

THIS QUARTERLY 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.

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

For the quarterly period ended November 30, 2015

OR

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

For the transition period from _____ to _____.

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 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

ASHTON WOODS USA L.L.C.
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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

Review Report of Independent Auditors

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

We have reviewed the condensed consolidated financial information of Ashton Woods USA L.L.C., which comprise the condensed consolidated balance sheet as of November 30, 2015, and the related condensed consolidated statements of income for the three-month and six-month periods ended November 30, 2015 and 2014, condensed consolidated statements of cash flows for the six-month periods ended November 30, 2015 and 2014, and condensed consolidated statement of members' equity for each of the three-month periods in the six-month period ended November 30, 2015.

Management's Responsibility for the Financial Information

Management is responsible for the preparation and fair presentation of the condensed financial information in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in conformity with U.S. generally accepted accounting principles.

Auditor's Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

Conclusion

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial information referred to above for it to be in conformity with U.S. generally accepted accounting principles.



Report on Condensed Balance Sheet as of May 31, 2015

We have previously audited, in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of Ashton Woods USA L.L.C. as of May 31, 2015, and the related consolidated statements of income, members' equity, and cash flows for the year then ended (not presented herein); and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated July 22, 2015. In our opinion, the accompanying condensed consolidated balance sheet of Ashton Woods USA L.L.C. as of May 31, 2015, is consistent, in all material respects, with the consolidated balance sheet from which it has been derived.

Ernst + Young LLP

January 13, 2016

PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements*

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

	November 30, 2015	May 31, 2015
Assets:	(Unaudited)	
Cash and cash equivalents	\$ —	\$ —
Restricted cash	4	3
Receivables	14,380	17,074
Inventory	667,644	546,255
Real estate not owned	47,603	38,278
Property and equipment, net	27,614	27,062
Investments in unconsolidated entities	8,276	9,427
Deposits on real estate under option or contract	65,535	65,538
Other assets	31,032	32,365
Total assets	<u>\$ 862,088</u>	<u>\$ 736,002</u>
Liabilities and members' equity:		
Liabilities:		
Accounts payable	\$ 60,737	\$ 44,367
Other liabilities	35,520	41,017
Customer deposits	35,031	25,727
Liabilities related to real estate not owned	37,473	30,449
Debt	447,383	347,519
Total liabilities	<u>616,144</u>	<u>489,079</u>
Members' equity:	245,944	246,923
Total liabilities and members' equity	<u>\$ 862,088</u>	<u>\$ 736,002</u>

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
(Unaudited)				
Revenues:				
Home sales	\$ 244,717	\$ 198,346	\$ 449,461	\$ 373,379
Land sales	455	—	455	3,938
	<u>245,172</u>	<u>198,346</u>	<u>449,916</u>	<u>377,317</u>
Cost of sales:				
Cost of sales - homes	200,785	157,881	367,069	299,273
Cost of sales - land	455	—	455	3,530
	<u>201,240</u>	<u>157,881</u>	<u>367,524</u>	<u>302,803</u>
Gross profit	43,932	40,465	82,392	74,514
Other expense (income):				
Selling, general and administrative	34,282	30,935	66,982	59,455
Interest expense	2,794	1,972	5,836	4,199
Depreciation and amortization	3,346	2,747	6,406	5,367
Other income	(757)	(611)	(1,415)	(1,144)
	<u>39,665</u>	<u>35,043</u>	<u>77,809</u>	<u>67,877</u>
Equity in earnings in unconsolidated entities	346	250	647	615
Net income	<u>\$ 4,613</u>	<u>\$ 5,672</u>	<u>\$ 5,230</u>	<u>\$ 7,252</u>

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Class A interest	Class B interests	Class C interests	Total members' equity
	(Unaudited)			
Members' equity at May 31, 2015	\$ 89,920	\$ 18,377	\$ 138,626	\$ 246,923
Net income	240	59	318	617
Contributions	—	—	41	41
Distributions	(1,490)	(365)	(1,988)	(3,843)
Members' equity at August 31, 2015	\$ 88,670	\$ 18,071	\$ 136,997	\$ 243,738
Net income	1,795	441	2,377	4,613
Distributions	(937)	(230)	(1,240)	(2,407)
Members' equity at November 30, 2015	\$ 89,528	\$ 18,282	\$ 138,134	\$ 245,944

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Six months ended November 30,	
	2015	2014
(Unaudited)		
Cash flows from operating activities:		
Net income	\$ 5,230	\$ 7,252
Adjustments to reconcile net income to net cash used in operating activities:		
Equity in earnings in unconsolidated entities	(647)	(615)
Return on investments in unconsolidated entities	501	218
Increase in liability for long-term compensation	669	394
Depreciation and amortization	6,406	5,367
Changes in operating assets and liabilities:		
Inventory	(117,602)	(104,338)
Receivables	2,694	12,240
Deposits on real estate under option or contract	3	(13,690)
Other assets	(637)	(3,149)
Accounts payable	16,370	12,770
Other liabilities	(6,254)	(5,020)
Customer deposits	9,304	5,339
Net cash used in operating activities	<u>(83,963)</u>	<u>(83,232)</u>
Cash flows from investing activities:		
Return of investments in unconsolidated entities	1,385	1,323
Additions to property and equipment	(7,080)	(10,303)
Changes in restricted cash	(1)	3,114
Net cash used in investing activities	<u>(5,696)</u>	<u>(5,866)</u>
Cash flows from financing activities:		
Borrowings from revolving credit facility	365,500	107,000
Repayments of revolving credit facility	(268,154)	(65,984)
Payments of debt issuance costs	(1,478)	(1,323)
Members' contributions	41	—
Members' distributions	(6,250)	(14,700)
Net cash provided by financing activities	<u>89,659</u>	<u>24,993</u>
Change in cash and cash equivalents	—	(64,105)
Cash and cash equivalents, beginning of period	—	64,105
Cash and cash equivalents, end of period	<u>\$ —</u>	<u>\$ —</u>
Supplemental cash flow information:		
Cash paid for interest, net of amounts capitalized	<u>\$ 5,502</u>	<u>\$ 3,546</u>
Supplemental disclosure of non-cash financing activity:		
Assumption of loan upon real estate acquisition	<u>\$ 2,338</u>	<u>\$ —</u>

See accompanying notes to unaudited condensed consolidated financial statements.

ASHTON WOODS USA L.L.C.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
November 30, 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, 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 offers title services in its Atlanta, Southwest Florida, Raleigh, and Orlando markets through a wholly-owned title agency.

(b) Basis of presentation and reclassification

The accompanying unaudited condensed 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 unaudited condensed consolidated balance sheets and the unaudited condensed consolidated statement of cash flows, the land development receivables and Municipal Utility Districts ("MUD") receivables have been reclassified from other assets to receivables (see Note 1(e)). Further, on the unaudited condensed consolidated statements of income, a portion of the equity in earnings in unconsolidated entities has been reclassified to other income for the three months ended November 30, 2014. In the Company's opinion, all adjustments (consisting solely of normal recurring accruals) necessary for a fair presentation of the results for the interim periods presented have been included in the accompanying unaudited condensed consolidated financial statements.

(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) 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 unaudited condensed 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.

(e) Receivables

Receivables at November 30, 2015 and May 31, 2015 consisted of the following (in thousands):

	November 30, 2015	May 31, 2015
Closing funds due	\$ 3,972	\$ 9,025
Land development receivables	5,317	4,841
MUD receivables ⁽¹⁾	3,440	1,738
Other receivables ⁽¹⁾	1,651	1,470
	<u>\$ 14,380</u>	<u>\$ 17,074</u>

(1) Includes amounts due from municipalities, utility, and insurance companies, escrow deposits, and drawn amounts due from salespersons.

(f) 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*, ASC Subtopic 470-40, *Product Financing Arrangements* or ASC Subtopic 810, *Consolidation* (see Note 4).

(g) 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 in the unaudited condensed consolidated statements of income (see Note 6).

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 in the unaudited condensed 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.

(h) Deposits and pre-acquisition costs

Deposits and pre-acquisition costs 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 unaudited condensed consolidated statements of income and was \$0.1 million and \$0.3 million for the three months ended November 30, 2015 and 2014, respectively, and \$0.2 million and \$0.6 million for the six months ended November 30, 2015 and 2014, respectively.

(i) 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 November 30, 2015 and May 31, 2015 consisted of the following (in thousands):

	November 30, 2015	May 31, 2015
Office furniture and equipment	\$ 3,486	\$ 3,134
Sales offices, design studios and model furnishings	44,527	40,876
Leasehold improvements	1,081	1,255
	49,094	45,265
Accumulated depreciation	(21,480)	(18,203)
	<u>\$ 27,614</u>	<u>\$ 27,062</u>

Depreciation and amortization expense approximated \$3.3 million and \$2.7 million for the three months ended November 30, 2015 and 2014, respectively, and \$6.4 million and \$5.4 million for the six months ended November 30, 2015 and 2014, respectively.

(j) 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.

(k) Prepaid expenses

Included in other assets are prepaid expenses of approximately \$7.9 million and \$9.3 million as of November 30, 2015 and May 31, 2015, respectively, which primarily represent prepaid insurance, fees, permits, and rent.

(l) 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 unaudited condensed consolidated balance sheets.

Presented below are summaries of the activity in the Company's warranty liability account for the three and six months ended November 30, 2015 and 2014 (in thousands):

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
Warranty liability, beginning of period	\$ 6,340	\$ 6,095	\$ 7,032	\$ 6,500
Costs accrued during period	2,308	1,778	4,059	3,339
Costs incurred during period	(2,325)	(1,826)	(4,768)	(3,792)
Warranty liability, end of period	<u>\$ 6,323</u>	<u>\$ 6,047</u>	<u>\$ 6,323</u>	<u>\$ 6,047</u>

(m) Advertising costs

The Company expenses advertising costs as they are incurred. Advertising expense, which is included in selling, general and administrative expenses in the unaudited condensed consolidated statements of income, was approximately \$1.6 million and \$2.2 million for the three months ended November 30, 2015 and 2014, respectively, and \$3.3 million and \$3.7 million for the six months ended November 30, 2015 and 2014, respectively.

(n) 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 11 for additional discussion regarding the Company's long-term incentive plan.

(o) 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 taxes payable directly by the Company. The Company calculates its Members' potential 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 \$6.3 million and \$14.7 million during the six months ended November 30, 2015 and 2014, respectively, based on estimated taxable income.

(p) Use of estimates

The preparation of unaudited condensed 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 unaudited condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

(q) 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, 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 14 for further discussion of the Company's reportable segments.

(r) Subsequent events

The Company has evaluated subsequent events through January 13, 2016. This date represents the date on which the financial statements were available to be issued.

On November 12, 2015, the Company entered into a purchase agreement to acquire lots from an unaffiliated third party that included two separate parcels. During the month ended November 30, 2015, the Company paid a deposit of \$1.5 million related to the first parcel and recorded real estate not owned of \$10.2 million, which is reflected in the November 30, 2015 unaudited condensed consolidated balance sheet, in accordance with ASC Subtopic 470-40, *Product Financing Arrangements*. During the month ended December 31, 2015, the Company paid an additional deposit of \$15.0 million related to the second parcel, which will be accounted for in the same manner as the first parcel.

On January 13, 2016, the Company increased the aggregate available commitment under the Restated Revolver to \$255.0 million based on the Company's Consolidated Tangible Assets as of November 30, 2015 (See **Note 7**).

Note 2 — Pending and Recently Adopted Accounting Pronouncements

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. In August 2015, the FASB issued Accounting Standards Update No. 2015-14, *Revenue from Contracts with Customers: Deferral of the Effective Date* ("ASU 2015-14"), which defers the effective date by one year while providing the option to early adopt the standard on the original effective date. Accordingly, the effective date for ASU 2015-14 for the Company is for annual periods beginning after December 15, 2018. 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 3 — Inventory

Inventory consisted of the following at November 30, 2015 and May 31, 2015 (in thousands):

	November 30, 2015	May 31, 2015
Homes under construction and finished homes	\$ 411,394	\$ 309,984
Finished lots	213,345	204,684
Land under development	29,853	27,676
Land held for future development	11,722	1,996
Commercial land	1,330	1,352
Land held for sale	—	563
	<u>\$ 667,644</u>	<u>\$ 546,255</u>

The Company capitalizes all interest incurred to the extent its qualifying assets exceed its debt obligations. 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 \$2.8 million and \$5.8 million for the three and six months ended November 30, 2015, respectively, and \$2.0 million and \$4.2 million for the three and six months ended November 30, 2014, respectively, in the unaudited condensed consolidated statements of income.

The following table summarizes interest costs incurred, charged to cost of sales and directly expensed during the three and six months ended November 30, 2015 and 2014 (in thousands):

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
Capitalized interest, beginning of period	\$ 10,215	\$ 11,287	\$ 10,241	\$ 10,592
Interest incurred	7,971	7,305	15,370	14,401
Interest amortized to cost of sales	(4,372)	(4,277)	(8,755)	(8,451)
Interest expensed	(2,794)	(1,972)	(5,836)	(4,199)
Capitalized interest, end of period	<u>\$ 11,020</u>	<u>\$ 12,343</u>	<u>\$ 11,020</u>	<u>\$ 12,343</u>

Note 4 — 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 November 30, 2015 and May 31, 2015, 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 November 30, 2015 and May 31, 2015, the Company recorded real estate not owned of \$17.9 million and \$25.6 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 five lot purchase agreements with two separate unaffiliated investor groups and has accounted for them pursuant to ASC 470-40. At November 30, 2015 and May 31, 2015, the Company recorded real estate not owned of \$29.7 million and \$12.7 million, respectively, related to the lot purchase agreements accounted for pursuant to ASC 470-40.

Note 5 — Other Assets

Other assets at November 30, 2015 and May 31, 2015 consisted of the following (in thousands):

	November 30, 2015	May 31, 2015
Deferred financing fees	\$ 9,472	\$ 9,264
Architecture plans	10,156	9,181
Prepaid expenses	7,882	9,319
Pre-acquisition costs	2,658	2,103
Other deposits	864	2,498
	<u>\$ 31,032</u>	<u>\$ 32,365</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. On July 31, 2015, the Company amended its senior secured revolving credit facility by entering into a Fifth Amended and Restated Credit Agreement. See Note 7 for additional information on the amendment to the senior secured revolving credit facility.

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

Note 6 — 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 November 30, 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 November 30, 2015 and May 31, 2015, 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 November 30, 2015, the Company had recorded \$7.1 million for its investment in this unconsolidated entity in the unaudited condensed 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 unaudited condensed consolidated statements of income. The Company is a party to a lot purchase agreement with the joint venture, which required a 10% deposit, and has no specific performance requirements for the Company. As of November 30, 2015, the total purchase price of lots remaining to be purchased under this agreement was approximately \$19.3 million. As of November 30, 2015, the joint venture had debt outstanding of \$10.6 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 Texas 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 November 30, 2015 and May 31, 2015 and for the three and six months ended November 30, 2015 and 2014 were as follows (in thousands):

	November 30, 2015	May 31, 2015
	(Unaudited)	
Assets:		
Cash	\$ 1,287	\$ 2,995
Real estate	33,471	34,807
Other	153	269
Total Assets	<u>\$ 34,911</u>	<u>\$ 38,071</u>
Liabilities:		
Liabilities:		
Accounts payable and other accruals	\$ 4,345	\$ 4,778
Notes payable	10,604	8,126
Total liabilities	<u>14,949</u>	<u>12,904</u>
Equity	<u>19,962</u>	<u>25,167</u>
Total liabilities and equity	<u>\$ 34,911</u>	<u>\$ 38,071</u>

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
	(Unaudited)			
Revenues	\$ 4,918	\$ 4,562	\$ 6,529	\$ 7,182
Gross profit	2,012	1,015	3,068	2,227
Operating expenses	266	221	466	551
Net earnings	1,746	794	2,749	1,677

Note 7 — Debt

Debt at November 30, 2015 and May 31, 2015 consisted of the following (in thousands):

	November 30, 2015	May 31, 2015
6.875% senior notes	\$ 347,699	\$ 347,519
Senior secured revolving credit facility	97,346	—
Note payable	2,338	—
	<u>\$ 447,383</u>	<u>\$ 347,519</u>

The 6.875% Notes

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

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 November 30, 2015, the Company was in compliance with the covenants in the indenture governing the 6.875% Notes.

Senior Secured Revolving Credit Facility

On July 31, 2015, the Company amended its senior secured revolving credit facility by entering into a Fifth Amended and Restated Credit Agreement (the "Restated Revolver"), providing for, among other things, an aggregate revolving loan commitment of \$260.0 million, with an accordion feature to permit the size of the facility to be increased in the future up to \$300 million (dependent upon Company needs and available lender commitments), of which up to \$45.0 million is available for the issuance of letters of credit and up to \$10 million is available for a swingline facility, and a maturity date of January 31, 2019. The Restated Revolver limits the principal amount of the aggregate commitment to the amount that is supported by the permitted lien basket in the indenture governing the Company's 6.875% Notes, which is 30% of Consolidated Tangible Assets, as defined therein ("CTA"), which resulted in an aggregate commitment of \$217.0 million at August 31, 2015. Aggregate commitments in excess of 30% of CTA as derived from the Company's fiscal year 2015 audited financial statements will initially be restricted. On October 14, 2015, the aggregate available commitment under the Restated Revolver was increased to \$231.0 million based on CTA as of August 31, 2015 pursuant to the terms of the Restated Revolver. The Restated Revolver also allowed the Company to increase the unrestricted available commitment based upon CTA derived from the corresponding financial statements for the quarter ended on and as of November 30, 2015 within 60 days of the end of the quarter (See Note 1(r)).

Interest accrues on borrowings under the Restated Revolver at the London Interbank Offered Rate (LIBOR) plus an applicable margin that ranges from 315 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 315 to 385 basis points if not secured by cash. The Restated Revolver has a maturity date of January 31, 2019, 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 in the Company so long as no change of control, as defined in the Restated Revolver, occurs and permits certain tax distributions to Members and permits certain other distributions to Members if certain Leverage Ratio and other conditions are met. As of November 30, 2015, the Company was in compliance with the covenants in the Restated Revolver.

At November 30, 2015, there was \$97.3 million outstanding under the Restated Revolver and \$7.0 million of letters of credit outstanding. As of November 30, 2015, and subject to a borrowing base formula, the Company had available additional borrowing capacity of \$106.8 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.

Note Payable

During the quarter ended November 30, 2015, the Company signed a note payable to an unaffiliated third party that totaled \$2.3 million at November 30, 2015. The note matures in two years, is collateralized by the applicable land positions to which it relates, and has no recourse to any other assets.

Note 8 — Other Liabilities

Other liabilities at November 30, 2015 and May 31, 2015 consisted of the following (in thousands):

	November 30, 2015	May 31, 2015
Salaries, bonuses and benefits	\$ 8,297	\$ 14,153
Accrued interest	7,566	7,499
Warranty accruals	6,323	7,029
Accrued long-term compensation	2,577	2,787
Other	10,757	9,549
	<u>\$ 35,520</u>	<u>\$ 41,017</u>

Note 9 — 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.

During the first quarter of fiscal year 2016, the Company sold 2,898 additional Class C Units for an aggregate purchase price of \$40.9 thousand in a preemptive rights offering made to Members pursuant to the Regulations.

At November 30, 2015, there were 20,628,729 membership interests outstanding, comprised as follows:

	Membership Interests	Ownership percentage	Percentage of membership class
Little Shots Nevada L.L.C.			
Class A	8,027,200	38.91%	100.00%
Class B	1,911,595	9.27%	96.90%
Class C	8,167,244	39.59%	76.84%
Total Little Shots Nevada L.L.C.	18,106,039	87.77%	
Various Holders			
Class B	61,205	0.30%	3.10%
Class C	2,461,485	11.93%	23.16%
	<u>20,628,729</u>	<u>100.00%</u>	

Note 10 — 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 certain of the Company's computer systems and 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 unaudited condensed consolidated statements of income. During the three months ended November 30, 2015 and 2014, the Company incurred fees of \$0.5 million and \$0.4 million, respectively, and during the six months ended November 30, 2015 and 2014, the Company incurred fees of \$0.9 million and \$0.8 million, respectively, under the services agreement. As of November 30, 2015, the balance due to the related party was \$0.5 million.

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 to rent approximately 8,000 square feet of commercial space in Dallas, Texas. The term of the lease is 66 months, with 61 months remaining as of November 30, 2015. 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 November 30, 2015.

Lot purchase agreements

As of November 30, 2015, the Company has entered into four 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 unaudited condensed consolidated balance sheets. As of November 30, 2015, the total purchase price of lots remaining to be purchased under such agreements was approximately \$19.5 million.

Land development receivables

The Company had \$1.3 million and \$1.2 million in land development receivables due from the Investors at November 30, 2015 and May 31, 2015, respectively, associated with the above mentioned lot purchase agreements. The amounts are included in receivables in the unaudited condensed consolidated balance sheets (see Note 1(e)).

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 November 30, 2015, the total purchase price of lots remaining to be purchased was \$19.3 million (see Note 6).

Land development agreement

The Company entered into a land development agreement with affiliates of the Company's majority equity holder and largest minority equity holder (the "Purchaser") for the development of a parcel of land and will be paid a fee for the oversight of the development. No payments were made to the Company during the quarter ended November 30, 2015, pursuant to the development agreement.

Note 11 — 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 of 2013, 2014, and 2015 awarded additional performance shares to these officers, along with certain members of the corporate and operating division senior management teams. 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 for the six months ended November 30, 2015:

	Full-value awards	Appreciation- only awards	Total awards
Outstanding units as of May 31, 2015	94,420	264,247	358,667
Units awarded during the period	46,437	92,874	139,311
Fully vested units paid	(20,315)	(35,955)	(56,270)
Total outstanding units as of November 30, 2015	<u>120,542</u>	<u>321,166</u>	<u>441,708</u>
Total vested units as of November 30, 2015	<u>55,702</u>	<u>191,466</u>	<u>247,168</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 unaudited condensed consolidated statements of income.

The total number of units vested as of November 30, 2015 and May 31, 2015 was 247,168 and 240,638, respectively. For the three months ended November 30, 2015 and 2014, the Company recorded \$0.4 million and \$0.2 million, respectively, in compensation expense associated with the full-value and appreciation-only awards. For the six months ended November 30, 2015 and 2014, the Company recorded \$0.7 million and \$0.4 million, respectively, in compensation expense associated with the full-value and appreciation-only awards. For the six months ended November 30, 2015 and 2014, \$0.9 million (56,270 units) and \$0.4 million (20,599 units), respectively, of vested awards were paid out to employees. As of November 30, 2015 and May 31, 2015, the Company's liability for the Plan awards was \$2.6 million and \$2.8 million, respectively, which is recorded in other liabilities in the unaudited condensed consolidated balance sheets.

Note 12 — 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 unaudited condensed 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 November 30, 2015 and May 31, 2015:

	Fair Value Hierarchy	November 30, 2015		May 31, 2015	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
(in thousands)					
Liabilities:					
6.875% senior notes	Level 2	\$ 347,699	\$ 322,000	\$ 347,519	\$ 329,000
Note Payable	Level 3	\$ 2,338	\$ 2,338	\$ —	\$ —

The fair value of the 6.875% Notes is derived from quoted market prices by independent dealers (Level 2). The fair value of the Note Payable is determined based on expected future cash flows, discounted at an estimated market interest rate.

Note 13 — 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 and certain other officers that provide for severance payments based on salary and the most recent bonus paid or target bonus upon termination without cause, or, with respect to certain of these officers, 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 November 30, 2015 and May 31, 2015, the Company had letters of credit outstanding of \$7.0 million and \$3.2 million, respectively, and surety bonds outstanding of \$14.3 million and \$20.7 million, respectively. As of November 30, 2015, the Company had \$38.0 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 \$64.2 million as of November 30, 2015. The Company would forfeit the remaining deposits if the lots are not purchased. The total purchase price of lots remaining to be purchased under option agreements with nonrefundable deposits was approximately \$615.2 million as of November 30, 2015. As of November 30, 2015, one of these purchase agreements, which has an aggregate purchase price of \$42.2 million and a \$1.4 million deposit, provides the seller with a specific performance right against the Company, subject to certain conditions.

Note 14 — 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, 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):

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
Revenues:				
Homebuilding:				
East	\$ 142,684	\$ 106,021	\$ 249,347	\$ 191,561
Central	102,033	92,325	200,114	181,818
Consolidated revenues	<u>\$ 244,717</u>	<u>\$ 198,346</u>	<u>\$ 449,461</u>	<u>\$ 373,379</u>
Gross profit:				
Homebuilding:				
East	\$ 26,154	\$ 22,887	\$ 47,201	\$ 39,502
Central	17,778	17,578	35,191	34,604
Consolidated gross profit	<u>\$ 43,932</u>	<u>\$ 40,465</u>	<u>\$ 82,392</u>	<u>\$ 74,106</u>
Equity in earnings in unconsolidated entities:				
East	\$ —	\$ —	\$ —	\$ 2
Central	346	250	647	613
Consolidated equity in earnings in unconsolidated entities	<u>\$ 346</u>	<u>\$ 250</u>	<u>\$ 647</u>	<u>\$ 615</u>
Net income:				
East	\$ 5,569	\$ 5,477	\$ 7,904	\$ 7,215
Central	1,838	2,245	3,162	4,355
	7,407	7,722	11,066	11,570
Other ⁽¹⁾	(2,794)	(2,050)	(5,836)	(4,318)
Consolidated net income	<u>\$ 4,613</u>	<u>\$ 5,672</u>	<u>\$ 5,230</u>	<u>\$ 7,252</u>

(1) "Other" primarily consists of interest directly expensed.

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

	November 30, 2015	May 31, 2015
Assets:		
Homebuilding:		
East	\$ 485,302	\$ 406,652
Central	364,540	317,449
	849,842	724,101
Other ⁽²⁾	12,246	11,901
Consolidated assets	<u>\$ 862,088</u>	<u>\$ 736,002</u>

(2) "Other" includes restricted cash, corporate assets and commercial land in Dallas.

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

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
Additions to property and equipment:				
Homebuilding:				
East	\$ 1,706	\$ 3,030	\$ 3,285	\$ 4,789
Central	1,989	2,138	3,624	5,243
	3,695	5,168	6,909	10,032
Other ⁽³⁾	153	24	171	271
Consolidated additions to property and equipment	\$ 3,848	\$ 5,192	\$ 7,080	\$ 10,303

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

Item 2. 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 unaudited condensed 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 could result in fines, penalties, delays, or increased costs in obtaining necessary permits and complying with environmental safety and other laws and regulations;
- 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;
- Judgments or other costs and exposure with respect to litigation and 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 unaudited condensed 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.

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
	(in thousands)			
Revenues:				
Home sales	\$ 244,717	\$ 198,346	\$ 449,461	\$ 373,379
Land sales	455	—	455	3,938
	<u>\$ 245,172</u>	<u>\$ 198,346</u>	<u>\$ 449,916</u>	<u>\$ 377,317</u>
Gross profit:				
Home sales	\$ 43,932	\$ 40,465	\$ 82,392	\$ 74,106
Land sales	—	—	—	408
	<u>\$ 43,932</u>	<u>\$ 40,465</u>	<u>\$ 82,392</u>	<u>\$ 74,514</u>
Selling, general and administrative	\$ 34,282	\$ 30,935	\$ 66,982	\$ 59,455
Net income ⁽¹⁾	\$ 4,613	\$ 5,672	\$ 5,230	\$ 7,252

- (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 \$2.4 million and \$6.3 million during the three and six months ended November 30, 2015, respectively, and \$3.9 million and \$14.7 million during the three and six months ended November 30, 2014, respectively.

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014

(\$ in thousands)

Supplemental data :

Active communities at end of period	107	77	107	77
Net new home orders (in units)	580	530	1,222	1,107
Homes closed (in units) ⁽²⁾	596	514	1,071	995
Average sales price per home closed	\$ 411	\$ 386	\$ 420	\$ 375
Backlog at end of period (in units)	1,364	1,118	1,364	1,118
Sales value of backlog at end of period	\$ 613,568	\$ 495,982	\$ 613,568	\$ 495,982
Home gross margin ⁽³⁾	18.0%	20.4%	18.3%	19.8%
Adjusted home gross margin ⁽⁴⁾	19.7%	22.6%	20.3%	22.2%
Ratio of selling, general and administrative expenses to home sales revenue	14.0%	15.6%	14.9%	15.9%
Interest incurred ⁽⁵⁾	\$ 7,971	\$ 7,305	\$ 15,370	\$ 14,401
EBITDA ⁽⁶⁾	\$ 15,125	\$ 14,668	\$ 26,227	\$ 25,269
EBITDA margin ⁽⁶⁾	6.2%	7.4%	5.8%	6.7%
Total debt to total capitalization	64.5%	64.9%	64.5%	64.9%
Total net debt to net capitalization	64.5%	64.9%	64.5%	64.9%
Cancellation rate (as a percentage of gross sales)	13.4%	12.5%	13.1%	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, which is the most directly comparable GAAP measure, to adjusted home gross margin:

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014

(in thousands)

Home sales revenues	\$ 244,717	\$ 198,346	\$ 449,461	\$ 373,379
Cost of sales - homes	200,785	157,881	367,069	299,273
Home gross margin	43,932	40,465	82,392	74,106
Add: Inventory impairments	27	21	60	149
Interest amortized to cost of sales	4,372	4,277	8,755	8,451
Adjusted home gross margin	\$ 48,331	\$ 44,763	\$ 91,207	\$ 82,706
Ratio of home gross margin to home sales revenue	18.0%	20.4%	18.3%	19.8%
Ratio of adjusted home gross margin to home sales revenue	19.7%	22.6%	20.3%	22.2%

- (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 three and six months ended November 30, 2015 and 2014:

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
	(in thousands)			
Capitalized interest, beginning of period	\$ 10,215	\$ 11,287	\$ 10,241	\$ 10,592
Interest incurred	7,971	7,305	15,370	14,401
Interest amortized to cost of sales	(4,372)	(4,277)	(8,755)	(8,451)
Interest expensed	(2,794)	(1,972)	(5,836)	(4,199)
Capitalized interest, end of period	<u>\$ 11,020</u>	<u>\$ 12,343</u>	<u>\$ 11,020</u>	<u>\$ 12,343</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 net income, which is the most directly comparable GAAP measure, to EBITDA:

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
	(in thousands)			
Net income	\$ 4,613	\$ 5,672	\$ 5,230	\$ 7,252
Depreciation and amortization	3,346	2,747	6,406	5,367
Interest amortized to cost of sales	4,372	4,277	8,755	8,451
Interest expensed	2,794	1,972	5,836	4,199
EBITDA	<u>\$ 15,125</u>	<u>\$ 14,668</u>	<u>\$ 26,227</u>	<u>\$ 25,269</u>

Results of operations—Consolidated discussion

We design, build, and market attached and detached single-family homes for entry-level, move-up, and multi-move-up buyers. Typically, multi-move-up communities have higher average sales prices than entry-level or move-up communities, as well as higher option revenue per home. Of our 107 active communities as of November 30, 2015, we consider 33 (30.8%) to be multi-move-up communities, compared to 19 (24.7%) of the 77 active communities as of November 30, 2014. The net 30 community increase in active communities from November 30, 2014 to November 30, 2015 was due to the Company adding 61 communities while also closing out of 31 communities. Of the 61 communities added, we consider 20 (32.8%) multi-move-up communities. The active community count remained flat at 107 during the three months ended November 30, 2015, with the Company adding four communities while also closing out of four communities. Of the four communities added, we consider one (25.0%) a multi-move-up community.

Of the 596 homes closed during the three months ended November 30, 2015, 321 (53.9%) were from communities in which we had closings from both the three months ended November 30, 2015 and November 30, 2014 (“legacy communities”). The remaining 275 (46.1%) of the homes closed were from communities that had no closings in the three months ended November 30, 2014 (“new communities” or “newer communities”).

Of the 1,071 homes closed during the six months ended November 30, 2015, 609 (56.9%) were from legacy communities. The remaining 462 (43.1%) of the homes closed were from newer communities.

Three and Six Months Ended November 30, 2015 Compared to Three and Six Months Ended November 30, 2014

Home sales revenues

Home sales revenues increased by 23.4% (\$46.4 million) and 20.4% (\$76.1 million), respectively, for the three and six months ended November 30, 2015 to \$244.7 million and \$449.5 million, respectively, from \$198.3 million and \$373.4 million for the three and six months ended November 30, 2014, respectively. The increase in revenues was due to an increase in the average sales price of homes closed, in addition to an increase in the number of homes closed. The average sales price of homes closed increased 6.5% and 12.0%, respectively, in the three and six months ended November 30, 2015 to an average of \$411,000 and \$420,000, respectively, from an average of \$386,000 and \$375,000 for the three and six months ended November 30, 2014, respectively. The number of homes closed increased 16.0% and 7.6%, respectively, in the three and six months ended November 30, 2015 to 596 and 1,071, respectively, from 514 and 995 for the three and six months ended November 30, 2014, respectively.

The increase in the average sales price of homes closed during the three and six months ended November 30, 2015 was primarily due to an increase in closings in our newer communities and our ability to raise base prices and increase option revenue in our legacy communities. During the three and six months ended November 30, 2015, the Company closed more homes in our newer communities than in the three and six months ended November 30, 2014, which include a higher percentage of multi-move-up homes, which typically have higher average sales prices than our entry-level and move-up homes. Further, in the three and six months ended November 30, 2015 as compared to the three and six months ended November 30, 2014, we were able to raise the average base sales price and increase option revenue in our legacy communities, which resulted in a 1.4% and 3.0%, respectively, increase in the average sales prices in our legacy communities.

Land sales

We periodically elect to sell parcels of land or finished lots. These land and finished lot sales are incidental to our business of selling and building homes and have fluctuated in the past. We had \$0.5 million in sales of land or finished lots during the three months ended November 30, 2015, no such sales during the three months ended November 30, 2014, and \$0.5 million and \$3.9 million of land sales for the six months ended November 30, 2015 and 2014, respectively. No significant profits were realized from the sales of land and finished lots, 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 the home closing, which is generally within nine months of the date the home is sold. Net new home orders increased 9.4% (50 homes) and 10.4% (115 homes) for the three and six months ended November 30, 2015, respectively, compared to the three and six months ended November 30, 2014. These new home orders contributed to a backlog at November 30, 2015 of 1,364 homes, which is a 22.0% increase from the 1,118 homes in backlog at November 30, 2014. The sales value of backlog at November 30, 2015 was \$613.6 million, a 23.7% increase over the sales value of backlog at November 30, 2014 of \$496.0 million. The average sales price of homes in backlog increased 1.4% from \$444,000 at November 30, 2014 to \$450,000 at November 30, 2015. The increase in the average sales price of homes in backlog was primarily driven by a higher percentage of new home orders in our newer communities, which includes a higher percentage of multi-move-up homes.

Gross margins

The average gross margin from homes closed for the three and six months ended November 30, 2015 decreased to 18.0% and 18.3%, respectively, from 20.4% and 19.8%, respectively, for the three and six months ended November 30, 2014. The decrease in average gross margin was primarily due to increases in land costs, as a percentage of revenue, as well as increases in labor and material costs. As discussed above, in the three and six months ended November 30, 2015, the Company closed more homes in our newer communities than in the three and six months ended November 30, 2014. The land costs, as a percentage of revenue, in these newer communities was 21.3% in both the three and six months ended November 30, 2015, as compared to 18.2% and 18.5%, respectively, in our legacy communities.

Adjusted home gross margin also decreased to 19.7% and 20.3%, respectively, for the three and six months ended November 30, 2015 from 22.6% and 22.2%, respectively, for the three and six months ended November 30, 2014. In addition to the factors noted above, the decrease in adjusted home gross margins was slightly offset by a decrease in interest amortized to cost of sales as a percent of revenue.

Selling, general and administrative expenses

Selling, general and administrative expenses ("SG&A") totaled \$34.3 million and \$67.0 million for the three and six months ended November 30, 2015, respectively, compared to \$30.9 million and \$59.5 million for the three and six months ended November 30, 2014, respectively. While SG&A increased by \$3.3 million and \$7.5 million, as a percentage of revenue SG&A decreased by 1.6% and 0.9% for the three and six months ended November 30, 2015, respectively, compared to the three and six months ended November 30, 2014. SG&A as a percentage of revenue was 14.0% and 14.9% for the three and six months ended November 30, 2015, respectively, compared to 15.6% and 15.8% for the three and six months ended November 30, 2014, respectively.

Sales commissions as a percentage of revenues remained relatively flat at 4.0% of home sales revenues in the three and six months ended November 30, 2015, increasing in absolute terms to \$9.6 million and \$17.7 million in the three and six months ended November 30, 2015, respectively, from \$7.9 million and \$14.9 million in the three and six months ended November 30, 2014, respectively. The remaining increases for the periods were due primarily to increases in settlements of lawsuits and other legal matters in the ordinary course of business, compensation, and professional fees, partially offset by a decrease in other sales and marketing costs.

Net income

Net income for the three and six months ended November 30, 2015 was \$4.6 million and \$5.2 million, respectively, compared to net income of \$5.7 million and \$7.3 million, respectively, for the three and six months ended November 30, 2014. While there was a 23.4% increase in home sales revenues, the decrease in net income for the three and six months ended November 30, 2015 is attributable to the decrease in gross margin and the increase in selling, general and administrative expenses, as discussed above.

Results of operations—Homebuilding segments discussion

We have grouped our homebuilding operating divisions into two reportable segments, East and Central. At November 30, 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, San Antonio, and Phoenix

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

Net new home orders (units):

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
East	284	267	605	561
Central	296	263	617	546
Company total	580	530	1,222	1,107

Homes closed (units):

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
East	325	249	544	465
Central	271	265	527	530
Company total	596	514	1,071	995

Average sales price per home closed:

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
(in thousands)				
East	\$ 439	\$ 426	\$ 458	\$ 412
Central	\$ 377	\$ 348	\$ 380	\$ 343
Company average	\$ 411	\$ 386	\$ 420	\$ 375

Backlog (units) at end of period:

	As of November 30,		Change	% Change
	2015	2014		
East	692	565	127	22.5%
Central	672	553	119	21.5%
Company total	1,364	1,118	246	22.0%

Sales value of backlog at end of period:

	As of November 30,		Change	% Change
	2015	2014		
(in thousands)				
East	\$ 340,009	\$ 285,537	\$ 54,472	19.1%
Central	273,559	210,445	63,114	30.0%
Company total	\$ 613,568	\$ 495,982	\$ 117,586	23.7%

Active communities:

	As of November 30,		Change	% Change
	2015	2014		
East	53	32	21	65.6%
Central	54	45	9	20.0%
Company total	107	77	30	39.0%

Total communities:

	As of November 30, 2015			
	Active ⁽¹⁾	Start-up ⁽²⁾	Close-out ⁽³⁾	Total
East	53	73	19	145
Central	54	44	17	115
Company total	107	117	36	260

	As of November 30, 2014			
	Active ⁽¹⁾	Start-up ⁽²⁾	Close-out ⁽³⁾	Total
East	32	75	31	138
Central	45	54	11	110
Company total	77	129	42	248

(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

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
	(\$ in thousands)			

Homebuilding East:

Home sales revenues	\$ 142,684	\$ 106,021	\$ 249,347	\$ 191,561
Home closed (in units)	325	249	544	465
Average sales price per home closed	\$ 439	\$ 426	\$ 458	\$ 412
Home gross margin	18.3%	21.6%	18.9%	20.6%
Adjusted home gross margin ⁽¹⁾	20.1%	23.8%	20.7%	22.9%

(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:

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
	(in thousands)			
Home sales revenues	\$ 142,684	\$ 106,021	\$ 249,347	\$ 191,561
Cost of sales - homes	116,530	83,134	202,146	152,059
Home gross margin	26,154	22,887	47,201	39,502
Add: Inventory impairments	—	16	—	97
Interest amortized to cost of sales	2,508	2,281	4,398	4,254
Adjusted home gross margin	\$ 28,662	\$ 25,184	\$ 51,599	\$ 43,853
Ratio of home gross margin to home sales revenues	18.3%	21.6%	18.9%	20.6%
Ratio of adjusted home gross margin to home sales revenues	20.1%	23.8%	20.7%	22.9%

Three and Six Months Ended November 30, 2015 Compared to Three and Six Months Ended November 30, 2014 - East

Home sales revenues

Revenues for the eastern segment increased by 34.6% (\$36.7 million) and 30.2% (\$57.8 million) for the three and six months ended November 30, 2015 to \$142.7 million and \$249.3 million, respectively, from \$106.0 million and \$191.6 million for the three and six months ended November 30, 2014. The increase in revenues for the three and six months ended November 30, 2015 was due to an increase in the average sales price of homes closed and an increase in the number of homes closed. The average sales price of homes closed increased 3.1% and 11.2%, respectively, in the three and six months ended November 30, 2015 to an average of \$439,000 and \$458,000, respectively, from an average of \$426,000 and \$412,000 for the three and six months ended November 30, 2014, respectively. The number of homes closed during the three and six months ended November 30, 2015 increased 30.5% (76 homes) and 17.0% (79 homes), respectively, compared to the three and six months ended November 30, 2014.

The increase in the average sales price of homes closed during the three months ended November 30, 2015 was primarily due to an increase in closings in our newer communities and our ability to raise base prices and increase option revenue in our legacy communities. In the three and six months ended November 30, 2015, 58.2% (189 units) and 57.9% (315 units), respectively, of the homes closed were in our newer communities, which includes a higher percentage of multi-move-up homes, which typically have higher average sales prices than our entry-level and move-up homes. Further, in the three and six months ended November 30, 2015, as compared to the three and six months ended November 30, 2014, we were able to raise the average base sales price and increase option revenue in our legacy communities which resulted in a 1.1% and 0.1% increase, respectively, in the average sales prices in our legacy communities.

Gross margins

The average gross margin from homes closed for the three and six months ended November 30, 2015 decreased to 18.3% and 18.9%, respectively, from 21.6% and 20.6% for the three and six months ended November 30, 2014, respectively. The decrease in average gross margin was primarily due to increases in land costs, as a percentage of revenue, as well as increases in labor and material costs. During the three and six months ended November 30, 2015, the Company closed more homes in our newer communities than in the three and six months ended November 30, 2014. The land costs, as a percentage of revenue, in these newer communities was 21.5% and 21.8% for the three and six months ended November 30, 2015, respectively, compared to 16.8% and 17.3%, respectively, in our legacy communities for the three and six months ended November 30, 2015. In addition, during the early stages of a community's life cycle, the average gross margin is typically lower and increases over the life of the community, as we are able to raise prices and/or reduce incentives. Gross margin in our legacy communities has increased slightly due to increases in base prices and option revenue, which has offset increases in land and construction costs.

Net new home orders and backlog

Net new home orders increased 6.4% (17 homes) and 7.8% (44 homes) during the three and six months ended November 30, 2015, respectively, compared to the three and six months ended November 30, 2014. These new home orders contributed to a backlog at November 30, 2015 of 692 homes, which is a 22.5% increase from the 565 homes in backlog at November 30, 2014. The sales value of backlog at November 30, 2015 was \$340.0 million, a 19.1% increase over the sales value of backlog at November 30, 2014 of \$285.5 million. The increase in net new home orders and backlog units was primarily due to an increase in active communities of 65.6% from 32 communities at November 30, 2014 to 53 communities at November 30, 2015. The increase in the average sales price of homes in backlog was primarily driven by a higher percentage of new home orders in our newer communities, which includes a higher percentage of multi-move-up homes, as well as increased sales prices in our legacy communities.

Homebuilding—Central

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
	(\$ in thousands)			
Homebuilding Central:				
Home sales revenues	\$ 102,033	\$ 92,325	\$ 200,114	\$ 181,818
Home closed (in units)	271	265	527	530
Average sales price per home closed	\$ 377	\$ 348	\$ 380	\$ 343
Home gross margin	17.4%	19.0%	17.6%	19.0%
Adjusted home gross margin ⁽¹⁾	19.3%	21.2%	19.8%	21.4%

(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:

	Three months ended November 30,		Six months ended November 30,	
	2015	2014	2015	2014
	(in thousands)			
Home sales revenues	\$ 102,033	\$ 92,325	\$ 200,114	\$ 181,818
Cost of sales - homes	84,255	74,747	164,923	147,214
Home gross margin	17,778	17,578	35,191	34,604
Add: Inventory Impairments	27	5	60	53
Interest amortized to cost of sales	1,864	1,996	4,357	4,197
Adjusted home gross margin	\$ 19,669	\$ 19,579	\$ 39,608	\$ 38,854
Ratio of home gross margin to home sales revenues	17.4%	19.0%	17.6%	19.0%
Ratio of adjusted home gross margin to home sales revenues	19.3%	21.2%	19.8%	21.4%

Three and Six Months Ended November 30, 2015 Compared to Three and Six Months Ended November 30, 2014 - Central

Home sales revenues

Revenues for the central segment increased by 10.5% (\$9.7 million) and 10.1% (\$18.3 million), respectively, for the three and six months ended November 30, 2015, to \$102.0 million and \$200.1 million, respectively, from \$92.3 million and \$181.8 million for the three and six months ended November 30, 2014. The increase in revenues for the three and six months ended November 30, 2015 was primarily due to the increase in the average sales price of homes closed and a slight increase in the number of homes closed for the three months ended November 30, 2015, while the number of homes closed for the six months ended November 30, 2015 decreased slightly. The average sales price of homes closed increased 8.3% and 10.8%, respectively, in the three and six months ended November 30, 2015 to an average of \$377,000 and \$380,000, respectively, from an average of \$348,000 and \$343,000, respectively, for the three and six months ended November 30, 2014. The number

of homes closed in the three months ended November 30, 2015 compared to the three months ended November 30, 2014 increased 2.3%, from 265 to 271, respectively, while the number of homes closed in the six months ended November 30, 2015 compared to the six months ended November 30, 2014 remained relatively flat.

The increase in the average sales price of homes closed during the three months ended November 30, 2015 was primarily due to our ability to raise base prices and increase option revenue in our legacy communities, partially offset by a slight decrease in closings in our newer communities. In the three and six months ended November 30, 2015, 31.7% (86 units) and 27.9% (147 units), respectively, of the homes closed were in our newer communities, which includes a higher percentage of multi-move-up homes, which typically have higher average sales prices than our entry-level and move-up homes. Further, in the three and six months ended November 30, 2015 as compared to the three and six months ended November 30, 2014, we were able to raise the average base sales price and increase option revenue in our legacy communities which resulted in a 1.0% and 5.0% increase, respectively, in the average sales prices in our legacy communities.

Gross margins

The average gross margin from homes closed for the three and six months ended November 30, 2015 decreased to 17.4% and 17.6%, respectively, from 19.0% in the three and six months ended November 30, 2014. The reduction in average gross margin for the three and six months ended November 30, 2015 as compared to the three and six months ended November 30, 2014 was primarily due to an increase in land costs, as a percentage of revenue, in our newer communities compared to our legacy communities. The land costs, as a percentage of revenue, in our newer communities was 20.7% and 20.0%, respectively, for the three and six months ended November 30, 2015, compared to 19.4% and 19.3%, respectively, in our legacy communities for the three and six months ended November 30, 2015. In addition, during the early stages of a community's life cycle, the average gross margin is typically lower and increases over the life of the community as we are able to raise prices and/or reduce incentives.

Net new home orders and backlog

Net new home orders increased 12.5% (33 homes) and 13.0% (71 homes) during the three and six months ended November 30, 2015, respectively, compared to the three and six months ended November 30, 2014. These new home orders contributed to a backlog at November 30, 2015 of 672 homes, which is a 21.5% increase from the 553 homes in backlog at November 30, 2014. The sales value of backlog at November 30, 2015 was \$273.6 million, a 30.0% increase over the sales value of backlog at November 30, 2014 of \$210.4 million. The average sales price of homes in backlog increased 6.8% from \$381,000 at November 30, 2014 to \$407,000 at November 30, 2015. The increase in net new home orders and backlog units was primarily due to an increase in active communities of 20.0%, from 45 communities at November 30, 2014 to 54 communities at November 30, 2015. The increase in the average sales price of homes in backlog was primarily driven by a higher percentage of new home orders in our newer communities, which includes a higher percentage of multi-move-up homes, as well as increased sales prices in our legacy communities.

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 six months ended November 30, 2015 was \$84.0 million compared to \$83.2 million for the six months ended November 30, 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. The slight increase in cash used in operating activities was due to an increase in homes under construction from 1,082 (714 sold and 368 unsold) at November 30, 2014 to 1,277 (888 sold and 389 unsold) at November 30, 2015, offset by a decrease in the deposits on real estate under option or contract.

Investing cash flows

Net cash used in investing activities was \$5.7 million for the six months ended November 30, 2015 compared to \$5.9 million for the six months ended November 30, 2014. Net cash used in investing activities for the six months ended November 30, 2015 included \$4.4 million for model home furnishings and sales offices, and \$2.1 million for new Design Studios. The cash outflows were partially offset by a \$1.4 million return on investment from an unconsolidated entity.

Financing cash flows

Net cash provided by financing activities was \$89.7 million for the six months ended November 30, 2015, compared to net cash provided by financing activities of \$25.0 million for the six months ended November 30, 2014. The funds provided by financing activities during the six months ended November 30, 2015 consisted of \$365.5 million of borrowings under the Restated Revolver of which \$268.2 million was repaid during the six month period, \$0.04 million received from the sale of Class C membership interests to our Members during the six months ended November 30, 2015, which was offset by distributions of \$6.3 million to our Members, and \$1.5 million of debt issuance costs paid in connection with the Restated Revolver. The funds used in financing activities during the six months ended November 30, 2014 consisted of \$14.7 million of distributions to our Members and \$1.3 million of debt issuance costs paid in connection with the issuance of 6.875% Notes in December 2013. As of November 30, 2015, we had \$97.3 million of outstanding borrowings under our Restated Revolver and available additional borrowing capacity of \$106.8 million based on outstanding borrowings, outstanding letters of credit, and the value of collateral pledged to secure the facility.

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 64.5% as of November 30, 2015 from 64.9% as of November 30, 2014. Our ratio of net debt to net capitalization decreased to 64.5% as of November 30, 2015 from 64.9% as of November 30, 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 November 30, 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	206	6	431	48	70	33	794
Central	173	4	457	60	73	38	805
Company total	379	10	888	108	143	71	1,599

As of November 30, 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	794	1,423	385	213	2,815	4,192	7,007
Central	805	952	43	55	1,855	3,763	5,618
Total Company	1,599	2,375	428	268	4,670	7,955	12,625
Percentage of total controlled	12.7%	18.8%	3.4%	2.1%	37.0%	63.0%	100.0%

In addition to the lots in the table above, the Company owns commercial land in Dallas with a book value of \$1.3 million at November 30, 2015 and 2014. This land is not being actively marketed and is included in commercial land.

In addition to the 4,670 lots we owned, we controlled, through the use of purchase and option agreements, 7,955 lots at November 30, 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 November 30, 2015 had an aggregate purchase price of \$628.1 million. In connection with these agreements, we had cash deposits of \$65.5 million at November 30, 2015. As of November 30, 2015, one of these purchase agreements, which has an aggregate purchase price of \$42.2 million and a \$1.4 million deposit, provides the seller with a specific performance right against the Company, subject to certain conditions. In addition, we had purchase and option agreements consolidated under ASC 360-20, or ASC 470-40 with an aggregate purchase price of \$49.2 million and cash deposits of \$10.1 million (See Note 4).

During the six months ended November 30, 2015, we acquired 1,555 lots for a total purchase price of \$125.0 million. We spent \$24.5 million on land development for the six months ended November 30, 2015. Additionally, we spent \$7.1 million during the six months ended November 30, 2015, to furnish model homes and sales offices, to build and furnish Design Studios and to update furnishings in existing communities.

Aggregate contractual commitments and off-balance sheet arrangements

There have been no significant changes outside the ordinary course of business to our contractual obligations under our debt agreements and lease payments as of November 30, 2015, compared to those contained in our audited consolidated financial statements for the year ended May 31, 2015. Our debt obligations are fully discussed in **Note 7** of our unaudited condensed consolidated financial statements as of November 30, 2015.

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 November 30, 2015, we had letters of credit and surety bonds outstanding of \$7.0 million and \$14.3 million, respectively. As of November 30, 2015, we had \$38.0 million of unused letters of credit capacity under the Restated Revolver.

During the quarter ended November 30, 2015, the Company signed a note payable to an unaffiliated third party that totaled \$2.3 million at November 30, 2015. The note matures in two years, is collateralized by the applicable land positions to which it relates, and has no recourse to any other assets.

At November 30, 2015, we controlled 12,625 lots and homes available to close. Of the 12,625 lots and homes controlled, we owned 37.0%, or 4,670 lots and homes, and 63.0%, or 7,955 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 November 30, 2015, these agreements had an aggregate remaining purchase price of \$628.1 million, net of deposits of \$65.5 million. In addition, we had purchase and option agreements recorded under ASC 360-20 or ASC 470-40 with an aggregate purchase price of \$49.2 million and cash deposits of \$10.1 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. As of November 30, 2015, one of these purchase agreements, which has an aggregate purchase price of \$42.2 million and a \$1.4 million deposit, provides the seller with a specific performance right against the Company, subject to certain conditions.

As of November 30, 2015, we recorded real estate not owned of \$47.6 million for eight lot purchase agreements. As of November 30, 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 in the unaudited condensed consolidated statements of income.

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. 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. Further, higher mortgage interest rates may accompany inflation and affect the affordability of mortgage financing for homebuyers. 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

There have been no significant changes to our critical accounting policies and estimates during the six months ended November 30, 2015, compared with those contained in Note 1 of our audited consolidated financial statements for the fiscal year ended May 31, 2015.

Transactions with related parties

See **Note 10** in our unaudited condensed consolidated financial statements as of November 30, 2015 and 2014 for transactions with related parties. Other than those noted below, the Company did not have any significant changes in or transactions with related parties during the first six months of fiscal year 2016. See the audited consolidated financial statements for the fiscal year ended May 31, 2015 for transactions existing at such date.

Land development agreement

The Company entered into a land development agreement with affiliates of the Company's majority equity holder and largest minority equity holder (the "Purchaser") for the development of a parcel of land and will be paid a fee for the oversight of the development. No payments were made to the Company during the quarter ended November 30, 2015, pursuant to the development agreement.

Pending accounting pronouncements

See **Note 2** in our unaudited condensed consolidated financial statements as of November 30, 2015.

Item 3. *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 November 30, 2015, we had outstanding borrowings of \$97.3 million under our senior secured revolving credit facility.

Item 4. *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.

PART II. OTHER INFORMATION

Item 1. *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.