-year term. Total minimum lease payments due under the lease were \$0.5 million as of May 31, 2015.

During the third quarter of fiscal year 2015, the Company entered into a lot purchase agreement with an affiliate of the Investors. The affiliate of the Investors purchased the land position directly from a third party; therefore, the lot purchase agreement entered into with the Company was accounted for as any other purchase agreement. As of May 31, 2015, the total purchase price of lots remaining to be purchased under this agreement was approximately \$9.2 million.

In February 2014, the Company entered into a land joint venture with certain beneficial owners of the Company's equity of their affiliates (each and collectively, the "Investors") in which the Company has a 49% limited partner interest that was accounted for under the equity method (see Note 10). As of May 31, 2015, the Company recorded \$7.1 million for its investment in this unconsolidated entity in the consolidated balance sheets. The Company entered into a services agreement with the joint venture to provide accounting and administrative services. The Company receives a monthly fee of \$6,000 for these services that is included in other income in the consolidated statements of income. The Company entered into a lot purchase agreement with the joint venture, in which a 10% deposit was required, and there were no specific performance requirements for the Company. As of May 31, 2015, the total purchase price of lots remaining to be purchased under this agreement was approximately \$19.3 million. As of May 31, 2015, the joint venture had debt outstanding of \$8.1 million, which is non-recourse to the joint venture and to the Company. The loan was obtained to acquire the land and fund the first phase of land development. The Company has provided the lender with a performance guarantee for the substantial completion of the first phase of development for this joint venture. In the event that we pay any money or perform any services pursuant to the guarantee, the joint venture has agreed to indemnify and reimburse us for any such costs incurred.

During fiscal year 2014, the Company entered into three lot purchase agreements with an affiliate of the Investors. The affiliate of the Investors purchased the land positions directly from a third party; therefore, the lot purchase agreements entered into with the Company were accounted for as any other purchase agreement.

In August 2012, the Company entered into a lot purchase agreement with the Investors. The Company recorded \$0.9 million as real estate not owned in the consolidated balance sheets related to such agreements as of May 31, 2014. The Company had no real estate not owned in the consolidated balance sheets related to such agreements as of May 31, 2015.

Pending accounting pronouncements

In April 2013, the FASB issued Accounting Standards Update No. 2013-04, *Liabilities* ("ASU 2013-04"), which provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. ASU 2013-04 is effective for annual reporting periods ending after December 15, 2014 (and interim and annual periods thereafter) and should be applied retrospectively for these obligations subject to the guidance. The adoption of ASU 2013-04 on June 1, 2014 did not have a material impact on the Company's consolidated financial statements or disclosures.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"). ASU 2014-09 states that an entity should recognize revenue to depict 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. The allowable methods of adoption are full retrospective adoption or modified retrospective adoption. The effective date for ASU 2014-09 for the Company is for annual periods beginning after December 15, 2017. The Company is currently evaluating the impact that ASU 2014-09 will have on its consolidated financial statements and disclosures. At this time the Company is unable to determine whether adoption of this standard will have a material impact on its consolidated financial position, results of operations, cash flows, or related disclosures.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, *Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern* ("ASU 2014-15"), which requires management to perform interim and annual assessments on whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year of the date the financial statements are issued and to provide related disclosures, if required. The amendments in ASU 2014-15 are effective for the annual period ending after December 15, 2016, and for annual and interim periods thereafter. Early adoption is permitted. The Company's adoption of ASU 2014-15 is not expected to have a material effect on its consolidated financial statements and related disclosures.

In February 2015, the FASB issued Accounting Standards Update No. 2015-02, *Amendments to the Consolidation Analysis* ("ASU 2015-02"), which changed the analysis a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The amendments in ASU 2015-02 affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The amendments in ASU 2015-02 are effective for annual periods ending after December 15, 2016, and for annual and interim periods thereafter. Early adoption is permitted. The Company's adoption of ASU 2015-02 is not expected to have a material effect on its consolidated financial statements and related disclosures.

In April 2015, the FASB issued Accounting Standards Update No. 2015-03, *Interest - Imputation of Interest* ("ASU 2015-03"), which requires 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 effective date for ASU 2015-03 for the Company is for annual periods beginning after December 15, 2015. The Company's adoption of ASU 2015-03 is not expected to have a material effect on its consolidated financial statements and related disclosures.

Item 7A. *Quantitative and qualitative disclosures about market risk*

We maintain a mix of variable-rate and fixed-rate debt and our primary market risk exposure for these financial instruments relates to fluctuations in interest rates, which include changes in the U.S. Treasury rates and LIBOR. For our variable-rate debt, our primary exposure is in interest expense.

We do not believe our exposure in these areas is material to cash flows or earnings. The borrowings under the Restated Revolver accrue interest at a variable rate. As of May 31, 2015, we had no outstanding borrowings under our senior secured revolving credit facility.

Item 8. *Financial Statements*

The financial statements are presented on pages 47 through 73.



Ernst & Young LLP
Suite 1000
55 Ivan Allen Jr. Boulevard
Atlanta, GA 30308

Tel: +1 404 874 8300
Fax: +1 404 817 5589
ey.com

Report of Independent Auditors

The Members of Ashton Woods USA L.L.C.

We have audited the accompanying consolidated financial statements of Ashton Woods USA L.L.C., which comprise the consolidated balance sheets as of May 31, 2015 and 2014, and the related consolidated statements of income, changes in members' equity, and cash flows for each of the three years in the period ended May 31, 2015, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Ashton Woods USA L.L.C. at May 31, 2015 and 2014, and the consolidated results of its operations and its cash flows for each of the three years in the period ended May 31, 2015 in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

July 22, 2015

ASHTON WOODS USA L.L.C.
CONSOLIDATED BALANCE SHEETS
(In thousands)

	May 31, 2015	May 31, 2014
Assets:		
Cash and cash equivalents	\$ —	\$ 64,105
Restricted cash	3	3,118
Receivables	10,495	11,499
Inventory	546,255	458,153
Real estate not owned	38,278	23,272
Property and equipment, net	27,062	17,746
Investments in unconsolidated entities	9,427	10,885
Deposits on real estate under option or contract	65,538	45,772
Other assets	38,944	35,641
Total assets	\$ 736,002	\$ 670,191
Liabilities and members' equity		
Liabilities:		
Accounts payable	\$ 44,367	\$ 35,882
Other liabilities	41,017	35,688
Customer deposits	25,727	16,625
Liabilities related to real estate not owned	30,449	17,466
Debt	347,519	347,179
Total liabilities	489,079	452,840
Members' equity:	246,923	217,351
Total liabilities and members' equity	\$ 736,002	\$ 670,191

See accompanying notes to consolidated financial statements.

ASHTON WOODS USA L.L.C.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands)

	Year ended May 31,		
	2015	2014	2013
Revenues:			
Home sales	\$ 949,267	\$ 808,547	\$ 650,234
Land sales	12,192	2,210	7,806
	961,459	810,757	658,040
Cost of sales:			
Cost of sales - homes	767,474	652,837	531,252
Cost of sales - land	11,507	2,107	7,596
	778,981	654,944	538,848
Gross profit	182,478	155,813	119,192
Other expense (income):			
Selling, general and administrative	130,891	108,911	85,070
Interest expense	10,327	8,049	2,754
Depreciation and amortization	11,425	9,483	6,961
Gain on paid-in-kind option settlement	—	—	(1,400)
Gain on early extinguishment of debt	—	—	(3,427)
Other income	(3,163)	(1,817)	(1,176)
	149,480	124,626	88,782
Equity in earnings in unconsolidated entities	1,274	1,200	1,952
Net income	\$ 34,272	\$ 32,387	\$ 32,362

See accompanying notes to consolidated financial statements.

ASHTON WOODS USA L.L.C.
CONSOLIDATED STATEMENTS OF MEMBERS' EQUITY
(In thousands)

	Class A interest	Class B interest	Class C interest	Total members' equity
Members' equity at May 31, 2012	\$ 58,514	\$ 10,658	\$ 18,110	\$ 87,282
Net income	15,766	3,874	12,722	32,362
Contributions	—	—	46,915	46,915
Members' equity at May 31, 2013	\$ 74,280	\$ 14,532	\$ 77,747	\$ 166,559
Net income	13,081	3,216	16,090	32,387
Contributions	—	—	30,250	30,250
Distributions	(5,048)	(1,240)	(5,557)	(11,845)
Members' equity at May 31, 2014	\$ 82,313	\$ 16,508	\$ 118,530	\$ 217,351
Net income	13,531	3,325	17,416	34,272
Contributions	—	—	10,000	10,000
Distributions	(5,924)	(1,456)	(7,320)	(14,700)
Members' equity at May 31, 2015	\$ 89,920	\$ 18,377	\$ 138,626	\$ 246,923

See accompanying notes to consolidated financial statements.

ASHTON WOODS USA L.L.C.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year ended May 31,		
	2015	2014	2013
Cash flows from operating activities:			
Net income	\$ 34,272	\$ 32,387	\$ 32,362
Adjustments to reconcile net income to net cash used in operating activities:			
Equity in earnings in unconsolidated entities	(1,274)	(1,200)	(1,952)
Return on investments in unconsolidated entities	1,180	2,691	2,711
Increase in liability for long-term compensation	1,592	622	1,367
Depreciation and amortization	11,425	9,483	6,961
Gain on paid-in-kind option settlement	—	—	(1,400)
Noncash gain on early extinguishment of debt	—	—	(12,807)
Changes in operating assets and liabilities:			
Inventory	(85,036)	(91,489)	(88,289)
Receivables	1,004	(6,687)	(3,279)
Deposits on real estate under option or contract	(19,766)	(27,596)	—
Other assets	(6,435)	(13,879)	(17,280)
Accounts payable	8,485	9,453	5,465
Other liabilities	3,769	5,602	9,025
Customer deposits	9,102	3,156	4,685
Net cash used in operating activities	<u>(41,682)</u>	<u>(77,457)</u>	<u>(62,431)</u>
Cash flows from investing activities:			
Investments in unconsolidated entities	—	(8,040)	—
Return of investments in unconsolidated entities	1,520	968	499
Additions to property and equipment	(21,035)	(15,178)	(11,153)
Changes in restricted cash	3,115	2,266	(5,384)
Net cash used in investing activities	<u>(16,400)</u>	<u>(19,984)</u>	<u>(16,038)</u>
Cash flows from financing activities:			
Borrowings from revolving credit facility	439,300	—	387,000
Repayments of revolving credit facility	(439,300)	—	(387,000)
Proceeds from issuance of 6.875% bonds	—	49,126	297,717
Interest payment on 11.0% senior subordinated notes	—	—	(7,346)
Payments of debt issuance costs	(1,323)	(1,475)	(11,370)
Members' contributions	10,000	30,250	46,915
Members' distributions	(14,700)	(11,845)	—
Repayment of senior secured second lien credit agreement	—	—	(115,000)
Redemption of 9.5% notes	—	—	(1,700)
Redemption of 11.0% notes	—	—	(64,116)
Net cash (used in) provided by financing activities	<u>(6,023)</u>	<u>66,056</u>	<u>145,100</u>
Change in cash and cash equivalents	(64,105)	(31,385)	66,631
Cash and cash equivalents, beginning of period	<u>64,105</u>	<u>95,490</u>	<u>28,859</u>
Cash and cash equivalents, end of period	<u>\$ —</u>	<u>\$ 64,105</u>	<u>\$ 95,490</u>
Supplemental cash flow information:			
Cash paid for interest, net of amounts capitalized	<u>\$ 8,106</u>	<u>\$ 7,240</u>	<u>\$ 245</u>

See accompanying notes to consolidated financial statements.

ASHTON WOODS USA L.L.C.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
May 31, 2015

Note 1 — Basis of Presentation and Significant Accounting Policies

(a) Operations

Ashton Woods USA L.L.C. (the "Company" or "Ashton Woods"), operating as Ashton Woods Homes, is a limited liability company that designs, builds and markets attached and detached single-family homes under the Ashton Woods Homes brand name. The Company has operations in the following markets:

East: Raleigh, Charleston, Atlanta, Orlando, and Southwest Florida (Tampa, Sarasota and Naples)

Central: Houston, Dallas, Central Texas (Austin and Killeen), San Antonio, and Phoenix

The Company provides title services to buyers in certain of its Texas markets through two unconsolidated entities in which the Company has 49.0% ownership interests. In addition, the Company began offering title services in its Southwest Florida and Orlando operating divisions during the first quarter of fiscal year 2015 and in its Atlanta operating division during the second quarter of fiscal year 2015 through a wholly-owned title agency.

(b) Basis of presentation and reclassification

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned, majority-owned and controlled subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to the prior year balances to conform to the current year presentation. On the consolidated statements of income, the write-off of pre-acquisition costs related to real estate purchases that are no longer probable has been reclassified to cost of sales – homes, from selling, general and administrative expenses for the fiscal years 2014 and 2013. (see Note 1 (i))

(c) Cash and cash equivalents

The Company considers all highly liquid investments with an initial maturity of three months or less when purchased to be cash equivalents.

(d) Restricted cash

Restricted cash consists of amounts held in a restricted account as collateral for letters of credit issued and outstanding, as permitted by the Company's senior secured revolving credit facility and other investments for the year ended May 31, 2014.

(e) Inventory

In addition to the costs of direct land acquisition, land development and home construction, inventory costs include interest, real estate taxes and indirect overhead costs incurred during development and home construction. The Company uses the specific identification method for the purpose of accumulating home construction costs. Cost of sales for homes closed includes the specific construction costs of each home (both incurred and estimated to be incurred) and all applicable land acquisition, land development and related costs based upon the total number of homes expected to be

closed in each community. Any changes to the estimated total development costs subsequent to the initial home closings in a community are allocated to the remaining homes in the community.

When a home is closed, the Company generally has not yet recorded all incurred costs necessary to complete the home. Each month, the Company records as a liability and a charge to cost of sales the amount it estimates will ultimately be paid related to completed homes that have been closed as of the end of that month. The Company compares its updated home construction budgets to actual recorded costs to estimate the additional costs remaining to be paid on each closed home. The Company monitors the accuracy of each month's accrual by comparing actual costs paid on closed homes in subsequent months to the amount accrued. Actual costs to be paid on closed homes in the future could differ from the current estimate.

Inventory is stated at cost, unless the carrying amount is determined not to be recoverable, in which case the inventory is written down to fair value in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standard Codification ("ASC") Subtopic 360-10, *Property, Plant and Equipment*. The Company reviews its inventory in accordance with ASC Subtopic 360-10, which requires long-lived assets to be assessed for impairment when facts and circumstances indicate an impairment may exist. The Company utilizes an undiscounted future cash flow model in this assessment. When the results of the undiscounted future cash flows are less than the carrying value of the community (asset group), an asset impairment must be recognized in the consolidated financial statements as a component of cost of sales. The amount of the impairment is calculated by subtracting the estimated fair value, less cost to sell, of the community from the carrying value. ASC Subtopic 360-10 also requires that assets held for sale be stated at the lower of cost or fair value less costs to sell. Accordingly, land held for sale is stated at the lower of accumulated cost or fair value less costs to sell.

In order for management to assess the fair value of its real estate assets, certain assumptions must be made that are highly subjective and susceptible to change. Management evaluates, among other things, the actual gross margins for homes closed and the gross margins for homes sold in backlog (representing the number or value of sales that have not yet closed, net of cancellations). This evaluation also includes assumptions with respect to future home sales prices, cost of sales, including levels of sales incentives, the monthly rate of sales, discount rates, profit margins, and potential buyers, which are critical in determining the fair value of the Company's real estate assets. If events and circumstances indicate that the carrying value of a real estate asset is not expected to be recoverable, then it is written down to its estimated fair value. Given the historical variability in the homebuilding industry cycle, the Company is of the view that the valuation of homebuilding inventories is sensitive to changes in economic conditions, such as interest rates, the availability of credit and unemployment levels. Changes in these economic conditions could materially affect the projected home sales prices, the level of sales incentives, the costs to develop land and construct homes and the monthly rate of sales. Because of these potential changes in economic and market conditions, in conjunction with the assumptions and estimates required of management in valuing homebuilding inventory, actual results could differ materially from management's assumptions and may require material inventory impairments to be recorded in the future.

(f) Receivables

Receivables totaled \$10.5 million and \$11.5 million as of May 31, 2015 and May 31, 2014, respectively. Net proceeds due from home closings as of May 31, 2015 and May 31, 2014, were approximately \$9.0 million and \$11.1 million, respectively. Other receivables of \$1.5 million and \$0.4 million at May 31, 2015 and May 31, 2014, respectively, included amounts due from municipalities, utility, and insurance companies, escrow deposits, and drawn amounts due from salespersons.

(g) Real estate not owned

Real estate not owned is based on the future purchase price of lots under option purchase agreements with entities under common control or with third parties pursuant to (depending on the circumstances) ASC Subtopic 360-20, *Property, Plant and Equipment – Real Estate Sales*, or ASC Subtopic 470-40, *Product Financing Arrangements* or pursuant to ASC Subtopic 810, *Consolidation* (see Note 5).

(h) Investments in unconsolidated entities

The Company participates in three land development joint ventures in which it has less than a controlling interest. The Company accounts for its interests in these entities under the equity method. The Company's share of profits from lots it purchases from these entities is deferred and treated as a reduction of the cost basis of land purchased from the entity. The Company's share of profits from lots purchased by other parties is recognized immediately and included within equity in earnings in unconsolidated entities on the consolidated statements of income (see Note 7).

The Company's investments in its two title service joint ventures are accounted for under the equity method. Under the equity method, the Company's share of the unconsolidated entities' income or loss is recognized as earned or incurred and is included within equity in earnings in unconsolidated entities on the consolidated statements of income.

Investments in unconsolidated entities are evaluated for other-than-temporary impairment during each reporting period pursuant to ASC Subtopic 323-10, *Investments—Equity Method and Joint Ventures*. A series of operating losses or other factors may indicate an other-than-temporary decrease in the value of the Company's investment in the unconsolidated entity. The amount of impairment recognized is the excess of the investment's carrying value over its estimated fair value.

(i) Deposits and pre-acquisition costs

Deposits and pre-acquisition costs paid related to purchase agreements are capitalized when paid and classified as deposits (for deposits) and other assets (for pre-acquisition costs) until the related land is acquired. These costs are transferred to inventory at the time the land or lots are acquired. Nonrefundable deposits and pre-acquisition costs are charged to expense when the real estate purchase is no longer considered probable. If the Company intends to terminate a purchase agreement, it records a charge to earnings for these costs associated with the purchase agreement in the period such a decision is made. This expense is included as a component of cost of sales – homes in the consolidated statements of income and was \$0.9 million, \$1.2 million, and \$0.6 million for the year ended May 31, 2015, 2014, and 2013, respectively.

(j) Property and equipment

Property and equipment is recorded at cost. Depreciation is generally recorded using the straight-line method over the estimated useful lives of the assets, which range from two to five years. Depreciable lives for leasehold improvements reflect the lesser of the economic life of the asset or the life of the lease. Repairs and maintenance costs are expensed as incurred. The Company's property and equipment at May 31, 2015 and May 31, 2014 consisted of the following (in thousands):

	May 31, 2015	May 31, 2014
Office furniture and equipment	\$ 3,134	\$ 2,853
Sales offices, design studios and model furnishings	40,876	28,220
Leasehold improvements	1,255	895
	<u>45,265</u>	<u>31,968</u>
Accumulated depreciation	(18,203)	(14,222)
	<u>\$ 27,062</u>	<u>\$ 17,746</u>

Depreciation and amortization expense approximated \$11.4 million, \$9.5 million, and \$7.0 million for the year ended May 31, 2015, 2014, and 2013, respectively.

(k) Revenue recognition

Homebuilding and lot sale revenues are recognized at the time of the closing of a sale, when title to and possession of the property are transferred to the buyer. Sales commissions are included in selling, general and administrative expenses. Virtually all homebuilding, land and lot net proceeds are received in cash within two business days of closing.

(l) Prepaid expenses

Included in other assets are prepaid expenses of approximately \$9.3 million and \$6.3 million as of May 31, 2015 and May 31, 2014, respectively, which primarily represent prepaid insurance, fees, permits, and rent.

(m) Warranty costs

The Company provides its homebuyers with limited warranties that generally provide for ten years of structural coverage, two years of coverage for plumbing, electrical and heating, ventilation and air conditioning systems and one year of coverage for workmanship and materials. Warranty liabilities are initially established on a per home basis by charging cost of sales and establishing a warranty liability for each home delivered to cover expected costs of materials and labor during the warranty period. The amounts accrued are based on management's estimate of expected warranty-related costs under all unexpired warranty obligation periods. The Company's warranty liability is based upon historical warranty cost experience in each operating division and is adjusted as appropriate to reflect qualitative risks associated with the types of homes built and the geographic areas in which they are built. The Company's warranty liability is included in other liabilities in the consolidated balance sheets.

Presented below are summaries of the activity in the Company's warranty liability account for the year ended May 31, 2015, 2014, and 2013 (in thousands):

	Year ended May 31,		
	2015	2014	2013
Warranty liability, beginning of period	\$ 6,500	\$ 5,012	\$ 3,861
Costs accrued during period	7,924	7,410	4,768
Costs incurred during period	(7,392)	(5,922)	(3,617)
Warranty liability, end of period	<u>\$ 7,032</u>	<u>\$ 6,500</u>	<u>\$ 5,012</u>

(n) Advertising costs

The Company expenses advertising costs as they are incurred. Advertising expense, which is included in selling, general and administrative expenses on the consolidated statements of income, was approximately \$7.4 million, \$4.3 million, and \$3.8 million for the year ended May 31, 2015, 2014, and 2013, respectively.

(o) Long-term incentive plan

The Company offers a long-term incentive compensation program designed to align the interests of the Company and its executives by enabling key employees to participate in the Company's future growth through the issuance of performance shares, which are the equivalent of phantom equity awards. The Company's performance shares are accounted for pursuant to ASC Subtopic 718-30, *Compensation – Awards Classified as Liabilities*. The Company measures the value of the performance shares on a quarterly basis using the intrinsic value method. Compensation expense is recorded on a straight-line basis over the vesting period based on the intrinsic value of the shares. Additional compensation expense may be recognized subsequent to completion of the vesting period for appreciation-only performance shares, based on the intrinsic value through the settlement date. See Note 12 for additional discussion regarding the Company's long-term incentive plan.

(p) Provision for income taxes

The Company operates as a limited liability company and is treated as a partnership for income tax purposes. Accordingly, the Company incurs no liability for federal or state income taxes, since the taxable income or loss is passed through to its Members, but incurs liabilities for certain state franchise taxes payable directly by the Company. The Company calculates its Members' tax liability related to their share of the Company's taxable income and may make a distribution to such members to allow them to satisfy their tax liability, subject to limitations contained in the Company's senior secured revolving credit facility and in the indenture governing its 6.875% Senior Notes due 2021 (the "6.875% Notes"). Any tax distribution made to the Members is treated as a reduction of equity. The Company made distributions of \$14.7 million and \$11.8 million during the year ended May 31, 2015 and 2014, respectively. The Company made no distributions during the year ended May 31, 2013.

(q) Use of estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

(r) Segments

ASC Subtopic 280, *Segment Reporting* ("ASC 280") provides standards for the way in which companies report information about operating segments. In accordance with ASC 280, the Company believes that each of its homebuilding operating markets is an operating segment. In accordance with the aggregation criteria defined in ASC 280, the Company has grouped its homebuilding operations into two reportable segments as follows:

- 1) East: Raleigh, Charleston, Atlanta, Orlando, and Southwest Florida (Tampa, Sarasota and Naples)
- 2) Central: Houston, Dallas, Central Texas (Austin and Killeen), San Antonio, and Phoenix

The Company has determined that the homebuilding operating markets within its respective reportable segments have similar economic characteristics and product types, and are similar in terms of geography. The Company's

homebuilding operating markets also share all other relevant aggregation characteristics prescribed in ASC 280, such as similar product types, production processes and methods of distribution. See Note 16 for further discussion of the Company's reportable segments.

(s) Subsequent events

The Company has evaluated subsequent events through July 22, 2015. This date represents the date on which the financial statements were available to be issued.

On July 22, 2015, the Board of Directors of the Company approved tax distributions of \$3.8 million to its Members based on estimates of its Members' tax liability related to their share of the Company's taxable income.

Note 2 — Debt Refinancing

On February 6, 2013, the Company issued \$300 million principal amount of 6.875% Senior Notes due 2021 in a private offering pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended. The 6.875% Notes were issued at a price of 99.239% of the principal amount to yield 7.00%.

The net proceeds of the 6.875% Notes were used by the Company, together with the proceeds from a contemporaneous equity contribution (see Note 10), to redeem the Company's 11.0% Senior Subordinated Notes due 2015 (the "11.0% Notes") and 9.5% Senior Subordinated Notes due 2015 (the "9.5% Notes") pursuant to the satisfaction and discharge procedures set out in the indentures governing these notes, to repay its senior secured second lien indebtedness, to pay any accrued and unpaid interest and redemption repayment premiums related to the foregoing debt instruments, and to repay outstanding borrowings under the Company's senior secured revolving credit facility. The net proceeds resulted in \$51.0 million of excess cash for the Company.

The Company recorded a \$3.4 million gain on early extinguishment of debt for the year ended May 31, 2013, comprised of a \$16.3 million reversal of accrued interest related to the 11.0% Notes that was recorded in 2009, offset by the write-off of \$2.8 million of unamortized deferred financing fees related to the senior secured second lien indebtedness and \$0.7 million of unamortized original issue discount on the senior secured second lien indebtedness, and the payment of \$9.4 million in redemption repayment premiums.

On December 16, 2013, the Company issued \$50 million aggregate principal amount of 6.875% Senior Notes due 2021 in a private offering pursuant to Rule 144A and Regulation S promulgated under the Securities Act of 1933, as amended. The notes were sold at an offering price of 98.251% plus accrued interest from August 15, 2013. The new notes constitute a further issuance of the \$300 million aggregate principal amount of 6.875% Notes issued in February 2013. The notes issued in December 2013 and the notes issued in February 2013 form a single series of debt securities and have identical terms, other than the issue date and the offer price. See Note 8 for further discussion of the Company's debt.

Note 3 — Pending and Recently Adopted Accounting Pronouncements

In April 2013, the FASB issued Accounting Standards Update No. 2013-04, *Liabilities* ("ASU 2013-04"), which provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. ASU 2013-04 is effective for annual reporting periods ending after December 15, 2014 (and interim and annual periods thereafter) and should be applied retrospectively for these obligations subject to the guidance. The adoption of ASU 2013-04 on June 1, 2014 did not have a material impact on the Company's consolidated financial statements or disclosures.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"). ASU 2014-09 states that an entity should recognize revenue to depict 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. The allowable methods of adoption are full retrospective adoption or modified retrospective adoption. The effective date for ASU 2014-09 for the Company is for annual periods beginning after December 15, 2017. The Company is currently evaluating the impact that ASU 2014-09 will have on its consolidated financial statements and disclosures. At this time the Company is unable to determine whether adoption of this standard will have a material impact on its consolidated financial position, results of operations, cash flows, or related disclosures.

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, *Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern* ("ASU 2014-15"), which requires management to perform interim and annual assessments on whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year of the date the financial statements are issued and to provide related disclosures, if required. The amendments in ASU 2014-15 are effective for the annual period ending after December 15, 2016, and for annual and interim periods thereafter. Early adoption is permitted. The Company's adoption of ASU 2014-15 is not expected to have a material effect on its consolidated financial statements and related disclosures.

In February 2015, the FASB issued Accounting Standards Update No. 2015-02, *Amendments to the Consolidation Analysis* ("ASU 2015-02"), which changed the analysis a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The amendments in ASU 2015-02 affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The amendments in ASU 2015-02 are effective for annual periods ending after December 15, 2016, and for annual and interim periods thereafter. Early adoption is permitted. The Company's adoption of ASU 2015-02 is not expected to have a material effect on its consolidated financial statements and related disclosures.

In April 2015, the FASB issued Accounting Standards Update No. 2015-03, *Interest - Imputation of Interest* ("ASU 2015-03"), which requires 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 effective date for ASU 2015-03 for the Company is for annual periods beginning after December 15, 2015. The Company's adoption of ASU 2015-03 is not expected to have a material effect on its consolidated financial statements and related disclosures.

Note 4 — Inventory

Inventory consisted of the following at May 31, 2015 and May 31, 2014 (in thousands):

	May 31, 2015	May 31, 2014
Homes under construction and finished homes	\$ 309,984	\$ 247,737
Finished lots	204,684	148,645
Land under development	27,676	34,867
Land held for future development	1,996	20,647
Commercial land	1,352	1,790
Land held for sale	563	4,467
	<u>\$ 546,255</u>	<u>\$ 458,153</u>

The Company capitalizes all interest incurred to the extent its qualifying assets exceed its debt obligations. However, if qualifying assets are less than the Company's debt obligations, there are limits on the amount of interest that can be capitalized, and the remainder of interest incurred must be directly expensed. The Company directly expensed interest of \$10.3 million, \$8.0 million, and \$2.8 million for the year ended May 31, 2015, 2014, and 2013, respectively, on the consolidating statements of income.

During the fiscal year ended May 31, 2015, the Company sold 218 lots in Denver for a total purchase price of \$7.5 million and a commercial tract in Orlando for a total purchase price of \$4.4 million. In addition, the Company owns a commercial parcel in Dallas.

The following table summarizes interest costs incurred, charged to cost of sales and directly expensed during the year ended May 31, 2015, 2014, and 2013 (in thousands):

	Year ended May 31,		
	2015	2014	2013
Capitalized interest, beginning of period	\$ 10,592	\$ 10,678	\$ 10,263
Interest incurred	30,563	26,404	22,627
Interest amortized to cost of sales	(20,587)	(18,441)	(19,458)
Interest expensed	(10,327)	(8,049)	(2,754)
Capitalized interest, end of period	<u>\$ 10,241</u>	<u>\$ 10,592</u>	<u>\$ 10,678</u>

Note 5 — Real Estate Not Owned

In the ordinary course of business, the Company enters into lot purchase agreements in order to procure lots for the construction of homes in the future. Pursuant to these lot purchase agreements, the Company generally will provide a deposit to the seller as consideration for the right, but not the obligation, to purchase lots at different times in the future, usually at predetermined prices. Depending on the circumstances of such lot purchase agreements, “Real estate not owned” may be recorded based on the application of different accounting provisions. In applying these provisions, the Company regularly evaluates its land and lot purchase agreements.

Pursuant to ASC Subtopic 810, *Consolidations (“ASC 810”)*, when the Company enters into a purchase agreement to acquire land or lots from an entity and pays a non-refundable deposit, the Company has concluded that a VIE, for which consolidation is required, may be created because it is deemed to have provided subordinated financial support that will absorb some or all of an entity’s expected losses if they occur. For each VIE, the Company assesses whether it is the primary beneficiary and thus must consolidate the entity by first determining if it has the ability to control the activities of the VIE that most significantly impact its economic performance. Such activities include, but are not limited to, the ability to determine the budget and scope of land development work, if any; the ability to control financing decisions for the VIE; the ability to acquire additional land into the VIE or dispose of land in the VIE not under contract; and the ability to change or amend the existing purchase contract with the VIE. If the Company is determined not to control such activities, it is not considered the primary beneficiary of the VIE. If it does have the ability to control such activities, it will continue the analysis by determining if it is expected to absorb a potentially significant amount of the VIE’s losses or, if no party absorbs the majority of such losses, if it will benefit from potentially a significant amount of the VIE’s expected gain. If the Company determines that it is the primary beneficiary of the VIE, it will consolidate the VIE in its financial statements and reflect such assets as “Real estate not owned” and the related liabilities as “Liabilities related to real estate not owned.” At May 31, 2015 and May 31, 2014, no purchase contracts or investments in unconsolidated entities were determined to require consolidation under ASC 810.

Based on the provisions of ASC Subtopic 360-20, *Property, Plant, and Equipment*, a seller may not recognize as a sale property it sells if there continues to be substantial continuing involvement with the property. If the Company enters into lot purchase agreements for land it has sold and determines that there is substantial continuing involvement at the reporting date, the Company records the lots subject to such sale as “Real Estate not owned” and the related liabilities as “Liabilities related to real estate not owned.” At May 31, 2015 and May 31, 2014, the Company recorded real estate not owned of \$25.6 million and \$18.9 million, respectively, for the sale of lots because of its continuing involvement.

Pursuant to ASC Subtopic 470-40, *Product Financing Arrangements ("ASC 470-40")*, if a buying entity participates in an arrangement in which it is economically compelled to purchase land, then the entity is required to consolidate such an arrangement. From time to time, the Company enters into arrangements in which it locates lots that it desires to purchase, finds an investor to purchase the lots and then enters into option purchase agreements to acquire the lots in staged takedowns. In consideration for such options, the Company generally makes nonrefundable deposits. The Company is generally not obligated to purchase the lots that are the subject of such agreements, but it would forfeit the remaining deposits if the lots are not purchased. Although the Company is not obligated to purchase the lots under option unless it enters into a contract with specific performance obligations, if, at the reporting date, it believes that due to the terms of the purchase contracts it is compelled to purchase the lots under option, the Company will record "Real estate not owned" and the related liabilities as "Liabilities related to real estate not owned" in connection with such option purchase agreements. The Company has entered into three lot purchase agreements with two separate unaffiliated investor groups and has accounted for them pursuant to ASC 470-40. At May 31, 2015 and May 31, 2014, the Company recorded real estate not owned of \$12.7 million and \$4.4 million, respectively, related to the lot purchase agreements accounted for pursuant to ASC 470-40.

Note 6 — Other Assets

Other assets at May 31, 2015 and May 31, 2014 consisted of the following (in thousands):

	<u>May 31, 2015</u>	<u>May 31, 2014</u>
Deferred financing fees	\$ 9,264	\$ 10,702
Architecture plans	9,181	7,057
MUD receivables	1,738	3,676
Land development receivables	4,841	5,741
Prepaid expenses	9,319	6,273
Pre-acquisition costs	2,103	983
Other deposits	2,498	1,209
	<u>\$ 38,944</u>	<u>\$ 35,641</u>

Deferred financing fees are comprised of costs incurred in connection with obtaining financing from third parties and are amortized as interest over the terms of the related financing arrangements using the effective interest method.

Deferred financing fees incurred during the year ended May 31, 2015 include \$1.3 million for amendments to the Company's senior secured revolving credit facility. Deferred financing fees incurred during the year ended May 31, 2014 include \$1.2 million related to the issuance of the additional 6.875% Notes. Deferred financing fees incurred during the year ended May 31, 2013 include \$3.4 million for amendments to the Company's senior secured revolving credit facility and \$8.0 million related to the issuance of the 6.875% Notes. For the year ended May 31, 2013, the Company wrote-off unamortized deferred financing fees of \$2.8 million associated with notes redeemed (see Note 2).

Included in other assets as of May 31, 2015 and May 31, 2014, are certain land development costs to be reimbursed by four Municipal Utility Districts ("MUD receivables") in Houston, Texas of \$1.7 million and \$3.7 million, respectively.

See Note 1(i) for additional information on pre-acquisition costs.

Note 7 — Investments in Unconsolidated Entities

The Company enters into land joint ventures from time to time as a means of accessing larger parcels of land and lot positions, managing its risk profile and leveraging its capital base. As of May 31, 2015, the Company participated in three such land joint ventures. The Company's partners in such joint ventures are both related parties and unrelated parties, including homebuilders, land developers or other real estate entities. The partners generally share profits and

losses in accordance with their ownership interests. The Company accounts for its interests in these entities under the equity method.

At May 31, 2015 and May 31, 2014, the Company had equity investments of less than 50% in each of its three land joint ventures and did not have a controlling interest in these unconsolidated entities. The Company and/or its land joint venture partners will sometimes enter into lot purchase agreements that permit the Company and/or its joint venture partners to purchase finished lots owned by the land joint venture. Lot prices are generally negotiated prices that approximate fair value when the purchase contract is signed. The Company's share of the unconsolidated entity's earnings on the sale of lots to the Company is deferred until homes related to the lots purchased by the Company are delivered and title passes to a homebuyer. The Company's share of the unconsolidated entity's earnings on the sale of lots to other parties is recognized at the time of the sale.

One of the Company's land joint ventures was entered into in February 2014 with certain beneficial owners of the Company's equity or their affiliates (each and collectively, the "Investors"), in which the Company has a 49% limited partner interest that was accounted for under the equity method. As of May 31, 2015, the Company had recorded \$7.1 million for its investment in this unconsolidated entity in the consolidated balance sheet. The Company entered into a services agreement with the joint venture to provide accounting and administrative services to the joint venture. The Company receives a monthly fee of \$6,000 for these services that is included in other income in the consolidated statements of income. The Company entered into a lot purchase agreement with the joint venture, in which a 10% deposit was required, and there were no specific performance requirements for the Company. As of May 31, 2015, the total purchase price of lots remaining to be purchased under this agreement was approximately \$19.3 million. As of May 31, 2015, the joint venture had debt outstanding of \$8.1 million, which is non-recourse to the joint venture and to the Company. The loan was obtained to acquire the land and fund the first phase of land development. The Company provided the lender with a performance guarantee for the substantial completion of the first phase of development for this joint venture. The guarantee of performance may include the payment of money for costs incurred during the completion of the development. In the event that the Company pays money or performs any services pursuant to the guarantee, the joint venture has agreed to indemnify and reimburse the Company for any such costs incurred.

The Company also offers title services to its homebuyers in Dallas and Houston through ownership interests in two title joint ventures. The Company has an ownership interest of less than 50% in each of these joint ventures. The joint ventures are managed by, and all underwriting risks associated with the title insurance reside with, the majority owner of each of these entities.

Summarized unaudited financial information related to unconsolidated entities that are accounted for using the equity method as of May 31, 2015 and May 31, 2014 and for the year ended May 31, 2015, 2014, and 2013 were as follows (in thousands):

	May 31, 2015	May 31, 2014
	(Unaudited)	
Assets:		
Cash	\$ 2,995	\$ 5,002
Real estate	34,807	32,000
Other	269	456
	<u>\$ 38,071</u>	<u>\$ 37,458</u>
Liabilities:		
Liabilities:		
Accounts payable and other accruals	\$ 4,778	\$ 3,598
Notes payable	8,126	4,210
Total liabilities	<u>12,904</u>	<u>7,808</u>
Equity	25,167	29,650
Total liabilities and equity	<u>\$ 38,071</u>	<u>\$ 37,458</u>

	Year ended May 31,		
	2015	2014	2013
	(Unaudited)		
Revenues	\$ 13,037	\$ 21,979	\$ 10,759
Gross profit	4,878	5,796	8,104
Operating expenses	1,111	1,086	3,492
Net earnings	3,766	4,776	4,652

Note 8 — Debt

Debt at May 31, 2015 and May 31, 2014 consisted of the following (in thousands):

	May 31, 2015	May 31, 2014
Senior secured revolving credit facility	\$ —	\$ —
6.875% senior notes	347,519	347,179
	<u>\$ 347,519</u>	<u>\$ 347,179</u>

Senior Secured Revolving Credit Facility

On August 21, 2014, the Company amended its senior secured revolving credit facility by entering into a First Amendment to Fourth Amended and Restated Credit Agreement (the “First Amendment”), providing for, among other things, an aggregate revolving loan commitment of \$195.0 million with up to \$45.0 million available for the issuance of letters of credit and extending the maturity date to February 21, 2018. The Fourth Amended and Restated Credit Agreement as amended by the First Amendment is referred to herein as the “Restated Revolver.”

Interest accrues on borrowings under the Restated Revolver at the London Interbank Offered Rate (LIBOR) plus an applicable margin that ranges from 325 to 385 basis points. Letters of credit may be issued under the Restated

Revolver at a rate of 100 basis points if secured by cash, or at a rate of 325 to 385 basis points if not secured by cash. The Restated Revolver has a maturity date of February 21, 2018, subject to an extension in accordance with the terms set forth therein. The Restated Revolver is secured by a continuing first priority security interest in the real property of certain operating divisions selected by the Company for inclusion in the borrowing base, and the personal property of the Company and its subsidiaries affixed to, placed upon, used in connection with, arising from or appropriated for use on the pledged real property and the continuing guarantee of substantially all of its subsidiaries. The Company may pledge additional collateral as needed to increase the borrowing base consistent with the maximum availability under the Restated Revolver.

The Restated Revolver contains the following material financial covenants:

- A minimum level of Tangible Net Worth;
- A maximum Leverage Ratio;
- A minimum Interest Coverage Ratio;
- Minimum liquidity;
- Maximum level of land supply; and
- Maximum level of Speculative Housing Units and Model Housing Units.

Availability under the Restated Revolver is based upon a borrowing base formula. Additionally, the Restated Revolver contains covenants in addition to the financial covenants noted above. The Restated Revolver permits sales and transfers of ownership interests so long as no change of control, as defined in the Restated Revolver, occurs and permits certain tax distributions to Members and certain other distributions to Members if certain Leverage Ratio and other conditions are met. As of May 31, 2015, the Company was in compliance with the covenants in the Restated Revolver.

At May 31, 2015, there were no borrowings outstanding under the Restated Revolver and \$3.2 million of letters of credit outstanding. As of May 31, 2015, and subject to a borrowing base formula, the Company had available additional borrowing capacity of \$185.8 million under the Restated Revolver based on outstanding borrowings on the Restated Revolver, outstanding letters of credit, and the value of collateral pledged to secure the facility.

At May 31, 2014, there were no borrowings outstanding under the Restated Revolver and \$3.0 million of letters of credit outstanding. The Company has elected to cash collateralize all letters of credits in restricted accounts. As of May 31, 2014, the Company had \$116.8 million available for borrowings under the Restated Revolver.

The 6.875% Notes

The Company has issued and outstanding \$350 million principal amount of 6.875% Senior Notes due February 15, 2021 (the "6.875% Notes").

Interest is payable on the 6.875% Notes on February 15 and August 15 of each year. The 6.875% Notes are senior, unsecured obligations of the Company and rank equally in right of payment to all of the Company's existing and future senior debt and senior in right of payment to the Company's existing and future subordinated debt. The 6.875% Notes are effectively subordinated to any of the Company's existing and future secured debt, including the Restated Revolver, to the extent of the value of the assets securing such debt. The obligations under the 6.875% Notes are jointly and severally guaranteed by each Restricted Subsidiary, as defined, that has assets with a book value of more than \$2.0 million.

The Company has the option to redeem the 6.875% Notes at any time or from time to time, in whole or in part, (a) until February 15, 2017, at a redemption price equal to 100% of their principal amount, together with accrued and

unpaid interest thereon, if any, to and excluding the redemption date, plus a make-whole premium as defined in the indenture governing the 6.875% Notes, (b) on or after February 15, 2017, at certain redemption prices set forth in the indenture governing the 6.875% Notes together with accrued and unpaid interest thereon, if any, to and excluding the redemption date, and (c) on or after February 15, 2019, at 100% of the principal amount to be redeemed, together with accrued and unpaid interest thereon, if any, to and excluding the redemption date. At any time before February 15, 2016, the Company may redeem up to 35% of the aggregate principal amount of the 6.875% Notes with the net cash proceeds of certain equity offerings, at a redemption price equal to 106.875% of the aggregate principal amount of the notes plus accrued and unpaid interest, if any, to and excluding the redemption date.

The indenture governing the 6.875% Notes contains a number of covenants, including covenants relating to the following:

- Limitations on indebtedness;
- Limitations on restricted payments;
- Limitations on dividends;
- Limitations on transactions with affiliates;
- Limitations on liens;
- Limitations on asset sales;
- Limitations on designation of unrestricted subsidiaries; and
- Limitations on mergers.

As of May 31, 2015, the Company was in compliance with the covenants in the indenture governing the 6.875% Notes.

Senior Secured Second Lien Credit Facility

Prior to repayment with the proceeds of the 6.875% Notes on February 6, 2013, the Company was a party to a Senior Secured Second Lien Credit Agreement dated July 6, 2010 under which a \$115 million term loan was outstanding (the "Term Loan"). The Term Loan bore interest at an annual rate of 11.75% payable on January 2 and July 1 of each year, commencing on January 2, 2011. The lenders under the Term Loan had a second priority security interest in the same assets securing the Restated Revolver and the Term Loan was guaranteed by the Company's subsidiaries.

The 11.0% Notes and the 9.5% Notes (together, the "Notes")

Prior to redemption with the proceeds of the 6.875% Notes on February 6, 2013, the Company had outstanding \$64.1 million principal amount of 11.0% Notes due 2015 and \$1.7 million principal amount of 9.5% Notes due 2015 (collectively the "Notes").

The 11.0% Notes did not bear interest during the first three years following their issuance on February 23, 2009. From and after February 23, 2012, the 11.0% Notes bore interest at the rate of 11.0% per year, payable on June 30 and December 30 of each year. For the period commencing February 23, 2012 until and including the first interest payment date of June 30, 2012, interest was required to be paid in cash only to the extent that the Consolidated Fixed Charge Coverage Ratio, as defined, calculated assuming the payment of such interest in cash, exceeded 1.75 to 1.00. If the Consolidated Fixed Charge Coverage Ratio, as defined, did not exceed 1.75 to 1.00, the first interest payment was payable, at the Company's option, in kind based on an annual rate of 13.05% for such interest payment period only. The Company settled the interest payment obligation in cash on its due date and recorded a \$1.4 million gain on paid-in-kind option settlement during the year ended May 31, 2013. The gain arose because the accrued interest of \$25.1 million that was recorded in fiscal year 2009, pursuant to ASC Subtopic 470-60, included an assumption that the first interest payment would be paid-in-kind.

The 9.5% Notes bore interest at a rate of 9.5% per annum, payable semiannually on October 1 and April 1 of each year.

The Notes were unsecured and subordinated in right of payment to all of the Company's existing and future senior debt. The obligations under the Notes were jointly and severally guaranteed by each Restricted Subsidiary, as defined. All of the Company's subsidiaries were Restricted Subsidiaries with respect to the Notes.

Note 9 — Other Liabilities

Other liabilities at May 31, 2015 and May 31, 2014 consisted of the following (in thousands):

	May 31, 2015	May 31, 2014
Salaries, bonuses and benefits	\$ 14,153	\$ 11,567
Accrued interest	7,499	7,148
Warranty accruals	7,029	6,500
Accrued long-term compensation	2,787	1,634
Other	9,549	8,839
	<u>\$ 41,017</u>	<u>\$ 35,688</u>

Note 10 — Members' Equity, Amended Regulations, and Ownership

The Second Amended and Restated Regulations (as amended, the "Regulations") of Ashton Woods created three classes of members and associated membership interests as follows: (1) Class A Membership Interests, all of which are held by Little Shots Nevada, L.L.C. ("Little Shots"), (2) Class B Membership Interests initially issued to the holders of our former 11.0% Senior Subordinated Notes due 2015, the majority of which are now held by Little Shots, and (3) Class C Membership Interests created in June 2010, the majority of which are also held by Little Shots. The Regulations set forth each Member's respective membership interests and sharing ratio. No Member is required to make any additional contributions to the Company. Subject to certain limited exceptions, including for tax distributions, all items of income, gain, loss, deduction and credit of Ashton Woods will be allocated among the Members in accordance with their sharing ratios.

In July 2014, Little Shots purchased 10,392 Class B Units and other Members purchased 8 Class B Units from various members. In May 2015, Little Shots purchased 44,034 Class B Units, an unaffiliated third-party investor purchased 5,932 Class B Units and other Members purchased 34 Class B Units from various members. In May 2015, the Company sold additional Class C Units to Little Shots for an aggregate purchase price of \$8.8 million. Additionally, the Company sold Class C Units to an unaffiliated third-party investor for an aggregate purchase price of \$1.2 million.

At May 31, 2015, there were 20,625,831 membership interests outstanding, comprised as follows:

	<u>Membership Interests</u>	<u>Ownership percentage</u>	<u>Percentage of membership class</u>
Little Shots Nevada L.L.C.			
Class A	8,027,200	38.92%	100.00%
Class B	1,911,595	9.27%	96.90%
Class C	8,166,793	39.59%	76.86%
Various Holders			
Class B	61,205	0.30%	3.10%
Class C	2,459,038	11.92%	23.14%
	<u>20,625,831</u>	<u>100.00%</u>	

Note 11 — Transactions with Related Parties

Services agreement

A services agreement with a related party provides the Company with a license, as well as development and support, for the Company's computer systems and certain administrative services. The Company pays \$800 per home closing quarterly, in arrears, for these services, which are included in selling, general and administrative expenses in the consolidated statements of income. During the year ended May 31, 2015, 2014, and 2013, the Company incurred fees of \$1.9 million, \$1.8 million, and \$1.7 million, respectively, under the services agreement. As of May 31, 2015 and 2014, the balance due to the related party was \$0.7 million and \$0.7 million, respectively.

Real estate not owned

In August 2012, the Company entered into a lot purchase agreement with the Investors (see Note 5). The Company recorded \$0.9 million as real estate not owned in the consolidated balance sheets related to such agreements as of May 31, 2014. The Company had no real estate not owned in the consolidated balance sheets related to such agreements as of May 31, 2015.

Lease agreement

During the first quarter of fiscal year 2015, the Company entered into a lease as a lessee with an affiliate of the Investors (as defined in Item 7) to rent approximately 8,000 square feet of commercial space in Dallas, Texas. The term of the lease is 66 months. The Company has the option to renew the lease for one additional five-year term. Total minimum lease payments due under the lease were \$0.5 million as of May 31, 2015.

Lot purchase agreements

As of May 31, 2015, the Company has entered into five lot purchase agreements with the Investors. A 10% deposit was required under each of the purchase agreements, and there were no specific performance requirements for the Company. These lot purchase agreements were not required to be consolidated as real estate not owned in the consolidated balance sheets. As of May 31, 2015, the total purchase price of lots remaining to be purchased under such agreements was approximately \$26.7 million.

Land development receivables

The Company had \$1.2 million and \$2.3 million in land development receivables due from the Investors at May 31, 2015 and May 31, 2014, respectively, associated with these lot purchase agreements. The amounts are included in other assets on the consolidated balance sheets (see Note 7).

Joint venture

In February 2014, the Company entered into a land joint venture with the Investors, which was accounted for under the equity method. The Company has an equity investment of less than 50% in the joint venture and does not have a controlling interest in the unconsolidated entity. Also, in February 2014, the Company entered into a lot purchase agreement with the joint venture to purchase 186 lots. A 10% deposit was required under the purchase agreement and there were no specific performance requirements for the Company. As of May 31, 2015, the total purchase price of lots remaining to be purchased was \$19.3 million (see Note 7).

Note 12 — Long-Term Incentive Plan

In July 2012, the Board of Directors adopted the Ashton Woods USA L.L.C. 2013 Performance Share Plan, a long-term incentive compensation program designed to align the interests of the Company and its executives by enabling key employees to participate in the Company's future growth. In July 2013, the Board of Directors adopted the Amended and Restated Performance Share Plan (the "Plan"). The Plan provides for the grant to participants of full-value performance shares and appreciation-only performance shares, which are the equivalent of phantom equity awards. Full-value performance shares allow the participant to receive a cash payment equal to the total value of the performance share on the designated date of payment. Appreciation-only performance shares allow the participant to receive a cash payment equal to the increase in value of the performance share measured from the date of grant to the designated date of payment. The Board of Directors approved awards to the Company's Chief Executive Officer, Chief Financial Officer and Chief Legal Officer in July 2012, and in July 2013 and July 2014 awarded additional performance shares to these officers, along with certain corporate senior management and presidents of the Company's operating divisions. In addition to awards that vest as set forth in the Plan, in July 2012 the Company's Chief Executive Officer and Chief Financial Officer were awarded a certain number of vested appreciation-only performance shares and vested full-value performance shares.

The value of a performance share awarded under the Plan is determined by multiplying the Company's book value, as defined under the Plan, by a multiple that is equal to the weighted average multiple of a book value of a share of common stock of a predetermined group of publicly traded homebuilders, divided by the number of performance shares available under the Plan. Generally, except as determined by the Board upon grant, awards under the Plan will vest ratably over three years and will be subject to forfeiture upon the occurrence of certain events, including termination of employment for cause. The performance shares will become fully vested upon a participant's resignation for good reason, the participant's death or disability or a change of control, and with respect to certain grants upon an equity sale, as defined in the Plan. In the absence of a payment event otherwise defined in the Plan, the full-value performance share awards pay out after the third anniversary of the award date, and the appreciation-only performance share awards pay out after the fifth anniversary of the award date.

The following table represents a rollforward of the outstanding units as of May 31, 2015:

	Full-value awards	Appreciation- only awards	Total awards
Outstanding units as of May 31, 2014	74,791	183,791	258,582
Units awarded during the period	40,228	80,456	120,684
Fully vested units paid	(20,599)	—	(20,599)
Total outstanding units as of May 31, 2015	<u>94,420</u>	<u>264,247</u>	<u>358,667</u>
Total vested units as of May 31, 2015	<u>55,076</u>	<u>185,562</u>	<u>240,638</u>

The Company has elected to account for awards under the Plan using the intrinsic value method. The Company's liability for awards under the Plan is remeasured quarterly to reflect the intrinsic value of the awards as of the balance sheet date. As a result, the Company may record an increase or decrease in compensation expense in any period. Compensation expense for the full-value and appreciation-only awards is included in selling, general and administrative expenses in the consolidated statements of income.

The total number of units vested as of May 31, 2015 and May 31, 2014 was 240,638 and 168,042, respectively. For the year ended May 31, 2015, 2014, and 2013, the Company recorded \$1.6 million, \$0.6 million, and \$1.4 million, respectively, in compensation expense associated with the full-value and appreciation-only awards. For the year ended May 31, 2015 and 2014, \$0.4 million (20,599 units) and \$0.4 million (20,517 units), respectively, of vested awards were paid out to employees. As of May 31, 2015 and May 31, 2014, the Company's liability for the Plan awards was \$2.8 million and \$1.6 million, respectively, which is recorded in other liabilities in the consolidated balance sheets.

Note 13 — Employee Benefit Plan

The Company has a 401(k) plan for all full and eligible part-time employees who have been with the Company for a period of three months or more. The Company matches 50% of employees' voluntary contributions up to 6% of employees' compensation, limited by the maximum allowed under federal guidelines. The cost of Company matches for the employees' voluntary contributions for the years ended May 31, 2015, 2014, and 2013 was \$1.1 million, \$0.9 million, and \$0.7 million, respectively, of which approximately \$133.0 thousand, \$35.6 thousand, and \$50.0 thousand were funded by forfeitures for the years ended May 31, 2015, 2014, and 2013, respectively. The remaining Company match is included within selling, general and administrative expenses in the consolidated statements of operations.

Note 14 — Fair Value Disclosures

ASC Subtopic 820, *Fair Value Measurement*, defines fair value, establishes a framework for measuring fair value and expands 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 that 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.

The carrying amounts of cash and cash equivalents, restricted cash, accounts receivable, accounts payable, customer deposits, and the Restated Revolver, as reported in the accompanying consolidated balance sheets, approximate their fair values due to their short-term maturity or floating interest rate terms, as applicable. The factors considered in determining fair values of the Company's communities when necessary under ASC 360 are described in the discussion of the Company's inventory impairment analysis (see Note 1), and are classified as Level 3 valuations.

The following table presents the carrying amounts and estimated fair values of the Company's outstanding debt at May 31, 2015 and May 31, 2014, derived from quoted market prices by independent dealers (Level 2).

Fair Value Hierarchy	May 31, 2015		May 31, 2014		
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	
		(in thousands)			
Liabilities:					
6.875% senior notes	Level 2	\$ 347,519	\$ 329,000	\$ 347,179	\$ 352,625

Note 15 — Commitments and Contingencies

The Company is involved in lawsuits and other contingencies in the ordinary course of business. Management believes that, while the ultimate outcome of the contingencies cannot be predicted with certainty, the ultimate liability, if any, net of anticipated recoveries including from insurance, will not have a material adverse effect on the Company's financial condition, results of operations or cash flows.

The Company has entered into employment agreements with its executive officers that provide for severance payments based on salary and the most recent bonus paid or target bonus upon termination without cause, or, following a change of control, by the Company without cause or by the executive for good reason.

In the normal course of business, the Company provides letters of credit and surety bonds to third parties to secure performance and provide deposits under various contracts and commitments. At May 31, 2015 and May 31, 2014, the Company had letters of credit of \$3.2 million and \$3.0 million, respectively, and surety bonds outstanding of \$20.7 million and \$20.2 million, respectively. As of May 31, 2015, the Company had \$41.8 million of unused letters of credit capacity under the Restated Revolver.

The Company enters into various option purchase agreements to acquire land. In connection with such agreements, the Company has made nonrefundable deposits of \$64.6 million as of May 31, 2015. The Company would forfeit the remaining deposits if the lots are not purchased. Total purchase price of lots remaining to be purchased under option agreements with nonrefundable deposits was approximately \$626.8 million as of May 31, 2015. With respect to these purchase agreements, the Company had one agreement as of May 31, 2015 that could result in a specific performance agreement with an aggregate purchase price of \$42.2 million and a \$1.4 million deposit.

The Company leases office space and equipment under various operating leases with varying commencement dates and renewal options. Minimum lease payments due under these leases as of May 31, 2015 were as follows (in thousands):

Year ending May 31, 2016	\$	3,167
Year ending May 31, 2017		3,117
Year ending May 31, 2018		3,060
Year ending May 31, 2019		3,053
Year ending May 31, 2020		2,083
Thereafter		1,936
	\$	<u>16,416</u>

Rent expense approximated \$2.5 million, \$2.2 million and \$1.2 million for the years ended May 31, 2015, 2014, and 2013, respectively, and is included within selling, general and administrative expenses in the consolidated statements of operations.

Note 16 — Information on Segments

The Company's homebuilding reportable segments are as follows:

- 1) East: Raleigh, Charleston, Atlanta, Orlando, and Southwest Florida (Tampa, Sarasota and Naples)
- 2) Central: Houston, Dallas, Central Texas (Austin and Killeen), San Antonio, and Phoenix

The following table summarizes revenue, gross profit, depreciation and amortization, equity in earnings in unconsolidated entities, and net income for each of the Company's reportable segments (in thousands):

	Year ended May 31,		
	2015	2014	2013
Revenues:			
Homebuilding:			
East	\$ 512,714	\$ 441,833	\$ 331,997
Central	436,553	366,714	318,237
Consolidated revenues	<u>949,267</u>	<u>808,547</u>	<u>650,234</u>
Gross profit:			
Homebuilding:			
East	101,319	82,467	62,382
Central	80,474	73,243	56,600
Consolidated gross profit	<u>181,793</u>	<u>155,710</u>	<u>118,982</u>
Depreciation and amortization:			
East	6,121	5,547	4,201
Central	5,139	3,865	2,744
Consolidated depreciation and amortization	<u>11,260</u>	<u>9,412</u>	<u>6,945</u>
Equity in earnings in unconsolidated entities:			
East	—	111	505
Central	1,274	1,089	1,447
Consolidated equity in earnings in unconsolidated entities	<u>1,274</u>	<u>1,200</u>	<u>1,952</u>
Net income:			
East	28,728	22,738	18,015
Central	15,871	18,113	12,392
	<u>44,599</u>	<u>40,851</u>	<u>30,407</u>
Other ⁽¹⁾	(10,327)	(8,464)	1,955
Consolidated net income	<u>\$ 34,272</u>	<u>\$ 32,387</u>	<u>\$ 32,362</u>

(1) For the years ended May 31, 2015 and May 31, 2014, "Other" primarily consists of interest directly expensed. For the year ended May 31, 2013, "Other" primarily consists of interest directly expensed, offset by gains on a paid-in-kind option settlement and the early extinguishment of debt.

The following table summarizes total assets for each of the Company's reportable segments (in thousands):

	<u>May 31, 2015</u>	<u>May 31, 2014</u>
Assets:		
Homebuilding:		
East	\$ 406,652	\$ 301,249
Central	317,449	262,693
	<u>724,101</u>	<u>563,942</u>
Other ⁽²⁾	11,901	106,249
Consolidated assets	<u>\$ 736,002</u>	<u>\$ 670,191</u>

(2) For the year ended May 31, 2015, "Other" includes cash and cash equivalents, restricted cash, corporate assets and a commercial parcel in Dallas. For the year ended May 31, 2014, "Other" includes cash and cash equivalents, restricted cash, corporate assets and a commercial parcel in Dallas and Orlando.

The following table summarizes additions to property and equipment for each of the Company's reportable segments for the periods presented (in thousands):

	<u>Year ended May 31,</u>		
	<u>2015</u>	<u>2014</u>	<u>2013</u>
Additions to property and equipment:			
Homebuilding:			
East	\$ 11,849	\$ 7,780	\$ 7,068
Central	8,762	7,195	4,004
	<u>20,611</u>	<u>14,975</u>	<u>11,072</u>
Other ⁽³⁾	424	203	81
Consolidated additions to property and equipment	<u>\$ 21,035</u>	<u>\$ 15,178</u>	<u>\$ 11,153</u>

(3) "Other" is comprised of property and equipment additions for the Corporate office.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Pursuant to section 4.03 of the 6.875% Notes indenture, the Company is not required to comply with Section 302 or Section 404 of the Sarbanes-Oxley Act of 2002, or related Items 307 and 308 of Regulation S-K promulgated by the Securities and Exchange Commission.

Item 9B. Other Information

None.

PART III.

Item 10. *Directors, Executive Officers and Corporate Governance*

The following table presents information with respect to our executive officers and directors:

Executive officers and directors

Name	Age	Position
Jerry Patava	61	Director, Chairman of the Board
Elly Reisman	65	Director
Seymour Joffe	62	Director, Chairman of the Audit Committee
Kris Miller	49	Director
Joseph Beard	54	Director
Ken Balogh	44	President and Chief Executive Officer
Cory Boydston	56	Chief Financial Officer
Deborah Danzig	42	Chief Legal Officer and Corporate Secretary

Mr. Patava, a member of our Board since February 2009, served as our Interim Chief Financial Officer between February 2008 and August 2009 and has served as the Chief Executive Officer of the Great Gulf Group since July 2007. Between January 2005 and 2007, he served on several public company Boards. Between 1998 and 2005, Mr. Patava served as Executive Vice President and Chief Financial Officer of Fairmont Hotels & Resorts Inc., between 1990 and 1998 as Vice President and Treasurer of Canadian Pacific Limited and between 1986 and 1990 as Vice President and Director of RBC Dominion Securities. Mr. Patava has a Bachelor of Arts degree from the University of Toronto and a Master of Business Administration degree from York University.

Mr. Reisman, a member of our Board since April 2013, is the chair and co-founder of the Great Gulf Group of Companies. The Great Gulf Group is an affiliate of the Company through common ownership. Mr. Reisman has over 35 years of real estate development and management experience throughout North America. Under his guidance, the Great Gulf Group has grown from a regional homebuilder to a broadly diversified real estate company.

Mr. Joffe, a member of our Board or our prior management committee since 1997, is a founder and principal of the Great Gulf Group. Prior to 1983, Mr. Joffe worked in real estate and public accounting. Mr. Joffe qualified as a Chartered Accountant in South Africa and in Canada.

Mr. Miller, a member of our Board since February 2009, has served as President of Ackerman & Co., a company involved in the development and acquisition of office, medical, retail and mixed use real estate space, since 1997. Mr. Miller joined Ackerman in 1996 as Chief Financial Officer. Prior to joining Ackerman, Mr. Miller was a Vice President of Citicorp, where he managed Citicorp's Atlanta real estate office. Mr. Miller is a graduate of Harvard University with an A.B. in Economics and attended the London School of Economic and Political Science in Citicorp's Institute of Global Finance and Management Program.

Mr. Beard, a member of our Board since April 2013, co-founded in 1991 and serves as President and Chief Executive Officer of Westdale Asset Management, Ltd. a subsidiary of Canada-based Westdale Properties. Westdale Asset Management is a nationwide real estate investment, property management, leasing and construction firm. Prior to forming Westdale Asset Management, Mr. Beard was responsible for the development and acquisition of over 10,000 apartment units. Mr. Beard is a graduate of Southern Methodist University where he obtained a degree in History with minors in Political Science and Psychology.

Mr. Balogh joined our Company as an executive vice president in September 2009 and was promoted to Chief Operating Officer in March 2010. In January 2011, he was appointed President and Chief Executive Officer. Prior to joining the

Company, Mr. Balogh worked for Centex Homes (now part of the Pulte Group) for 16 years, serving in various positions including as Executive Vice President of its East Region (Florida, the Carolinas, Virginia and New Jersey). Prior to that, he served in various other roles at Centex, including Division President, Division Manager, Vice President of Land Acquisitions, Entitlement and Development, Vice President of Finance, Division Controller, Assistant Controller and Accountant. Mr. Balogh has been in the homebuilding industry for over 19 years and has a finance degree from the University of Central Florida.

Mrs. Boydston has served as our Chief Financial Officer since August 2009. Prior to joining the Company, Mrs. Boydston worked for Starwood Land Ventures for one and a half years, where she served as Senior Vice President and Chief Financial Officer. Prior to that, she was with Beazer Homes USA Inc., where she worked for 10 years and served as Senior Vice President and Treasurer. Between 1987 and 1997, Mrs. Boydston was with Lennar Corporation, where she served as Vice President of Finance and Chief Financial Officer, Corporate Controller and Division Controller. She was also a Senior Auditor at Arthur Andersen LLP. Mrs. Boydston has a Bachelor of Science in Accounting degree from Florida State University and is a Certified Public Accountant.

Mrs. Danzig has been our Chief Legal Officer since July 2011 and our Corporate Secretary since October 2011. Prior to joining the Company, Mrs. Danzig was with Beazer Homes USA Inc. for six years where she served most recently as Vice President, Compliance Officer. Prior to joining Beazer Homes USA Inc., Mrs. Danzig was in private practice with Sutherland, Asbill & Brennan in Atlanta, Georgia and Davis Polk & Wardwell in New York, New York. Mrs. Danzig also clerked for the Honorable Phyllis A. Kravitch of the U.S. Court of Appeals for the Eleventh Circuit. Mrs. Danzig obtained her law degree from Cornell Law School and her B.A. from Emory University.

The Company does not currently have a separately designated compensation committee or nominating and corporate governance committee. The full Board performs all functions these committees would otherwise perform. In April 2013, the Board formed an Audit Committee consisting of Messrs. Patava and Joffe. The Audit Committee's primary function is to assist the Board in (a) the financial reporting process, including the integrity of the Company's financial statements and systems of internal controls regarding finance and accounting; (b) the qualifications and independence of the Company's independent auditors; (c) management of the Company's financial policies and procedures; and (d) the performance of the Company's independent auditors. The Audit Committee has direct responsibility for the appointment, compensation, retention, and oversight of the work of our outside accounting firm, Ernst & Young LLP. The Board has determined that each of the Audit Committee members satisfies the requirements for financial literacy under current SEC requirements. The Board has also determined that Mr. Joffe is an "audit committee financial expert," as that term is defined by the SEC. Although neither Mr. Patava nor Mr. Joffe is an independent director, the Board chose them to serve on the Audit Committee due to their financial expertise and their expertise in the homebuilding and real estate industries, including their level of experience with financial matters related to these industries. The Audit Committee operates pursuant to a written charter.

The Company maintains a Code of Business Conduct and Ethics, which applies to all of its employees including its executive officers. The Company will provide to any person without charge, upon request to Deborah Danzig at 678-597-2122, a copy of its Code of Business Conduct and Ethics.

Item 11. Executive Compensation

Pursuant to section 4.03 of the 6.875% Notes indenture, the Company is not required to provide disclosure regarding executive compensation, a description of employment agreements with officers or a description of any incentive plans.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters

The following table sets forth certain information as of June 30, 2015 regarding the beneficial ownership of the membership interests in the Company by executive officers, directors and owners of greater than 5% of the Company's equity. The Company has three classes of membership interests, Class A, Class B and Class C, which are *pari passu*

and share ratably in the ownership of the Company. Percentages below are based on sharing ratios held directly or indirectly in the Company.

Name and address of beneficial owner	Membership interest(1)
Seymour Joffe ⁽²⁾⁽³⁾	6.27%
Elly Reisman ⁽²⁾⁽⁴⁾	34.48%
Jerry Patava	—
Kris Miller	—
Joseph Beard ⁽⁵⁾	11.82%
Ken Balogh	—
Cory Boydston	—
Deborah Danzig	—
All directors and executive officers as a group	52.57%
Little Shots Nevada L.L.C. ⁽²⁾	87.78%
Little Shots Nevada Holdings L.L.C. ⁽²⁾	18.82%
Westdale Properties America I, Ltd. ⁽⁵⁾	11.82%
Harry Nevada Inc. ⁽²⁾⁽⁶⁾	6.27%
Norman Nevada Inc. ⁽²⁾⁽⁷⁾	34.48%
Bruce Nevada Inc. ⁽²⁾⁽⁸⁾	6.27%

- (1) Beneficial ownership is determined in accordance with Section 13 of the Exchange Act and the rules promulgated thereunder. Accordingly, if an individual or entity is a member of a “group” which has agreed to act together for the purpose of acquiring, holding, voting or disposing of membership interests, such individual or entity is deemed to be the beneficial owner of the membership interests held by all members of the group. Further, if an individual or entity has or shares the power to vote or dispose of membership interests held by another entity, beneficial ownership of the interests held by such entity may be attributed to such other individuals or entities.
- (2) The address of this beneficial owner is 3751 Victoria Park Avenue, Toronto, Ontario M1W 3Z4 Canada.
- (3) Mr. Joffe holds an interest in the Company through ownership by Seymour Nevada, Inc. of a 33.33% membership interest in Little Shots Holdings L.L.C., which holds an 18.82% interest in the Company through its 21.44% ownership interest in Little Shots Nevada L.L.C. For beneficial ownership purposes, the membership interests held by Little Shots Nevada L.L.C. are attributable to Little Shots Nevada Holdings L.L.C. based on its ownership interest and ultimately to Mr. Joffe.
- (4) Mr. Reisman holds an interest in the Company through ownership by Elly Nevada Inc. of a 39.28% interest in Little Shots Nevada L.L.C.
- (5) The address of this beneficial owner is 3100 Monticello Avenue, Suite 660, Dallas, Texas 75205. This interest is held of record by Westdale Properties America I, Ltd. (“Westdale”). Mr. Beard through wholly owned entities serves as the general partner of and has a 10% ownership interest in Westdale. Mr. Beard disclaims beneficial ownership of the interests held by Westdale except to the extent of his 10% pecuniary interest.
- (6) This entity, which is owned by entities and/or family trusts associated with Harry Rosenbaum, holds an interest in the Company through its 33.33% membership interest in Little Shots Holdings L.L.C.

- (7) This entity, which is owned by entities and/or family trusts associated with Norman Reisman, holds an interest in the Company through its ownership of a 39.28% interest in Little Shots Nevada L.L.C.
- (8) This entity, which is owned by entities and/or family trusts associated with Bruce Freeman, holds an interest in the Company through its 33.33% membership interest in Little Shots Holdings L.L.C.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Pursuant to section 4.03 of the 6.875% Notes indenture, the Company is not required to disclose related party transactions outside of the financial statement footnotes.

Our board of directors, which we refer to as our Board, consists of five members—Messrs. Patava (Chairman), Reisman, Joffe, Miller, and Beard. As required by our Regulations, Messrs. Patava, Reisman and Joffe are Class A Directors elected by our Class A Unit holder, Mr. Beard is a Class B Director elected by our Class B Unit holders and Mr. Miller is an Independent Director, as defined by our Regulations, elected by our Class A, Class B and Class C Unit holders voting as a class. Each director serves a term of one year automatically renewed until a successor is elected and qualified, or until his earlier death, resignation or removal. We do not have any equity listed on a securities exchange, and therefore are not required to comply with any independence requirements imposed by the exchanges. Although we are not required to maintain a specified number of independent directors on our Board, our Board has concluded that through the fiscal year ended May 31, 2015, Messrs. Miller and Beard were independent directors based on the standards applicable to companies listed on the New York Stock Exchange.

Item 14. Principal Accounting Firm Fees and Services

Ernst & Young LLP served as the Company's independent registered public accounting firm for the 2015, 2014, and 2013 fiscal years. For the year ended May 31, 2015, 2014, and 2013, audit fees incurred were \$0.6 million, \$0.8 million, and \$0.4 million, respectively, excluding fees for offerings. The Company incurred additional fees of \$0.3 million for the year ended May 31, 2014 related to the issuance of additional 6.875% Notes and other services related to potential transactions. The Company incurred additional fees of \$0.3 million for the year ended May 31, 2013 related to the issuance of the 6.875% Notes.