NOT FILED WITH THE SEC

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. AND IN THE INDENTURE, DATED AS OF AUGUST 8, 2017 GOVERNING THE 6.750% SENIOR NOTES DUE 2025 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 August 31, 2017

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	**37-1590746**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
1405 Old Alabama Road Suite 200 Roswell, GA	**30076**
(Address of Principal Executive Offices)	(Zip Code)

(770) 998-9663

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:	Securities registered pursuant to Section 12(g) of the Act:
Title of Each Class	Title of Each Class
NONE	**NONE**

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

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

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

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

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

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company	Emerging growth company
[ ]	[ ]	[X]	[ ]	[ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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.
INDEX TO FORM 10-Q

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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 is comprised of the condensed consolidated balance sheet as of August 31, 2017, the related condensed consolidated statements of operations and cash flows for the three-month periods ended August 31, 2017 and August 31, 2016, and the condensed consolidated statement of members' equity for the three-month period ended August 31, 2017.

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 Consolidated Balance Sheet as of May 31, 2017

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, 2017, 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 20, 2017. In our opinion, the accompanying condensed consolidated balance sheet of Ashton Woods USA L.L.C. as of May 31, 2017, is consistent, in all material respects, with the consolidated balance sheet from which it has been derived.

Ernst & Young LLP

October 11, 2017

PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements*

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

	August 31, 2017	May 31, 2017
Assets:	(Unaudited)	
Cash and cash equivalents	$ —	$ —
Restricted cash	194	198
Receivables	8,763	10,719
Inventory	853,608	757,856
Real estate not owned	82,183	96,454
Property and equipment, net	19,553	21,184
Investments in unconsolidated entities	9,098	9,034
Deposits on real estate under option or contract	56,637	55,385
Other assets	23,311	22,267
Total assets	$ 1,053,347	$ 973,097
Liabilities and members' equity:		
Liabilities:		
Accounts payable	$ 64,712	$ 63,470
Other liabilities	36,929	57,761
Customer deposits	33,532	28,845
Liabilities related to real estate not owned	62,971	72,639
Debt	561,463	437,179
Total liabilities	759,607	659,894
Members' equity:	293,740	313,203
Total liabilities and members' equity	$ 1,053,347	$ 973,097

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three months ended	
	August 31, 2017	August 31, 2016
	(Unaudited)	
Revenues:		
Home sales	$ 254,087	$ 213,652
Land sales	572	130
	254,659	213,782
Cost of sales:		
Cost of sales - homes	209,298	177,242
Cost of sales - land	574	128
	209,872	177,370
Gross profit	44,787	36,412
Other expense (income):		
Selling, general and administrative	40,615	34,285
Interest expense	3,391	3,130
Depreciation and amortization	3,170	3,362
Loss from early extinguishment of debt	5,263	—
Other income	(1,267)	(1,096)
	51,172	39,681
Equity in earnings in unconsolidated entities	272	117
Net loss	$ (6,113)	$ (3,152)

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, 2017	$ 115,700	$ 24,714	$ 172,789	$ 313,203
Net loss	(2,379)	(585)	(3,149)	(6,113)
Distributions	(5,195)	(1,277)	(6,878)	(13,350)
Members' equity at August 31, 2017	$ 108,126	$ 22,852	$ 162,762	$ 293,740

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three months ended	
	August 31, 2017	August 31, 2016
	(Unaudited)	
Cash flows from operating activities:		
Net loss	$ (6,113)	$ (3,152)
Adjustments to reconcile net loss to net cash used in operating activities:		
Equity in earnings in unconsolidated entities	(272)	(117)
Returns on investments in unconsolidated entities	—	99
Decrease in liability for long-term compensation	516	202
Loss on early extinguishment of debt	5,263	—
Depreciation and amortization	3,170	3,362
Changes in operating assets and liabilities:		
Inventory	(95,737)	(77,290)
Receivables	1,956	8,037
Deposits on real estate under option or contract	(1,252)	917
Real estate not owned, net	4,603	232
Other assets	1,566	2,150
Accounts payable	1,242	(9,730)
Other liabilities	(21,449)	(16,280)
Customer deposits	4,687	2,850
Net cash used in operating activities	(101,820)	(88,720)
Cash flows from investing activities:		
Returns of investments in unconsolidated entities	309	79
Investments in unconsolidated entities	—	(98)
Additions to property and equipment	(1,602)	(2,670)
Changes in restricted cash	4	50
Net cash used in investing activities	(1,289)	(2,639)
Cash flows from financing activities:		
Borrowings from revolving credit facility	312,100	257,900
Repayments of revolving credit facility	(334,512)	(157,118)
Proceeds from issuance of 6.750% Notes	250,000	—
Repayment of 6.875% Notes	(100,000)	—
Payment of repayment premiums	(3,820)	—
Payments of debt issuance costs	(7,309)	(165)
Members' distributions	(13,350)	(9,258)
Net cash provided by financing activities	103,109	91,359
Change in cash and cash equivalents	—	—
Cash and cash equivalents, beginning of period	—	—
Cash and cash equivalents, end of period	$ —	$ —
Supplemental cash flow information:		
Cash paid for interest, net of amounts capitalized	$ 5,173	$ 5,108

See accompanying notes to unaudited condensed consolidated financial statements.

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 and Starlight Homes brand names. The Company offers entry-level, move-up, and multi-move-up homes under the Ashton Woods Homes brand name and offers additional entry-level homes under the Starlight 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, Austin, San Antonio, and Phoenix

The Company also offers title services to its homebuyers in its Dallas, San Antonio, Austin, Houston, Orlando, Southwest Florida, Raleigh, and Atlanta operating divisions through two wholly-owned title agencies.

In addition, the Company offers residential mortgage services to its homebuyers and the public at large in Austin, Dallas, Houston, San Antonio, and Phoenix through a mortgage joint venture. The Company has an ownership interest of 49% in the joint venture.

(b) Basis of presentation

The accompanying 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 statement of cash flows, the change in real estate not owned, net has been reclassified from other assets. 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") ASC Subtopic 360-10, *Property, Plant and Equipment*. The Company reviews its inventory in accordance with ASC Subtopic 360-10, which requires long-lived assets to be assessed for impairment when facts and circumstances indicate an impairment may exist. The Company utilizes an undiscounted future cash flow model in this assessment. When the results of the undiscounted future cash flows are less than the carrying value of the community (asset group), an asset impairment must be recognized in the consolidated financial statements as a component of cost of sales. The amount of the impairment is calculated by subtracting the estimated fair value, less cost to sell, of the community from the carrying value. ASC Subtopic 360-10 also requires that assets held for sale be stated at the lower of cost or fair value less costs to sell. Accordingly, land held for sale is stated at the lower of accumulated cost or fair value less costs to sell.

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

(e) Receivables

Receivables at August 31, 2017 and May 31, 2017 consisted of the following (in thousands):

	August 31, 2017	May 31, 2017
Closing funds due	$ 611	$ 2,743
Land development receivables	2,092	1,854
MUD receivables (1)	3,769	3,689
Other receivables (2)	2,291	2,433
	$ 8,763	$ 10,719

(1) Includes certain land development costs to be reimbursed by three Municipal Utility Districts in Houston, Texas.

(2) Includes amounts due from utility companies, insurance companies, refundable deposits, and drawn amounts due from salespersons.

(f) Real estate not owned

Real estate not owned reflects 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 5).

(g) Investments in unconsolidated entities

The Company participates in two 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 third parties is recognized immediately and included within equity in earnings in unconsolidated entities in the consolidated statements of operations (see Note 7).

The Company also offers title services to its homebuyers in its Dallas, San Antonio, Austin, Houston, Orlando, Southwest Florida, Raleigh, and Atlanta operating divisions through two wholly-owned title agencies.

In addition, the Company offers residential mortgage services to its homebuyers and the public at large in Austin, Dallas, Houston, San Antonio, and Phoenix through a mortgage joint venture. The Company has an ownership interest of 49% in the joint venture. The Company's investment in this mortgage joint venture is accounted for under the equity method.

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 in the consolidated balance sheets as deposits on real estate under option contract (for deposits) and other assets (for pre-acquisition costs) until the related land is acquired. These costs are transferred to inventory at the time the land or lots are acquired. Nonrefundable deposits and pre-acquisition costs are charged to expense when the real estate purchase is no longer considered probable. If the Company intends to terminate a purchase agreement, it records a charge to earnings for these costs associated with the purchase agreement in the period such a decision is made. This expense is included as a component of cost of sales – homes in the consolidated statements of operations and was \$0.1 million and \$0.4 million for the three months ended August 31, 2017 and 2016, 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 August 31, 2017 and May 31, 2017 consisted of the following (in thousands):

	August 31, 2017	May 31, 2017
Office furniture and equipment	$ 3,922	$ 3,866
Sales offices, design studios, and model furnishings	45,328	45,534
Leasehold improvements	1,856	1,833
	51,106	51,233
Accumulated depreciation and amortization(1)	(31,553)	(30,049)
	$ 19,553	$ 21,184

(1) Net of retirements and disposals.

Depreciation and amortization expense approximated \$3.2 million and \$3.4 million for the three months ended August 31, 2017 and 2016, respectively.

(j) Revenue recognition

Revenues from homebuilding and land sales are recognized at the time of the closing of each sale, when title to and possession of the property are transferred to the buyer. Internal and external sales commissions are included in selling, general and administrative expenses in the consolidated statement of operations. Typically, all homebuilding and land net sales proceeds are received in cash within two business days of closing.

(k) Prepaid expenses

Included in other assets are prepaid expenses of approximately \$7.8 million and \$8.7 million as of August 31, 2017 and May 31, 2017, 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 consolidated balance sheets.

Presented below are summaries of the activity in the Company's warranty liability account for the three months ended August 31, 2017 and 2016 (in thousands):

	Three months ended	
	August 31, 2017	August 31, 2016
Warranty liability, beginning of period	$ 9,877	$ 9,431
Costs accrued during period	2,285	2,158
Costs incurred during period	(3,048)	(2,702)
Warranty liability, end of period	$ 9,114	$ 8,887

(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 consolidated statements of operations, was approximately $2.4 million and $1.6 million for the three months ended August 31, 2017 and 2016, 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 issued prior to June 1, 2016 are accounted for pursuant to ASC Subtopic 718-30, *Compensation – Awards Classified as Liabilities*, as the value of such shares is based, in part, on the price of the shares of a comparable set of public builders. The Company's performance shares issued on or after June 1, 2016 are accounted for pursuant to ASC Subtopic 710-10-25-9 to 25-11, *Deferred Compensation Arrangements*, as the value is not based on the shares of a comparable set of public builders or other equity instruments, but is based on the book value of equity of the Company. The Company measures the value of the performance shares on a quarterly basis using the intrinsic value method. Additional compensation expense may be recognized subsequent to completion of the vesting period for appreciation-only performance shares. See Note 12 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 distributions 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 indentures governing its 6.875% Senior Notes due 2021 (the "6.875% Notes") and its 6.750% Senior Notes due 2025 (the "6.750% Notes"). Any tax distributions made to the Members are treated as a reduction of equity. The Company made distributions to its Members of $13.4 million and $9.3 million during the three months ended August 31, 2017 and 2016, respectively.

(p) Use of estimates

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

(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, Austin, 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 15 for further discussion of the Company's reportable segments.

(r) Subsequent events

The Company has evaluated subsequent events through October 11, 2017. This date represents the date on which the consolidated financial statements were available to be issued.

Note 2 — Debt Transactions

On July 24, 2017, the Company and Ashton Woods Finance Co. launched a tender offer (the "Tender Offer") for $100.0 million principal amount of their outstanding 6.875% Notes. Holders of $246.8 million aggregate principal amount of outstanding 6.875% Notes validly tendered their 6.875% Notes on or before the Early Tender Date of August 4, 2017. The Company accepted for purchase 6.875% Notes with an aggregate principal amount of $100.0 million, the maximum amount subject to the Tender Offer. Holders of 6.875% Notes validly tendered as of the Early Tender Date and accepted for purchase in accordance with the terms of the Tender Offer received payment of the Total Consideration ($1,038.20) per $1,000.00 principal amount of tendered 6.875% Notes, plus accrued and unpaid interest from the last interest payment date to, but not including, the settlement date.

On August 8, 2017, the Company and its wholly owned subsidiary, Ashton Woods Finance Co., issued and sold $250.0 million aggregate principal amount of their 6.750% Notes through a private placement to qualified institutional buyers pursuant to Rule 144A and Regulation S, promulgated under the Securities Act of 1933, as amended. The 6.750% Notes were issued at a price of 100.00% of the principal amount to yield 6.750%.

The net proceeds of the 6.750% Notes were used by the Company to pay the purchase price to the holders of the 6.875% Notes who validly tendered and did not withdraw 6.875% Notes in the Tender Offer by the Early Tender Date, to repay a portion of the indebtedness outstanding under the Company's senior secured revolving credit facility, and to pay accrued and unpaid interest and prepayment premiums payable on any of the foregoing.

The Company recorded a $5.3 million loss on the early extinguishment of debt during the three months ended August 31, 2017, comprised of a write-off of $1.0 million of unamortized deferred financing fees related to the 6.875% Notes, $0.5 million of unamortized original issue discount on the 6.875% Notes, and the payment of $3.8 million in repayment premiums. The Company incurred deferred financing fees during the three months ended August 31, 2017 of $5.2 million related to the issuance of the 6.750% Notes.

See Note 8 for further discussion of the Company's debt.

Note 3 — 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 and interim periods within annual periods beginning after December 15, 2019. The Company is currently evaluating the impact that ASU 2014-09 will have on its consolidated financial statements and related disclosures.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities* ("ASU 2016-01"), which updates certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The effective date for ASU 2016-01 for the Company is for annual periods beginning after December 15, 2018. The Company is currently evaluating the impact that ASU 2016-01 will have on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases* ("ASU 2016-02"), which requires, among other things, that lessees recognize the assets and liabilities arising from operating leases on the balance sheet. The effective date of ASU 2016-02 for the Company is for annual periods beginning after December 15, 2019, and for annual and interim periods thereafter. The Company is currently evaluating the impact that ASU 2016-02 will have on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued Accounting Standards Update No. 2016-07, *Investments - Equity Method and Joint Ventures* ("ASU 2016-07"), which eliminates the requirement to apply the equity method of accounting retrospectively when a reporting entity obtains significant influence over a previously held investment. The effective date of ASU 2016-07 for the Company is for annual and interim periods beginning after December 15, 2016. The Company's adoption of ASU 2016-07 did not have a material effect on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, *Compensation - Stock Compensation (Topic 718)* ("ASU 2016-09"), which simplifies several aspects related to the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification in the statement of cash flows. The effective date of ASU 2016-09 for the Company is for annual periods beginning after December 15, 2017. The Company is currently evaluating the impact that ASU 2016-09 will have on its consolidated financial statements and related disclosures.

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* ("ASU 2016-15"), which addresses several specific cash flow issues. The effective date of ASU 2016-15 for the Company is for annual periods beginning after December 15, 2018, with early adoption permitted, and requires full retrospective application on adoption. The Company is currently evaluating the impact that ASU 2016-15 will have on its consolidated financial statements and related disclosures.

In October 2016, the FASB issued Accounting Standards Update No. 2016-17, *Consolidation (Topic 810): Interests Held through Related Parties That Are under Common Control* ("ASU 2016-17") which amends the consolidation guidance on how a reporting entity that is the single decision maker of a variable interest entity ("VIE") should treat indirect interests in the entity held through related parties that are under common control with the reporting entity when determining whether it is the primary beneficiary of that VIE. The effective date of ASU 2016-17 for the Company is for annual periods beginning after December 15, 2016, with early adoption permitted. The Company's adoption of ASU 2016-17 did not have a material effect on its consolidated financial statements and related disclosures.

In November 2016, the FASB issued Accounting Standards Update No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* ("ASU 2016-18"), which provides specific guidance on the cash flow classification and presentation of changes in restricted cash and restricted cash equivalents. The effective date of ASU 2016-18 for the Company is for annual periods beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact that ASU 2016-18 will have on its consolidated financial statements and related disclosures.

Note 4 — Inventory

Inventory consisted of the following at August 31, 2017 and May 31, 2017 (in thousands):

	August 31, 2017	May 31, 2017
Homes under construction and finished homes	$ 506,056	$ 432,231
Finished lots	276,044	277,481
Land under development	41,646	27,265
Land held for sale	2,515	2,515
Land held for future development	27,337	18,354
Commercial land	10	10
	$ 853,608	$ 757,856

The Company capitalizes all interest incurred to the extent its qualifying assets meet or 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 $3.4 million and $3.1 million for the three months ended August 31, 2017 and 2016, respectively, in the consolidated statements of operations.

The following table summarizes interest costs incurred, charged to cost of sales and directly expensed during the three months ended August 31, 2017 and 2016 (in thousands):

	Three months ended	
	August 31, 2017	August 31, 2016
Capitalized interest, beginning of period	$ 10,813	$ 9,951
Interest incurred	9,296	8,374
Interest amortized to cost of sales	(4,308)	(3,885)
Interest expensed	(3,391)	(3,130)
Capitalized interest, end of period	$ 12,410	$ 11,310

Note 5 — Real Estate Not Owned

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

Pursuant to ASC Subtopic 810, *Consolidations* ("*ASC 810*"), when the Company enters into a purchase agreement to acquire land or lots from an entity and pays a non-refundable deposit, the Company has concluded that a VIE, for which consolidation is required, may be created because it is deemed to have provided subordinated financial support that will absorb some or all of an entity's expected losses if they occur. For each VIE, the Company assesses whether it is the primary beneficiary of the VIE 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 August 31, 2017 and May 31, 2017, 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 August 31, 2017 and May 31, 2017, the Company recorded real estate not owned of $18.3 million and $20.2 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 two lot purchase agreements with two separate unaffiliated investor groups and has accounted for them pursuant to ASC 470-40. At August 31, 2017 and May 31, 2017, the Company recorded real estate not owned of $63.9 million and $76.2 million, respectively, related to the lot purchase agreements accounted for pursuant to ASC 470-40.

Note 6 — Other Assets

Other assets at August 31, 2017 and May 31, 2017 consisted of the following (in thousands):

	August 31, 2017	May 31, 2017
Prepaid expenses	$ 7,827	$ 8,714
Architecture plans	7,881	8,133
Deferred financing fees	3,896	2,277
Pre-acquisition costs	2,052	1,572
Other deposits	1,655	1,571
	$ 23,311	$ 22,267

Architecture plans are comprised of the costs incurred related to architecture plans, associated engineering costs, and interactive floor plans for house plans and are amortized through cost of sales on a per closing basis.

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

Deferred financing fees included in other assets are comprised of costs incurred in connection with obtaining financing for the senior secured revolving credit facility. Deferred financing fees are amortized as interest over the terms of the related financing arrangement using the effective interest method. The Company incurred deferred financing fees during the three months ended August 31, 2017 of $2.1 million as a result of the amendment to the Company's senior secured revolving credit facility as discussed below in Note 8, and $0.2 million during the three months ended August 31, 2016 as a result of the Company partially exercising the accordion feature under the Company's senior secured revolving credit facility to increase the total commitments.

Note 7 — Investments in Unconsolidated Entities

The Company enters into land joint ventures from time to time as a means of accessing larger parcels of land and lot positions, managing its risk profile and leveraging its capital base. As of August 31, 2017, the Company participated in two 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.

As of August 31, 2017, the Company had equity investments of less than 50% in each of its two land joint ventures and did not have a controlling interest in these unconsolidated entities. The Company and/or its land joint venture partners will typically 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 with an affiliate of certain of the beneficial owners of the Company's equity or their affiliates (individually and collectively, the "Investors"). The Company has a 49% limited partner interest in this joint venture that is accounted for under the equity method. As of August 31, 2017, the Company had recorded $7.8 million for its investment in this unconsolidated entity in the consolidated balance sheet. The Company entered into a services agreement with the joint venture to provide accounting and administrative services to the joint venture. The Company receives a monthly fee of $6,000 for these services that is included in other income in the consolidated statements of operations. 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 August 31, 2017, the total purchase price of lots remaining to be purchased under this agreement was approximately $6.9 million. As of August 31, 2017, the joint venture had no debt outstanding.

During the year ended May 31, 2017, the Company offered title services to its homebuyers in its Houston operating division through ownership in a title joint venture. The Company has an ownership interest of 49% in the joint venture, which is managed by the majority owner with whom the underwriting risks associated with the title insurance reside. During the three months ended August 31, 2017, the joint venture ceased operations and began winding down.

The Company offers residential mortgage services to its homebuyers and the public at large in Austin, Dallas, Houston, and San Antonio through a mortgage joint venture. The Company has an ownership percentage of 49% in this joint venture and has accounted for it under the equity method. The debt of the mortgage joint venture is non-recourse to the Company.

Summarized unaudited financial information related to unconsolidated entities that are accounted for using the equity method as of August 31, 2017 and May 31, 2017 and for the three months ended August 31, 2017 and 2016 was as follows (in thousands):

	August 31, 2017	May 31, 2017
Assets:		
Cash	$ 4,185	$ 2,645
Mortgage notes receivable	3,725	15,518
Real estate	17,756	20,344
Other	1,408	162
Total assets	$ 27,074	$ 38,669
Liabilities:		
Liabilities:		
Accounts payable and other accruals	$ 2,847	$ 2,862
Notes payable [(1)]	4,804	16,742
Total liabilities	7,651	19,604
Equity	19,423	19,065
Total liabilities and equity	$ 27,074	$ 38,669

(1) Comprised of $4.8 million outstanding on two warehouse lines at August 31, 2017.

	Three months ended	
	August 31, 2017	August 31, 2016
Revenues:		
Lot sales	$ 3,592	$ 3,999
Financial services	1,054	—
Total revenues	$ 4,646	$ 3,999
Expenses:		
Lot sales	$ 38	$ 175
Financial services	249	—
Total expenses	$ 287	$ 175
Net earnings	$ 988	$ 598

Note 8 — Debt

Debt at August 31, 2017 and May 31, 2017 consisted of the following (in thousands):

		August 31, 2017		May 31, 2017
6.875% Notes (1)	$	246,392	$	344,560
6.750% Notes (2)		244,849		—
Senior secured revolving credit facility		61,988		84,400
Notes payable		8,234		8,219
	$	561,463	$	437,179

(1) Net of \$2.5 million and \$3.7 million, respectively, of unamortized deferred financing costs as of August 31, 2017 and May 31, 2017.

(2) Net of \$5.2 million of unamortized deferred financing costs as of August 31, 2017.

The 6.875% Notes

On August 18, 2017, pursuant to the Tender Offer, the Company purchased \$100.0 million aggregate principal of the Company's issued and outstanding \$350 million principal amount of 6.875% Notes with the proceeds from the issuance of the 6.750% Notes, as discussed below. At August 31, 2017, 6.875% Notes in the aggregate principal amount of \$250 million were outstanding.

The 6.875% Notes mature on 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 Company's senior secured revolving credit facility, 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 indenture governing the 6.875% Notes gives the Company 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, 2019, 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 (b) 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.

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 August 31, 2017, the Company was in compliance with the covenants in the indenture governing the 6.875% Notes.

The 6.750% Notes

On August 8, 2017, the Company issued \$250 million principal amount of 6.750% Notes in a private offering pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended. The 6.750% Notes were issued at a price of 100.00% of the principal amount to yield 6.750%.

The 6.750% Notes mature on August 1, 2025. Interest is payable on February 1 and August 1 of each year, commencing February 1, 2018. The 6.750% 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 all the Company's existing and future subordinated debt. The 6.750% Notes are effectively subordinated to any of the Company's existing and future secured debt, including the senior secured revolving credit facility, to the extent of the value of the assets securing such debt. The obligations under the 6.750% 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. All of the Company's subsidiaries with a book value of more than $2.0 million are Restricted Subsidiaries with respect to the 6.750% Notes, with the exception of AW Mortgage Holdings L.L.C., which has been designated an Unrestricted Subsidiary pursuant to the indenture governing the 6.750% Notes.

The Company has the option to redeem the 6.750% Notes at any time or from time to time, in whole or in part, (a) until August 1, 2020, 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 an applicable premium as defined in the indenture governing the 6.750% Notes, (b) on or after August 1, 2020, at certain redemption prices set forth in the indenture governing the 6.750% Notes together with accrued and unpaid interest thereon, if any, to and excluding the redemption date, and (c) on or after August 1, 2023, at 100% of the principal amount to be redeemed, together with accrued and unpaid interest thereon, if any, to and excluding the redemption date.

The indenture governing the 6.750% 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 August 31, 2017, the Company was in compliance with the covenants in the indenture governing the 6.750% Notes.

Senior Secured Revolving Credit Facility

On June 23, 2017, the Company amended its senior secured revolving credit facility by entering into its First Amendment to Fifth Amended and Restated Credit Agreement (as amended, the "Restated Revolver"), providing for, among other things, (i) an aggregate revolving loan commitment of up to $350.0 million with up to $45.0 million available for the issuance of letters of credit and a $10.0 million swingline facility, and with an accordion feature to permit the size of the facility to be increased in the future up to $400.0 million (dependent upon Company needs and available lender commitments), (ii) a maturity date of December 31, 2020, (iii) modify certain covenants, and (iv) increase borrowing base advance rates. The Restated Revolver limits the principal amount of the aggregate commitment available at any time to the amount that is supported by the permitted lien basket in the indentures governing the Company's 6.750% Notes and 6.875% Notes, which is 30% of Consolidated Tangible Assets, as defined therein.

Interest accrues on borrowings under the Restated Revolver at the London Interbank Offered Rate (LIBOR) plus an applicable margin that ranges from 305 to 375 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 305 to 375 basis points if not secured by cash. The Restated Revolver has a maturity date of December 31, 2020, 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 August 31, 2017, the Company was in compliance with the covenants in the Restated Revolver.

At August 31, 2017, there was $62.0 million outstanding under the Restated Revolver and $7.0 million of letters of credit outstanding. As of August 31, 2017, and subject to a borrowing base formula, the Company had available additional borrowing capacity of $244.1 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.

Notes Payable

On November 19, 2015, the Company issued a $2.3 million note payable to an unaffiliated third party which matures on November 19, 2017. The non-interest bearing note is collateralized by the land to which it relates and has no recourse to any other assets or the Company. At August 31, 2017, the outstanding note payable balance totaled $2.3 million.

On September 23, 2016, the Company issued a $5.8 million note payable to an unaffiliated third party which initially matured on September 23, 2017. The note payable was modified prior to maturity, has an interest rate of 6.00%, and matures on January 2, 2018. The note is collateralized by the land to which it relates and has no recourse to any other assets or the Company. At August 31, 2017, the outstanding note payable balance, including accrued interest, totaled $5.9 million.

Note 9 — Other Liabilities

Other liabilities at August 31, 2017 and May 31, 2017 consisted of the following (in thousands):

	August 31, 2017	May 31, 2017
Salaries, bonuses and benefits	$ 8,118	$ 20,993
Accrued interest	2,482	7,884
Warranty accruals	9,114	9,877
Accrued long-term compensation	3,195	4,223
Other	14,020	14,784
	$ 36,929	$ 57,761

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

The Second Amended and Restated Regulations (as amended, the "Regulations") of Ashton Woods created three classes of members and associated membership interests as follows: (1) Class A Membership Interest, which is 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 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.

At August 31, 2017, 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	1,918,979	9.31%	97.27%
Class C	8,167,244	39.59%	76.84%
Total Little Shots Nevada L.L.C.	18,113,423	87.81%	
Various Holders			
Class B	53,821	0.26%	2.73%
Class C	2,461,485	11.93%	23.16%
	20,628,729	100.00%	

Note 11 — Transactions with Related Parties

Services agreement

The Company is a party to a services agreement with the Investors that 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 fees of $800 per home closing quarterly, in arrears, for these services, which are included in selling, general and administrative expenses in the consolidated statements of operations. During the three months ended August 31, 2017 and 2016 the Company incurred fees of $0.5 million and $0.4 million, respectively, under the services agreement. As of August 31, 2017 and 2016, the balance due to the Investors was $0.5 million and $0.4 million, respectively.

Lease

The Company is a party to a lease as a lessee with the Investors to rent approximately 8,000 square feet of commercial space in Dallas, Texas. The initial term of the lease was 66 months, with 40 months remaining as of August 31, 2017. The Company has the option to renew the lease for one additional five-year term. Total minimum lease payments due under the lease were $0.3 million and $0.4 million as of August 31, 2017 and 2016, respectively.

Lot purchase agreements

The Company is a party to five lot purchase agreements with the Investors. A 10% deposit was required under each of the purchase agreements, and there are no specific performance requirements for the Company. Three of these lot purchase agreements are required to be recorded as real estate not owned in the consolidated balance sheets. As of August 31, 2017, the total purchase price of lots remaining to be purchased under such agreements was approximately $17.0 million.

Joint venture

The Company is a party to a land joint venture with the Investors, which is 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, the Company is a party to a lot purchase agreement with the joint venture to purchase 60 lots. A 10% deposit was required under the purchase agreement and there are no specific performance requirements for the Company. As of August 31, 2017, the total purchase price of lots remaining to be purchased was $6.9 million. As of August 31, 2017, the joint venture had no debt outstanding.

Offsite road improvements agreement

During the year ended May 31, 2016, the Company entered into a joint development agreement with an affiliate of the Company's largest minority equity holder for the construction of offsite road improvements adjacent to a land parcel. The Company will be paid a fee for the oversight of the improvements. Work commenced during the year ended May 31, 2017. As of August 31, 2017, the Company has been paid $0.2 million under this agreement.

Note 12 — Long-Term Incentive Plan

In July 2012, the Board of Directors adopted the Ashton Woods USA L.L.C. 2013 Performance Share Plan (the "2013 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 "First Amended Plan"), and in July 2016, the Board of Directors adopted the Second Amended and Restated Performance Share Plan, with an effective date of June 1, 2016 (the "Second Amended Plan") (together with the 2013 Plan and the First Amended 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. In each July of 2013 through 2017, the Board of Directors awarded outstanding performance shares to the Company's executive officers, and certain members of the corporate and operating division senior management teams.

The value of a performance share awarded under the 2013 Plan and the First Amended 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 hypothetical shares as defined by the Plan. The value of a performance share under the Second Amended Plan is determined by dividing the Company's book value, as defined under the Plan, by the number of hypothetical shares as defined by the Plan. Generally, except as determined by the Board upon grant, performance shares awarded 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 performance shares as of August 31, 2017:

	Full-value shares	Appreciation-only shares	Total shares
Outstanding performance shares as of May 31, 2017	164,135	432,764	596,899
Performance shares awarded during the period	79,762	159,524	239,286
Fully vested performance shares paid	(39,185)	(38,883)	(78,068)
Total outstanding performance shares as of August 31, 2017	204,712	553,405	758,117
Total vested performance shares as of August 31, 2017	56,188	256,353	312,541

The Company has elected to account for performance shares awarded under the Plan using the intrinsic value method. The Company's liability for performance shares awarded under the Plan is remeasured quarterly to reflect the intrinsic value of the performance shares awarded 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 performance shares is included in selling, general and administrative expenses in the consolidated statements of operations.

The total number of performance shares vested as of August 31, 2017 and May 31, 2017 was 312,541 and 384,053, respectively. For the three months ended August 31, 2017 and 2016, the Company recorded $0.5 million and $0.2 million, respectively, in compensation expense associated with the full-value and appreciation-only performance shares.

For the three months ended August 31, 2017 and 2016, $1.5 million (78,068 units) and $1.3 million (74,000 units), respectively, of vested performance shares were paid out to employees. As of August 31, 2017 and May 31, 2017, the Company's liability for the performance shares was $3.2 million and $4.2 million, respectively, which is recorded in other liabilities in the consolidated balance sheets.

Note 13 — 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, notes payable, and the Restated Revolver, as reported in the accompanying consolidated balance sheets, approximate their fair values due to their short-term maturity or floating interest rate terms, as applicable. The factors considered in determining fair values of the Company's communities when necessary under ASC 360 are described in the discussion of the Company's inventory impairment analysis (see Note 1), and are classified as Level 3 valuations.

The following table presents the carrying amounts and estimated fair values of the Company's 6.750% Notes and 6.875% Notes at August 31, 2017 and May 31, 2017:

		August 31, 2017		May 31, 2017	
	Fair Value Hierarchy	Carrying Amount	Fair Value	Carrying Amount	Fair Value
		(in thousands)			
Liabilities:					
6.750% Notes	Level 2	$ 244,849	$ 248,125	$ —	$ —
6.875% Notes	Level 2	246,392	256,875	344,560	356,125
		$ 491,241	$ 505,000	$ 344,560	$ 356,125

The Company's 6.750% Notes and 6.875% Notes are recorded at their carrying values in the consolidated balance sheets, which may differ from their respective fair values. The carrying values of the Company's 6.750% Notes and 6.875% Notes reflect their face amount, adjusted for any unamortized debt issuance costs and discount. The fair values of the 6.750% Notes and 6.875% Notes are derived from quoted market prices by independent dealers (Level 2).

Note 14 — 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 these ordinary course matters 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.

In addition, on June 27, 2016, FCC Marsh, LLC (the "Seller") filed a complaint against the Company in the Circuit Court for Collier County, Florida, alleging that the Company breached a lot purchase agreement that provided the Seller with a specific performance right against the Company, subject to certain conditions, by allegedly failing to close on certain lot purchases. The Seller has dismissed its claim for specific performance, and seeks declaratory relief and damages. The Company filed a counterclaim seeking declaratory relief, return of the earnest money deposit and foreclosure of the mortgage that secures that deposit, and amended its counterclaim, adding a claim for breach of contract and damages based on the Company's claim that the Seller breached the terms of a lease agreement between the parties. While it is premature to predict the ultimate outcome of these proceedings, the Company intends to vigorously defend the lawsuit and pursue its claims against the Seller.

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 August 31, 2017 and May 31, 2017, the Company had letters of credit outstanding of $7.0 million and $4.0 million, respectively, and surety bonds outstanding of $19.6 million and $23.5 million, respectively. As of August 31, 2017, the Company had $38.0 million of unused letter of credit capacity under the Restated Revolver.

The Company enters into various option purchase agreements to acquire land. In connection with such agreements, as of August 31, 2017, the Company has made nonrefundable deposits of $75.2 million, which includes $19.2 million of nonrefundable deposits related to purchase and option agreements consolidated under ASC 360-20 or ASC 470-40 (See Note 5). 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 $557.8 million as of August 31, 2017.

Note 15 — 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, Austin, San Antonio, and Phoenix

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

	Three months ended	
	August 31, 2017	**August 31, 2016**
Revenues:		
Homebuilding:		
East	$ 122,523	$ 120,297
Central	131,564	93,355
Consolidated revenues	$ 254,087	$ 213,652
Gross profit:		
Homebuilding:		
East	$ 21,227	$ 19,627
Central	23,562	16,783
Consolidated gross profit	$ 44,789	$ 36,410

	Three months ended	
	August 31, 2017	August 31, 2016
Depreciation and amortization:		
East	$ 1,492	$ 1,801
Central	1,597	1,480
Consolidated depreciation and amortization	$ 3,089	$ 3,281
Equity in earnings in unconsolidated entities:		
East	$ —	$ —
Central	272	117
Consolidated equity in earnings in unconsolidated entities	$ 272	$ 117
Net (loss) income:		
East	$ (303)	$ (476)
Central	2,993	453
	2,690	(23)
Other (1)	(8,803)	(3,129)
Consolidated net loss	$ (6,113)	$ (3,152)

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

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

	August 31, 2017	May 31, 2017
Assets:		
Homebuilding:		
East	$ 588,733	$ 561,893
Central	457,136	405,105
	1,045,869	966,998
Other (2)	7,478	6,099
Consolidated assets	$ 1,053,347	$ 973,097

(2) "Other" is comprised of restricted cash and corporate assets.

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	
	August 31, 2017	August 31, 2016
Additions to property and equipment:		
Homebuilding:		
East	$ 783	$ 1,420
Central	797	1,250
	1,580	2,670
Other (3)	22	—
Consolidated additions to property and equipment	$ 1,602	$ 2,670

(3) "Other" is comprised of property and equipment additions for the Company's 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 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:

- Reversal of homebuilding recovery or decline in economic conditions;
- 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, impact inflation, consumer confidence and consumer preferences;
- Government regulatory actions, which could affect tax laws and could result in delays or increased costs in obtaining necessary permits and complying with environmental laws;
- Timing of permits and other regulatory approvals;
- Our substantial indebtedness and our ability to comply with the related financial and other covenants and our ability to obtain replacement financing as these instruments mature;
- The cost and availability of insurance and the level of warranty claims;
- 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, including those discussed in our annual report on Form 10-K for the fiscal year ended May 31, 2017, and over which the Company has little or no control.

Overview

We design, build, and market attached and detached single-family homes in six states under the Ashton Woods Homes and Starlight Homes brand names. The Company offers entry-level, move-up, and multi-move-up homes under the Ashton Woods Homes brand name and offers additional entry-level homes under the Starlight Homes brand name.

During the three months ended August 31, 2017, we closed 632 homes. Of those closings, 567 (90%) were single-family detached product, while the remaining 65 (10%) of the homes closed were single-family attached product.

During the three months ended August 31, 2017, 158 (25%) of the homes closed were considered entry-level, compared to 65 (13%) closed during the three months ended August 31, 2016. The increase in entry-level closings was driven by the east segment, with 102 (34%) of the homes closed during the three months ended August 31, 2017 considered entry-level, compared to 52 (20%) for the three months ended August 31, 2016. The central segment had an increase in the percentage of entry-level closings from 13 (6%) for the three months ended August 31, 2016 to 56 (17%) for the three months ended August 31, 2017.

Of our 137 active communities as of August 31, 2017, we consider 115 (84%) to be move-up or multi-move-up communities and 22 (16%) to be entry-level communities, compared to 105 (89%) that we consider to be move-up or multi-move-up communities and 13 (11%) that we considered to be entry-level communities out of our 118 active communities as of August 31, 2016. Both the east and central segments had an increase in the number and percentage of communities that we consider to be entry-level at August 31, 2017, compared to August 31, 2016.

During the three months ended August 31, 2017, the Company added 11 new active communities while closing out 6 communities. Of the 11 active communities added during the three months ended August 31, 2017, four are considered to be entry-level.

Results of operations

The consolidated financial statements included herein have been prepared in accordance with GAAP and in accordance with Article 10 of Regulation S-X.

	Three months ended	
	August 31, 2017	August 31, 2016
Revenues:	(in thousands)	
Home sales	$ 254,087	$ 213,652
Land sales	572	130
	$ 254,659	$ 213,782
Gross profit:		
Home sales	$ 44,789	$ 36,410
Land sales	(2)	2
	$ 44,787	$ 36,412
Selling, general and administrative	$ 40,615	$ 34,285
Net loss (1)	$ (6,113)	$ (3,152)

(1) Because we are structured as a limited liability company, income tax obligations are paid by our Members and are not borne by us. As a limited liability company, we periodically make distributions to our Members. The Company made distributions of $13.4 million and $9.3 million during the three months ended August 31, 2017 and 2016 respectively.

	Three months ended	
	August 31, 2017	August 31, 2016
	($ in thousands)	
Supplemental data:		
Active communities at end of period	137	118
Net new home orders (in units)	801	695
Homes closed (in units) (2)	632	485
Average sales price per home closed	$ 402	$ 440
Backlog at end of period (in units)	1,539	1,389
Sales value of backlog at end of period	$ 696,155	$ 621,629
Home gross margin (3)	17.6%	17.0%
Adjusted home gross margin (4)	19.3%	18.9%
Ratio of selling, general and administrative expenses to home sales revenue	16.0%	16.0%
Interest incurred (5)	$ 9,296	$ 8,374
Adjusted EBITDA (6)	$ 10,019	$ 7,225
Adjusted EBITDA margin (6)	3.9%	3.4%
Total debt to total capitalization	66.0%	64.2%
Total net debt to net capitalization	66.0%	64.2%
Cancellation rate (as a percentage of gross sales)	15.1%	13.0%

(2) A home is included in "homes closed" when title to and possession of the property is transferred to the buyer. Revenues and cost of sales for a home are recognized at the time of the closing of a sale, when title to and possession of the property are transferred to the buyer.

(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	
	August 31, 2017	August 31, 2016
	(in thousands)	
Home sales revenues	$ 254,087	$ 213,652
Cost of sales homes	209,298	177,242
Home gross margin	44,789	36,410
Add: Inventory impairments	—	77
Interest amortized to cost of sales	4,308	3,885
Adjusted home gross margin	$ 49,097	$ 40,372
Ratio of home gross margin to home sales revenue	17.6%	17.0%
Ratio of adjusted home gross margin to home sales revenue	19.3%	18.9%

(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 months ended August 31, 2017 and 2016:

	Three months ended	
	August 31, 2017	August 31, 2016
	(in thousands)	
Capitalized interest, beginning of period	$ 10,813	$ 9,951
Interest incurred	9,296	8,374
Interest amortized to cost of sales	(4,308)	(3,885)
Interest expensed	(3,391)	(3,130)
Capitalized interest, end of period	$ 12,410	$ 11,310

(6) Adjusted EBITDA (earnings before interest, taxes, depreciation, and amortization further adjusted to eliminate a loss from early extinguishment of debt) 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. Adjusted 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 Adjusted EBITDA in the same manner as us, the Adjusted EBITDA information in this report may not be comparable to similar presentations by others. Adjusted EBITDA margin is calculated by dividing Adjusted EBITDA by total revenues.

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

	Three months ended	
	August 31, 2017	August 31, 2016
	(in thousands)	
Net loss	$ (6,113)	$ (3,152)
Depreciation and amortization	3,170	3,362
Interest amortized to cost of sales	4,308	3,885
Interest expensed	3,391	3,130
EBITDA	4,756	7,225
Loss from early extinguishment of debt	5,263	—
Adjusted EBITDA	$ 10,019	$ 7,225

Results of operations - Segments

We have grouped our homebuilding operating divisions into two reportable segments, east and central. At August 31, 2017, 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, Austin, San Antonio, and Phoenix

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

Net new home orders (units):

	Three months ended	
	August 31, 2017	August 31, 2016
East	365	389
Central	436	306
Company total	801	695

Homes closed (units):

	Three months ended	
	August 31, 2017	August 31, 2016
East	302	257
Central	330	228
Company total	632	485

Average sales price per home closed:

	Three months ended	
	August 31, 2017	August 31, 2016
	(in thousands)	
East	$ 406	$ 468
Central	$ 399	$ 409
Company average	$ 402	$ 440

Backlog (units) at end of period:

	As of August 31,	
	2017	2016
East	713	709
Central	826	680
Company total	1,539	1,389

Sales value of backlog at end of period:

	As of August 31,	
	2017	2016
	(in thousands)	
East	$ 342,402	$ 334,042
Central	353,753	287,587
Company total	$ 696,155	$ 621,629

Active communities:

	As of August 31,	
	2017	2016
East	68	56
Central	69	62
Company total	137	118

The Company presents adjusted home gross margin on a segment basis in this discussion. Adjusted home gross margin is a non-GAAP measure. The following is a reconciliation of home gross margin of our segments, the most directly comparable U.S. GAAP measure, to our segments' adjusted home gross margin:

	Three months ended	
	August 31, 2017	August 31, 2016
Homebuilding East:	(in thousands)	
Home sales revenues	$ 122,523	$ 120,297
Cost of sales homes	101,296	100,670
Home gross margin	21,227	19,627
Add: Inventory impairments	—	77
Interest amortized to cost of sales	2,242	2,174
Adjusted home gross margin	$ 23,469	$ 21,878
Ratio of home gross margin to home sales revenues	17.3%	16.3%
Ratio of adjusted home gross margin to home sales revenues	19.2%	18.2%
Homebuilding Central:		
Home sales revenues	$ 131,564	$ 93,355
Cost of sales homes	108,002	76,572
Home gross margin	23,562	16,783
Add: Inventory impairments	—	—
Interest amortized to cost of sales	2,066	1,711
Adjusted home gross margin	$ 25,628	$ 18,494
Ratio of home gross margin to home sales revenues	17.9%	18.0%
Ratio of adjusted home gross margin to home sales revenues	19.5%	19.8%

Results of operations - Discussion

Three Months Ended August 31, 2017 Compared to Three Months Ended August 31, 2016

Home sales revenues - Consolidated

Home sales revenues increased by 18.9% ($40.4 million) for the three months ended August 31, 2017 to $254.1 million from $213.7 million for the three months ended August 31, 2016. The increase in revenues for the three months ended August 31, 2017, as compared to the three months ended August 31, 2016, was due to an increase in the number of homes closed and was partially offset by a decrease in the average sales price of homes closed. The number of homes closed increased 30.3% in the three months ended August 31, 2017 to 632 compared to 485 for the three months ended August 31, 2016. The average sales price of homes closed decreased 8.6% in the three months ended August 31, 2017 to an average of $402,000 from an average of $440,000 for the three months ended August 31, 2016.

The decrease in the average sales price of homes closed on a consolidated basis for the three months ended August 31, 2017, compared to the three months ended August 31, 2016, was primarily due to a shift in the mix of communities from which we had closings. As discussed above, we had a higher percentage of closings in entry-level communities, with generally lower average sales prices.

Home sales revenues - East segment

Home sales revenues for the east segment increased by 1.9% ($2.2 million) for the three months ended August 31, 2017 to $122.5 million from $120.3 million for the three months ended August 31, 2016. The increase in revenues for the three months ended August 31, 2017, as compared to the three months ended August 31, 2016, was due to an increase in the number of homes closed and was partially offset by a decrease in the average sales price of homes closed. The number of homes closed during the three months ended August 31, 2017 increased 17.5% (45 homes) as compared to the three months ended August 31, 2016. The average sales price of homes closed decreased 13.2% in the three months ended August 31, 2017 to an average of $406,000 from an average of $468,000 for the three months ended August 31, 2016.

The decrease in the average sales price of homes closed for the three months ended August 31, 2017, compared to the three months ended August 31, 2016, was primarily due to a shift in the mix of communities from which we had closings. As discussed above, we had a higher percentage of closings in entry-level communities, with generally lower average sales prices.

Home sales revenues - Central segment

Home sales revenues for the central segment increased by 40.9% ($38.2 million) for the three months ended August 31, 2017 to $131.6 million from $93.4 million for the three months ended August 31, 2016. The increase in revenues for the three months ended August 31, 2017, as compared to the three months ended August 31, 2016, was due to an increase in the number of homes closed, offset in part by a decrease in the average sales price of homes closed. The number of homes closed during the three months ended August 31, 2017 increased 44.7% (102 homes) as compared to the three months ended August 31, 2016. The average sales price of homes closed decreased (2.4)% in the three months ended August 31, 2017 to an average of $399,000 from an average of $409,000 for the three months ended August 31, 2016.

The decrease in the average sales price of homes closed during the three months ended August 31, 2017, compared to the three months ended August 31, 2016, was primarily due to a shift in the mix of communities from which we had closings. As discussed above, we had a higher percentage of closings in entry-level communities, with generally lower average sales prices.

Net new home orders and backlog - Consolidated

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 15.3% (106 homes) for the three months ended August 31, 2017 compared to the three months ended August 31, 2016. Backlog increased 10.8% from 1,389 homes in backlog at August 31, 2016 to 1,539 homes in backlog at August 31, 2017. The increase in backlog is a result of the Company selling 801 homes, which is 169 more homes than were closed (632 homes closed) during the three months ended August 31, 2017. The increase in homes sold was largely driven by an increase in the number of active communities.

The sales value of backlog at August 31, 2017 was $696.2 million, a 12.0% increase from the sales value of backlog at August 31, 2016 of $621.6 million. The average sales price of homes in backlog increased 0.9% from $448,000 at August 31, 2016 to $452,000 at August 31, 2017. The increase in the average sales price of homes in backlog is a result of the mix of types of communities with homes in backlog. As discussed above, the shift in the mix of active communities has trended more towards those we consider to be entry-level, which on average have a shorter time between the sale and closing of each home due to a large percentage of the sales being homes that are already under construction or completed. It is not uncommon for entry-level homes to be sold and closed in the same reporting period.

Net new home orders and backlog - East segment

Net new home orders in the east segment decreased 6.2% (24 homes) during the three months ended August 31, 2017 compared to the three months ended August 31, 2016. Backlog consisted of 713 homes at August 31, 2017, which is a 0.6% increase from 709 homes in backlog at August 31, 2016. The increase in backlog is a result of selling 63 more homes than we closed during the three months ended August 31, 2017. The east segment sold 365 homes, while closing 302 homes during the three months ended August 31, 2017.

The sales value of backlog at August 31, 2017 was $342.4 million, a 2.5% increase over the sales value of backlog at August 31, 2016 of $334.0 million. The average sales price of homes in backlog at August 31, 2017 was $480,000 compared to $471,000 at August 31, 2016. The increase in the average sales price of homes in backlog is a result of the mix of types of communities with homes in backlog. As discussed above, the shift in the mix of active communities has trended more towards those we consider to be entry-level, which on average have a shorter time between the sale and closing of each home due to a large percentage of the sales being homes that are already under construction or completed. It is not uncommon for entry-level homes to be sold and closed in the same reporting period.

Net new home orders and backlog - Central segment

Net new home orders in the central segment increased 42.5% (130 homes) during the three months ended August 31, 2017 compared to the three months ended August 31, 2016. Backlog consisted of 826 homes at August 31, 2017, which is a 21.5% increase from 680 homes in backlog at August 31, 2016. The increase in backlog is the result of selling 106 more homes than were closed during the three months ended August 31, 2017. The central segment sold 436 homes, while closing 330 homes during the three months ended August 31, 2017.

The sales value of backlog at August 31, 2017 was $353.8 million, a 23.0% increase over sales value of backlog at August 31, 2016 of $287.6 million. The average sales price of homes in backlog at August 31, 2017 was $428,000 million compared to $423,000 at August 31, 2016. The increase in the average sales price of homes in backlog is a result of the mix of types of communities with homes in backlog. As discussed above, the shift in the mix of active communities has trended more towards those we consider to be entry-level, which on average have a shorter time between the sale and closing of each home due to a large percentage of the sales being homes that are already under construction or completed. It is not uncommon for entry-level homes to be sold and closed in the same reporting period.

Gross margins - Consolidated

The average gross margin from homes closed for the three months ended August 31, 2017 increased to 17.6% from 17.0% for the three months ended August 31, 2016. Adjusted gross margin from homes closed for the three months ended August 31, 2017 increased to 19.3% from 18.9% for the three months ended August 31, 2016.

The increase in both the average gross margin and the adjusted gross margin for the three months ended August 31, 2017, compared to the three months ended August 31, 2016, was primarily due to reductions in construction costs, as a percentage of revenue, due to shifts in community mix, offset in part by an increase in land costs as a percentage of revenue. While the average gross margin on a consolidated basis increased for the three months ended August 31, 2017, as compared to the three months ended August 31, 2016, the increase in the average gross margin in the east segment was partially offset by a slight decrease in the average gross margin in the central segment.

Gross margins - East segment

The average gross margin from homes closed in the east segment for the three months ended August 31, 2017 increased to 17.3% from 16.3% for the three months ended August 31, 2016. The increase in average gross margin for the three months ended August 31, 2017 as compared to the three months ended August 31, 2016 was primarily due to reductions in construction costs, as a percentage of revenue, due to shifts in community mix, offset in part by an increase in land costs as a percentage of revenue. The Company continues to close out of older communities and open new communities, for which land cost as a percentage of revenue tends to be higher due to rising land prices over the past several years.

Gross margins - Central segment

The average gross margin from homes closed in the central segment for the three months ended August 31, 2017 decreased to 17.9%, from 18.0% for the three months ended August 31, 2016. The slight decrease in average gross margin for the three months ended August 31, 2017 as compared to the three months ended August 31, 2016 was primarily due to an increase in construction costs as a percentage of revenue, while land cost as a percentage of revenue remained flat.

Selling, general and administrative expenses

SG&A totaled $40.6 million for the three months ended August 31, 2017 compared to $34.3 million for the three months ended August 31, 2016, a $6.3 million increase. SG&A as a percentage of revenue was 16.0% for both the three months ended August 31, 2017 and the three months ended August 31, 2016.

While SG&A as a percentage of revenue remained flat at 16.0% for both the three months ended August 31, 2017 and the three months ended August 31, 2016, the increase in SG&A for the three months ended August 31, 2017, compared to the three months ended August 31, 2016, was primarily related to an increase in sales commissions resulting from an increase in the number of closings, increased advertising expenses due to an increase in the number of communities with selling activity, and an increase in compensation expense.

Land sales

We periodically elect to sell parcels of land or lots. These land and lot sales are incidental to our business of selling and building homes. We had $0.6 million in sales of land and lots during the three months ended August 31, 2017 and $0.1 million in sales of land and lots during the three months ended August 31, 2016. No significant profits or losses were realized from the sales of land and lots, as the parcels were generally sold at prices that were substantially equivalent to their cost basis.

Net loss

For the three months ended August 31, 2017, compared to the three months ended August 31, 2016, net loss increased by $3.0 million, primarily attributable to the $5.3 million loss from the early extinguishment of debt related to the debt transactions discussed in Note 2. Excluding the loss from the early extinguishment of debt, net loss decreased for the three months ended August 31, 2017, as compared to three months ended August 31, 2016, primarily due to an increase in home sales revenues and an increase in average gross margin, offset in part by an increase in SG&A expense, as discussed above.

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 First Amendment to Fifth Amended and Restated Credit Agreement dated as of June 23, 2017 (as amended to date, the "Restated Revolver"), 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 three months ended August 31, 2017 was $101.8 million compared to $88.7 million for the three months ended August 31, 2016. The primary source of operating funds was the sale of homes, and we primarily used these funds to buy and develop land, build homes, pay interest, and fund overhead expenses. The increase in cash used in operating activities was primarily due to an increase in inventory from $757.9 million at May 31, 2017 to $853.6 million at August 31, 2017 as the result of land acquisition and development investments to support future operations, as well as more homes under construction.

Investing cash flows

Net cash used in investing activities was $1.3 million for the three months ended August 31, 2017 and $2.6 million for the three months ended August 31, 2016. Net cash used in investing activities for the three months ended August 31, 2017 included $1.6 million to furnish and/or update furnishings in model homes and sales offices. The cash outflows were partially offset by a $0.3 million return of investment from our unconsolidated entities.

Financing cash flows

Net cash provided by financing activities was $103.1 million for the three months ended August 31, 2017, compared to $91.4 million for the three months ended August 31, 2016. The funds provided by financing activities during the three months ended August 31, 2017 consisted of $250.0 million received from the issuance of the 6.875% Notes, offset by (i) the payment of $100.0 million principal amount of repurchased 6.875% Notes, (ii) $22.4 million of net repayments on the Restated Revolver, (iii) distributions of $13.4 million to our Members, (iv) $7.3 million of debt issuance costs paid in connection with the issuance of the 6.750% Notes and the amendment to our Restated Revolver, and (v) the payment of $3.8 million in repayment premiums on the repurchased 6.875% Notes. As of August 31, 2017, we had $62.0 million of outstanding borrowings under our Restated Revolver and available additional borrowing capacity of $244.1 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). 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. Our ratios of total debt to total capitalization and net debt to net capitalization each increased to 66.0% as of August 31, 2017 from 64.2% as of August 31, 2016.

Inventory

As of August 31, 2017, we had the following owned homes in our reportable segments (in units):

	Homes Under Construction			Completed Homes			
	Unsold	**Models**	**Sold**	**Unsold**	**Models**	**Sold**	**Total Homes**
East	305	24	437	99	54	69	988
Central	253	2	537	77	82	59	1,010
Company total	558	26	974	176	136	128	1,998

As of August 31, 2017 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	988	2,086	568	187	3,829	3,776	7,605
Central	1,010	1,072	648	1,058	3,788	5,369	9,157
Total Company	1,998	3,158	1,216	1,245	7,617	9,145	16,762
Percentage of total controlled	11.9%	18.8%	7.3%	7.4%	45.4%	54.6%	100.0%

In addition to the 7,617 lots we owned, we controlled, through the use of purchase and option agreements, 9,145 lots at August 31, 2017. Purchase and option agreements that did not require consolidation under Accounting Standard Codification ("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 August 31, 2017 had an aggregate remaining purchase price of $517.8 million. In connection with these agreements, we had cash deposits of $56.6 million at August 31, 2017. In addition, we had purchase and option agreements consolidated under ASC 360-20 or ASC 470-40 with an aggregate remaining purchase price of $83.6 million and cash deposits of $19.2 million (See Note 5).

During the three months ended August 31, 2017, we acquired 1,801 lots for a total purchase price of $95.2 million, net of 72 lots ($2.7 million) of land sold that were accounted for under the provisions of ASC 360-20 due to the Company's continuing involvement. We spent $17.1 million on land development during the three months ended August 31, 2017. We spent $1.6 million during the three months ended August 31, 2017 to furnish and/or update furnishings in model homes and sales offices.

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 August 31, 2017, compared to those contained in our audited consolidated financial statements for the year ended May 31, 2017. Our debt obligations are fully discussed in Note 8 of our consolidated financial statements as of August 31, 2017.

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 August 31, 2017, we had letters of credit and surety bonds outstanding of $7.0 million and $19.6 million, respectively. As of August 31, 2017, we had $38.0 million of unused letter of credit capacity under the Restated Revolver.

On November 19, 2015, the Company issued a $2.3 million note payable to an unaffiliated third party which matures on November 19, 2017. The non-interest bearing note is collateralized by the land to which it relates and has no recourse to any other assets or the Company. At August 31, 2017, the outstanding note payable balance totaled $2.3 million.

On September 23, 2016, the Company issued a $5.8 million note payable to an unaffiliated third party which initially matured on September 23, 2017. The note payable was modified prior to maturity, has an interest rate of 6.00%, and matures on January 2, 2018. The note is collateralized by the land to which it relates and has no recourse to any other assets or the Company. At August 31, 2017, the outstanding note payable balance, including accrued interest, totaled $5.9 million.

At August 31, 2017, we controlled 16,762 lots and homes available to close. Of the 16,762 lots and homes controlled, we owned 45.4%, or 7,617 lots and homes, and 54.6%, or 9,145 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 August 31, 2017, these agreements had an aggregate remaining purchase price of $517.8 million, net of deposits of $56.6 million. In addition, we had purchase and option agreements recorded under ASC 360-20 or ASC 470-40 with an aggregate remaining purchase price of $83.6 million and cash deposits of $19.2 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 August 31, 2017, real estate not owned totaled $82.2 million related to eight lot purchase agreements. Refer to our discussion in Note 5 of our consolidated financial statements as of August 31, 2017.

As of August 31, 2017, we participated in two 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 consolidated statements of operations.

As of August 31, 2017, we participated in a mortgage joint venture in which we offer residential mortgage services to our homebuyers and the public at large in Austin, Dallas, Houston, and San Antonio. The Company does not have a controlling interest in the joint venture. We account for our interest in the joint ventures under the equity method. Our share of profits is included within equity in earnings in unconsolidated entities in the consolidated statements of operations.

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 three months ended August 31, 2017, compared with those disclosed in our audited consolidated financial statements for the fiscal year ended May 31, 2017.

Transactions with related parties

See Note 11 in our unaudited condensed consolidated financial statements as of August 31, 2017 for transactions with related parties. The Company did not have any significant changes in or transactions with related parties during the first three months of fiscal year 2018. See the audited consolidated financial statements for the fiscal year ended May 31, 2017 for transactions existing at such date.

Pending accounting pronouncements

See Note 3 in our unaudited condensed consolidated financial statements as of August 31, 2017.

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 August 31, 2017, we had outstanding borrowings of $62.0 million under the Restated Revolver.

Item 4. *Controls and Procedures*

Pursuant to section 4.03 of each of the indentures governing the 6.875% Notes and 6.750% Notes, 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 these ordinary course 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.

In addition, on June 27, 2016, FCC Marsh, LLC (the “Seller”) filed a complaint against the Company in the Circuit Court for Collier County, Florida, alleging that the Company breached a lot purchase agreement that provided the Seller with a specific performance right against the Company, subject to certain conditions, by allegedly failing to close on certain lot purchases. The Seller has dismissed its claim for specific performance, and seeks declaratory relief and damages. The Company filed a counterclaim seeking declaratory relief, return of the earnest money deposit and foreclosure of the mortgage that secures that deposit, and amended its counterclaim, adding a claim for breach of contract and damages based on the Company’s claim that the Seller breached the terms of a lease agreement between the parties. While it is premature to predict the ultimate outcome of these proceedings, the Company intends to vigorously defend the lawsuit and pursue its claims against the Seller.