

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2018

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____.

Commission file number 001-36126

LGI HOMES, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

46-3088013

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

1450 Lake Robbins Drive, Suite 430, The Woodlands, Texas
(Address of principal executive offices)

77380
(Zip code)

(281) 362-8998

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

Yes No

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," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

As of August 3, 2018, there were 22,632,991 shares of the registrant's common stock, par value \$.01 per share, outstanding.

[Table of Contents](#)

TABLE OF CONTENTS

	Page
PART I - FINANCIAL INFORMATION	
Item 1.	
LGI Homes, Inc. Consolidated Financial Statements (Unaudited)	
Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017	3
Consolidated Statements of Operations for the three and six months ended June 30, 2018 and 2017	4
Consolidated Statement of Equity for the six months ended June 30, 2018	5
Consolidated Statements of Cash Flows for the six months ended June 30, 2018 and 2017	6
Notes to the Consolidated Financial Statements	7
Item 2.	
Management’s Discussion and Analysis of Financial Condition and Results of Operations	19
Item 3.	
Quantitative and Qualitative Disclosures About Market Risk	35
Item 4.	
Controls and Procedures	36
PART II - OTHER INFORMATION	
Item 1.	
Legal Proceedings	37
Item 5.	
Other Information	37
Item 6.	
Exhibits	38
SIGNATURES	39

[Table of Contents](#)

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LGI HOMES, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands, except share data)

	June 30, 2018	December 31, 2017
ASSETS		
Cash and cash equivalents	\$ 48,886	\$ 67,571
Accounts receivable	31,746	44,706
Real estate inventory	1,062,696	918,933
Pre-acquisition costs and deposits	29,562	18,866
Property and equipment, net	1,675	1,674
Other assets	11,168	14,196
Deferred tax assets, net	2,168	1,928
Goodwill	12,018	12,018
Total assets	<u>\$ 1,199,919</u>	<u>\$ 1,079,892</u>
LIABILITIES AND EQUITY		
Accounts payable	\$ 19,893	\$ 12,020
Accrued expenses and other liabilities	56,805	102,831
Notes payable	554,539	475,195
Total liabilities	<u>631,237</u>	<u>590,046</u>
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Common stock, par value \$0.01, 250,000,000 shares authorized, 23,632,991 shares issued and 22,632,991 shares outstanding as of June 30, 2018 and 22,845,580 shares issued and 21,845,580 shares outstanding as of December 31, 2017	236	228
Additional paid-in capital	233,598	229,680
Retained earnings	351,398	276,488
Treasury stock, at cost, 1,000,000 shares	(16,550)	(16,550)
Total equity	<u>568,682</u>	<u>489,846</u>
Total liabilities and equity	<u>\$ 1,199,919</u>	<u>\$ 1,079,892</u>

See accompanying notes to the consolidated financial statements.

LGI HOMES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Home sales revenues	\$ 419,847	\$ 324,178	\$ 698,871	\$ 487,089
Cost of sales	310,082	237,830	519,847	357,242
Selling expenses	29,301	24,193	52,250	40,300
General and administrative	18,302	13,680	33,742	24,945
Operating income	62,162	48,475	93,032	64,602
Other income, net	(509)	(167)	(866)	(882)
Net income before income taxes	62,671	48,642	93,898	65,484
Income tax provision	15,063	16,443	18,988	21,505
Net income	\$ 47,608	\$ 32,199	\$ 74,910	\$ 43,979
Earnings per share:				
Basic	\$ 2.11	\$ 1.49	\$ 3.34	\$ 2.05
Diluted	\$ 1.90	\$ 1.39	\$ 3.01	\$ 1.91
Weighted average shares outstanding:				
Basic	22,616,085	21,602,261	22,403,266	21,481,842
Diluted	25,000,647	23,242,589	24,884,628	23,032,648

See accompanying notes to the consolidated financial statements.

LGI HOMES, INC.
CONSOLIDATED STATEMENT OF EQUITY
(Unaudited)
(In thousands, except share data)

	Common Stock		Additional Paid- In Capital	Retained Earnings	Treasury Stock	Total Equity
	Shares	Amount				
BALANCE—December 31, 2017	22,845,580	\$ 228	\$ 229,680	\$ 276,488	\$ (16,550)	\$ 489,846
Net income	—	—	—	74,910	—	74,910
Issuance of shares in settlement of Convertible Notes	486,679	5	(475)	—	—	(470)
Issuance of restricted stock units in settlement of accrued bonuses	—	—	181	—	—	181
Compensation expense for equity awards	—	—	2,770	—	—	2,770
Stock issued under employee incentive plans	300,732	3	1,442	—	—	1,445
BALANCE— June 30, 2018	23,632,991	\$ 236	\$ 233,598	\$ 351,398	\$ (16,550)	\$ 568,682

See accompanying notes to the consolidated financial statements.

LGI HOMES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$ 74,910	\$ 43,979
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	366	406
Loss on extinguishment of debt	530	—
Compensation expense for equity awards	2,770	1,580
Deferred income taxes	(95)	(631)
Changes in assets and liabilities:		
Accounts receivable	12,960	(17,082)
Real estate inventory	(143,449)	(116,654)
Pre-acquisition costs and deposits	(10,696)	(2,793)
Other assets	3,028	(822)
Accounts payable	7,873	6,730
Accrued expenses and other liabilities	(43,867)	17,625
Net cash used in operating activities	<u>(95,670)</u>	<u>(67,662)</u>
Cash flows from investing activities:		
Purchases of property and equipment	(367)	(323)
Net cash used in investing activities	<u>(367)</u>	<u>(323)</u>
Cash flows from financing activities:		
Proceeds from notes payable	120,000	60,000
Payments on notes payable	(40,038)	(15,000)
Loan issuance costs	(3,923)	(4,359)
Proceeds from sale of stock, net of offering expenses	1,445	5,503
Payment for offering costs	—	(69)
Payment for earnout obligation	(132)	(308)
Net cash provided by financing activities	<u>77,352</u>	<u>45,767</u>
Net decrease in cash and cash equivalents	(18,685)	(22,218)
Cash and cash equivalents, beginning of period	67,571	49,518
Cash and cash equivalents, end of period	<u>\$ 48,886</u>	<u>\$ 27,300</u>

See accompanying notes to the consolidated financial statements.

LGI HOMES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization and Description of the Business

LGI Homes, Inc., a Delaware corporation (the “Company”, “us,” “we,” or “our”), is engaged in the development of communities and the design, construction and sale of new homes in Texas, Arizona, Florida, Georgia, New Mexico, Colorado, North Carolina, South Carolina, Washington, Tennessee, Minnesota, Oklahoma, Alabama, California and Oregon.

Basis of Presentation

The unaudited consolidated financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements included in our [Annual Report on Form 10-K](#) for the fiscal year ended December 31, 2017. The accompanying unaudited consolidated financial statements include all adjustments that are of a normal recurring nature and necessary for the fair presentation of our results for the interim periods presented. Results for interim periods are not necessarily indicative of results to be expected for the full year.

The accompanying unaudited financial statements as of June 30, 2018, and for the three and six months ended June 30, 2018 and 2017, include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and these differences could have a significant impact on the financial statements.

Recently Adopted Accounting Standards

Effective January 1, 2018, we adopted the Financial Accounting Standards Board (the “FASB”) Accounting Standards Update (“ASU”) No. 2016-15, “*Statement of Cash Flows - Classification of Certain Cash Receipts and Cash Payments*” (“ASU 2016-15”), which addresses specific classification issues and is intended to reduce diversity in current practice regarding the manner in which certain cash receipts and cash payments are presented and classified in the consolidated statements of cash flows. The adoption of ASU 2016-15 did not have a material effect on our consolidated statements of cash flows or disclosures.

Effective January 1, 2018, we adopted the FASB ASU No. 2014-09, “*Revenue from Contracts with Customers (Topic 606)*” (“Topic 606”), which provides guidance for revenue recognition. Topic 606 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets and supersedes the revenue recognition requirements in Topic 605, “*Revenue Recognition*” (“Topic 605”) and most industry-specific guidance. Topic 606 also supersedes certain cost guidance included in Subtopic 605-35, “*Revenue Recognition—Construction-Type and Production-Type Contracts.*” Topic 606’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. We adopted Topic 606 using the modified retrospective transition method only with respect to contracts not completed at the date of adoption. We have developed the additional expanded disclosures required; however, the adoption of Topic 606 did not have a material effect on our consolidated statements of operations, balance sheets or cash flows. See [Note 2](#) for further details.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, “*Leases (Topic 842)*” (“ASU 2016-02”), which amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets. Under ASU 2016-02, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than twelve months. Lessor accounting remains substantially similar to current GAAP. In addition, disclosures of leasing activities will be expanded to include qualitative and specific quantitative information. ASU 2016-02 will be effective for annual reporting periods beginning after December 15, 2018, and early adoption is permitted. ASU 2016-02 requires a modified retrospective transition approach. As part of our assessment work-to-date, we have formed an implementation work team and identified non-cancelable operating leases primarily associated with office facilities, real estate and office equipment. We believe the recognition of new right-of-use assets

[Table of Contents](#)

and lease liabilities will be the most significant change for us under ASU 2016-02. We are in the process of identifying and implementing appropriate changes to our business processes, systems and controls to support the adoption and disclosures required under ASU 2016-02.

2. REVENUES

Adoption of Topic 606, “Revenue from Contracts with Customers”

On January 1, 2018, we adopted Topic 606 using the modified retrospective method. The results of applying Topic 606 did not affect our contracts as all contracts were completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605. We did not record any adjustments or net reductions to opening retained earnings as of January 1, 2018 in relation to the adoption of Topic 606.

Revenue Recognition

Revenues from home sales are recognized when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services. Revenues from home sales are recorded at the time each home sale is closed, title and possession are transferred to the customer and we have no significant continuing involvement with the home. Proceeds from home sales are generally received from the title company within a few business days after closing. Home sales discounts and incentives granted to customers, which are related to the customers’ closing costs that we pay on the customer’s behalf, are recorded as a reduction of revenue in our consolidated financial statements of operations.

The following table presents our home sales revenues disaggregated by revenue stream (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Retail home sales revenues	\$ 392,320	\$ 310,188	\$ 664,358	\$ 471,683
Other	27,527	13,990	34,513	15,406
Total home sales revenues	\$ 419,847	\$ 324,178	\$ 698,871	\$ 487,089

The following table presents our home sales revenues disaggregated by geography, based on our determined operating segments in [Note 13](#) (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Central	\$ 181,268	\$ 139,762	\$ 288,766	\$ 204,680
Southwest	73,030	63,258	127,313	96,384
Southeast	60,369	51,487	105,477	79,334
Florida	55,018	48,974	97,461	73,174
Northwest	49,463	20,697	79,155	33,517
Midwest	699	—	699	—
Total home sales revenues	\$ 419,847	\$ 324,178	\$ 698,871	\$ 487,089

Home Sales Revenues

We generate revenues primarily by delivering move-in ready spec homes with our entry-level and move-up homes sold under our LGI Homes brand and our luxury series homes sold under our Terrata Homes brand.

Retail homes sold under both our LGI Homes brand and Terrata Homes brand focus on providing move-in ready homes with standardized features within favorable markets that meet certain demographic and economic conditions. Our LGI Homes brand primarily markets to entry-level or first-time homebuyers, while our Terrata Homes brand primarily markets to move-up homebuyers.

Our other revenues are composed of our wholesale home sales under our LGI Homes brand in existing markets. Wholesale homes are primarily sold under a bulk sales agreement and focus on providing move-in ready homes with standardized features to real estate investors that will ultimately use the single-family homes as rental properties.

[Table of Contents](#)

Performance Obligations

Our contracts with customers include a single performance obligation to transfer a completed home to the customer. We generally determine selling price per home on the expected cost plus margin. Our contracts contain no significant financing terms as customers who finance do so through a third party. Performance obligations are satisfied at a moment in time when the home is complete and control of the asset is transferred to the customer at closing. Home sales proceeds are generally received from the title company within a few business days after closing.

Sales and broker commissions are incremental costs incurred to obtain a contract with a customer that would not have been incurred if the contract had not been obtained. Sales and broker commissions are expensed upon fulfillment of a home closing. Advertising costs are costs to obtain a contract that would have been incurred regardless of whether the contract was obtained and are recognized as an expense when incurred. Sales and broker commissions and advertising costs are recorded within sales and marketing expense presented in our consolidated statements of operations as selling expenses.

3. REAL ESTATE INVENTORY

Our real estate inventory consists of the following (in thousands):

	June 30, 2018	December 31, 2017
Land, land under development and finished lots	\$ 582,872	\$ 494,552
Information centers	19,974	18,327
Homes in progress	212,674	191,659
Completed homes	247,176	214,395
Total real estate inventory	<u>\$ 1,062,696</u>	<u>\$ 918,933</u>

Inventory is stated at cost unless the carrying amount is determined not to be recoverable, in which case the affected inventory is written down to fair value.

Land, development and other project costs, including interest and property taxes incurred during development and home construction and net of expected reimbursements of development costs, are capitalized to real estate inventory. Land development and other common costs that benefit the entire community, including field construction supervision and related direct overhead, are allocated to individual lots or homes, as appropriate. The costs of lots are transferred to homes in progress when home construction begins. Home construction costs and related carrying charges are allocated to the cost of individual homes using the specific identification method. Costs that are not specifically identifiable to a home are allocated on a pro rata basis, which we believe approximates the costs that would be determined using an allocation method based on relative sales values since the individual lots or homes within a community are similar in value. Inventory costs for completed homes are expensed to cost of sales as homes are closed. Changes to estimated total development costs subsequent to initial home closings in a community are generally allocated to the remaining unsold lots and homes in the community on a pro rata basis.

The life cycle of a community generally ranges from two to five years, commencing with the acquisition of land, continuing through the land development phase and concluding with the construction and sale of homes. A constructed home is used as the community information center during the life of the community and then sold. Actual individual community lives will vary based on the size of the community, the sales absorption rate and whether the property was purchased as raw land or finished lots.

Interest and financing costs incurred under our debt obligations, as more fully discussed in [Note 5](#), are capitalized to qualifying real estate projects under development and homes under construction.

[Table of Contents](#)

4. ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued and other current liabilities consist of the following (in thousands):

	June 30, 2018	December 31, 2017
Inventory related obligations	\$ 11,060	\$ 12,906
Taxes payable	3,917	48,733
Retentions and development payable	16,092	12,025
Accrued compensation, bonuses and benefits	9,771	14,462
Accrued interest	2,647	2,096
Warranty reserve	2,800	2,450
Other	10,518	10,159
Total accrued expenses and other liabilities	<u>\$ 56,805</u>	<u>\$ 102,831</u>

Inventory Related Obligations

We own lots in certain communities in Arizona, California, Florida and Texas that have Community Development Districts (“CDD”) or similar utility and infrastructure development special assessment programs that allocate a fixed amount of debt service associated with development activities to each lot. This obligation for infrastructure development is attached to the land, is typically payable over a 30-year period and is ultimately assumed by the homebuyer when home sales are closed. Such obligations represent a non-cash cost of the lots.

Estimated Warranty Reserve

We typically provide homebuyers with a one-year warranty on the house and a ten-year limited warranty for major defects in structural elements such as framing components and foundation systems.

Changes to our warranty accrual are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Warranty reserves, beginning of period	\$ 2,600	\$ 1,650	\$ 2,450	\$ 1,600
Warranty provision	695	847	1,683	1,199
Warranty expenditures	(495)	(647)	(1,333)	(949)
Warranty reserves, end of period	<u>\$ 2,800</u>	<u>\$ 1,850</u>	<u>\$ 2,800</u>	<u>\$ 1,850</u>

5. NOTES PAYABLE

Revolving Credit Agreement

On May 25, 2018, we entered into that certain Third Amended and Restated Credit Agreement with several financial institutions, and Wells Fargo Bank, National Association, as administrative agent, which was amended as of June 19, 2018 by that certain First Amendment thereto (the “First Amendment”; such credit agreement, as amended by the First Amendment, the “Credit Agreement”). The Credit Agreement has substantially similar terms and provisions to our second amended and restated credit agreement entered into in May 2017 with several financial institutions, and Wells Fargo Bank, National Association, as administrative agent (the “2017 Credit Agreement”) but, among other things, provides for an increase of the revolving credit facility from \$600.0 million to \$750.0 million (which was reduced in July 2018 upon issuance of the Senior Notes (as defined herein) to \$450.0 million; see [Note 14](#) for further details), which could be increased at our request by up to \$50.0 million if the lenders make additional commitments, subject to the terms and conditions of the Credit Agreement.

The Credit Agreement matures on May 31, 2021. Before each anniversary of the Credit Agreement, we may request a one-year extension of the maturity date. The Credit Agreement is guaranteed by each of our subsidiaries that have gross assets equal to or greater than \$0.5 million. The revolving credit facility is currently unsecured, but we have agreed to provide collateral if we fail to meet certain financial conditions in the future. As of June 30, 2018, the borrowing base under the Credit Agreement was \$677.4 million, of which borrowings of \$495.0 million were outstanding, \$10.1 million of letters of credit were outstanding and \$172.3 million was available to borrow.

[Table of Contents](#)

Interest is paid monthly on borrowings under the Credit Agreement at LIBOR plus 2.90%. The Credit Agreement applicable margin for LIBOR loans ranges from 2.65% to 3.25% based on our leverage ratio. At June 30, 2018, LIBOR was 2.07%.

The Credit Agreement contains various financial covenants, including a minimum tangible net worth, a leverage ratio, a minimum liquidity amount and an EBITDA to interest expense ratio. The Credit Agreement contains various covenants that, among other restrictions, limit the amount of our additional debt and our ability to make certain investments. At June 30, 2018, we were in compliance with all of the covenants contained in the Credit Agreement.

Convertible Notes

We issued \$85.0 million aggregate principal amount of our 4.25% Convertible Notes due 2019 (the “Convertible Notes”) in November 2014 pursuant to an exemption from the registration requirements afforded by Section 4(a)(2) of the Securities Act of 1933, as amended (the “Securities Act”). The Convertible Notes mature on November 15, 2019. Interest on the Convertible Notes is payable semi-annually in arrears on May 15 and November 15 of each year at a rate of 4.25%. When the Convertible Notes were issued, the fair value of \$76.5 million was recorded to notes payable. \$5.5 million of the remaining proceeds was recorded to additional paid in capital to reflect the equity component and the remaining \$3.0 million was recorded as a deferred tax liability. The carrying amount of the Convertible Notes is being accreted to face value over the term to maturity.

Prior to May 15, 2019, the Convertible Notes are convertible only upon satisfaction of any of the specified conversion events. On or after May 15, 2019, the holders of the Convertible Notes can convert their Convertible Notes at any time at their option. Upon the election of a holder of Convertible Notes to convert their Convertible Notes, we may settle the conversion of the Convertible Notes using any combination of cash and shares of our common stock. It is our intent, and belief that we have the ability, to settle in cash the conversion of any Convertible Notes that the holders elect to convert. The initial conversion rate of the Convertible Notes is 46.4792 shares of our common stock for each \$1,000 principal amount of Convertible Notes, which represents an initial conversion price of approximately \$21.52 per share of our common stock. The conversion rate is subject to adjustments upon the occurrence of certain specified events.

During the fourth quarter of 2017, we received notice from holders of \$15.0 million principal amount of the Convertible Notes to convert their Convertible Notes. The conversion of such Convertible Notes were settled in the first quarter of 2018, resulting in the issuance of 486,679 shares of our common stock, a \$0.6 million reduction to debt discount and additional paid in capital, a \$0.2 million loss on the extinguishment of debt and a cash payment of \$15.0 million for the principal amount of such Convertible Notes. As of June 30, 2018, we have \$70.0 million aggregate principal amount of Convertible Notes outstanding.

During the second quarter of 2018, the Convertible Notes were convertible because the closing sale price of our common stock was greater than 130% of the \$21.52 conversion price on at least 20 trading days during the 30 trading day period ending on March 31, 2018. As a result, the holders of the Convertible Notes could elect to convert some or all of their Convertible Notes in accordance with the terms and provisions of the indenture governing the Convertible Notes during the conversion period of April 1, 2018 through June 30, 2018 (inclusive). The Convertible Notes continue to be convertible during the third quarter of 2018. As of the date of the filing of this Quarterly Report on Form 10-Q, no other conversion notices have been received by us.

On July 6, 2018, concurrently with the offering of the Senior Notes, we entered into that certain First Supplemental Indenture, dated as of July 6, 2018, among us, our subsidiaries that guarantee our obligations under our revolving credit facility (the “Subsidiary Guarantors”) and Wilmington Trust, National Association, as trustee, which supplements the indenture governing the Convertible Notes, pursuant to which (i) the subordination provisions in the indenture governing the Convertible Notes were eliminated, (ii) each Subsidiary Guarantor agreed (A) to, concurrently with the issuance of the Senior Notes, fully and unconditionally guarantee the Convertible Notes to the same extent that such Subsidiary Guarantor is guaranteeing the Senior Notes and (B) that such Subsidiary Guarantor’s guarantee of the Convertible Notes ranks equally with such Subsidiary Guarantor’s guarantee of the Senior Notes and (iii) the Company agreed to not, directly or indirectly, incur any indebtedness in the form of, or otherwise become liable in respect of, any notes or other debt securities issued pursuant to an indenture or note purchase agreement (including the Senior Notes) unless such indebtedness is equal with or contractually subordinated to the Convertible Notes in right of payment.

[Table of Contents](#)

Notes payable consist of the following (in thousands):

	<u>June 30, 2018</u>	<u>December 31, 2017</u>
Notes payable under the Credit Agreement (\$750.0 million revolving credit facility at June 30, 2018) maturing on May 31, 2021; interest paid monthly at LIBOR plus 2.90%; net of debt issuance costs of approximately \$7.7 million and \$5.3 million at June 30, 2018 and December 31, 2017, respectively	\$ 487,304	\$ 394,714
4.25% Convertible Notes due November 15, 2019; interest paid semi-annually at 4.25%; net of debt issuance costs of approximately \$0.6 million and \$1.0 million at June 30, 2018 and December 31, 2017, respectively; and approximately \$2.1 million and \$3.5 million in unamortized discount at June 30, 2018 and December 31, 2017, respectively	67,235	80,481
Total notes payable	<u>\$ 554,539</u>	<u>\$ 475,195</u>

Capitalized Interest

Interest activity, including other financing costs, for notes payable for the periods presented is as follows (in thousands):

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Interest incurred	\$ 8,787	\$ 6,028	\$ 15,980	\$ 11,102
Less: Amounts capitalized	(8,787)	(6,028)	(15,980)	(11,102)
Interest expense	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Cash paid for interest	\$ 8,100	\$ 5,752	\$ 13,269	\$ 8,911

Included in interest incurred was amortization of deferred financing costs for notes payable and amortization of Convertible Notes discount of \$1.4 million and \$1.0 million for the three months ended June 30, 2018 and 2017, respectively, and \$2.2 million and \$1.8 million for the six months ended June 30, 2018 and 2017, respectively.

6. INCOME TAXES

We file U.S. federal and state income tax returns. As of June 30, 2018, we have no unrecognized tax benefits. We are no longer subject to exam for years before 2014 (2013 for Texas).

For the six months ended June 30, 2018, our effective tax rate of 20.2% is lower than the Federal statutory rate primarily as a result of the deductions in excess of compensation cost (“windfalls”) for share-based payments, offset by an increase in rate for state income taxes, net of the federal benefit payments.

The Securities and Exchange Commission (the “SEC”) staff issued Staff Accounting Bulletin 118, which provides guidance on accounting for the tax effects of the U.S. federal income tax legislation signed into law on December 22, 2017, commonly known as the “Tax Cuts and Jobs Act of 2017” (the “Tax Act”), for which the accounting under Accounting Standards Codification (“ASC”) 740 is incomplete. To the extent that a company’s accounting for certain income tax effects of the Tax Act is incomplete but the company is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. If a company cannot determine a provisional estimate to be included in the financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before enactment of the Tax Act.

As of June 30, 2018, we have completed the majority of our accounting for the tax effects of the Tax Act. However, as there is some uncertainty around the grandfathering provisions related to performance-based executive compensation, we have estimated a provisional amount for deferred tax assets related to performance-based executive compensation. In addition, we also re-measured the applicable deferred tax assets and liabilities based on the rates at which they are expected to reverse. However, we are still analyzing certain aspects of the Tax Act and refining our calculations, which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts.

During the three months ended June 30, 2018, the Internal Revenue Service (“IRS”) commenced an examination of the Company’s U.S. income tax return for 2016 that is anticipated to be completed in early 2019. As of June 30, 2018, the IRS has not proposed any adjustments to our tax positions.

Income taxes paid were \$20.8 million and \$14.7 million for the three months ended June 30, 2018 and 2017, respectively. Income taxes paid were \$63.7 million and \$14.7 million for the six months ended June 30, 2018 and 2017, respectively.

[Table of Contents](#)**7. EQUITY****Convertible Notes**

During the fourth quarter of 2017, we received notice from holders of \$15.0 million principal amount of the Convertible Notes to convert their Convertible Notes. The conversion of such Convertible Notes was settled in the first quarter of 2018, resulting in the issuance of 486,679 shares of our common stock, a \$0.5 million reduction to additional paid in capital, net of tax and a cash payment of \$15.0 million for the principal amount of such Convertible Notes. As of the date of the filing of this Quarterly Report on Form 10-Q, no other conversion notices have been received by us. See the “Convertible Notes” section within [Note 5](#) for further details on this debt obligation.

Shelf Registration Statement and ATM Offering Program

We have an effective shelf registration statement on Form S-3 (the “Registration Statement”), to offer and sell from time to time various securities with a maximum offering price of \$300.0 million. In November 2017, we concluded our prior \$25.0 million at-the-market common stock offering program (the “2016 ATM Program”) under the Registration Statement. During the three and six months ended June 30, 2017, we issued and sold 4,990 and 154,990 shares of our common stock, respectively, under the 2016 ATM Program and received net proceeds of approximately \$0.2 million and \$4.8 million, respectively.

8. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2018 and 2017:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Numerator (in thousands):				
Numerator for basic and dilutive earnings per share	\$ 47,608	\$ 32,199	\$ 74,910	\$ 43,979
Denominator:				
Basic weighted average shares outstanding	22,616,085	21,602,261	22,403,266	21,481,842
Effect of dilutive securities:				
Convertible Notes - treasury stock method	2,166,333	1,417,163	2,191,836	1,296,413
Stock-based compensation units	218,229	223,165	289,526	254,393
Diluted weighted average shares outstanding	25,000,647	23,242,589	24,884,628	23,032,648
Basic earnings per share	\$ 2.11	\$ 1.49	\$ 3.34	\$ 2.05
Diluted earnings per share	\$ 1.90	\$ 1.39	\$ 3.01	\$ 1.91
Antidilutive non-vested restricted stock units excluded from calculation of diluted earnings per share	2,871	3,758	13,118	23,089

In accordance with ASC 260-10, *Earnings Per Share*, we calculated the dilutive effect of the Convertible Notes using the treasury stock method, since we have the intent and ability to settle the principal amount of the outstanding Convertible Notes in cash. Under the treasury stock method, the Convertible Notes have a dilutive impact on diluted earnings per share to the extent that the average market price of our common stock for a reporting period exceeds the conversion price of \$21.52 per share.

During the three and six months ended June 30, 2018 and 2017, the average market price of our common stock exceeded the conversion price of \$21.52 per share. Included in the calculation of diluted earnings per share was the effect of approximately 2.2 million and 1.4 million shares of our common stock related to the conversion spread of the Convertible Notes for the three months ended June 30, 2018 and 2017, respectively, and 2.2 million and 1.3 million shares of our common stock related to the conversion spread of the Convertible Notes for the six months ended June 30, 2018 and 2017, respectively.

9. STOCK-BASED COMPENSATION

Non-performance Based Restricted Stock Units

The following table summarizes the activity of our time-vested restricted stock units (“RSUs”):

	Six Months Ended June 30,			
	2018		2017	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Beginning balance	175,100	\$ 27.66	133,853	\$ 20.13
Granted	38,546	\$ 64.06	65,869	\$ 31.96
Vested	(35,968)	\$ 15.51	(11,269)	\$ 15.32
Forfeited	(4,993)	\$ 33.79	(6,419)	\$ 20.28
Ending balance	172,685	\$ 38.14	182,034	\$ 24.70

During the six months ended June 30, 2018, we issued 15,867 RSUs to senior management for the time-based portion of our 2018 long-term incentive compensation program, 11,780 RSUs for 2017 bonuses to managers under our Annual Bonus Plan and 10,899 RSUs to other employees. Generally, the RSUs cliff vest on the third anniversary of the grant date and can only be settled in shares of our common stock.

We recognized \$0.5 million and \$0.3 million of stock-based compensation expense related to outstanding RSUs for the three months ended June 30, 2018 and 2017, respectively. We recognized \$0.9 million and \$0.6 million of stock-based compensation expense related to outstanding RSUs for the six months ended June 30, 2018 and 2017, respectively. At June 30, 2018, we had unrecognized compensation cost of \$4.1 million related to unvested RSUs, which is expected to be recognized over a weighted average period of 2.2 years.

Performance-Based Restricted Stock Units

The Compensation Committee of our Board of Directors has granted awards of Performance-Based RSUs (“PSUs”) under the Amended and Restated LGI Homes, Inc. 2013 Equity Incentive Plan to certain members of senior management based on the three-year performance cycles. The PSUs provide for shares of our common stock to be issued based on the attainment of certain performance metrics over the applicable three-year periods. The number of shares of our common stock that may be issued to the recipients for the PSUs range from 0% to 200% of the target amount depending on actual results as compared to the target performance metrics. The terms of the PSUs provide that the payouts will be capped at 100% of the target number of PSUs granted if absolute total stockholder return is negative during the performance period, regardless of EPS performance; this market condition applies for amounts recorded above target. The compensation expense associated with the PSU grants is determined using the derived grant date fair value, based on a third-party valuation analysis, and expensed over the applicable period. The PSUs vest upon the determination date for the actual results at the end of the three-year period and require that the recipients continue to be employed by us through the determination date. The PSUs can only be settled in shares of our common stock.

The following table summarizes the activity of our PSUs for the six months ended June 30, 2018:

Period Granted	Performance Period	Target PSUs Outstanding at December 31, 2017	Target PSUs Granted	Target PSUs Vested	Target PSUs Forfeited	Target PSUs Outstanding at June 30, 2018	Weighted Average Grant Date Fair Value
2015	2015 - 2017	120,971	—	(120,971)	—	—	\$ 13.34
2016	2016 - 2018	87,605	—	—	(3,929)	83,676	\$ 21.79
2017	2017 - 2019	111,035	—	—	(2,788)	108,247	\$ 31.64
2018	2018 - 2020	—	61,898	—	—	61,898	\$ 64.60
Total		319,611	61,898	(120,971)	(6,717)	253,821	

At June 30, 2018, management estimates that the recipients will receive approximately 139%, 179% and 200% of the 2018, 2017 and 2016 target number of PSUs, respectively, at the end of the applicable three-year performance cycle based on projected performance compared to the target performance metrics. We recognized \$0.9 million and \$0.1 million of total stock-based compensation expense related to outstanding PSUs for the three months ended June 30, 2018 and 2017, respectively. We recognized

[Table of Contents](#)

\$1.8 million and \$1.9 million of total stock-based compensation expense related to outstanding PSUs for the six months ended June 30, 2018 and 2017, respectively. PSUs granted in 2015 vested on March 15, 2018 at 200% of the target amount, and 241,942 shares of our common stock were issued upon such vesting. At June 30, 2018, we had unrecognized compensation cost of \$8.0 million, based on the target amount, related to unvested PSUs, which is expected to be recognized over a weighted average period of 1.0 year.

10. FAIR VALUE DISCLOSURES

ASC Topic 820, *Fair Value Measurements* (“ASC 820”), defines fair value as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date” within an entity’s principal market, if any. The principal market is the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity, regardless of whether it is the market in which the entity will ultimately transact for a particular asset or liability or if a different market is potentially more advantageous. Accordingly, this exit price concept may result in a fair value that differs from the transaction price or market price of the asset or liability.

ASC 820 provides a framework for measuring fair value under GAAP, expands disclosures about fair value measurements and establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of the fair value hierarchy are summarized as follows:

Level 1 - Fair value is based on quoted prices in active markets for identical assets or liabilities.

Level 2 - Fair value is determined using significant observable inputs, generally either quoted prices in active markets for similar assets or liabilities, or quoted prices in markets that are not active.

Level 3 - Fair value is determined using one or more significant inputs that are unobservable in active markets at the measurement date, such as a pricing model, discounted cash flow or similar technique.

We utilize fair value measurements to account for certain items and account balances within our consolidated financial statements. Fair value measurements may also be utilized on a nonrecurring basis, such as for the impairment of long-lived assets. The fair value of financial instruments, including cash and cash equivalents, accounts receivable and accounts payable, approximate their carrying amounts due to the short-term nature of these instruments. As of June 30, 2018, our revolving credit facility’s carrying value approximates market value since it has a floating interest rate, which increases or decreases with market interest rates and our leverage ratio.

In order to determine the fair value of the Convertible Notes listed below, the future contractual cash flows are discounted at our estimate of current market rates of interest, which were determined based upon the average interest rates of similar convertible notes within the homebuilding industry (Level 2 measurement).

The following table below shows the level and measurement of liabilities at June 30, 2018 and December 31, 2017 (in thousands):

	Fair Value Hierarchy	June 30, 2018		December 31, 2017	
		Carrying Value	Estimated Fair Value ⁽¹⁾	Carrying Value	Estimated Fair Value ⁽¹⁾
Convertible Notes	Level 2	\$ 67,235	\$ 67,785	\$ 80,481	\$ 81,523

(1) Excludes the fair value of the equity component of the Convertible Notes. See the “Convertible Notes” section within [Note 5](#) for further details.

11. RELATED PARTY TRANSACTIONS

Land Purchases from Affiliates

In April 2018, we completed our commitments under a land purchase contract to purchase 106 finished lots in Montgomery County, Texas from an affiliate of a family member of our chief executive officer for a total base purchase price of approximately \$8.0 million. The lots were purchased in takedowns of at least 21 lots during successive six-month periods, subject to 5% annual price escalation and certain price protection terms. During the three and six months ended June 30, 2018, we purchased the final takedown of 22 lots under this land purchase contract for \$1.8 million and a \$100,000 non-refundable deposit related to this land purchase contract was applied to this takedown. During the three and six months ended June 30, 2017, we purchased 21 lots under this land purchase contract for \$1.7 million.

As of June 30, 2018, we have two land purchase contracts to purchase a total of 198 finished lots in Pasco County and Manatee County, Florida from affiliates of one of our directors for a total base purchase price of approximately \$6.9 million. The lots will be purchased in takedowns, subject to annual price escalation ranging from 3% to 6% per annum, and may provide for additional payments to the seller at the time of sale to the homebuyer. We have a \$0.7 million non-refundable deposit at June 30,

[Table of Contents](#)

2018 related to these land purchase contracts. We anticipate closing on these contracts in the fourth quarter of 2018.

Home Sales to Affiliates

We had no home closings to affiliates during the three and six months ended June 30, 2018 or the three months ended June 30, 2017. During the six months ended June 30, 2017, we closed on three homes sold to an affiliate of one of our directors for approximately \$0.7 million.

12. COMMITMENTS AND CONTINGENCIES

Contingencies

In the ordinary course of doing business, we are subject to claims or proceedings from time to time relating to the purchase, development and sale of real estate and homes and other aspects of our homebuilding operations. Management believes that these claims include usual obligations incurred by real estate developers and residential home builders in the normal course of business. In the opinion of management, these matters will not have a material effect on our consolidated financial position, results of operations or cash flows.

We have provided unsecured environmental indemnities to certain lenders and other counterparties. In each case, we have performed due diligence on the potential environmental risks including obtaining an independent environmental review from outside environmental consultants. These indemnities obligate us to reimburse the guaranteed parties for damages related to environmental matters. There is no term or damage limitation on these indemnities; however, if an environmental matter arises, we may have recourse against other previous owners. In the ordinary course of doing business, we are subject to regulatory proceedings from time to time related to environmental and other matters. In the opinion of management, these matters will not have a material effect on our consolidated financial position, results of operations or cash flows.

Land Deposits

We have land purchase contracts, generally through cash deposits, for the right to purchase land or lots at a future point in time with predetermined terms. We do not have title to the property, and obligations with respect to the land purchase contracts are generally limited to the forfeiture of the related nonrefundable cash deposits. The following is a summary of our land purchase deposits included in pre-acquisition costs and deposits (in thousands, except for lot count):

	June 30, 2018	December 31, 2017
Land deposits and option payments	\$ 27,870	\$ 17,761
Commitments under the land purchase contracts if the purchases are consummated	\$ 665,398	\$ 460,714
Lots under land purchase contracts	22,296	18,758

As of June 30, 2018 and December 31, 2017, approximately \$12.7 million and \$8.4 million, respectively, of the land deposits are related to purchase contracts to deliver finished lots that are refundable under certain circumstances and secured by mortgages, or letters of credit or guaranteed by the seller or its affiliates.

Bonding and Letters of Credit

We have outstanding letters of credit and performance and surety bonds totaling \$60.7 million (including \$10.1 million of letters of credit issued under our revolving credit facility) and \$49.7 million at June 30, 2018 and December 31, 2017, respectively, related to our obligations for site improvements at various projects. Management does not believe that draws upon the letters of credit, surety bonds or financial guarantees if any, will have a material effect on our consolidated financial position, results of operations or cash flows.

13. SEGMENT INFORMATION

Beginning in the fourth quarter of 2017, we changed our reportable segment to Central, Southwest, Southeast, Florida, Northwest and Midwest. These segments reflect the way the Company evaluates its business performance and manages its operations. Prior year information has been restated for corresponding items of our segment information.

We operate one principal homebuilding business that is organized and reports by division. We have six operating segments at June 30, 2018: our Central, Southwest, Southeast, Florida, Northwest and Midwest divisions. The Central division is our largest division and comprised approximately 41% and 42% of total home sales revenues for the six months ended June 30, 2018 and 2017, respectively.

[Table of Contents](#)

In accordance with ASC Topic 280, *Segment Reporting*, operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision-makers (“CODMs”) in deciding how to allocate resources and in assessing performance. The CODMs primarily evaluate performance based on the number of homes closed, gross margin and average sales price.

The operating segments qualify as our six reportable segments. In determining the most appropriate reportable segments, we consider operating segments’ economic and other characteristics, including home floor plans, average selling prices, gross margin percentage, geographical proximity, production construction processes, suppliers, subcontractors, regulatory environments, customer type and underlying demand and supply. Each operating segment follows the same accounting policies and is managed by our management team. We have no inter-segment sales, as all sales are to external customers. Operating results for each segment may not be indicative of the results for such segment had it been an independent, stand-alone entity for the periods presented.

Financial information relating to our reportable segments was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues:				
Central	\$ 181,268	\$ 139,762	\$ 288,766	\$ 204,680
Southwest	73,030	63,258	127,313	96,384
Southeast	60,369	51,487	105,477	79,334
Florida	55,018	48,974	97,461	73,174
Northwest	49,463	20,697	79,155	33,517
Midwest	699	—	699	—
Total home sales revenues	\$ 419,847	\$ 324,178	\$ 698,871	\$ 487,089
Net income (loss) before income taxes:				
Central	\$ 34,225	\$ 26,000	\$ 50,043	\$ 34,421
Southwest	10,189	8,612	15,175	11,177
Southeast	7,599	6,606	11,926	8,920
Florida	7,585	6,494	11,557	8,792
Northwest	5,793	2,444	8,850	3,812
Midwest	(688)	(123)	(1,200)	(227)
Corporate ⁽¹⁾	(2,032)	(1,391)	(2,453)	(1,411)
Total net income (loss) before income taxes	\$ 62,671	\$ 48,642	\$ 93,898	\$ 65,484

(1) The Corporate balance consists primarily of general and administration unallocated costs for various shared service functions, as well as our warranty reserve. Actual warranty expenses are reflected within the reportable segments.

	June 30, 2018	December 31, 2017
Assets:		
Central	\$ 495,185	\$ 439,833
Southwest	188,939	175,786
Southeast	204,101	155,928
Florida	105,883	119,257
Northwest	130,574	80,350
Midwest	20,749	15,066
Corporate ⁽¹⁾	54,488	93,672
Total assets	\$ 1,199,919	\$ 1,079,892

(1) As of June 30, 2018, the Corporate balance consists primarily of cash, prepaid insurance, and prepaid expenses. As of December 31, 2017, the Corporate balance consists primarily of cash, deposits and pre-acquisition costs, prepaid insurance, and prepaid expenses. \$18.9 million of deposits and pre-acquisition costs were reported at Corporate as of December 31, 2017 and balances as of June 30, 2018 were allocated to the six reportable segments.

14. SUBSEQUENT EVENTS

Senior Notes Offering

On July 6, 2018, we issued \$300.0 million aggregate principal amount of our 6.875% Senior Notes due 2026 (the “Senior Notes”) in an offering to persons reasonably believed to be qualified institutional buyers in the United States pursuant to Rule 144A under the Securities Act and to certain non-U.S. persons in transactions outside the United States pursuant to Regulation S under the Securities Act. Interest on the Senior Notes accrues at a rate of 6.875% per annum, payable semi-annually in arrears on January 15 and July 15 of each year, commencing on January 15, 2019 and maturing on July 15, 2026. Terms of the Senior Notes are governed by an indenture, dated July 6, 2018, among us, the Subsidiary Guarantors and Wilmington Trust, National Association, as trustee.

We received net proceeds from the offering of the Senior Notes of approximately \$296.2 million, after deducting the initial purchasers’ discounts and commissions and offering expenses. The net proceeds from the offering were used to repay a portion of the borrowings under the Credit Agreement. The impact of the offering of the Senior Notes will be recorded in the third quarter of 2018.

In connection with the issuance of the Senior Notes, we reduced the revolving commitment under the Credit Agreement from \$750.0 million to \$450.0 million pursuant to the First Amendment. We expect to record approximately \$3.1 million in debt extinguishment costs related to the Credit Agreement during the third quarter of 2018.

Wynn Acquisition

On August 2, 2018, we acquired certain real estate assets owned by Wynn Homes and its affiliates for a purchase price of approximately \$80.0 million, subject to certain post-closing adjustments. We paid the cash closing payment of \$74.3 million using cash on hand and borrowings under our revolving credit facility. We acquired approximately 200 homes under construction and approximately 4,000 owned and controlled lots in central and eastern North Carolina, assumed certain land acquisition and land development contracts of Wynn Homes and acquired certain tangible and intangible assets. As a portion of the purchase price, we will issue to the owner of Wynn Homes, within 30 days after August 2, 2018, subject to the owner of Wynn Homes meeting certain requirements, a number of unregistered shares of our common stock equal to (i) \$4,000,000 divided by (ii) the lesser of (a) the average of the closing sale price of our common stock for each of the ten trading days immediately prior to the date of August 2, 2018, or (b) the average of the closing sale price of our common stock for each of the five trading days immediately following August 7, 2018. Additionally, the acquisition provides that, in the event that we acquire certain specified developed or undeveloped real property following the August 2, 2018 acquisition date, we shall pay to the the owner of Wynn Homes an agreed cash amount for such property on the date of such acquisition, subject to certain restrictions. Due to the closing of this acquisition subsequent to the period end, we are currently determining the fair value of assets acquired and liabilities assumed necessary to develop the purchase price allocation. Therefore, disclosure of the purchase price allocation to the tangible and intangible assets acquired and liabilities assumed is not practicable.

[Table of Contents](#)

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For purposes of this Management's Discussion and Analysis of Financial Condition and Results of Operation, references to "we," "our," "us" or similar terms refer to LGI Homes, Inc. and its subsidiaries.

Business Overview

We are engaged in the design, construction and sale of new homes in the following markets:

Central	Southwest	Southeast	Florida	Northwest	Midwest
Houston, TX	Phoenix, AZ	Atlanta, GA	Tampa, FL	Seattle, WA	Minneapolis, MN
Dallas/Ft. Worth, TX	Tucson, AZ	Charlotte, NC/SC	Orlando, FL	Portland, OR	
San Antonio, TX	Albuquerque, NM	Nashville, TN	Fort Myers, FL	Sacramento, CA	
Austin, TX	Denver, CO	Raleigh, NC	Jacksonville, FL		
Oklahoma City, OK	Colorado Springs, CO	Winston-Salem, NC			
		Birmingham, AL			

Our management team has been in the residential land development business since the mid-1990s. Since commencing home building operations in 2003, we have constructed and closed over 25,000 homes. During the six months ended June 30, 2018, we had 3,059 home closings, compared to 2,272 home closings during the six months ended June 30, 2017.

We sell homes under the LGI Homes and Terrata Homes brands. Our 79 active communities at June 30, 2018 included five Terrata Homes communities.

Recent Developments

During June 2018, we closed on our first home in the Sacramento, California market.

On July 6, 2018, we completed an offering of \$300.0 million aggregate principal amount of our 6.875% Senior Notes due 2026 (the "Senior Notes"). We received net proceeds from the offering of the Senior Notes of approximately \$296.2 million, after deducting the initial purchasers' discounts and commissions and offering expenses. The net proceeds from the offering were used to repay a portion of the borrowings under the Credit Agreement.

On August 2, 2018, we acquired certain real estate assets owned by Wynn Homes and its affiliates for a purchase price of approximately \$80.0 million, subject to certain post-closing adjustments. As a portion of the purchase price, we will issue to the owner of Wynn Homes, unregistered shares of our common stock, with the actual number of shares to be determined based on the lower of (i) the average stock price over a period of time prior to the acquisition or (ii) the average closing price of our common stock over a period of time occurring after the filing of this Quarterly Report on Form 10-Q.

Key Results

Key financial results as of and for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, were as follows:

- Home sales revenues increased 29.5% to \$419.8 million from \$324.2 million.
- Homes closed increased 20.1% to 1,815 homes from 1,511 homes.
- Average sales price of our homes increased 7.8% to \$231,321 from \$214,545.
- Gross margin as a percentage of home sales revenues decreased to 26.1% from 26.6%.
- Adjusted gross margin (non-GAAP) as a percentage of home sales revenues decreased to 27.7% from 28.0%.
- Net income before income taxes increased 28.8% to \$62.7 million from \$48.6 million.
- Net income increased 47.9% to \$47.6 million from \$32.2 million.
- EBITDA (non-GAAP) as a percentage of home sales revenues remained flat at 16.4%.
- Adjusted EBITDA (non-GAAP) as a percentage of home sales revenues remained flat at 16.4%.
- Total owned and controlled lots increased 3.4% to 46,855 lots at June 30, 2018 from 45,321 lots at March 31, 2018.

For reconciliations of the non-GAAP financial measures of adjusted gross margin, EBITDA and adjusted EBITDA to the most directly comparable GAAP financial measures, please see "[—Non-GAAP Measures.](#)"

[Table of Contents](#)

Key financial results as of and for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, were as follows:

- Home sales revenues increased 43.5% to \$698.9 million from \$487.1 million.
- Homes closed increased 34.6% to 3,059 homes from 2,272 homes.
- Average sales price of our homes increased 6.6% to \$228,464 from \$214,388.
- Gross margin as a percentage of home sales revenues decreased to 25.6% from 26.7%.
- Adjusted gross margin (non-GAAP) as a percentage of home sales revenues decreased to 27.2% from 28.0%.
- Net income before income taxes increased 43.4% to \$93.9 million from \$65.5 million.
- Net income increased 70.3% to \$74.9 million from \$44.0 million.
- EBITDA (non-GAAP) as a percentage of home sales revenues increased to 14.9% from 14.7%.
- Adjusted EBITDA (non-GAAP) as a percentage of home sales revenues increased to 14.9% from 14.7%.
- Total owned and controlled lots increased 18.0% to 46,855 lots at June 30, 2018 from 39,709 lots at December 31, 2017.

For reconciliations of the non-GAAP financial measures of adjusted gross margin, EBITDA and adjusted EBITDA to the most directly comparable GAAP financial measures, please see “[—Non-GAAP Measures.](#)”

[Table of Contents](#)

Results of Operations

The following table sets forth our results of operations for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
(dollars in thousands, except per share data and average home sales price)				
Statement of Income Data:				
Home sales revenues	\$ 419,847	\$ 324,178	\$ 698,871	\$ 487,089
Expenses:				
Cost of sales	310,082	237,830	519,847	357,242
Selling expenses	29,301	24,193	52,250	40,300
General and administrative	18,302	13,680	33,742	24,945
Operating income	62,162	48,475	93,032	64,602
Other income, net	(509)	(167)	(866)	(882)
Net income before income taxes	62,671	48,642	93,898	65,484
Income tax provision	15,063	16,443	18,988	21,505
Net income	\$ 47,608	\$ 32,199	\$ 74,910	\$ 43,979
Basic earnings per share	\$ 2.11	\$ 1.49	\$ 3.34	\$ 2.05
Diluted earnings per share	\$ 1.90	\$ 1.39	\$ 3.01	\$ 1.91
Other Financial and Operating Data:				
Active communities at end of period	79	71	79	71
Home closings	1,815	1,511	3,059	2,272
Average sales price of homes closed	\$ 231,321	\$ 214,545	\$ 228,464	\$ 214,388
Gross margin ⁽¹⁾	\$ 109,765	\$ 86,348	\$ 179,024	\$ 129,847
Gross margin % ⁽²⁾	26.1%	26.6%	25.6%	26.7%
Adjusted gross margin ⁽³⁾	\$ 116,353	\$ 90,823	\$ 189,921	\$ 136,432
Adjusted gross margin % ⁽²⁾⁽³⁾	27.7%	28.0%	27.2%	28.0%
EBITDA ⁽⁴⁾	\$ 69,445	\$ 53,175	\$ 105,164	\$ 72,303
EBITDA margin % ⁽²⁾⁽⁴⁾	16.4%	16.4%	14.9%	14.7%
Adjusted EBITDA ⁽⁴⁾	\$ 68,936	\$ 53,145	\$ 104,295	\$ 71,593
Adjusted EBITDA margin % ⁽²⁾⁽⁴⁾	16.4%	16.4%	14.9%	14.7%

(1) Gross margin is home sales revenues less cost of sales.

(2) Calculated as a percentage of home sales revenues.

(3) Adjusted gross margin is a non-GAAP financial measure used by management as a supplemental measure in evaluating operating performance. We define adjusted gross margin as gross margin less capitalized interest and adjustments resulting from the application of purchase accounting included in cost of sales. Our management believes this information is useful because it isolates the impact that capitalized interest and purchase accounting adjustments have on gross margin. However, because adjusted gross margin information excludes capitalized interest and purchase accounting adjustments, which have real economic effects and could impact our results, the utility of adjusted gross margin information as a measure of our operating performance may be limited. In addition, other companies may not calculate adjusted gross margin information in the same manner that we do. Accordingly, adjusted gross margin information should be considered only as a supplement to gross margin information as a measure of our performance. Please see "[Non-GAAP Measures](#)" for a reconciliation of adjusted gross margin to gross margin, which is the GAAP financial measure that our management believes to be most directly comparable.

(4) EBITDA and adjusted EBITDA are non-GAAP financial measures used by management as supplemental measures in evaluating operating performance. We define EBITDA as net income before (i) interest expense, (ii) income taxes, (iii) depreciation and amortization and (iv) capitalized interest charged to the cost of sales. We define adjusted EBITDA as net income before (i) interest expense, (ii) income taxes, (iii) depreciation and amortization, (iv) capitalized interest charged to the cost of sales, (v) other income, net and (vi) adjustments resulting from the application of purchase accounting. Our management believes that the presentation of EBITDA and adjusted EBITDA provides useful information to investors regarding our results of operations because it assists both investors and management in analyzing and benchmarking the performance and value of our business. EBITDA and adjusted EBITDA provide indicators of general economic performance that are not affected by fluctuations in interest rates or effective tax rates, levels of depreciation or amortization and items

[Table of Contents](#)

considered to be unusual or non-recurring. Accordingly, our management believes that these measures are useful for comparing general operating performance from period to period. Other companies may define these measures differently and, as a result, our measures of EBITDA and adjusted EBITDA may not be directly comparable to the measures of other companies. Although we use EBITDA and adjusted EBITDA as financial measures to assess the performance of our business, the use of these measures is limited because they do not include certain material costs, such as interest and taxes, necessary to operate our business. EBITDA and adjusted EBITDA should be considered in addition to, and not as a substitute for, net income in accordance with GAAP as a measure of performance. Our presentation of EBITDA and adjusted EBITDA should not be construed as an indication that our future results will be unaffected by unusual or non-recurring items. Our use of EBITDA and adjusted EBITDA is limited as an analytical tool, and you should not consider these measures in isolation or as substitutes for analysis of our results as reported under GAAP. Please see “[Non-GAAP Measures](#)” for a reconciliations of EBITDA and adjusted EBITDA to net income, which is the GAAP financial measure that our management believes to be most directly comparable.

[Table of Contents](#)

Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Homes Sales. Our home sales revenues, closings, average sales price (ASP) and ending community count by division for the three months ended June 30, 2018 and 2017 were as follows (revenues in thousands):

	Three Months Ended June 30,					
	2018			2017		
	Revenues	Closings	ASP	Revenues	Closings	ASP
Central	\$ 181,268	850	\$ 213,256	\$ 139,762	679	\$ 205,835
Southwest	73,030	262	278,740	63,258	248	255,073
Southeast	60,369	298	202,581	51,487	275	187,225
Florida	55,018	257	214,078	48,974	245	199,894
Northwest	49,463	145	341,124	20,697	64	323,391
Midwest	699	3	233,000	—	—	—
Total home sales revenues	\$ 419,847	1,815	\$ 231,321	\$ 324,178	1,511	\$ 214,545

	As of June 30,	
	2018	2017
Community count		
Central	29	25
Southwest	14	16
Southeast	17	14
Florida	12	12
Northwest	5	4
Midwest	2	—
Total community count	79	71

Home sales revenues for the three months ended June 30, 2018 were \$419.8 million, an increase of \$95.7 million, or 29.5%, from \$324.2 million for the three months ended June 30, 2017. The increase in home sales revenues is primarily due to a 20.1% increase in homes closed and an increase in the average sales price per home during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017. The increase in home closings was largely due to the increase in the number of active communities in the three months ended June 30, 2018 as compared to the three months ended June 30, 2017. The average sales price per home closed during the three months ended June 30, 2018 was \$231,321, an increase of \$16,776, or 7.8%, from the average sales price per home of \$214,545 for the three months ended June 30, 2017. The increase in the average sales price per home is primarily due to changes in product mix, price points in new markets and a favorable pricing environment. We increased our home sales revenues in our Central division by \$41.5 million, or 29.7% of home sales revenues, during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017, representing a 25.2% increase in the number of homes closed in this division during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017. We increased our home sales revenues outside of the Central division by \$54.2 million, or 29.4% of home sales revenues, during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017, representing a 16.0% increase in the number of homes closed in these divisions during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017. Our active selling communities at June 30, 2018 increased to 79 from 71 at June 30, 2017. Four of the eight active selling communities added between June 30, 2017 and June 30, 2018 were outside of our Central division. All divisions added communities by expanding into new markets or deepening existing markets with the exception of the Southwest division, which had two fewer active communities due to close out or transition between certain of its active communities, and our Florida division, which maintained the same level of active communities for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017.

Cost of Sales and Gross Margin (home sales revenues less cost of sales). Cost of sales increased for the three months ended June 30, 2018 to \$310.1 million, an increase of \$72.3 million, or 30.4%, from \$237.8 million for the three months ended June 30, 2017. This increase is primarily due to a 20.1% increase in homes closed during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017, and, to a lesser degree, product mix and higher construction costs. Gross margin for the three months ended June 30, 2018 was \$109.8 million, an increase of \$23.4 million, or 27.1%, from \$86.3 million for the three months ended June 30, 2017. Gross margin as a percentage of home sales revenues was 26.1% for the three months ended June 30, 2018 and 26.6% for the three months ended June 30, 2017. This decrease in gross margin as a percentage of home sales revenues is primarily due to a combination of higher construction costs and to a lesser extent due to 103 wholesale home closings during

[Table of Contents](#)

the three months ended June 30, 2018 compared to 65 wholesale home closings during the three months ended June 30, 2017, partially offset by higher average home sales prices.

Selling Expenses. Selling expenses for the three months ended June 30, 2018 were \$29.3 million, an increase of \$5.1 million, or 21.1%, from \$24.2 million for the three months ended June 30, 2017. Sales commissions increased to \$16.3 million for the three months ended June 30, 2018 from \$12.6 million for the three months ended June 30, 2017, primarily due to a 29.5% increase in home sales revenues during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017. Selling expenses as a percentage of home sales revenues were 7.0% and 7.5% for the three months ended June 30, 2018 and 2017, respectively. The decrease in selling expenses as a percentage of home sales revenues reflects operating leverage realized from the increase in home sales revenues.

General and Administrative. General and administrative expenses for the three months ended June 30, 2018 were \$18.3 million, an increase of \$4.6 million, or 33.8%, from \$13.7 million for the three months ended June 30, 2017. The increase in general and administrative expenses as a percentage of home sales revenues is 4.4% and 4.2% for the three months ended June 30, 2018 and 2017, respectively. The increases are primarily due to professional fees and additional compensation costs associated with an increase of active communities and home closings during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017.

Operating Income, Net Income before Taxes and Net Income. Operating income for the three months ended June 30, 2018 was \$62.2 million, an increase of \$13.7 million, or 28.2%, from \$48.5 million for the three months ended June 30, 2017. Net income before income taxes for the three months ended June 30, 2018 was \$62.7 million, an increase of \$14.0 million, or 28.8%, from \$48.6 million for the three months ended June 30, 2017. The following divisions contributed to net income before income taxes during the three months ended June 30, 2018: Central - \$34.2 million or 54.6%; Southwest - \$10.2 million or 16.3%; Florida - \$7.6 million or 12.1%; Southeast - \$7.6 million or 12.1%; and Northwest - \$5.8 million or 9.2%. Net income for the three months ended June 30, 2018 was \$47.6 million, an increase of \$15.4 million, or 47.9%, from \$32.2 million for the three months ended June 30, 2017. The increases in operating income, net income before taxes and net income are primarily attributed to a 20.1% increase in homes closed, the 7.8% increase in average home sales price, a decrease in the effective tax rate, and operating leverage realized related to selling expenses during the three months ended June 30, 2018 as compared to the three months ended June 30, 2017.

Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017

Homes Sales. Our home sales revenues, closings and average sales price (ASP) by division for the six months ended June 30, 2018 and 2017 were as follows (revenues in thousands):

	Six Months Ended June 30,					
	2018			2017		
	Revenues	Closings	ASP	Revenues	Closings	ASP
Central	\$ 288,766	1,371	\$ 210,624	\$ 204,680	994	\$ 205,915
Southwest	127,313	459	277,370	96,384	380	253,642
Southeast	105,477	527	200,146	79,334	426	186,230
Florida	97,461	466	209,144	73,174	368	198,842
Northwest	79,155	233	339,721	33,517	104	322,279
Midwest	699	3	233,000	—	—	—
Total home sales revenues	\$ 698,871	3,059	\$ 228,464	\$ 487,089	2,272	\$ 214,388

Home sales revenues for the six months ended June 30, 2018 were \$698.9 million, an increase of \$211.8 million, or 43.5%, from \$487.1 million for the six months ended June 30, 2017. The increase in home sales revenues is primarily due to a 34.6% increase in homes closed and an increase in the average sales price per home during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. This increase in home closings was largely due to the overall increase in the number of active communities in the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. The average sales price per home closed during the six months ended June 30, 2018 was \$228,464, an increase of \$14,076, or 6.6%, from the average sales price per home of \$214,388 for the six months ended June 30, 2017. This increase in the average sales price per home was primarily due to changes in product mix, higher price points in certain new markets and a favorable pricing environment. We increased our home sales revenues in our Central division by \$84.1 million, or 41.1% of home sales revenues, during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017, representing a 37.9% increase in the number of homes closed in this division during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. We increased our home sales revenues in our divisions other than our Central division by \$127.7 million, or 45.2% of home sales revenues, during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017, representing

[Table of Contents](#)

a 32.1% increase in the number of homes closed in these divisions during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. Our active selling communities at June 30, 2018 increased to 79 from 71 at June 30, 2017. Four of the eight active selling communities added between June 30, 2017 and June 30, 2018 were outside of our Central division, contributing to the further geographic diversification of our business. All divisions added communities by expanding into new markets or deepening existing markets with the exception of the Southwest division, which had two fewer active communities due to close out or transition between certain of its active communities, and our Florida division, which maintained the same level of active communities for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017.

Cost of Sales and Gross Margin (home sales revenues less cost of sales). Cost of sales increased for the six months ended June 30, 2018 to \$519.8 million, an increase of \$162.6 million, or 45.5%, from \$357.2 million for the six months ended June 30, 2017. This increase is primarily due to a 34.6% increase in homes closed during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017, and to a lesser degree, product mix. The increase in average cost of sales per home is primarily due to changes in construction costs associated with product mix and lot costs. Gross margin for the six months ended June 30, 2018 was \$179.0 million, an increase of \$49.2 million, or 37.9%, from \$129.8 million for the six months ended June 30, 2017. Gross margin as a percentage of home sales revenues was 25.6% for the six months ended June 30, 2018 and 26.7% for the six months ended June 30, 2017. This decrease in gross margin as a percentage of home sales revenues is primarily due to a combination of higher construction costs and lot costs partially offset by higher average home sales price for the six months ended June 30, 2018 as compared to the six months ended June 30, 2017, and to a lesser extent due to 134 wholesale home closings during the six months ended June 30, 2018 compared to 72 wholesale home closings during the six months ended June 30, 2017.

Selling Expenses. Selling expenses for the six months ended June 30, 2018 were \$52.3 million, an increase of \$12.0 million, or 29.7%, from \$40.3 million for the six months ended June 30, 2017. Sales commissions increased to \$27.4 million for the six months ended June 30, 2018 from \$19.1 million for the six months ended June 30, 2017, largely due to a 43.5% increase in home sales revenues during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. Selling expenses as a percentage of home sales revenues were 7.5% and 8.3% for the six months ended June 30, 2018 and 2017, respectively. The decrease in selling expenses as a percentage of home sales revenues reflects operating leverage realized from the increase in home sales revenues during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017.

General and Administrative. General and administrative expenses for the six months ended June 30, 2018 were \$33.7 million, an increase of \$8.8 million, or 35.3%, from \$24.9 million for the six months ended June 30, 2017. The increase in the amount of general and administrative expenses is primarily due to professional fees and additional compensation costs associated with an increase of active communities and home closings during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017. General and administrative expenses as a percentage of home sales revenues were 4.8% and 5.1% for the six months ended June 30, 2018 and 2017, respectively. The decrease in general and administrative expenses as a percentage of home sales revenues reflects leverage realized from the increase in home sales revenues during the six months ended June 30, 2018 as compared to the six months ended June 30, 2017.

Operating Income, Net Income before Income Taxes and Net Income. Operating income for the six months ended June 30, 2018 was \$93.0 million, an increase of \$28.4 million, or 44.0%, from \$64.6 million for the six months ended June 30, 2017. Net income before income taxes for the six months ended June 30, 2018 was \$93.9 million, an increase of \$28.4 million, or 43.4%, from \$65.5 million for the six months ended June 30, 2017. The following divisions contributed to net income before income taxes during the six months ended June 30, 2018: Central - \$50.0 million or 53.3%; Southwest - \$15.2 million or 16.2%; Florida - \$11.6 million or 12.3%; Southeast - \$11.9 million or 12.7%; and Northwest - \$8.9 million or 9.4%. Net income for the six months ended June 30, 2018 was \$74.9 million, an increase of \$30.9 million, or 70.3%, from \$44.0 million for the six months ended June 30, 2017. The increases in operating income, net income before income taxes and net income are primarily attributed to a 34.6% increase in homes closed, a higher average sales price, a decrease in the effective tax rate, and improved leverage realized during the six months ended June 30, 2018 as compared to six months ended June 30, 2017.

Non-GAAP Measures

In addition to the results reported in accordance with U.S. GAAP, we have provided information in this Quarterly Report on Form 10-Q relating to adjusted gross margin, EBITDA and adjusted EBITDA.

Adjusted Gross Margin

Adjusted gross margin is a non-GAAP financial measure used by management as a supplemental measure in evaluating operating performance. We define adjusted gross margin as gross margin less capitalized interest and adjustments resulting from the application of purchase accounting included in the cost of sales. Our management believes this information is useful because it isolates the impact that capitalized interest and purchase accounting adjustments have on gross margin. However, because adjusted gross margin information excludes capitalized interest and purchase accounting adjustments, which have real economic effects and could impact our results, the utility of adjusted gross margin information as a measure of our operating performance may be limited. In addition,

[Table of Contents](#)

other companies may not calculate adjusted gross margin information in the same manner that we do. Accordingly, adjusted gross margin information should be considered only as a supplement to gross margin information as a measure of our performance.

The following table reconciles adjusted gross margin to gross margin, which is the GAAP financial measure that our management believes to be most directly comparable (dollars in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Home sales revenues	\$ 419,847	\$ 324,178	\$ 698,871	\$ 487,089
Cost of sales	310,082	237,830	519,847	357,242
Gross margin	109,765	86,348	179,024	129,847
Capitalized interest charged to cost of sales	6,588	4,338	10,900	6,413
Purchase accounting adjustments ⁽¹⁾	—	137	(3)	172
Adjusted gross margin	\$ 116,353	\$ 90,823	\$ 189,921	\$ 136,432
Gross margin % ⁽²⁾	26.1%	26.6%	25.6%	26.7%
Adjusted gross margin % ⁽²⁾	27.7%	28.0%	27.2%	28.0%

(1) Adjustments result from the application of purchase accounting for acquisitions and represent the amount of the fair value step-up adjustments included in cost of sales for real estate inventory sold after the acquisition dates.

(2) Calculated as a percentage of home sales revenues.

EBITDA and Adjusted EBITDA

EBITDA and adjusted EBITDA are non-GAAP financial measures used by management as supplemental measures in evaluating operating performance. We define EBITDA as net income before (i) interest expense, (ii) income taxes, (iii) depreciation and amortization and (iv) capitalized interest charged to the cost of sales. We define adjusted EBITDA as net income before (i) interest expense, (ii) income taxes, (iii) depreciation and amortization, (iv) capitalized interest charged to the cost of sales, (v) other income, net and (vi) adjustments resulting from the application of purchase accounting included in the cost of sales. Our management believes that the presentation of EBITDA and adjusted EBITDA provides useful information to investors regarding our results of operations because it assists both investors and management in analyzing and benchmarking the performance and value of our business. EBITDA and adjusted EBITDA provide indicators of general economic performance that are not affected by fluctuations in interest rates or effective tax rates, levels of depreciation or amortization and items considered to be unusual or non-recurring. Accordingly, our management believes that these measures are useful for comparing general operating performance from period to period. Other companies may define these measures differently and, as a result, our measures of EBITDA and adjusted EBITDA may not be directly comparable to the measures of other companies. Although we use EBITDA and adjusted EBITDA as financial measures to assess the performance of our business, the use of these measures is limited because they do not include certain material costs, such as interest and taxes, necessary to operate our business. EBITDA and adjusted EBITDA should be considered in addition to, and not as a substitute for, net income in accordance with GAAP as a measure of performance. Our presentation of EBITDA and adjusted EBITDA should not be construed as an indication that our future results will be unaffected by unusual or non-recurring items. Our use of EBITDA and adjusted EBITDA is limited as an analytical tool, and you should not consider these measures in isolation or as substitutes for analysis of our results as reported under GAAP. Some of these limitations are:

- (i) they do not reflect every cash expenditure, future requirements for capital expenditures or contractual commitments, including for purchase of land;
- (ii) they do not reflect the interest expense or the cash requirements necessary to service interest or principal payments on our debt;
- (iii) although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced or require improvements in the future, and EBITDA and adjusted EBITDA do not reflect any cash requirements for such replacements or improvements;
- (iv) they are not adjusted for all non-cash income or expense items that are reflected in our statements of cash flows;
- (v) they do not reflect the impact of earnings or charges resulting from matters we consider not to be indicative of our ongoing operations; and
- (vi) other companies in our industry may calculate them differently than we do, limiting their usefulness as a comparative measure.

Because of these limitations, our EBITDA and adjusted EBITDA should not be considered as measures of discretionary cash available to us to invest in the growth of our business or as measures of cash that will be available to us to meet our obligations. We compensate for these limitations by using our EBITDA and adjusted EBITDA along with other comparative tools, together with

[Table of Contents](#)

GAAP measures, to assist in the evaluation of operating performance. These GAAP measures include operating income, net income and cash flow data. We have significant uses of cash flows, including capital expenditures, interest payments and other non-recurring charges, which are not reflected in our EBITDA or adjusted EBITDA. EBITDA and adjusted EBITDA are not intended as alternatives to net income as indicators of our operating performance, as alternatives to any other measure of performance in conformity with GAAP or as alternatives to cash flows as a measure of liquidity. You should therefore not place undue reliance on our EBITDA or adjusted EBITDA calculated using these measures.

The following table reconciles EBITDA and adjusted EBITDA to net income, which is the GAAP measure that our management believes to be most directly comparable (dollars in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$ 47,608	\$ 32,199	\$ 74,910	\$ 43,979
Income taxes	15,063	16,443	18,988	21,505
Depreciation and amortization	186	195	366	406
Capitalized interest charged to cost of sales	6,588	4,338	10,900	6,413
EBITDA	69,445	53,175	105,164	72,303
Purchase accounting adjustments ⁽¹⁾	—	137	(3)	172
Other income, net	(509)	(167)	(866)	(882)
Adjusted EBITDA	\$ 68,936	\$ 53,145	\$ 104,295	\$ 71,593
EBITDA margin % ⁽²⁾	16.4%	16.4%	14.9%	14.7%
Adjusted EBITDA margin % ⁽²⁾	16.4%	16.4%	14.9%	14.7%

(1) Adjustments result from the application of purchase accounting related to prior acquisitions and represent the amount of the fair value step-up adjustments for real estate inventory included in cost of sales.

(2) Calculated as a percentage of home sales revenues.

Backlog

We sell our homes under standard purchase contracts, which generally require a homebuyer to pay a deposit at the time of signing the purchase contract. The amount of the required deposit is minimal (generally \$1,000 or less). The deposits are refundable if the retail homebuyer is unable to obtain mortgage financing. We permit our retail homebuyers to cancel the purchase contract and obtain a refund of their deposit in the event mortgage financing cannot be obtained within a certain period of time, as specified in their purchase contract. Typically, our retail homebuyers provide documentation regarding their ability to obtain mortgage financing within 14 days after the purchase contract is signed. If we determine that the homebuyer is not qualified to obtain mortgage financing or is not otherwise financially able to purchase the home, we will terminate the purchase contract. If a purchase contract has not been cancelled or terminated within 14 days after the purchase contract has been signed, then the homebuyer has met the preliminary criteria to obtain mortgage financing. Only purchase contracts that are signed by homebuyers who have met the preliminary criteria to obtain mortgage financing are included in new (gross) orders.

Our “backlog” consists of homes that are under a purchase contract that has been signed by homebuyers who have met the preliminary criteria to obtain mortgage financing but have not yet closed. Since our business model is generally based on building move-in ready homes before a purchase contract is signed, the majority of our homes in backlog are currently under construction or complete. Ending backlog represents the number of homes in backlog from the previous period plus the number of net orders (new orders for homes less cancellations) generated during the current period minus the number of homes closed during the current period. Our backlog at any given time will be affected by cancellations, the number of our active communities and the timing of home closings. Homes in backlog are generally closed within one to two months, although we may experience cancellations of purchase contracts at any time prior to closing. It is important to note that net orders, backlog and cancellation metrics are operational, rather than accounting data, and should be used only as a general gauge to evaluate performance. Backlog may be impacted by customer cancellations for various reasons that are beyond our control, and in light of our minimal required deposit, there is little negative impact to the potential homebuyer from the cancellation of the purchase contract.

[Table of Contents](#)

As of the dates set forth below, our net orders, cancellation rate and ending backlog homes and value were as follows (dollars in thousands):

Backlog Data	Six Months Ended June 30,	
	2018 ⁽⁴⁾	2017 ⁽⁵⁾
Net orders ⁽¹⁾	3,427	3,371
Cancellation rate ⁽²⁾	22.5%	21.3%
Ending backlog – homes ⁽³⁾	1,184	1,545
Ending backlog – value ⁽³⁾	\$ 296,904	\$ 352,543

- (1) Net orders are new (gross) orders for the purchase of homes during the period, less cancellations of existing purchase contracts during the period.
- (2) Cancellation rate for a period is the total number of purchase contracts cancelled during the period divided by the total new (gross) orders for the purchase of homes during the period.
- (3) Ending backlog consists of homes at the end of the period that are under a purchase contract that has been signed by homebuyers who have met our preliminary financing criteria but have not yet closed and wholesale contracts for which the required deposit has been made. Ending backlog is valued at the contract amount.
- (4) 41 units and values related to bulk sales agreements are not included in the table above.
- (5) 59 units and values related to bulk sales agreements are not included in the table above.

Land Acquisition Policies and Development

We increased our active communities to 79 as of June 30, 2018 from 78 as of December 31, 2017. We also increased our lot inventory to 46,855 owned or controlled lots as of June 30, 2018 from 39,709 owned or controlled lots as of December 31, 2017.

The table below shows (i) home closings by division for the six months ended June 30, 2018 and (ii) our owned or controlled lots by division as of June 30, 2018.

Division	Six Months Ended June 30, 2018	As of June 30, 2018		
	Home Closings	Owned ⁽¹⁾	Controlled	Total
Central	1,371	13,656	10,190	23,846
Southwest	459	2,445	1,672	4,117
Southeast	527	5,010	7,535	12,545
Florida	466	2,034	1,566	3,600
Northwest	233	1,143	1,292	2,435
Midwest	3	271	41	312
Total	3,059	24,559	22,296	46,855

- (1) Of the 24,559 owned lots as of June 30, 2018, 14,823 were raw/under development lots and 9,736 were finished lots.

Homes in Inventory

When entering a new community, we build a sufficient number of move-in ready homes to meet our budgets. We base future home starts on closings. As homes are closed, we start more homes to maintain our inventory. As of June 30, 2018, we had a total of 1,522 completed homes, including information centers, and 1,781 homes in progress.

Raw Materials and Labor

When constructing homes, we use various materials and components. We generally contract for our materials and labor at a fixed price for the anticipated construction period of our homes. This allows us to mitigate the risks associated with increases in building materials and labor costs between the time construction begins on a home and the time it is closed. Typically, the raw materials and most of the components used in our business are readily available in the United States. In addition, the majority of our raw materials is supplied to us by our subcontractors, and is included in the price of our contract with such subcontractors. Most of the raw materials necessary for our subcontractors are standard items carried by major suppliers. Substantially all of our construction work is done by third-party subcontractors, most of whom are non-unionized. We continue to monitor the supply

[Table of Contents](#)

markets to achieve the best prices available. Typically, the price changes that most significantly influence our operations are price increases in labor, commodities and lumber.

Seasonality

In all of our regions, we have historically experienced similar variability in our results of operations and in capital requirements from quarter to quarter due to the seasonal nature of the homebuilding industry. We generally close more homes in our second, third and fourth quarters of the year. Thus, our revenue may fluctuate on a quarterly basis and we may have higher capital requirements in our second, third and fourth quarters in order to maintain our inventory levels. Our revenue and capital requirements are generally similar across our second, third and fourth quarters.

As a result of seasonal activity, our quarterly results of operation and financial position at the end of a particular quarter, especially the first quarter, are not necessarily representative of the results we expect at year end. We expect this seasonal pattern to continue in the long term.

Liquidity and Capital Resources

Overview

As of June 30, 2018, we had \$48.9 million of cash and cash equivalents. Cash flows for each of our active communities depend on the status of the development cycle and can differ substantially from reported earnings. Early stages of development or expansion require significant cash outlays for land acquisitions, land development, plats, vertical development, construction of information centers, general landscaping and other amenities. Because these costs are a component of our inventory and are not recognized in our statement of operations until a home closes, we incur significant cash outflows prior to recognition of home sales revenues. In the later stages of an active community, cash inflows may exceed home sales revenues reported for financial statement purposes, as the costs associated with home and land construction were previously incurred.

Our principal uses of capital are operating expenses, land and lot purchases, lot development, home construction, interest costs on our indebtedness and the payment of various liabilities. In addition, we may purchase land, lots, homes under construction or other assets as part of a business combination.

We generally rely on our ability to finance our operations by generating operating cash flows, borrowing under our revolving credit facility or the issuance and sale of shares of our common stock. As needed, we will consider accessing the debt and equity capital markets as part of our ongoing financing strategy. We also rely on our ability to obtain performance, payment and completion surety bonds as well as letters of credit to finance our projects.

Under our \$300.0 million shelf registration statement on Form S-3, which was declared effective in August 2015, we have the ability to access the debt and equity capital markets as needed as part of our ongoing financing strategy. At June 30, 2018, we have used approximately \$55.0 million of the securities registered under the shelf registration statement. We currently intend to renew our shelf registration statement prior to its expiration in August 2018.

We believe that we will be able to fund our current and foreseeable liquidity needs for at least the next twelve months with our cash on hand, cash generated from operations and cash expected to be available from our revolving credit facility or through accessing debt or equity capital, as needed.

Revolving Credit Facility

On May 25, 2018, we entered into that certain Third Amended and Restated Credit Agreement with several financial institutions, and Wells Fargo Bank, National Association, as administrative agent, which was amended as of June 19, 2018 by that certain First Amendment thereto (the "First Amendment"; such credit agreement, as amended by the First Amendment, the "Credit Agreement"). The Credit Agreement has substantially similar terms and provisions to our second amended and restated credit agreement entered into in May 2017 with several financial institutions, and Wells Fargo Bank, National Association, as administrative agent (the "2017 Credit Agreement") but, among other things, provides for an increase of the revolving credit facility from \$600.0 million to \$750.0 million (which was reduced in July 2018 upon issuance of the Senior Notes (as defined herein) to \$450.0 million), which could be increased at our request by up to \$50.0 million if the lenders make additional commitments, subject to the terms and conditions of the Credit Agreement.

The Credit Agreement matures on May 31, 2021. Before each anniversary of the closing of the Credit Agreement, we may request a one-year extension of the maturity date. The Credit Agreement is guaranteed by each of our subsidiaries that have gross assets equal to or greater than \$0.5 million. The revolving credit facility is currently unsecured, but we have agreed to provide collateral if we fail to meet certain financial conditions in the future. As of June 30, 2018, the borrowing base under the Credit Agreement was \$677.4 million, of which borrowings of \$495.0 million were outstanding, \$10.1 million of letters of credit were outstanding and the remaining \$172.3 million was available to borrow.

[Table of Contents](#)

The Credit Agreement requires us to maintain (i) a tangible net worth of not less than \$400.0 million plus 75% of the net proceeds of all equity issuances plus 50% of the amount of our positive net income in any fiscal quarter after December 31, 2017, (ii) a leverage ratio of not greater than 64.0%, (iii) liquidity of at least \$50.0 million and (iv) a ratio of EBITDA to interest expense for the most recent four quarters of at least 2.50 to 1.00. The Credit Agreement contains various covenants that, among other restrictions, limit the amount of our additional debt and our ability to make certain investments. At June 30, 2018, we were in compliance with all of the covenants contained in the Credit Agreement.

Senior Notes Offering

On July 6, 2018, we issued \$300.0 million aggregate principal amount of our 6.875% Senior Notes due 2026 (the “Senior Notes”) in an offering to persons reasonably believed to be qualified institutional buyers in the United States pursuant to Rule 144A under the Securities Act of 1933, as amended (the “Securities Act”), and to certain non-U.S. persons in transactions outside the United States pursuant to Regulation S under the Securities Act. Interest on the Senior Notes accrues at a rate of 6.875% per annum, payable semi-annually in arrears on January 15 and July 15 of each year, commencing on January 15, 2019 and maturing on July 15, 2026. Terms of the Senior Notes are governed by an indenture, dated July 6, 2018, among us, our subsidiaries that guarantee our obligations under our revolving credit facility (the “Subsidiary Guarantors”) and Wilmington Trust, National Association, as trustee.

We received net proceeds from the offering of the Senior Notes of approximately \$296.2 million, after deducting the initial purchasers’ discounts and commissions and offering expenses. The net proceeds from the offering were used to repay a portion of the borrowings under the Credit Agreement. The impact of the offering of the Senior Notes will be recorded in the third quarter of 2018.

In connection with the issuance of the Senior Notes, we reduced the revolving commitment under the Credit Agreement from \$750.0 million to \$450.0 million pursuant to the First Amendment. We expect to record approximately \$3.1 million in debt extinguishment costs related to the Credit Agreement during the third quarter of 2018.

Convertible Notes

In November 2014, we issued \$85.0 million aggregate principal amount of our 4.25% Convertible Notes due 2019 (the “Convertible Notes”) pursuant to an exemption from the registration requirements afforded by Section 4(a)(2) of the Securities Act. The Convertible Notes mature on November 15, 2019 and bear interest at a rate of 4.25%, payable semi-annually in arrears on May 15 and November 15 of each year.

Prior to May 15, 2019, the Convertible Notes are convertible only upon satisfaction of any of the specified conversion events. On or after May 15, 2019, the holders of Convertible Notes can convert their Convertible Notes at any time at their option. Upon the election of a holder of Convertible Notes to convert their Convertible Notes, we may settle the conversion of the Convertible Notes using any combination of cash and shares of our common stock. It is our intent, and belief that we have the ability, to settle in cash the conversion of any Convertible Notes that the holders elect to convert. The initial conversion rate of the Convertible Notes is 46.4792 shares of our common stock for each \$1,000 principal amount of Convertible Notes, which represents an initial conversion price of approximately \$21.52 per share of our common stock. The conversion rate is subject to adjustments upon the occurrence of certain specified events.

During the fourth quarter of 2017, we received notice from holders of \$15.0 million principal amount of the Convertible Notes to convert their Convertible Notes. The conversion of such Convertible Notes was settled in the first quarter of 2018, resulting in the issuance of 486,679 shares of our common stock, a \$0.6 million reduction to debt discount and additional paid in capital, a \$0.2 million loss on the extinguishment of debt and a cash payment of \$15.0 million for the principal amount of such Convertible Notes. As of June 30, 2018, we have \$70.0 million aggregate principal amount of Convertible Notes outstanding.

During the second quarter of 2018, the Convertible Notes were convertible because the closing sale price of our common stock was greater than 130% of the \$21.52 conversion price on at least 20 trading days during the 30 trading day period ending on March 31, 2018. As a result, the holders of the Convertible Notes could elect to convert some or all of their Convertible Notes in accordance with the terms and provisions of the indenture governing the Convertible Notes during the conversion period of April 1, 2018 through June 30, 2018 (inclusive). The Convertible Notes continue to be convertible during the third quarter of 2018. As of the date of the filing of this Quarterly Report on Form 10-Q, no other conversion notices have been received by us.

On July 6, 2018, concurrently with the offering of the Senior Notes, we entered into that certain First Supplemental Indenture, dated as of July 6, 2018, among us, the Subsidiary Guarantors and Wilmington Trust, National Association, as trustee, which supplements the indenture governing the Convertible Notes, pursuant to which (i) the subordination provisions in the indenture governing the Convertible Notes were eliminated, (ii) each Subsidiary Guarantor agreed (A) to, concurrently with the issuance of the Senior Notes, fully and unconditionally guarantee the Convertible Notes to the same extent that such Subsidiary Guarantor is guaranteeing the Senior Notes and (B) that such Subsidiary Guarantor’s guarantee of the Convertible Notes ranks equally with such Subsidiary Guarantor’s guarantee of the Senior Notes and (iii) the Company agreed to not, directly or indirectly, incur any

[Table of Contents](#)

indebtedness in the form of, or otherwise become liable in respect of, any notes or other debt securities issued pursuant to an indenture or note purchase agreement (including the Senior Notes) unless such indebtedness is equal with or contractually subordinated to the Convertible Notes in right of payment.

Letters of Credit, Surety Bonds and Financial Guarantees

We are often required to provide letters of credit and surety bonds to secure our performance under construction contracts, development agreements and other arrangements. The amount of such obligations outstanding at any time varies in accordance with our pending development activities. In the event any such bonds or letters of credit are drawn upon, we would be obligated to reimburse the issuer of such bonds or letters of credit.

Under these letters of credit, surety bonds and financial guarantees, we are committed to perform certain development and construction activities and provide certain guarantees in the normal course of business. Outstanding letters of credit, surety bonds and financial guarantees under these arrangements, totaled \$60.7 million as of June 30, 2018. Although significant development and construction activities have been completed related to the improvements at these sites, the letters of credit and surety bonds are not generally released until all development and construction activities are completed. We do not believe that it is probable that any outstanding letters of credit, surety bonds or financial guarantees as of June 30, 2018 will be drawn upon.

Cash Flows

Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017

Net cash used in operating activities during the six months ended June 30, 2018 was \$95.7 million as compared to \$67.7 million during the six months ended June 30, 2017. The \$28.0 million increase in net cash used in operating activities was primarily attributable to cash outlays for the \$26.8 million increase in the net change in real estate inventory year-over-year, which was primarily related to our increased community count, additional homes under construction and land acquisitions, and to the \$60.3 million decrease in accounts payable, accrued expenses and other liabilities, which was primarily related to payment of income taxes. Year-over-year change in net cash provided by working capital items were a \$30.0 million decrease in accounts receivable, and a \$3.9 million decrease in other assets, offset by a \$7.9 million increase in cash paid for pre-acquisition costs and deposits year-over-year. The increase in cash used in operating activities reflects our continued growth and, to a lesser extent, the timing of home sales and homebuilding activities.

Net cash used in investing activities was \$0.4 million and \$0.3 million during the six months ended June 30, 2018 and 2017, respectively, and reflects the purchase of property and equipment.

Net cash provided by financing activities totaled \$77.4 million during the six months ended June 30, 2018, as compared to \$45.8 million during the six months ended June 30, 2017. The \$31.6 million increase in net cash provided by financing activities in the six months ended June 30, 2018 as compared to the six months ended June 30, 2017 consists primarily of the \$35.0 million increase in net borrowings under our revolving credit facility, offset by the \$4.1 million decrease in net proceeds realized from the issuance and sale of shares of our common stock.

Off-Balance Sheet Arrangements

In the ordinary course of business, we enter into land purchase contracts in order to procure land and lots for the construction of our homes. We are subject to customary obligations associated with entering into contracts for the purchase of land and improved lots. These contracts typically require cash deposits and the purchase of properties under these contracts is generally contingent upon satisfaction of certain requirements by the sellers, which may include obtaining applicable property and development entitlements or the completion of development activities and the delivery of finished lots. We also utilize contracts with land sellers as a method of acquiring lots and land in staged takedowns, which helps us manage the financial and market risk associated with land holdings and minimize the use of funds from our corporate financing sources. Such contracts generally require a non-refundable deposit for the right to acquire land or lots over a specified period of time at pre-determined prices. We generally have the right at our discretion to terminate our obligations under purchase contracts during the initial feasibility period and receive a refund of our deposit, or we may terminate the contracts after the end of the feasibility period by forfeiting our cash deposit with no further financial obligations to the land seller. In addition, our deposit may also be refundable if the land seller does not satisfy all conditions precedent in the respective contract. As of June 30, 2018, we had \$27.9 million of cash deposits pertaining to land purchase contracts for 22,296 lots with an aggregate purchase price of \$665.4 million. Approximately \$12.7 million of the cash deposits as of June 30, 2018 are secured by third-party guarantees or indemnity mortgages on the related property.

Our utilization of land purchase contracts is dependent on, among other things, the availability of land sellers willing to enter into contracts at acceptable terms, which may include option takedown arrangements, the availability of capital to financial intermediaries to finance the development of optioned lots, general housing conditions and local market dynamics. Land purchase contracts may be more difficult to procure from land sellers in strong housing markets and are more prevalent in certain markets.

[Table of Contents](#)

Inflation

Our business can be adversely impacted by inflation, primarily from higher land, financing, labor, material and construction costs. In addition, inflation can lead to higher mortgage rates, which can significantly affect the affordability of mortgage financing to homebuyers.

Contractual Obligations

As of June 30, 2018, there have been no material changes to our contractual obligations appearing in the “Contractual Obligations” section of *Management’s Discussion and Analysis of Financial Condition and Results of Operations* included in our [Annual Report on Form 10-K](#) for the fiscal year ended December 31, 2017. See [Item 5](#). Other Information of Part II of this Quarterly Report on Form 10-Q for a discussion of certain contractual obligations under the asset purchase agreement for the Wynn Homes acquisition.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. On an ongoing basis, management evaluates such estimates and judgments and makes adjustments as deemed necessary. Actual results could differ from these estimates using different estimates and assumptions, or if conditions are significantly different in the future.

Revenue Recognition

Effective January 1, 2018, we adopted the FASB ASU No. 2014-09, “*Revenue from Contracts with Customers (Topic 606)*” (“Topic 606”), which provides guidance for revenue recognition. Topic 606 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets and supersedes the revenue recognition requirements in Topic 605, “*Revenue Recognition*” (“Topic 605”) and most industry-specific guidance. Topic 606 also supersedes certain cost guidance included in Subtopic 605-35, “*Revenue Recognition—Construction-Type and Production-Type Contracts*.” Topic 606’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. We adopted Topic 606 using the modified retrospective transition method only with respect to contracts not completed at the date of adoption. We have developed the additional expanded disclosures required; however, the adoption of Topic 606 did not have a material effect on our consolidated statements of operations, balance sheets or cash flows.

We recognize revenue upon the transfer of promised goods to our customers in an amount that reflects the consideration to which we expect to be entitled by applying the following five-step process specified in Topic 606.

- Identify the contract(s) with a customer
- Identify the performance obligations
- Determine the transaction price
- Allocate the transaction price
- Recognize revenue when the performance obligations are met

Our contracts with customers include a single performance obligation to transfer a completed home to the customer. We generally determine selling price per home on the expected cost plus margin. Our contracts contain no significant financing terms as customers who finance do so through a third party. Performance obligations are satisfied at a moment in time when the home is complete and control of the asset is transferred to the customer at closing. Home sales proceeds are generally received from the title company within a few business days after closing.

Sales and broker commissions are incremental costs incurred to obtain a contract with a customer that would not have been incurred if the contract had not been obtained. Sales and broker commissions are expensed upon fulfillment of a home closing. Advertising costs are costs to obtain a contract that would have been incurred regardless of whether the contract was obtained and are recognized as an expense when incurred. Sales and broker commissions and advertising costs are recorded within sales and marketing expense presented in our consolidated statements of operations as selling expenses.

With exception of the aforementioned, we believe that there have been no significant changes to our critical accounting policies during the six months ended June 30, 2018 as compared to those disclosed in *Management’s Discussion and Analysis of Financial Condition and Results of Operations* included in our [Annual Report on Form 10-K](#) for the fiscal year ended December 31, 2017.

[Table of Contents](#)

Cautionary Statement about Forward-Looking Statements

From time to time we make statements concerning our expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements that are not historical facts. These statements are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those expressed or implied by these statements. You can generally identify our forward-looking statements by the words “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “forecast,” “goal,” “intend,” “may,” “objective,” “plan,” “potential,” “predict,” “projection,” “should,” “will” or other similar words.

We have based our forward-looking statements on our management’s beliefs and assumptions based on information available to our management at the time the statements are made. We caution you that assumptions, beliefs, expectations, intentions and projections about future events may, and often do, vary materially from actual results. Therefore, we cannot assure you that actual results will not differ materially from those expressed or implied by our forward-looking statements.

The following are some of the factors that could cause actual results to differ materially from those expressed or implied in forward-looking statements:

- adverse economic changes either nationally or in the markets in which we operate, including, among other things, increases in unemployment, volatility of mortgage interest rates and inflation and decreases in housing prices;
- a slowdown in the homebuilding industry;
- volatility and uncertainty in the credit markets and broader financial markets;
- the cyclical and seasonal nature of our business;
- our future operating results and financial condition;
- our business operations;
- changes in our business and investment strategy;
- the success of our operations in recently opened new markets and our ability to expand into additional new markets;
- our ability to successfully extend our business model to building homes with higher price points, developing larger communities and producing and selling multi-unit products, townhouses, wholesale products and acreage home sites;
- our ability to develop our projects successfully or within expected timeframes;
- our ability to identify potential acquisition targets and close such acquisitions;
- our ability to successfully integrate any acquisitions with our existing operations;
- availability of land to acquire and our ability to acquire such land on favorable terms or at all;
- availability, terms and deployment of capital;
- decisions of the lender group of our revolving credit facility;
- the occurrence of the specific conversion events that enable early conversion of our 4.25% Convertible Notes due 2019;
- decline in the market value of our land portfolio;
- disruption in the terms or availability of mortgage financing or increase in the number of foreclosures in our markets;
- shortages of or increased prices for labor, land or raw materials used in land development and housing construction;
- delays in land development or home construction resulting from natural disasters, adverse weather conditions or other events outside our control;
- uninsured losses in excess of insurance limits;
- the cost and availability of insurance and surety bonds;
- changes in, liabilities under, or the failure or inability to comply with, governmental laws and regulations;
- the timing of receipt of regulatory approvals and the opening of projects;
- the degree and nature of our competition;
- increases in taxes or government fees;
- poor relations with the residents of our projects;
- existing and future litigation, arbitration or other claims;
- availability of qualified personnel and third-party contractors and subcontractors;
- information system interruptions or breaches in security;
- our ability to retain our key personnel;
- our leverage and future debt service obligations;
- the impact on our business of any future government shutdown;
- other risks and uncertainties inherent in our business;
- other factors we discuss under the section entitled “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*”; and
- the risk factors set forth in our [Annual Report on Form 10-K](#) for the fiscal year ended December 31, 2017.

You should not place undue reliance on forward-looking statements. Each forward-looking statement speaks only as of the date of the particular statement. We expressly disclaim any intent, obligation or undertaking to update or revise any forward-looking statements to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances

[Table of Contents](#)

on which any such statements are based. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements contained in this Quarterly Report on Form 10-Q.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our operations are interest rate sensitive. As overall housing demand is adversely affected by increases in interest rates, a significant increase in mortgage interest rates may negatively affect the ability of homebuyers to secure adequate financing. Higher interest rates could adversely affect our revenues, gross margin and net income. We do not enter into, or intend to enter into, derivative financial instruments for trading or speculative purposes.

Quantitative and Qualitative Disclosures About Interest Rate Risk

We currently utilize both fixed-rate debt (\$70.0 million aggregate principal amount of the Convertible Notes, \$300.0 million aggregate principal amount of the Senior Notes and certain inventory related obligations) and variable-rate debt (our \$450.0 million revolving credit facility, which may be increased to \$500.0 million in accordance with the terms and conditions of the Credit Agreement) as part of financing our operations. Upon the election of a holder of Convertible Notes to convert their Convertible Notes, we may settle the conversion of the Convertible Notes using any combination of cash and shares of our common stock. Other than as a result of an election of a holder of Convertible Notes to convert their Convertible Notes, we do not have the obligation to prepay the Convertible Notes or our fixed-rate inventory related obligations prior to maturity, and, as a result, interest rate risk and changes in fair market value should not have a significant impact on our fixed-rate debt.

We are exposed to market risks related to fluctuations in interest rates on our outstanding variable rate indebtedness. We did not utilize swaps, forward or option contracts on interest rates or commodities, or other types of derivative financial instruments as of or during the six months ended June 30, 2018. We have not entered into and currently do not hold derivatives for trading or speculative purposes, but we may do so in the future. Many of the statements contained in this section are forward looking and should be read in conjunction with our disclosures under the heading "[Cautionary Statement about Forward-Looking Statements](#)" above.

As of June 30, 2018, we had \$495.0 million of variable rate indebtedness outstanding under the Credit Agreement. In connection with the issuance of the Senior Notes, we repaid \$296.2 million of borrowings under the Credit Agreement on July 6, 2018. All of the outstanding borrowings under the Credit Agreement are at variable rates based on LIBOR. The interest rate for our variable rate indebtedness as of June 30, 2018 was LIBOR plus 2.90%. At June 30, 2018, LIBOR was 2.07%. A hypothetical 100 basis point increase in the average interest rate on our variable rate indebtedness would increase our annual interest cost by approximately \$5.0 million.

Based on the current interest rate management policies we have in place with respect to our outstanding indebtedness, we do not believe that the future interest rate risks related to our existing indebtedness will have a material adverse impact on our financial position, results of operations or liquidity.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, management has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934) as of June 30, 2018. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure information is recorded, processed, summarized and reported within the periods specified in the Securities and Exchange Commission's rules and forms and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error and mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management's override of controls.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, a control may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

Changes in Internal Controls

No change in our internal control over financial reporting as such term is defined in Exchange Act Rule 13a-15(f) occurred during the three months ended June 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Class Action Lawsuit

On May 11, 2018, a putative opt-in class action was filed by Christopher Munson, a former employee, on behalf of himself and all others similarly situated, in the United States District Court, Middle District of Florida, Tampa Division (8:18-cv-01154-EAK-JSS), against LGI Homes Corporate, LLC, a subsidiary of the Company, alleging failure to pay overtime wages under the Fair Labor Standards Act. The plaintiff in the lawsuit is requesting as liquidated damages unpaid back wages of the plaintiff and all opt-in members of the class (who would need to proactively join this lawsuit in order to become a member of the class) at the applicable overtime rate, as well as prejudgment interest on such amounts. We do not anticipate that additional plaintiffs will join the lawsuit. We have responded to the complaint and intend to defend ourselves vigorously against the allegations.

ITEM 5. OTHER INFORMATION

Wynn Homes Acquisition

On August 2, 2018, LGI Homes - NC, LLC, a North Carolina limited liability company and wholly owned subsidiary of the Company (“LGI NC”), completed the acquisition (the “Acquisition”) of certain real estate assets owned by Wynn Homes and its affiliates in connection with the business of land acquisition, residential real property development, homebuilding and home sales and other related transactions (the “Business”), pursuant to an asset purchase agreement, dated as of August 2, 2018 (the “Asset Purchase Agreement”), with Crosswind Properties, LLC, a North Carolina limited liability company, Wynn Construction, Inc., a North Carolina corporation, Crosswind Development, Inc., a North Carolina corporation, Crosswind Investments, Inc., a North Carolina corporation, and First Continental Communities, Inc., a North Carolina corporation (collectively, the “Sellers”), and William Wynn. Pursuant to the Acquisition, LGI NC acquired approximately 200 homes under construction and approximately 4,000 owned and controlled lots in central and eastern North Carolina, assumed certain land acquisition and land development contracts of the Sellers and acquired certain tangible and intangible assets of the Business, for a purchase price of approximately \$80.0 million, subject to adjustment. We paid the cash closing payment of \$74.3 million using cash on hand and borrowings under our revolving credit facility. As a portion of the purchase price, we will issue to William Wynn, the owner of Wynn Homes, within 30 days after the date of the Asset Purchase Agreement, subject to the Sellers meeting certain requirements, a number of unregistered shares of our common stock equal to (i) \$4,000,000 divided by (ii) the lesser of (a) the average of the closing sale price of our common stock for each of the ten trading days immediately prior to the date of the Asset Purchase Agreement or (b) the average of the closing sale price of our common stock for each of the five trading days immediately following August 7, 2018. The offer and issuance of such shares will not be registered under the Securities Act and therefore may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. For this issuance, the Company will rely on the exemption from registration provided by Section 4(a)(2) of the Securities Act as sales by an issuer not involving any public offering. The Asset Purchase Agreement also provides that, in the event that LGI NC acquires certain specified developed or undeveloped real property following the date of the Asset Purchase Agreement, LGI NC shall pay to the Sellers an agreed cash amount for such property on the date of such acquisition, subject to certain restrictions.

Table of Contents

ITEM 6. EXHIBITS

<u>Exhibit No.</u>	<u>Description</u>
3.1**	<u>Certificate of Incorporation of LGI Homes, Inc. (incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-1 (File No. 33-190853) of LGI Homes, Inc. filed with the SEC on August 28, 2013).</u>
3.2**	<u>Bylaws of LGI Homes, Inc. (incorporated by reference to Exhibit 3.2 to the Registration Statement on Form S-1 (File No. 333-190853) of LGI Homes, Inc. filed with the SEC on August 28, 2013).</u>
4.1**	<u>Indenture, dated as of July 6, 2018, among LGI Homes, Inc., the potential subsidiary guarantors listed therein and Wilmington Trust, National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K (File No. 001-36126) of LGI Homes, Inc. filed with the SEC on July 6, 2018).</u>
4.2**	<u>First Supplemental Indenture, dated as of July 6, 2018, among LGI Homes, Inc., the subsidiary guarantors listed therein and Wilmington Trust, National Association, as trustee, governing LGI Homes, Inc.'s 6.875% Senior Notes due 2026, including the form of the senior notes (incorporated by reference to Exhibit 4.2 to the Current Report on Form 8-K (File No. 001-36126) of LGI Homes, Inc. filed with the SEC on July 6, 2018).</u>
4.3**	<u>First Supplemental Indenture, dated as of July 6, 2018, among LGI Homes, Inc., the subsidiary guarantors listed therein and Wilmington Trust, National Association, as trustee, governing LGI Homes, Inc.'s 4.25% Convertible Notes due 2019 (incorporated by reference to Exhibit 4.3 to the Current Report on Form 8-K (File No. 001-36126) of LGI Homes, Inc. filed with the SEC on July 6, 2018).</u>
10.1**	<u>Third Amended and Restated Credit Agreement, dated as of May 25, 2018, by and among LGI Homes, Inc., each of the financial institutions initially a signatory thereto, and Wells Fargo Bank, National Association, as administrative agent, with Wells Fargo Securities, LLC, as sole Lead Arranger and sole Bookrunner, and Fifth Third Bank and U.S. Bank, National Association, as Documentation Agents (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K (File No. 001-36126) of LGI Homes, Inc. filed with the SEC on May 29, 2018).</u>
10.2**	<u>First Amendment to the Third Amended and Restated Credit Agreement, dated as of June 19, 2018, by and among LGI Homes, Inc., the lenders party thereto and Wells Fargo Bank, National Association, as administrative agent (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K (File No. 001-36126) of LGI Homes, Inc. filed with the SEC on June 21, 2018).</u>
31.1*	<u>CEO Certification, Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
31.2*	<u>CFO Certification, Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>
32.1*	<u>Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2*	<u>Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101.INS†	XBRL Instance Document.
101.SCH†	XBRL Taxonomy Extension Schema Document.
101.CAL†	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF†	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB†	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE†	XBRL Taxonomy Extension Presentation Linkbase Document.
*	Filed herewith.
**	Previously filed.
†	XBRL information is deemed not filed or a part of a registration statement or Annual Report for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under such sections.

[Table of Contents](#)

SIGNATURES

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

LGI Homes, Inc.

Date: August 7, 2018

/s/ Eric Lipar

Eric Lipar

Chief Executive Officer and Chairman of the Board

August 7, 2018

/s/ Charles Merdian

Charles Merdian

Chief Financial Officer and Treasurer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of LGI Homes, Inc. (the "Company") on Form 10-Q for the quarterly period ended June 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Quarterly Report"), I, Eric Lipar, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

August 7, 2018

/s/ Eric Lipar

Eric Lipar
Chief Executive Officer and Chairman of the Board
LGI Homes, Inc.

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of LGI Homes, Inc. (the "Company") on Form 10-Q for the quarterly period ended June 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Charles Merdian, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

August 7, 2018

/s/ Charles Merdian

Charles Merdian
Chief Financial Officer and Treasurer
LGI Homes, Inc.

