

AV Homes, Inc.
Form 10-Q
October 27, 2017
Table of Contents

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 September 30, 2017.

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

For the transition period from _____ to _____.

001-07395

Commission File Number

AV HOMES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other Jurisdiction of Incorporation or Organization) 23-1739078
(I.R.S. Employer Identification No.)

8601 N. Scottsdale Rd., Suite 225, Scottsdale, Arizona 85253
(Address of Principal Executive Offices) (Zip Code)

(480) 214-7400

(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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

	Accelerated filer	Emerging growth company
		Smaller reporting company
Large Accelerated filer	Non-accelerated filer	

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

Edgar Filing: AV Homes, Inc. - Form 10-Q

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

As of October 20, 2017, there were 22,455,689 shares of common stock, \$1.00 par value, issued and outstanding.

Table of Contents

AV HOMES, INC. AND SUBSIDIARIES

FORM 10-Q

INDEX

<u>PART I.</u>	<u>Financial Information</u>	1
<u>Item 1.</u>	<u>Financial Statements:</u>	1
	<u>Consolidated Balance Sheets as of September 30, 2017 (unaudited) and December 31, 2016</u>	1
	<u>Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended September 30, 2017 and 2016 (unaudited)</u>	2
	<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2017 and 2016 (unaudited)</u>	3
	<u>Notes to Consolidated Financial Statements (unaudited)</u>	4
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	27
<u>Item 4.</u>	<u>Controls and Procedures</u>	27
<u>PART II.</u>	<u>Other Information</u>	28
<u>Item 1.</u>	<u>Legal Proceedings</u>	28
<u>Item 1A.</u>	<u>Risk Factors</u>	28
<u>Item 6.</u>	<u>Exhibits</u>	28
	<u>Signatures</u>	29



Table of Contents

PART I. Financial Information

ITEM 1. FINANCIAL STATEMENTS

AV HOMES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(in thousands, except per share amount)

	September 30, 2017	December 31, 2016
Assets	(unaudited)	
Cash and cash equivalents	\$ 169,332	\$ 67,792
Restricted cash	1,182	1,231
Receivables	8,016	10,827
Land and other inventories	679,895	584,408
Property and equipment, net	33,209	33,680
Prepaid expenses and other assets	12,664	12,753
Deferred tax assets, net	108,734	110,257
Goodwill	30,003	19,285
Total assets	\$ 1,043,035	\$ 840,233
Liabilities and Stockholders' Equity		
Liabilities		
Accounts payable	\$ 37,223	\$ 37,387
Accrued and other liabilities	32,639	34,298
Customer deposits	14,894	9,979
Estimated development liability	31,700	32,102
Senior debt, net	471,644	275,660
Total liabilities	588,100	389,426
Stockholders' equity		
Common stock, par value \$1 per share	22,567	22,624
Additional paid-in capital	404,187	401,558
Retained earnings	31,200	29,644
	457,954	453,826
Treasury stock	(3,019)	(3,019)
Total stockholders' equity	454,935	450,807
Total liabilities and stockholders' equity	\$ 1,043,035	\$ 840,233

See notes to consolidated financial statements (unaudited).

1

Table of Contents

AV HOMES, INC. AND SUBSIDIARIES

Consolidated Statements of Operations and Comprehensive Income

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues				
Homebuilding	\$ 201,724	\$ 201,821	\$ 547,268	\$ 507,659
Amenity and other	3,875	3,315	12,637	8,834
Land sales	140	291	2,576	1,120
Total revenues	205,739	205,427	562,481	517,613
Expenses				
Homebuilding cost of revenue	168,555	163,911	454,020	414,290
Amenity and other	3,167	3,101	11,063	8,057
Land sales	124	295	1,286	685
Total real estate expenses	171,846	167,307	466,369	423,032
Selling, general and administrative expenses	27,085	25,484	76,470	71,639
Interest income and other	(407)	—	(665)	(1)
Interest expense	2,625	701	7,147	2,853
Loss on extinguishment of debt	6,939	—	9,872	—
Total expenses	208,088	193,492	559,193	497,523
Income (loss) before income taxes	(2,349)	11,935	3,288	20,090
Income tax expense (benefit)	(872)	38	1,679	(109,959)
Net income (loss) and comprehensive income (loss)	\$ (1,477)	\$ 11,897	\$ 1,609	\$ 130,049
Basic earnings (loss) per share	\$ (0.07)	\$ 0.53	\$ 0.07	\$ 5.81
Basic weighted average shares outstanding	22,504	22,416	22,487	22,403
Diluted earnings (loss) per share	\$ (0.07)	\$ 0.49	\$ 0.07	\$ 5.02
Diluted weighted average shares outstanding	22,504	26,654	22,674	26,606

See notes to consolidated financial statements (unaudited).

Table of Contents

AV HOMES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2017	2016
Operating Activities		
Net income	\$ 1,609	\$ 130,049
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,331	4,729
Amortization of share-based compensation	2,534	1,911
Change in fair value of contingent consideration	(647)	(422)
Impairment charges	535	335
Loss on extinguishment of debt	9,872	—
Deferred income taxes, net	1,523	(110,501)
Payment of withholding taxes on share-based awards	363	115
Other adjustments, net	5	14
Changes in operating assets and liabilities:		
Restricted cash	49	25,809
Receivables	2,970	(1,070)
Land and other inventories	(56,675)	(48,713)
Prepaid expenses and other assets	(1,327)	2,704
Accounts payable, estimated development liability, and accrued and other liabilities	(9,066)	(1,595)
Customer deposits	4,915	3,594
Net cash provided by (used in) operating activities	(38,009)	6,959
Investing Activities		
Investment in property and equipment	(1,647)	(1,389)
Proceeds from sales of property and equipment	5	11
Business acquisitions	(41,150)	10
Investment in unconsolidated entities	(17)	(20)
Net cash used in investing activities	(42,809)	(1,388)
Financing Activities		
Proceeds from issuance of debt	400,000	—
Gross proceeds from Senior Secured Credit Facility	30,000	35,000
Payments of Senior Secured Credit Facility	(30,000)	(20,000)
Debt issuance costs	(8,146)	—
Principal payments of senior debt	(200,000)	(46,793)

Edgar Filing: AV Homes, Inc. - Form 10-Q

Premium paid on redemption of debt	(6,718)	—
Payment of withholding taxes on share-based awards	(363)	(115)
Contingent consideration and other financing activities	(2,415)	(4,272)
Net cash provided by (used in) financing activities	182,358	(36,180)
Increase (decrease) in cash and cash equivalents	101,540	(30,609)
Cash and cash equivalents at beginning of year	67,792	46,898
Cash and cash equivalents at end of year	\$ 169,332	\$ 16,289
Supplemental cash flow information:		
Interest paid, net of capitalized interest	\$ 4,600	\$ 7,476
Income taxes paid	\$ 580	\$ 810
Supplemental non-cash investing activity:		
Accrual of contingent consideration as of the acquisition date	\$ 1,818	\$ —

See notes to consolidated financial statements (unaudited).

Table of Contents

AV HOMES, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (unaudited)

September 30, 2017

Note 1 - Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of AV Homes, Inc. and all subsidiaries, partnerships and other entities in which AV Homes, Inc. (“AV Homes,” “we,” “us,” “our,” or “the Company”) has a controlling interest. The interim consolidated financial statements have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all information and footnotes required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. These statements reflect all normal and recurring adjustments which, in the opinion of management, are necessary to present fairly the financial position, results of operations and cash flows of AV Homes as of September 30, 2017 and for all periods presented. These statements should be read in conjunction with our consolidated financial statements and notes thereto included in AV Homes’ Annual Report on Form 10-K for the year ended December 31, 2016. All significant intercompany accounts and transactions have been eliminated in consolidation. For comparative purposes, certain prior year amounts have been reclassified to conform to the current year presentation.

Use of Estimates

The preparation of our consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents and Restricted Cash

We consider all highly liquid investments purchased with an initial maturity of three months or less to be cash equivalents. As of September 30, 2017, our cash and cash equivalents were primarily in money market accounts. Due to the short maturity period of the cash equivalents, the carrying amounts of these instruments approximate their fair values.

Our cash items that are restricted as to withdrawal or usage include deposits of \$1.2 million as of September 30, 2017 and December 31, 2016.

Receivables

Receivables primarily consist of amounts in transit or due from title companies for home closings and for rebates.

Land and Other Inventories and Homebuilding Cost of Revenue

Land and other inventories include expenditures for land acquisition, land development, home construction, construction costs for amenities, and direct and allocated indirect costs, including interest cost capitalized until development and construction are substantially completed. These costs are assigned to components of land and other inventories based on specific identification, relative sales value, or area allocation methods.

Land and other inventories are stated at cost unless the asset is determined to be impaired, in which case the asset is written to its fair value, in accordance with Accounting Standards Codification (“ASC”) 360, Property, Plant and Equipment (“ASC 360”).

Homebuilding cost of revenue is comprised of direct and allocated costs, including estimated future costs for the limited warranty we provide on our homes. Land acquisition, land development and other common costs are generally allocated on a relative sales value or area allocation basis to the homes or lots within the applicable community or land parcel. Land acquisition and land development costs include related interest and real estate taxes during the period of time under development.

We evaluate our land and other inventories for impairment on a quarterly basis in accordance with ASC 360 to reflect market conditions, including a consideration of supply of new and resale homes for sale in the respective market, level of

Table of Contents

foreclosure activity and competition. For assets held and used, if indicators are present, we perform an impairment test by comparing the estimated future undiscounted cash flows to be generated by the asset to its carrying value. If such cash flows are less than the asset's carrying value, the carrying value is written down to its estimated fair value. Generally, fair value is determined by discounting the estimated cash flows at a rate commensurate with the inherent risks associated with the asset and related estimated cash flow streams. The discount rate used in the determination of fair value would vary, depending on the state of development. Assumptions and estimates used in the determination of the estimated future cash flows are based on several factors, including expectations of future operations and economic conditions. Changes to these assumptions could significantly affect the estimates of future cash flows, which could affect the potential for future impairments. Due to the uncertainties of the estimation process, actual results could differ significantly from such estimates.

During the three and nine months ended September 30, 2017, our impairment assessments resulted in \$0.3 million and \$0.5 million of impairment charges, respectively, and are included in homebuilding cost of revenue in the consolidated statements of operations and comprehensive income. During the three and nine months ended September 30, 2016, our impairment assessments resulted in \$0.1 million and \$0.3 million of impairment charges, respectively.

Property and Equipment, net

Property and equipment, net are stated at cost less accumulated depreciation, and depreciation is computed by the straight-line method over the following estimated useful lives of the assets: land improvements 5 to 15 years; buildings and improvements 3 to 40 years; and machinery, equipment and fixtures 2 to 10 years. Maintenance and operating expenses of equipment utilized in the development of land are capitalized to land inventory. All other repairs and maintenance are expensed as incurred.

Property and equipment includes amenity assets such as club facilities on properties owned by us. The cost of amenity assets includes expenditures for land acquisition, construction, land development and direct and allocated costs. Property and equipment owned and constructed by us also includes interest cost incurred during development and construction.

Each reporting period, we review our property and equipment for indicators of impairment in accordance with ASC 360. For our amenities, which are located within our housing communities, indicators of impairment are similar to those of our housing communities (described above), as these factors may impact our ability to generate revenues at our amenities or cause construction costs to increase. In addition, we factor in the collectability and potential delinquency of the fees due for our amenity memberships. During the three and nine months ended September 30, 2017 and 2016, we did not identify indicators of impairment for our property and equipment.

Investments in Partnerships and Limited Liability Companies

When we are either deemed to hold the controlling interest in a voting interest entity or deemed to be the primary beneficiary of a variable interest entity (“VIE”), we are required to consolidate the investment.

Factors considered when determining if we hold the controlling interest in a voting interest entity include who holds the general partnership or managing member interests, which partner or member makes the day-to-day decisions regarding the operations of the entity, and whether or not the other partners or members have substantive participating rights.

With respect to VIEs, our variable interests may be in the form of (1) equity ownership, (2) contracts to purchase assets and/or (3) loans provided by us to the investor. We examine specific criteria and use judgment when determining if we are the primary beneficiary of a VIE. The primary beneficiary of a VIE is the entity that has both of the following characteristics: (a) the power to direct the activities of a VIE that most significantly impact the VIE’s economic performance and (b) the obligation to absorb the majority of losses of the VIE or the right to receive the majority of benefits from the VIE.

Investments, including joint ventures with independent third parties, where we do not hold the controlling interest and we are not the primary beneficiary, but over which we have significant influence, are accounted for under the equity method. Under the equity method of accounting, we recognize our proportionate share of the earnings and losses of these entities.

We evaluate our investments in unconsolidated entities for recoverability in accordance with ASC 323, Investments - Equity Method and Joint Ventures. If we determine that a loss in the value of the investment is other than temporary, we write down the investment to its estimated fair value. Any such losses are recorded to interest income and other in the consolidated statements of operations and comprehensive income. Due to uncertainties in the estimation process and the significant

Table of Contents

volatility in demand for new housing, actual results could differ significantly from such estimates. During the three and nine months ended September 30, 2017 and 2016, we did not identify indicators of impairment for our investments in unconsolidated entities.

Business Acquisitions

When acquiring a business, we allocate the purchase price of the business to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. In making estimates of fair values for this purpose, we use a number of sources, including independent appraisals and information obtained about each property as a result of our pre-acquisition due diligence and its marketing and housing activities.

Goodwill

Goodwill arises from business combinations and represents the excess of the consideration transferred for an acquired entity over the net fair value amounts that were assigned to the identifiable assets acquired and the liabilities assumed. Goodwill is tested for impairment at the reporting unit level on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. There were no indicators of impairment during the three and nine months ended September 30, 2017 and 2016.

Revenue Recognition

In accordance with ASC 360, homebuilding revenue and related profit from the sale of homes are recognized when title to and possession of the property are transferred to the buyer. In addition, revenues from land sales are recognized in full at closing, provided the buyer's initial and continuing investment is adequate, any financing is considered collectible and there is no significant continuing involvement.

Sales Incentives

When sales incentives involve a discount on the selling price of the home, we record the discount as a reduction of revenue at the time of home closing. If the sales incentive requires us to provide a free product or service to the customer, the cost of the free product or service is recorded as homebuilding cost of revenue at the time of home closing. This includes the cost related to optional upgrades and seller-paid financing costs, closing costs, homeowners'

association fees, or merchandise.

Advertising Costs

Advertising costs are expensed as incurred. During the three and nine months ended September 30, 2017, advertising costs were \$1.1 million and \$3.0 million, respectively. During the three and nine months ended September 30, 2016, advertising costs were \$0.9 million and \$2.6 million, respectively. Advertising costs, sales commissions and closing costs are included in selling, general and administrative expenses in the accompanying consolidated statements of operations and comprehensive income.

Warranty Costs

Warranty reserves for homes are established to cover estimated costs for materials and labor with regard to warranty-type claims to be incurred subsequent to the closing of a home. Reserves are determined based on historical data and other relevant factors. We have, and require our subcontractors to have, general liability, property, workers' compensation, and other business insurance. These insurance policies protect us against a portion of our risk of loss from claims, subject to certain self-insured per occurrence and aggregate retentions, deductibles, and available policy limits. We may have recourse against subcontractors for certain claims relating to workmanship and materials. Warranty reserves are included in accrued and other liabilities in the accompanying consolidated balance sheets.

Table of Contents

During the three and nine months ended September 30, 2017 and 2016, changes in the warranty reserve consisted of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Accrued warranty reserve, beginning of period	\$ 3,864	\$ 3,581	\$ 4,033	\$ 3,333
Reserve provided	687	952	2,496	2,440
Payments	(997)	(1,004)	(2,975)	(2,244)
Accrued warranty reserve, end of period	\$ 3,554	\$ 3,529	\$ 3,554	\$ 3,529

Income Taxes

Our effective tax rate is impacted by a number of factors, the most significant of which are the valuation allowance related to our deferred tax assets and changes to tax laws or other circumstances that affect the value of our deferred tax assets. Our 2017 effective tax rate approximates our blended statutory tax rate. Our income tax benefit for the nine months ended September 30, 2016 consisted primarily of the reversal of a valuation allowance related to our deferred tax assets.

We evaluate our deferred tax assets each period to determine if a valuation allowance is required based on whether it is “more likely than not” that some portion of the deferred tax assets would not be realized. The ultimate realization of these deferred tax assets is dependent upon the generation of sufficient taxable income during future periods. We conduct our evaluation by considering all available positive and negative evidence. This evaluation considers, among other factors, historical operating results, forecasts of future profitability, the duration of statutory carryforward periods, and the outlooks for the U.S. housing industry and broader economy. Based on our evaluation through June 30, 2016, we determined that the valuation allowance against all of our federal and state deferred tax assets was no longer required. Accordingly, we reversed \$112.9 million of valuation allowance in the second quarter of 2016 and an additional \$4.3 million during the third quarter of 2016. As of September 30, 2017, we do not have a valuation allowance related to our deferred tax assets.

The accounting for deferred taxes is based upon estimates of future results. Differences between estimated and actual results could result in changes in the valuation of our deferred tax assets that could have a material impact on our consolidated results of operations or financial position. Changes in existing tax laws could also affect actual tax results and the realization of deferred tax assets over time. Certain states enacted changes to tax rates that impacted the value of our deferred tax assets in 2017. The estimated impact of such change was recorded to income tax expense during the period of change.

Unrecognized tax benefits represent the difference between tax positions taken or expected to be taken in a tax return and the benefits recognized for financial statement purposes. As of September 30, 2017, we had no unrecognized tax benefits.

Any interest or penalties assessed have been minimal and immaterial to our financial results. In the event we are assessed any interest or penalties in the future, we plan to include them in our consolidated statements of operations and comprehensive income as income tax expense.

Share-Based Compensation

The Amended and Restated 1997 Incentive and Capital Accumulation Plan (2011 Restatement), as amended (“Incentive Plan”), and the 2015 Incentive Compensation Plan (the “2015 Plan”) provide for the grant of stock options, stock appreciation rights, stock awards, performance awards, and stock units to officers, employees and directors of AV Homes. The exercise prices of stock options granted under the Incentive Plan and the 2015 Plan may not be less than the stock exchange closing price of our common stock on the date of grant. Stock option awards under the Incentive Plan and 2015 Plan generally expire 10 years after the date of grant.

As of September 30, 2017, there were an aggregate of 1,404,572 shares available for grant under the 2015 Plan and 343,649 shares reserved for future issuance relating to stock options, performance share units, and restricted stock units previously awarded and currently outstanding under the 2015 Plan. Additionally, as of September 30, 2017, an aggregate of 490,483 shares of our common stock were reserved for future issuance in connection with options and restricted stock units previously awarded under the Incentive Plan.

Table of Contents

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of AV Homes. The computation of diluted earnings (loss) per share for the three and nine months ended September 30, 2017 did not assume the effect of employee stock options or convertible notes because the effects were antidilutive. The computation of diluted earnings per share for the three and nine months ended September 30, 2016 did not assume the effect of employee stock options because the effects were antidilutive.

The following table represents a reconciliation of the net income (loss) and weighted average shares outstanding for the calculation of basic and diluted earnings (loss) per share for the three and nine months ended September 30, 2017 and 2016 (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Numerator:				
Basic net income (loss)	\$ (1,477)	\$ 11,897	\$ 1,609	\$ 130,049
Effect of dilutive securities	—	1,201	—	3,600
Diluted net income (loss)	\$ (1,477)	\$ 13,098	\$ 1,609	\$ 133,649
Denominator:				
Basic weighted average shares outstanding	22,504	22,416	22,487	22,403
Effect of dilutive securities	—	4,238	187	4,203
Diluted weighted average shares outstanding	22,504	26,654	22,674	26,606
Basic earnings (loss) per share	\$ (0.07)	\$ 0.53	\$ 0.07	\$ 5.81
Diluted earnings (loss) per share	\$ (0.07)	\$ 0.49	\$ 0.07	\$ 5.02

Comprehensive Income (Loss)

Net income (loss) and comprehensive income (loss) are the same for the three and nine months ended September 30, 2017 and 2016 because we do not have components of comprehensive income (loss).

Recent Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment (“ASU 2017-04”), which removes the requirement to perform a hypothetical purchase price allocation to measure goodwill impairment. A goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. ASU 2017-04 is effective for us for annual and interim periods beginning January 1, 2020, with early adoption permitted, and applied prospectively. We adopted this guidance in the first quarter of 2017 and there was no impact on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805), Clarifying the Definition of a Business (“ASU 2017-01”). ASU 2017-01 clarifies the definition of a business with the objective of addressing whether transactions involving in-substance nonfinancial assets, held directly or in a subsidiary, should be accounted for as acquisitions or disposals of nonfinancial assets or of businesses. ASU 2017-01 is effective for us for the fiscal year and interim periods beginning January 1, 2018, with early adoption permitted, and applied prospectively. We do not anticipate the adoption of ASU 2017-01 to have a material impact on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 reduces the existing diversity in practice in financial reporting across all industries by clarifying certain existing principles in ASC 230, Statement of Cash Flows, including providing additional guidance on how and what an entity should consider in determining the classification of certain cash flows. ASU 2016-15 is effective for us for the fiscal year and interim periods beginning January 1, 2018. The adoption of ASU

Table of Contents

2016-15 will modify our current disclosures within the consolidated statements of cash flows but is not expected to have a material effect on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”). ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions. ASU 2016-09 became effective for us for fiscal years and interim periods beginning January 1, 2017. Amendments related to the timing of when excess tax benefits are recognized, minimum statutory withholding requirements and forfeitures were applied on a modified retrospective transition method through a cumulative-effect adjustment to equity as of January 1, 2017. The adoption of the provisions of ASU 2016-09 in the first quarter of 2017 had no material effect on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 will require organizations that lease assets—referred to as “lessees”—to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. 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 are to be expanded to include qualitative along with specific quantitative information. ASU 2016-02 is effective for us for fiscal years and interim periods beginning January 1, 2019. The standard mandates a modified retrospective transition method. We continue to evaluate the impact of adopting this guidance on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”). The standard is a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. ASU 2014-09 also affects certain industry-specific cost guidance. The FASB has also issued several updates to this standard. The standard is effective for us for annual and interim periods beginning January 1, 2018. We expect to apply the modified retrospective method of adoption. We do not anticipate the adoption of ASU 2014-09 to have a material impact on the amount or timing of our homebuilding, amenity and other, and land sales revenues; however, we do expect the standard to impact our timing of recognition for certain selling costs. Currently, certain selling costs are capitalized for selling communities and expensed as homes in the communities are sold in accordance with ASC 970-340. Under the new guidance, some of these selling costs may be expensed as incurred. We are continuing to evaluate the impact that the standard will have on our consolidated financial statements.

Note 2 – Business Acquisitions

On April 3, 2017, we acquired substantially all of the assets of Savvy Homes, LLC and certain of its affiliated entities (“Savvy”) for approximately \$43 million, including an earn-out, which remains subject to customary post-closing adjustments. The assets acquired included substantially all of the real estate, land acquisition agreements and permits associated with the Savvy business, and certain of its leases, contracts, commitments and purchase orders. We also

assumed certain liabilities of Savvy, including the liabilities and obligations relating to the acquired contracts, but excluding other liabilities including home warranty obligations relating to homes closed by Savvy prior to the acquisition. Savvy acquires raw and developed land, develops raw land and constructs single-family homes in the Raleigh, North Carolina area and enhances our position in a key growth market. The results of Savvy's operations are included in our consolidated financial statements from the acquisition date of April 3, 2017. During the three months ended September 30, 2017, Savvy's revenues and net loss were \$18.4 million and \$1.3 million, respectively. During the nine months ended September 30, 2017, Savvy's revenues and net loss were \$35.8 million and \$1.5 million, respectively.

The Savvy acquisition was accounted for in accordance with ASC 805, Business Combinations ("ASC 805"). We recorded the acquired assets and liabilities at their estimated fair values. We determined the estimated fair values with the assistance of appraisals or valuations performed by independent third-party specialists, discounted cash flow analyses, quoted market prices where available, and estimates by management. To the extent the consideration transferred exceeded the fair value of the net assets acquired in this transaction, such excess was assigned to goodwill.

Table of Contents

The following table summarizes the calculation of the fair value of the total consideration transferred to Savvy and its preliminary allocation to the assets acquired and liabilities assumed as of the acquisition date (in thousands):

Fair value of consideration transferred:	
Cash paid for Savvy net assets	\$ 41,150
Contingent consideration (earn-out)	1,818
Total consideration transferred	\$ 42,968

Assets acquired and liabilities assumed:

Assets	
Receivables and other assets	\$ 159
Land and other inventories	39,311
Property and equipment	455
Trade name	407
Goodwill	10,718
Total assets acquired	51,050

Liabilities

Accounts payable	7,692
Accrued and other liabilities	390
Total liabilities assumed	8,082
Total net assets acquired	\$ 42,968

Fair Value

Receivables and other assets, property and equipment, accounts payable and accrued and other liabilities were generally stated at historical carrying values given the short-term nature of these assets and liabilities.

We determined the fair value of land and other inventories on a lot-by-lot basis primarily using market comparable land and home sales transactions combined with our estimates related to expected average home selling prices and sales incentives, expected sales paces and cancellation rates, expected land development and construction timelines, and anticipated land development, construction, and overhead costs. Such estimates must be made for each individual community and may vary significantly between communities. The fair values of identified intangible assets were determined using discounted cash flow models.

The \$0.4 million of acquired intangible assets relates to trade names that are being amortized over 2.75 years. Amortization expense for these assets totaled less than \$0.1 million and \$0.1 million for the three and nine months ended September 30, 2017, respectively, which is included in selling, general and administrative expenses in the consolidated statements of operations and comprehensive income.

We engaged a third-party valuation specialist to assist with the determination of the estimated fair value of intangible assets acquired. We estimated the preliminary fair value of acquired assets and liabilities as of the date of acquisition based on information available at that time. The valuation of these tangible and identifiable intangible assets and liabilities is subject to further management review and may change between the preliminary allocation and the end of the purchase price allocation period.

Transaction and Integration Costs

Transaction and integration costs directly related to the Savvy acquisition, including legal and accounting fees, were \$0.1 million and \$1.0 million for the three and nine months ended September 30, 2017, respectively, which are included in selling, general and administrative expenses in the consolidated statements of operations and comprehensive income. Such costs were expensed as incurred in accordance with ASC 805.

Table of Contents

Goodwill

As of the acquisition date, goodwill included the expected economic value attributable to Savvy's assembled workforce. The acquisition provided increased scale and presence in an existing market with immediate revenue opportunities through an established backlog.

Supplemental Pro Forma Information

The following represents pro forma operating results as if Savvy had been included in our consolidated statements of operations and comprehensive income as of the beginning of the fiscal year presented (in thousands, except per share data):

	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	2016
Revenue	\$ 220,569	\$ 579,951	\$ 572,868
Net income	12,678	1,823	132,752
Basic earnings per share	0.57	0.08	5.93
Diluted earnings per share	0.52	0.08	5.12

The supplemental pro forma operating results have been determined after adjusting the operating results of Savvy to reflect additional expense that would have been recorded assuming the fair value adjustments to inventory and intangible assets had been applied as of January 1, 2016. These results may not be indicative of future operating results.

Note 3 - Land and Other Inventories

As of September 30, 2017 and December 31, 2016, land and other inventories consisted of the following (in thousands):

Edgar Filing: AV Homes, Inc. - Form 10-Q

	September 30, 2017	December 31, 2016
Land held for future development	\$ 29,201	\$ 29,089
Land developed and in process of development	355,068	349,891
Homes completed or under construction	295,626	205,428
Total	\$ 679,895	\$ 584,408

We capitalize interest to inventories during the period of development in accordance with ASC 835, Interest (“ASC 835”). Homebuilding interest capitalized to inventory is included in homebuilding cost of revenue as related units or lots are closed. To the extent our homebuilding debt exceeds our qualified assets, as defined in ASC 835, we expense a portion of interest incurred. Qualified homebuilding assets consist of land, lots and homes that are under development or construction, excluding finished unsold homes or finished models.

The following table represents interest incurred, interest capitalized, and interest expense for the three and nine months ended September 30, 2017 and 2016 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Interest incurred	\$ 8,523	\$ 6,483	\$ 24,046	\$ 19,873
Interest capitalized	(5,898)	(5,782)	(16,899)	(17,020)
Interest expense	\$ 2,625	\$ 701	\$ 7,147	\$ 2,853

Table of Contents

Note 4 – Senior Debt

As of September 30, 2017 and December 31, 2016, senior debt, net consisted of the following (in thousands):

	September 30, 2017	December 31, 2016
8.50% Senior Notes due 2019	\$ —	\$ 200,000
6.00% Senior Convertible Notes due 2020	80,000	80,000
6.625% Senior Notes due 2022	400,000	—
Senior Unsecured Credit Facility	—	N/A
Senior Secured Credit Facility	N/A	—
Total senior debt	480,000	280,000
Deferred debt issuance costs	(8,313)	(4,285)
Debt discount	(43)	(55)
Total senior debt, net	\$ 471,644	\$ 275,660

8.50% Senior Notes due 2019

On June 30, 2014, we completed an underwritten offering for \$200.0 million aggregate principal amount of our 8.50% Senior Notes due 2019 (the “8.50% Notes”). The 8.50% Notes were scheduled to mature on July 1, 2019, unless earlier redeemed or repurchased. Interest on the 8.50% Notes was payable semi-annually in arrears in cash on January 1 and July 1 of each year, commencing January 1, 2015. The 8.50% Notes were redeemable at our option, in whole or in part, at any time on or after July 1, 2016, at certain redemption prices, together with accrued and unpaid interest, if any, to, but excluding, the date of redemption.

Certain of our subsidiaries were guarantors of the 8.50% Senior Notes. All of the subsidiary guarantors were 100% owned by us, and all of the guarantees were full, unconditional, and joint and several. We have no independent assets or operations and our subsidiaries, other than the subsidiary guarantors, are minor.

On May 18, 2017, in conjunction with the completion of our private offering of \$400.0 million of the 6.625% Notes (as defined below), we repurchased \$45.5 million aggregate principal amount of the 8.50% Notes representing approximately 23% of the total principal amount outstanding. Holders of the tendered notes received the total consideration of \$1,038.87 per \$1,000 principal amount of 8.50% Notes tendered, which includes an early tender payment of \$6.99 per \$1,000 principal amount of 8.50% Notes tendered. In addition, holders of the tendered notes received accrued and unpaid interest up to, but not including, May 18, 2017. Effective July 1, 2017, we redeemed the remaining \$154.5 million principal of our 8.50% Notes. As a result, we recognized a loss on extinguishment of debt of \$6.9 million in the third quarter of 2017, which includes a redemption premium of \$4.9 million and the write-off of

unamortized debt issuance costs. During the nine months ended September 30, 2017, we recognized a total loss on extinguishment of debt of \$9.9 million.

6.00% Senior Convertible Notes due 2020

On June 23, 2015, we completed a private offering of \$80.0 million aggregate principal amount of 6.00% Senior Convertible Notes due 2020 (the “6.00% Notes”). The proceeds of the 6.00% Notes were used to (i) repurchase 7.50% Senior Exchange Convertible Notes due 2016 and 7.50% Senior Convertible Notes due 2016, and (ii) pay approximately \$1.5 million of accrued interest (in respect of the notes being exchanged or repurchased) and premium (in respect of the notes being repurchased). The 6.00% Notes will mature on July 1, 2020, unless earlier repurchased or converted. The 6.00% Notes are governed by the Indenture dated February 4, 2011 and the Third Supplemental Indenture dated June 23, 2015 between us and the trustee named therein. The 6.00% Notes bear regular cash interest on the principal amount of each note, payable semi-annually in arrears on January 1 and July 1 of each year, beginning on January 1, 2016.

The 6.00% Notes were issued pursuant a series of separate, privately negotiated note purchase agreements entered into on June 17, 2015 by us and certain qualified institutional buyers. TPG Aviator, L.P. (“TPG”) purchased \$20.0 million aggregate principal amount of the 6.00% Notes for \$20.0 million in cash and waived its rights to purchase additional 6.00% Notes, resulting in a fully diluted beneficial ownership for TPG of approximately 43.8% of our common stock at the time of the transaction. Pursuant to the terms of our Related Person Transaction Policy, the audit committee of our board of directors reviewed and approved the terms of the 6.00% Notes and TPG’s purchase of 6.00% Notes.

Table of Contents

6.625% Senior Notes due 2022

On May 18, 2017, we completed a private offering of \$400.0 million of our 6.625% Senior Notes due 2022 (the “6.625% Notes”). The proceeds of the 6.625% Notes were used to (i) fund the repurchase and redemption of the \$200.0 million in aggregate principal amount of our outstanding 8.50% Notes and (ii) pay amounts outstanding under our Senior Secured Credit Facility (as defined below), totaling \$30.0 million. We intend to use the remaining proceeds for general corporate purposes, which may include the financing of acquisitions. The 6.625% Notes mature on May 15, 2022, unless earlier redeemed or repurchased. Interest on the 6.625% Notes is payable semi-annually in arrears in cash on May 15 and November 15 of each year, commencing November 15, 2017.

We have the option to redeem all or a portion of the 6.625% Notes at any time on or after May 15, 2019 at certain redemption prices, plus accrued and unpaid interest, if any, to but excluding the date of redemption. At any time prior to May 15, 2019, we have the option to redeem up to 35% of the original principal amount of the 6.625% Notes with the proceeds of certain equity offerings by us at a redemption price of 106.625% of the principal amount of the 6.625% Notes, plus accrued and unpaid interest, if any, to but excluding the date of redemption, provided that at least 65% of the original aggregate principal amount of the 6.625% Notes remains outstanding after such redemption. Prior to May 15, 2019, we may redeem some or all of the 6.625% Notes at a redemption price equal to 100% of the principal amount of the 6.625% Notes, plus accrued and unpaid interest, if any, to but excluding the applicable redemption date plus the applicable “make-whole” premium.

The indenture governing the 6.625% Notes contains covenants that limit our ability and the ability of certain of our subsidiaries to (i) pay dividends, or make other distributions or redeem or repurchase our capital stock; (ii) prepay, redeem or repurchase certain debt; (iii) incur additional and guarantee indebtedness; (iv) issue certain preferred stock or similar equity securities; (v) make loans and investments; (vi) incur liens; (vii) sell assets; (viii) enter into transactions with affiliates; (ix) enter into agreements restricting our subsidiaries’ ability to pay dividends; and (x) consolidate, merge or sell all or substantially all assets. These covenants are subject to important exceptions and qualifications.

The indenture further provides that upon certain specified change of control events, certain covenants will no longer apply to the 6.625% Notes and will be replaced with new covenants (a “Covenant Replacement Event”). Additionally, if we experience specific kinds of changes in control that do not result in a Covenant Replacement Event or, if following a Covenant Replacement Event we experience a subsequent change of control that result in a downgrade of the rating assigned to the 6.625% Notes, holders of the 6.625% Notes will be entitled to require us to purchase all or a portion of the 6.625% Notes at 101% of their principal amount, plus accrued and unpaid interest to but excluding the date of repurchase.

Certain of our subsidiaries are guarantors of the 6.625% Notes. All of the subsidiary guarantors are 100% owned by us, and all of the guarantees are full, unconditional, and joint and several. We have no independent assets or operations and our subsidiaries, other than the subsidiary guarantors, are minor.

In August 2017, we satisfied our obligation to exchange the 6.625% Notes and related guarantees for registered notes and guarantees having substantially the same terms.

We have assessed the 6.625% Notes and concluded that the impact of any embedded derivative features are not material as of September 30, 2017.

Senior Unsecured Credit Facility

On May 18, 2017, we entered into an unsecured revolving credit agreement (the “Senior Unsecured Credit Facility”) with each of the financial institutions party thereto, JPMorgan Chase Bank, N.A., as administrative agent and Citibank, N.A., as syndication agent. As of June 30, 2017, the Senior Unsecured Credit Facility had replaced the previously outstanding Senior Secured Credit Facility, as more fully described below.

The Senior Unsecured Credit Facility has substantially similar terms and provisions to the Senior Secured Credit Facility, except that the facility is no longer secured by substantially all of our assets and the assets of certain of our subsidiaries.

The Senior Unsecured Credit Facility includes a revolving credit facility in an aggregate principal amount of up to \$155.0 million, with an “accordion” feature that allows us, with the consent of the lenders, to increase the aggregate amount to

Table of Contents

\$250.0 million. The facility includes a letter of credit sub-facility in an amount equal to 50% of total commitments then in effect. The maximum amount available under the Senior Unsecured Credit Facility is limited to the lesser of (i) \$155.0 million (subject to increase pursuant to the “accordion”) and (ii) an amount equal to the borrowing base minus our consolidated senior debt. The borrowing base includes 100% of unrestricted cash, to the extent it exceeds the interest reserve, and escrowed deposits and funds payable to us following the sale of real property, plus the following, subject to certain limitations:

- 85% of the book value of our real property that is under contract or under construction and is or is planned to be residential housing units or model homes; plus
- 65% of the book value of our finished lots and lots under development; plus
- 50% of the book value of our entitled lands that are not finished lots or lots under development.

To be included in the borrowing base, the real property must be owned by us or one of our subsidiaries that guarantees the Company’s obligations under the Senior Unsecured Credit Facility and meet certain criteria. As of September 30, 2017, we had sufficient qualified assets in the borrowing base to cover borrowings of up to \$155.0 million and had no borrowings outstanding.

Interest will be payable on revolving credit borrowings at variable rates determined by the applicable LIBOR plus 3.25% or the prime rate plus 2.25%, at our election. We pay quarterly fees of 0.50% per annum on the unused portion of the lenders’ commitments under the Senior Unsecured Credit Facility to the lenders.

The Senior Unsecured Credit Facility expires on July 28, 2020. Upon expiration, all borrowings become due and payable. We may prepay loans borrowed under the Senior Unsecured Credit Facility or reduce the commitments thereunder at our option, without any prepayment fee or penalty.

The Senior Unsecured Credit Facility is guaranteed by certain of our subsidiaries and we have the option to add or remove guarantors from time to time, subject to certain limitations.

The Senior Unsecured Credit Facility contains certain restrictions and covenants, which, among other things, restrict our ability to acquire or merge with another entity, make investments, loans or guarantees, incur additional indebtedness, create liens or other encumbrances, or pay cash dividends or make other distributions. The Senior Unsecured Credit Facility also requires that we comply with the following financial covenants as of the end of each fiscal quarter:

- our leverage ratio may not exceed 60%;

if our interest coverage ratio is less than 1.50 to 1.00, we must deposit to an interest reserve account an amount equal to the interest we have incurred on all indebtedness during the prior twelve months; and our consolidated tangible net worth, excluding the tangible net worth of our subsidiaries that do not guarantee the Senior Unsecured Credit Facility unless such subsidiaries are a subsidiary of a guarantor, must be at least \$325.1 million plus 50% of our cumulative consolidated net income since December 31, 2016 plus 50% of the net proceeds of any equity offerings.

We were in compliance with all financial covenants as of September 30, 2017.

Senior Secured Credit Facility

On April 7, 2014, we entered into a \$65.0 million senior secured credit facility with JPMorgan Chase Bank, N.A., as agent, a lender and a letter of credit issuer (the "Senior Secured Credit Facility"). The other original lenders and letter of credit issuers include Royal Bank of Canada and Credit Suisse AG. Later in 2014, we increased the Senior Secured Credit Facility by \$40.0 million with the addition of Citibank, N.A., and Deutsche Bank, A.G., as additional lenders. The Senior Secured Credit Facility included revolving credit and letter of credit facilities in an aggregate principal amount of up to \$105.0 million, with an "accordion" feature that allowed us, with the consent of the lenders, to increase the aggregate amount to \$175.0 million. The Senior Secured Credit Facility also included a swing line loan facility in an aggregate principal amount of up to \$30.0 million.

On July 28, 2016, we entered into an amendment to our Senior Secured Credit Facility and existing Guarantee and Collateral Agreement (the "Amendment"), which included the addition of Flagstar Bank, FSB and U.S. Bank, National Association as additional lenders, and on October 26, 2016, we received a commitment from Wells Fargo Bank, N.A.,

Table of Contents

increasing the amount committed under the Senior Secured Credit Facility by \$25 million. Pursuant to the Amendment, and after giving effect to the commitment from Wells Fargo Bank, N.A., the committed amount for revolving credit available under the Senior Secured Credit Facility was increased to \$190.0 million. On June 6, 2017, Deutsche Bank, A.G.'s commitment would have expired and the total committed amount available under the Senior Secured Credit Facility would have been reduced by \$15.0 million. The remaining commitments were scheduled to expire on July 28, 2019 and any loans outstanding on such date would mature and be payable. In connection with the Amendment, the "accordion" feature was increased from \$175.0 million to \$200.0 million, the committed amount available under the letter of credit facilities was reduced to 50% of the total commitments in respect of the Senior Secured Credit Facility, and the \$30.0 million swing line loan facility was discontinued.

We were in compliance with all financial covenants under the Senior Secured Credit Facility as of December 31, 2016. As of June 30, 2017, the Senior Secured Credit Facility was replaced in its entirety by the Senior Unsecured Credit Facility (as described above).

Note 5 - Estimated Development Liability

The estimated development liability consists primarily of utility completion obligations in Rio Rico, Arizona and Poinciana, Florida for more than 8,000 home sites previously sold, in most cases prior to 1980. The estimated development liability is reduced by actual expenditures and is evaluated and adjusted, as appropriate, to reflect management's estimate of potential costs. In addition, we obtain third-party engineer evaluations on an annual basis and adjust this liability to reflect changes in the estimated completion costs. Cash expenditures associated with these obligations were \$0.1 million and \$0.4 million during the three and nine months ended September 30, 2017, respectively, and were \$0.2 million and \$0.3 million during the three and nine months ended September 30, 2016, respectively. Future increases or decreases of costs for construction, material and labor, as well as other land development and utilities infrastructure costs, may have a significant effect on the estimated development liability. The balance of the estimated development liability was \$31.7 million and \$32.1 million as of September 30, 2017 and December 31, 2016, respectively.

Note 6 - Commitments and Contingencies

Legal

We are involved in litigation from time to time, primarily arising in the normal course of our business. These cases are in various procedural stages. In view of the inherent difficulty of predicting the outcome of these legal and regulatory matters, we generally cannot predict the ultimate resolution of the pending matters, the related timing, or the eventual loss. While the outcome of such contingencies cannot be predicted with certainty, we do not believe that the resolution of such matters will have a material adverse impact on our results of operations, financial position, or cash flows.

On April 26, 2017, we received notice of a Class Action Complaint filed in the Circuit Court for the 10th Judicial Circuit, Polk County, Florida, generally alleging that the collection of club membership fees in connection with the use and enjoyment of the club facilities located within the Solivita community is illegal in that it violates, among other laws, Florida's Homeowners' Association Act ("FLHOA") and Florida's Deceptive and Unfair Trade Practices Act ("FDUTPA"). It also generally alleges that certain other actions by us have violated FLHOA and FDUTPA. The complaint seeks relief in various forms including recovery for the prior payment of club membership fees and an injunction to prohibit the future collection of club membership fees. On June 9, 2017, we filed an amended motion to dismiss this matter, which was heard on June 13, 2017. On August 8, 2017, the judge issued an order denying in part and granting in part the motion to dismiss. Plaintiffs were provided leave to amend the FDUTPA claims and filed an amended complaint on September 15, 2017. We filed our amended answer on September 29, 2017 along with certain affirmative defenses. The amended complaint also contains counterclaims against the plaintiffs for breach of contract and tortious interference with contractual relations, among other claims. On October 5, 2017, we also filed a motion for summary judgment. Based on facts and information available to us, we believe these claims to be without merit and intend to vigorously defend against them.

Surety Bonds

Surety bonds, issued by third-party entities, are used primarily to guarantee our performance to construct improvements in our various communities. As of September 30, 2017, we had outstanding surety bonds of approximately \$38.0 million. The amount of outstanding surety bonds could fluctuate depending on the level of development activity. We do not believe that it is likely any of these outstanding surety bonds will be drawn upon.

Table of Contents

Note 7 - Segment Information

Our operating segments are defined as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the chief operating decision maker to evaluate performance and make operating decisions. We have identified our chief operating decision maker as our Chief Executive Officer. Our reportable segments are as follows: Florida, the Carolinas and Arizona.

The following table summarizes our information for reportable segments for the three and nine months ended September 30, 2017 and 2016 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Operating income:				
Florida				
Revenues:				
Homebuilding	\$ 81,796	\$ 96,943	\$ 231,395	\$ 251,587
Amenity and other	3,875	3,315	12,637	8,834
Land sales	30	26	1,499	670
Total revenues	85,701	100,284	245,531	261,091
Expenses:				
Homebuilding cost of revenue	64,739	74,872	183,373	196,045
Homebuilding selling, general and administrative	9,837	12,189	28,241	33,374
Amenity and other	3,145	3,075	11,000	7,978
Land sales	14	6	210	225
Segment operating income	\$ 7,966	\$ 10,142	\$ 22,707	\$ 23,469
Carolinas				
Revenues:				
Homebuilding	\$ 84,893	\$ 62,864	\$ 214,255	\$ 151,817
Land sales	110	265	892	265
Total revenues	85,003	63,129	215,147	152,082
Expenses:				
Homebuilding cost of revenue	74,376	53,803	184,557	130,573
Homebuilding selling, general and administrative	8,791	5,744	22,954	15,525
Land sales	110	289	896	289
Segment operating income	\$ 1,726	\$ 3,293	\$ 6,740	\$ 5,695
Arizona				
Revenues:				
Homebuilding	\$ 35,035	\$ 42,014	\$ 101,618	\$ 104,255
Land sales	—	—	185	185

Edgar Filing: AV Homes, Inc. - Form 10-Q

Total revenues	35,035	42,014	101,803	104,440
Expenses:				
Homebuilding cost of revenue	29,440	35,236	86,090	87,672
Homebuilding selling, general and administrative	3,797	3,854	10,950	10,773
Amenity and other	22	26	63	79
Land sales	—	—	180	171
Segment operating income	\$ 1,776	\$ 2,898	\$ 4,520	\$ 5,745
Operating income	\$ 11,468	\$ 16,333	\$ 33,967	\$ 34,909
Unallocated income (expenses):				
Interest income and other	407	—	665	1
Corporate general and administrative expenses	(4,660)	(3,697)	(14,325)	(11,967)
Loss on extinguishment of debt	(6,939)	—	(9,872)	—
Interest expense	(2,625)	(701)	(7,147)	(2,853)
Income (loss) before income taxes	(2,349)	11,935	3,288	20,090
Income tax expense (benefit)	(872)	38	1,679	(109,959)
Net income (loss)	\$ (1,477)	\$ 11,897	\$ 1,609	\$ 130,049

Table of Contents

Note 8 - Fair Value Disclosures

ASC 820, Fair Value Measurements and Disclosures (“ASC 820”), provides guidance for using fair value to measure assets and liabilities, defines fair value, establishes a framework for measuring fair value under GAAP, disclosures about fair value measurements, and a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The accounting standards require that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Fair value determined based on quoted market prices in active markets for identical assets and liabilities.

Level 2: Fair value determined using significant observable inputs, such as quoted prices for similar assets or liabilities or quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data, by correlation or other means.

Level 3: Fair value determined using significant unobservable inputs, such as discounted cash flows, or similar techniques.

The carrying amounts of cash and cash equivalents, restricted cash, receivables, accounts payable, the Senior Secured Credit Facility, and the Senior Unsecured Credit Facility approximate the fair values due to their short-term nature.

Certain assets are required to be recorded at fair value on a non-recurring basis when events and circumstances indicate that the carrying value may not be recoverable.

The carrying amounts and fair values of our financial liabilities as of September 30, 2017 and December 31, 2016 are as follows (in thousands):

September 30, 2017

December 31, 2016

Edgar Filing: AV Homes, Inc. - Form 10-Q

	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Senior notes:				
8.50% Notes, net (1)	\$ —	\$ —	\$ 196,782	\$ 206,500
6.00% Notes, net (1)	79,119	90,936	78,878	84,984
6.625% Notes, net (1)	392,525	409,000	—	—
Contingent consideration (earn-out) (2)	1,171	1,171	2,400	2,400

- (1) The carrying amount of the debt instruments are net of unamortized debt issuance costs and certain debt discounts.
(2) During the three months ended September 30, 2017, we reduced the carrying amount of the Savvy earn-out by \$0.6 million to its estimated fair value.

In estimating the fair value of financial liabilities, we used the following methods and assumptions:

Senior Notes

As of September 30, 2017 and December 31, 2016, the fair values of the 8.50% Notes, 6.00% Notes and 6.625% Notes are estimated, based on quoted or estimated market prices. These fall within Level 2 of the fair value hierarchy.

Contingent Consideration (“earn-out”)

This was recognized as part of the purchase price paid for the Bonterra Builders acquisition in 2015 and the Savvy acquisition in 2017. At inception, the fair values were determined through the use of valuation models that simulated earnings, applying the terms of the earn-out in each simulated path, determining the average payment in each year across all the trials of the simulation, and calculating the present values of the future payments. The primary inputs and key assumptions include estimated future earnings, probabilities of achievement, earnings volatility, and the discount rate. These fall within Level 3 of the fair value hierarchy.

Table of Contents

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

Executive Overview

We are engaged in the business of homebuilding and community development in Florida, the Carolinas and Arizona. We also engage to a limited degree in other real estate activities, such as the operation of amenities and the sale of land for third-party development. We manage our business through three reportable segments: Florida, the Carolinas and Arizona.

For the nine months ended September 30, 2017, we derived 44% of our revenues from Florida, 38% of our revenues from the Carolinas and 18% of our revenues from Arizona.

Our primary business is the development of land and the construction and sale of homes. Our current homebuilding sales activities include locations in Florida, the Carolinas and Arizona, with additional communities in the pipeline for each region. Within each geographical segment, we build both active adult communities, which are restricted to homeowners that are age 55 and older, and primary residential communities, which are open to all ages. This geographic and product segment diversification helps mitigate our overall business risks. We also opportunistically sell existing non-core commercial and industrial land positions, as well as scattered lot positions and land assets, that are in excess of our needed supply in a given market.

As of September 30, 2017, our selling community count included 72 locations: 25 in Florida, 40 in the Carolinas, and seven in Arizona, with additional communities in the pipeline for each region. Our count of communities with closings as of September 30, 2017 included 66 locations: 24 in Florida, 35 in the Carolinas, and seven in Arizona.

Solivita and Vitalia in Central Florida; CantaMia and Encore in Arizona; and Creekside at Bethpage in Raleigh, North Carolina currently serve as our flagship communities in the active adult market. These communities broaden our geographic footprint and product offering, and should provide us with market participation in the long-term growth of demand from the wave of Baby Boomers entering their retirement years.

We continue to invest in new and existing markets to create a more diversified portfolio that mitigates cyclical impact over time. Through homebuilder acquisitions and purchases of new land and lot positions, we have expanded and continue to expand within our existing markets in Central Florida, Charlotte, Raleigh, Jacksonville and the greater Phoenix area. Replacement lot positions require new acquisitions of developed lots or platted or unplatted undeveloped land, or we may decide to develop current land holdings, depending on market conditions within the

submarket of these assets.

Our business is significantly influenced by a number of factors that affect our revenues and costs, including market demand for new homes, labor supply and wages, materials prices and availability, land availability, and mortgage rates and availability. In managing our business and the influence of these factors, we track several key operating metrics described below.

Key Operating Metrics

Contracts signed. Net contracts signed for a given period represents the number of contracts we have entered into with home buyers for the purchase and sale of homes, less the number of contracts that were cancelled in the same period. We consider a home sales contract cancelled when the customer terminates the contract or when we provide notice of termination due to a failure on the part of the customer to close on the home or meet a contingency under the contract.

Home starts. Home starts is the number of new homes on which we have started construction in a given period. Home starts are monitored by management in order to minimize the time between contract signing and home closing.

Closings. Closings represents the number of home sales closed in the period. We recognize revenue equal to the sales price of a home when the sales are closed and title passes to the purchasers.

Backlog. Backlog is the number of homes we are building that are under contract for sale that have not closed as of the end of the period being presented. The dollar value of backlog is the revenue anticipated to be realized at closing equal to the purchase price provided in the applicable contract. Backlog is an important indicator of home closings and homebuilding revenues in future periods.

Average sales price. Average sales price represents total revenue for a given period divided by the number of closings for such period.

Table of Contents

Seasonality

Our business is affected to some extent by the seasonality of home sales, which generally produce increased closings in the latter half of the year. However, periods of economic downturn in the industry can alter seasonal patterns.

Results of Operations

The following table provides a comparison of certain financial data related to our operations for the three and nine months ended September 30, 2017 and 2016 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Operating income:				
Florida				
Revenues:				
Homebuilding	\$ 81,796	\$ 96,943	\$ 231,395	\$ 251,587
Amenity and other	3,875	3,315	12,637	8,834
Land sales	30	26	1,499	670
Total revenues	85,701	100,284	245,531	261,091
Expenses:				
Homebuilding cost of revenue	64,739	74,872	183,373	196,045
Homebuilding selling, general and administrative	9,837	12,189	28,241	33,374
Amenity and other	3,145	3,075	11,000	7,978
Land sales	14	6	210	225
Segment operating income	\$ 7,966	\$ 10,142	\$ 22,707	\$ 23,469
Carolinas				
Revenues:				
Homebuilding	\$ 84,893	\$ 62,864	\$ 214,255	\$ 151,817
Land sales	110	265	892	265
Total revenues	85,003	63,129	215,147	152,082
Expenses:				
Homebuilding cost of revenue	74,376	53,803	184,557	130,573
Homebuilding selling, general and administrative	8,791	5,744	22,954	15,525
Land sales	110	289	896	289
Segment operating income	\$ 1,726	\$ 3,293	\$ 6,740	\$ 5,695
Arizona				
Revenues:				

Edgar Filing: AV Homes, Inc. - Form 10-Q

Homebuilding	\$ 35,035	\$ 42,014	\$ 101,618	\$ 104,255
Land sales	—	—	185	185
Total revenues	35,035	42,014	101,803	104,440
Expenses:				
Homebuilding cost of revenue	29,440	35,236	86,090	87,672
Homebuilding selling, general and administrative	3,797	3,854	10,950	10,773
Amenity and other	22	26	63	79
Land sales	—	—	180	171
Segment operating income	\$ 1,776	\$ 2,898	\$ 4,520	\$ 5,745
Operating income	\$ 11,468	\$ 16,333	\$ 33,967	\$ 34,909
Unallocated income (expenses):				
Interest income and other	407	—	665	1
Corporate general and administrative expenses	(4,660)	(3,697)	(14,325)	(11,967)
Loss on extinguishment of debt	(6,939)	—	(9,872)	—
Interest expense	(2,625)	(701)	(7,147)	(2,853)
Income (loss) before income taxes	(2,349)	11,935	3,288	20,090
Income tax expense (benefit)	(872)	38	1,679	(109,959)
Net income (loss)	\$ (1,477)	\$ 11,897	\$ 1,609	\$ 130,049

Table of Contents

Data from closings for the Florida, Carolinas and Arizona segments for the three and nine months ended September 30, 2017 and 2016 is summarized as follows (dollars in thousands):

	Number of Units	Revenues	Average Price Per Unit
For the three months ended September 30, 2017			
Florida	279	\$ 81,796	\$ 293
Carolinas	227	84,893	374
Arizona	102	35,035	343
Total	608	\$ 201,724	332
2016			
Florida	340	\$ 96,943	\$ 285
Carolinas	166	62,864	379
Arizona	129	42,014	326
Total	635	\$ 201,821	318
	Number of Units	Revenues	Average Price Per Unit
For the nine months ended September 30, 2017			
Florida	794	\$ 231,395	\$ 291
Carolinas	569	214,255	377
Arizona	302	101,618	336
Total	1,665	\$ 547,268	329
2016			
Florida	904	\$ 251,587	\$ 278
Carolinas	413	151,817	368
Arizona	340	104,255	307
Total	1,657	\$ 507,659	306

Three Months Ended September 30, 2017 and 2016

Total revenue increased by \$0.3 million or 0.2% to \$205.7 million during the three months ended September 30, 2017 compared to the three months ended September 30, 2016. Homebuilding revenue, which is revenue from home closings, decreased \$0.1 million to \$201.7 million for the three months ended September 30, 2017 compared to the same period in 2016, primarily due to a 4.3% decline in volume primarily in Florida and Arizona, partially offset by a

volume increase in the Carolinas primarily due to the Savvy acquisition and a 4.4% increase in the average sales price for homes closed. In the Florida segment, homebuilding revenue decreased \$15.1 million or 15.6% for the three months ended September 30, 2017 compared to the same period in 2016 due to a decrease in the number of communities in which we had closings from 26 to 24, partially offset by a 2.8% increase in the average selling price of homes closed. In the Carolinas segment, homebuilding revenue increased by \$22.0 million or 35.0% for the three months ended September 30, 2017 compared to the same period in 2016 due to an increase in the number of communities in which we had closings from 25 to 35, primarily as a result of the Savvy acquisition. In the Arizona segment, homebuilding revenue decreased \$7.0 million or 16.6% for the three months ended September 30, 2017 compared to the same period in 2016 due to a decrease in the number of communities in which we had closings from nine to seven, partially offset by a 5.2% increase in the average selling price of homes closed.

Gross margin, which is homebuilding revenue less homebuilding cost of revenue, from total home closings decreased by 240 basis points to 16.4% from 18.8% for the three months ended September 30, 2017 compared to the same period in 2016. Gross margin from the Florida segment decreased by 190 basis points to 20.9% from 22.8% for the three months ended September 30, 2017 compared to the same period in 2016, primarily due to the change in the mix of communities with home closings in each year, as well as an increase in construction costs. Gross margin from the Carolinas segment decreased by 200 basis points to 12.4% from 14.4% for the three months ended September 30, 2017 compared to the same period in 2016, primarily due to the change in the mix of communities with home closings, as well as an increase in construction costs. Gross margin from

Table of Contents

the Arizona segment remained flat decreasing 10 basis points to 16.0% from 16.1% for the three months ended September 30, 2017 compared to the same period in 2016. Capitalized interest included in cost of sales for the Florida, Carolinas and Arizona segments was \$1.9 million, \$2.2 million and \$1.3 million, respectively, for the three months ended September 30, 2017 and was \$2.3 million, \$1.6 million and \$1.5 million, respectively, for the same period in 2016.

Total selling, general and administrative expenses as a percentage of homebuilding revenue increased to 13.4% for the three months ended September 30, 2017 from 12.6% for the same period in 2016. Homebuilding selling, general and administrative expenses as a percentage of homebuilding revenue (“Homebuilding SG&A to Revenue Ratio”) increased to 11.1% for the three months ended September 30, 2017 from 10.8% for the same period in 2016. The Homebuilding SG&A to Revenue Ratio for the Florida segment improved to 12.0% for the three months ended September 30, 2017 compared to 12.6% for the same period in 2016, primarily due to lower external commission costs resulting from a decline in home closing volume and a decline in general and administrative expenses for the period. The Homebuilding SG&A to Revenue Ratio for the Carolinas segment increased to 10.4% for the three months ended September 30, 2017 compared to 9.1% for the three months ended September 30, 2016 primarily due to higher external commission costs and an increase in general and administrative expenses for the period. The Homebuilding SG&A to Revenue Ratio for the Arizona segment increased to 10.8% for the three months ended September 30, 2017 from 9.2% for the three months ended September 30, 2016 primarily due to lower revenue over a fixed cost base.

Corporate general and administrative expenses increased by \$1.0 million to \$4.7 million for the three months ended September 30, 2017 compared to the same period in 2016. As a percentage of homebuilding revenue, corporate general and administrative expenses increased to 2.3% for the three months ended September 30, 2017 compared to 1.8% for the same period in 2016. The increase as a percentage of revenue was primarily driven by the decrease in revenue and non-recurring adjustments related to the forfeiture of unvested share-based awards in 2016.

Interest expense increased by \$1.9 million to \$2.6 million for the three months ended September 30, 2017 compared to the same period in 2016. The increase in interest expense is a result of the increase in debt compared to the prior year, partially offset by a lower weighted average interest rate. As of September 30, 2017, our total principal outstanding was \$480.0 million compared to \$295.0 million as of September 30, 2016, and the weighted average interest rate was 7.03% and 8.31% for the three months ended September 30, 2017 and 2016, respectively.

Income (loss) before income taxes for the three months ended September 30, 2017 was \$(2.3) million compared to \$11.9 million for the three months ended September 30, 2016. The decrease was primarily due to (i) the \$6.9 million loss on extinguishment associated with the redemption of our 8.50% Notes in the third quarter of 2017, (ii) the \$4.6 million increase in homebuilding cost of revenue mainly driven by increased construction costs, and (iii) the \$2.6 million of interest expense during the three months ended September 30, 2017 compared to \$0.7 million for the same period in 2016 due to the issuance of the 6.625% Notes in May 2017.

Income tax expense (benefit) for the three months ended September 30, 2017 and 2016 was \$(0.9) million and less than \$0.1 million, respectively.

Net income (loss) for the three months ended September 30, 2017 was \$(1.5) million or \$(0.07) per diluted share compared to \$11.9 million or \$0.49 per diluted share for the three months ended September 30, 2016.

Table of Contents

Nine Months Ended September 30, 2017 and 2016

Total revenue increased by \$44.9 million or 8.7% to \$562.5 million during the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016. Homebuilding revenue, which is revenue from home closings, increased \$39.6 million or 7.8% to \$547.3 million for the nine months ended September 30, 2017 compared to the same period in 2016, primarily due to a 7.5% increase in the average sales price for homes closed. In the Florida segment, homebuilding revenue decreased \$20.2 million or 8.0% for the nine months ended September 30, 2017 compared to the same period in 2016, primarily driven by a decrease in the number of communities in which we had closings from 26 to 24. In the Carolinas segment, homebuilding revenue increased by \$62.4 million or 41.1% for the nine months ended September 30, 2017 compared to the same period in 2016 due to an increase in the number of communities in which we had closings from 25 to 35, primarily as a result of the Savvy acquisition. In the Arizona segment, homebuilding revenue decreased \$2.6 million or 2.5% for the nine months ended September 30, 2017 compared to the same period in 2016 driven by a decrease in the number of communities in which we had closings from nine to seven.

Gross margin, which is homebuilding revenue less homebuilding cost of revenue, from total home closings decreased by 140 basis points to 17.0% from 18.4% for the nine months ended September 30, 2017 compared to the same period in 2016. Gross margin from the Florida segment decreased by 130 basis points to 20.8% from 22.1% for the nine months ended September 30, 2017 compared to the same period in 2016 mainly due to the change in mix of communities with home closings in each year and increased construction costs. Gross margin from the Carolinas segment decreased by 10 basis points to 13.9% from 14.0% for the nine months ended September 30, 2017 compared to the same period in 2016, primarily due to the change in the mix of communities with home closings and the effects of purchase accounting inventory valuations in each year. Gross margin from the Arizona segment decreased by 60 basis points to 15.3% from 15.9% for the nine months ended September 30, 2017 compared to the same period in 2016 mainly due to lower margins in close-out communities and increased construction costs. Capitalized interest included in cost of sales for the Florida, Carolinas and Arizona segments was \$5.7 million, \$5.7 million and \$3.8 million, respectively, for the nine months ended September 30, 2017 and was \$6.1 million, \$4.0 million and \$3.9 million, respectively, for the same period in 2016.

Total selling, general and administrative expenses as a percentage of homebuilding revenue improved to 14.0% for the nine months ended September 30, 2017 from 14.1% for the same period in 2016. The Homebuilding SG&A to Revenue Ratio improved to 11.4% for the nine months ended September 30, 2017 from 11.8% for the same period in 2016 as we were able to continue to leverage the cost base over our increased revenues. The Homebuilding SG&A to Revenue Ratio for the Florida segment improved to 12.2% for the nine months ended September 30, 2017 compared to 13.3% for the same period in 2016 due to lower external commission costs resulting from a decline in home closing volume. The Homebuilding SG&A to Revenue Ratio for the Carolinas segment increased to 10.7% for the nine months ended September 30, 2017 from 10.2% for the nine months ended September 30, 2016 due to higher external commission costs. The Homebuilding SG&A to Revenue Ratio for the Arizona segment increased to 10.8% for the nine months ended September 30, 2017 from 10.3% for the nine months ended September 30, 2016, primarily due to lower revenue over a fixed cost base.

Corporate general and administrative expenses increased by \$2.4 million to \$14.3 million for the nine months ended September 30, 2017 compared to the same period in 2016. As a percentage of homebuilding revenue, corporate general and administrative expenses increased to 2.6% for the nine months ended September 30, 2017 compared to 2.4% for the same period in 2016. The increase as a percentage of revenue was driven by \$1.0 million of transaction and integration costs directly related to the Savvy acquisition in 2017 and non-recurring adjustments related to the forfeiture of unvested share-based awards in 2016.

Interest expense increased by \$4.3 million to \$7.1 million for the nine months ended September 30, 2017 compared to the same period in 2016. The increase in interest expense is a result of the increase in debt compared to the prior year, partially offset by a lower weighted average interest rate. As of September 30, 2017, our total principal outstanding was \$480.0 million compared to \$295.0 million as of September 30, 2016 and the weighted average interest rate was 7.80% and 8.33% for the nine months ended September 30, 2017 and 2016, respectively.

Income before income taxes for the nine months ended September 30, 2017 was \$3.3 million compared to \$20.1 million for the nine months ended September 30, 2016. The decrease was primarily due to (i) the \$9.9 million loss on extinguishment associated with the repurchase of our 8.50% Notes and the replacement of our Senior Secured Credit Facility, (ii) the \$7.1 million of interest expense during the nine months ended September 30, 2017 compared to \$2.9 million for the same period in 2016 due to the issuance of the 6.625% Notes in May 2017, and (iii) the \$1.0 million of acquisition-related costs.

Table of Contents

Income tax expense (benefit) for the nine months ended September 30, 2017 and 2016 was \$1.7 million and \$(110.0) million, respectively. The income tax benefit in 2016 was due to the reversal of the deferred tax asset valuation allowance during the period.

Net income for the nine months ended September 30, 2017 was \$1.6 million or \$0.07 per diluted share compared to net income of \$130.0 million or \$5.02 per diluted share for the nine months ended September 30, 2016. The decrease in net income for the nine months ended September 30, 2017 compared to the same period in 2016 was primarily due to the loss on extinguishment of debt, increased interest expense, and a \$110.0 million income tax benefit recognized in 2016.

Data from contracts signed for the Florida, Carolinas and Arizona segments for the three and nine months ended September 30, 2017 and 2016 is summarized as follows (dollars in thousands):

For the three months ended September 30, 2017	Gross Number of Contracts		Contracts Signed, Net of	Dollar	Average Price Per
	Signed	Cancellations	Cancellations	Value	Unit
Florida	271	(25)	246	\$ 73,070	\$ 297
Carolinas	225	(32)	193	69,357	359
Arizona	132	(20)	112	39,607	354
Total	628	(77)	551	\$ 182,034	330
2016					
Florida	373	(68)	305	\$ 89,076	\$ 292
Carolinas	191	(20)	171	64,457	377
Arizona	125	(29)	96	31,896	332
Total	689	(117)	572	\$ 185,429	324
For the nine months ended September 30, 2017	Gross Number of Contracts		Contracts Signed, Net of	Dollar	Average Price Per
	Signed	Cancellations	Cancellations	Value	Unit
Florida	1,078	(100)	978	\$ 286,905	\$ 293
Carolinas	666	(81)	585	216,440	370
Arizona	414	(71)	343	117,173	342
Total	2,158	(252)	1,906	\$ 620,518	326

Edgar Filing: AV Homes, Inc. - Form 10-Q

2016					
Florida	1,245	(201)	1,044	\$ 294,413	\$ 282
Carolinas	591	(53)	538	200,827	373
Arizona	465	(108)	357	113,427	318
Total	2,301	(362)	1,939	\$ 608,667	314

Three Months Ended September 30, 2017 and 2016

The total number of net housing contracts signed during the three months ended September 30, 2017 compared to the same period in 2016 decreased by 21 units or 3.7%. The dollar value of housing contracts signed decreased by \$3.4 million or 1.8% over the same period. The decrease in units was driven by the Florida segment, partially offset by increases in the Carolinas and Arizona segments. The number of net housing contracts signed for the Florida segment during the three months ended September 30, 2017 decreased by 59 units or 19.3%, while the dollar value of housing contracts signed decreased by \$16.0 million or 18.0%, due to timing and launch of newer communities being more than offset by the decreased sales in our close-out communities. The number of net housing contracts signed for the Carolinas segment during the three months ended September 30, 2017 increased by 22 units or 12.9%, primarily as a result of the Savvy acquisition, while the dollar value of housing contracts signed increased by \$4.9 million or 7.6%. The number of net housing contracts signed for the Arizona segment during the three months ended September 30, 2017 increased by 16 units or 16.7%, while the dollar value of housing contracts signed increased by \$7.7 million or 24.2%, driven mainly by improved sales in our active adult communities and a 6.6% increase in average sales

Table of Contents

price for the segment. The overall decrease in the number and dollar value of net housing contracts signed is a result of the volume decrease in Florida more than offsetting increases in the Carolinas and Arizona.

The cancellation rate during the three months ended September 30, 2017 improved to 12.3% from 17.0% compared to the same period in 2016. The cancellation rate in the Florida segment decreased to 9.2% from 18.2% over the same period due to certain closed out communities that had higher cancellation rates in the prior period. The cancellation rate in the Carolinas segment during three months ended September 30, 2017 increased to 14.2% from 10.5% during the three months ended September 30, 2016, attributable to newer communities focused on first-time home buyers who tend to have higher cancellation rates. The cancellation rate in the Arizona segment during the three months ended September 30, 2017 decreased to 15.2% from 23.2% compared to the same period in 2016, primarily due to communities closing out in 2017 that had higher first-time home buyer volume in 2016.

Nine Months Ended September 30, 2017 and 2016

The total number of net housing contracts signed during the nine months ended September 30, 2017 compared to the same period in 2016 decreased by 33 units or 1.7%. The dollar value of housing contracts signed increased by \$11.9 million or 1.9% over the same period. The decrease in units was driven by the Florida and Arizona segments, partially offset by an increase in the Carolinas. The number of net housing contracts signed for the Florida segment during the nine months ended September 30, 2017 decreased by 66 units or 6.3%, while the dollar value of housing contracts signed decreased by \$7.5 million or 2.6%, due to timing and launch of newer communities being more than offset by the decreased sales in our close-out communities. The number of net housing contracts signed for the Carolinas segment during the nine months ended September 30, 2017 increased by 47 units or 8.7%, while the dollar value of housing contracts signed increased by \$15.6 million or 7.8%, primarily as a result of the Savvy acquisition. The number of net housing contracts signed for the Arizona segment during the nine months ended September 30, 2017 decreased by 14 units or 3.9%, while the dollar value of housing contracts signed increased by \$3.7 million or 3.3%, due to lower volumes at communities that are expected to close out in 2017. The overall decrease in the number of net housing contracts signed reflects the winding down of older communities, while the overall increase in the dollar value of housing contracts signed is due to an increase in the average sales price.

The cancellation rate during the nine months ended September 30, 2017 improved to 11.7% from 15.7% compared to the same period in 2016. The cancellation rate in the Florida segment decreased to 9.3% from 16.1% over the same period due to certain closed out communities that had higher cancellation rates in the prior period. The cancellation rate in the Carolinas segment during nine months ended September 30, 2017 increased to 12.2% from 9.0% during the nine months ended September 30, 2016, attributable to newer communities focused on first-time home buyers who tend to have higher cancellation rates. The cancellation rate in the Arizona segment during the nine months ended September 30, 2017 decreased to 17.1% from 23.2% compared to the same period in 2016, primarily due to communities closing out in 2017, which had higher first-time home buyer volume in 2016.

Edgar Filing: AV Homes, Inc. - Form 10-Q

Backlog for the Florida, Carolinas and Arizona segments as of September 30, 2017 and 2016 is summarized as follows (dollars in thousands):

As of September 30,	Number	Dollar	Average
2017	of Units	Volume	Price
			Per Unit
Florida	526	\$ 157,054	\$ 299
Carolinas	277	103,152	372
Arizona	210	72,967	347
Total	1,013	\$ 333,173	329
2016			
Florida	556	\$ 160,007	\$ 288
Carolinas	275	105,302	383
Arizona	250	81,834	327
Total	1,081	\$ 347,143	321

The backlog of housing contracts as of September 30, 2017 compared to September 30, 2016 decreased by 68 units or 6.3%, and the dollar value of backlog decreased by \$14.0 million or 4.0% over the same period. The decrease in units was driven by decreased sales due to lower community counts in the Florida segment and communities in the Arizona segment that are

Table of Contents

expected to close out in 2017. The backlog of housing contracts in the Florida segment as of September 30, 2017 compared to September 30, 2016 decreased by 30 units or 5.4%, and the dollar value decreased by \$3.0 million or 1.8% over the same period, driven by the decrease in selling communities from 26 to 24 and the wind-down of additional communities expected to close out in 2017. The backlog of housing contracts in the Carolinas segment as of September 30, 2017 compared to September 30, 2016 increased by 2 units or 0.7%, and the dollar value decreased by \$2.2 million or 2.0% over the same period, primarily as a result of the Savvy acquisition. The backlog of housing contracts in the Arizona segment as of September 30, 2017 compared to September 30, 2016 decreased by 40 units or 16.0%, due mainly to a decrease in net housing contracts signed and the higher number of closings in 2016. The dollar value decreased by \$8.9 million or 10.8% over the same period driven by lower sales in communities that are expected to close out in 2017.

As of September 30, 2017, our inventory of unsold (speculative) homes, both completed and under construction, was 493 units, as compared to 403 units as of September 30, 2016. As of September 30, 2017, approximately 28% of unsold homes were completed compared to approximately 30% as of September 30, 2016. The increase in speculative homes is mainly due to the Savvy acquisition.

The following is a breakdown of our land holdings as of September 30, 2017 and December 31, 2016:

	September 30, 2017				December 31, 2016			
	Developed Lots	Partially Developed Lots	Raw Lots	Total Remaining Lots (1)	Developed Lots	Partially Developed Lots	Raw Lots	Total Remaining Lots (1)
Florida								
Active adult	714	533	6,179	7,426	858	233	5,264	6,355
Primary								
residential	1,586	950	1,408	3,944	1,480	677	1,193	3,350
	2,300	1,483	7,587	11,370	2,338	910	6,457	9,705
Carolinas								
Active adult	255	4	234	493	148	187	221	556
Primary								
residential	1,350	650	1,129	3,129	723	443	324	1,490
	1,605	654	1,363	3,622	871	630	545	2,046
Arizona								
Active adult	693	564	452	1,709	611	836	452	1,899
Primary								
residential	243	155	462	860	352	—	429	781
	936	719	914	2,569	963	836	881	2,680
Total principal communities	4,841	2,856	9,864	17,561	4,172	2,376	7,883	14,431

(1) Estimated lots are based on historical densities for our land. New projects may ultimately be developed into more or less than the number of lots stated.

In addition to the lots presented in the table above, we also have approximately 1,700 acres of commercial and industrial land and approximately 5,200 acres of unplatted scattered mixed-use land, primarily in Florida. We also have 688 platted scattered lots, primarily in Arizona.

Income Taxes

Our effective tax rate is impacted by a number of factors, the most significant of which are the valuation allowance related to our deferred tax assets and changes to tax laws or other circumstances that affect the value of our deferred tax assets. Our 2017 effective tax rate approximates our blended statutory tax rate. Our income tax expense (benefit) for the three and nine months ended September 30, 2016 consisted primarily of the reversal of the valuation allowance related to our federal and state deferred tax assets.

Certain states enacted changes to tax rates that impacted the value of our deferred tax assets in 2017. The estimated impact of such change was recorded to income tax expense during the period of change.

Table of Contents

Liquidity and Capital Resources

Our primary business activities are capital intensive in nature. Significant capital resources are required to finance planned residential communities, homebuilding construction in process, community infrastructure, selling expenses, new projects and working capital needs, including funding of debt service requirements, operating deficits and the carrying costs of land. We finance these activities using cash provided by operating activities, capital market financing and our Senior Unsecured Credit Facility. For more information regarding our debt, see Note 4, Senior Debt, to our unaudited consolidated financial statements in Item 1 of this Form 10-Q.

Cash Flows

As of September 30, 2017, our cash and cash equivalents totaled \$169.3 million compared to \$67.8 million as of December 31, 2016. As of September 30, 2017, total consolidated indebtedness was \$480.0 million compared to \$280.0 million as of December 31, 2016. The increase in cash and cash equivalents as of September 30, 2017 is primarily due to the issuance of \$400.0 million of our 6.625% Notes in May 2017, partially offset by the repurchase and redemption of \$200.0 million in principal of the 8.50% Notes with available cash.

Our operating cash flows fluctuate relative to the status of development within existing communities, expenditures for land, new developments and other real estate activities, sales of various homebuilding product lines within those communities and other developments and to fund operating deficits.

For the nine months ended September 30, 2017, net cash used in operating activities was \$38.0 million. The operating cash outflow was primarily due to the \$56.7 million increase in land and other inventories as we further developed and completed our land and lots for delivery commensurate with the increase in our home closings and the \$9.1 million increase in accounts payable and accrued and other liabilities. These outflows were partially offset by a \$9.9 million loss on extinguishment of debt related to the repurchase of a portion of our 8.50% Notes, \$5.3 million in depreciation and amortization, a \$3.0 million decrease in receivables, a \$4.9 million increase in our customer deposits driven by a 44% increase in backlog since December 31, 2016, and a \$1.5 million decrease in our net deferred tax assets. Net cash used in investing activities was \$42.8 million mainly due to the acquisition of Savvy. Net cash provided by financing activities was \$182.4 million, primarily due to proceeds from the issuance of the 6.625% Notes, partially offset by the repurchase of the 8.50% Notes and \$8.1 million in debt issuance costs.

For the nine months ended September 30, 2016, net cash provided by operating activities was \$7.0 million. The operating cash inflow was primarily due to the net income of \$130.0 million offset by the \$110.5 million decrease in deferred tax assets, net due to the reversal of the deferred tax asset valuation allowance in the second and third quarters of 2016. The remaining change was due to the increase in land and other inventories of \$48.7 million, and an increase in customer deposits of \$3.6 million, partially offset by a decrease in restricted cash of \$25.8 million related

to the release of the interest reserve requirement for our Senior Secured Credit Facility. Net cash used in investing activities was \$1.4 million, primarily due to the purchase of property and equipment. Net cash used in financing activities was \$36.2 million, primarily due to the repayment of the remaining \$46.8 million of 7.50% Notes at maturity, partially offset by a net draw of \$15.0 million on the Senior Secured Credit Facility during the third quarter of 2016.

Other

Assuming that no significant adverse changes occur in our business, we anticipate the aggregate cash on hand, cash flow generated through homebuilding and related operations, and the Senior Unsecured Credit Facility will provide sufficient liquidity to fund our business for the next twelve months.

Off Balance Sheet Arrangements

Surety bonds, issued by third-party entities, are used primarily to guarantee our performance to construct improvements in our various communities. As of September 30, 2017, we had outstanding surety bonds of approximately \$38.0 million. The amount of outstanding surety bonds could fluctuate depending on the level of development activity. We do not believe that it is likely any of these outstanding surety bonds will be drawn upon.

Table of Contents

Critical Accounting Policies

There were no material changes in AV Homes' critical accounting policies during the nine months ended September 30, 2017. For additional information regarding AV Homes' critical accounting policies, refer to Item 7, Management's Discussion and Analysis, in our Annual Report on Form 10-K for the year ended December 31, 2016.

Special Notes Concerning Forward-Looking Statements

Certain statements discussed in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this Form 10-Q constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of results to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Such risks, uncertainties and other important factors include, among others: the cyclical nature of the homebuilding industry and its dependence on broader economic conditions; availability and suitability of undeveloped land and improved lots; ability to develop communities within expected timeframes; increases in interest rates and availability of mortgage financing; the prices and supply of building materials; the availability and skill of subcontractors; competition for home buyers, properties, financing, raw materials and skilled labor; our ability to access sufficient capital; our ability to generate sufficient cash to service our indebtedness; terms of our financing documents that may restrict our operations and corporate actions; fluctuations in interest rates; our current level of indebtedness and potential need for additional financing; our ability to purchase outstanding notes upon certain fundamental changes; our ability to obtain letters of credit and surety bonds; cancellations of home sale orders; the geographic concentration of our operations; inflation affecting homebuilding costs or deflation affecting declines in spending and borrowing levels; our ability to successfully integrate acquired businesses; elimination or reduction of tax benefits associated with home ownership; warranty and construction defect claims; health and safety incidents in homebuilding activities; the seasonal nature of our business; impacts of weather conditions and natural disasters; resource shortages and rate fluctuations; value and costs related to our land and lot inventory; overall market supply and demand for new homes; our ability to recover our costs in the event of reduced home sales; conflicts of interest involving our largest stockholder; contractual restrictions under a stockholders agreement with our largest stockholder; dependence on our senior management; effect of our expansion efforts on our cash flows and profitability; effects of government regulation of development and homebuilding projects; development liabilities that may impose payment obligations on us; our ability to utilize our deferred income tax asset; impact of environmental changes and governmental actions in response to environmental changes; dependence on digital technologies and related cyber risks; future sales or dilution of our equity; impairment of intangible assets; and other factors described in our Annual Report on Form 10-K for the year ended December 31, 2016. Readers are cautioned not to place undue reliance on any forward-looking statements contained herein, which reflect management's opinions only as of the date hereof.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in AV Homes' market risk during the nine months ended September 30, 2017. For additional information regarding AV Homes' market risk, refer to Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our Annual Report on Form 10-K for the year ended December 31, 2016.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, with the participation of the Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Internal Control Over Financial Reporting

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have determined that, during the fiscal quarter ended September 30, 2017, there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. Other Information

ITEM 1. LEGAL PROCEEDINGS

We are involved in litigation from time to time, primarily arising in the normal course of our business. These cases are in various procedural stages. In view of the inherent difficulty of predicting the outcome of these legal and regulatory matters, we generally cannot predict the ultimate resolution of the pending matters, the related timing, or the eventual loss. While the outcome of such contingencies cannot be predicted with certainty, we do not believe that the resolution of such matters will have a material adverse impact on our results of operations, financial position, or cash flows. Information related to pending legal proceedings is presented in Note 6 - Commitments and Contingencies, in the accompanying consolidated financial statements and is incorporated by reference herein.

ITEM 1A. RISK FACTORS

There have not been any material changes to the risk factors discussed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016.

ITEM 6. EXHIBITS

- 3.1 * Certificate of Incorporation, as amended and restated May 28, 1998 (filed as Exhibit 3(a) to Form 10-Q for the quarter ended June 30, 1998 (File No. 1-7395), and incorporated herein by reference).
- 3.2 * Certificate of Amendment of Restated Certificate of Incorporation, dated May 25, 2000 (filed as Exhibit 3(a) to Form 10-Q for the quarter ended June 30, 2000 (File No. 1-7395), and incorporated herein by reference).
- 3.3 * Amended and Restated By-Laws, dated March 31, 2014 (filed as Exhibit 3.2 to Form 8-K filed on April 1, 2014 (File No. 1-7395), and incorporated herein by reference).
- 4.1 * Indenture, dated February 4, 2011, between Avatar Holdings Inc. and Wilmington Trust FSB, as Trustee (filed as Exhibit 4.1 to Form 8-K dated February 4, 2011 (File No. 1-7395), and incorporated herein by reference).
- 4.2 * Senior Notes Indenture, dated June 30, 2014, by and among AV Homes, Inc., certain subsidiaries of AV Homes, Inc. and Wilmington Trust, National Association, as Trustee, in respect of 8.50% Senior Notes due 2016 (filed as Exhibit 4.1 to Form 8-K dated July 1, 2014 (File No. 1-7395), and incorporated herein by reference).
- 4.3 * Third Supplemental Indenture, dated June 23, 2015, between AV Homes, Inc. and Wilmington Trust FSB, as Trustee, in respect of 6.00% Senior Convertible Notes due 2020 (filed as Exhibit 4.2 to Form 8-K dated June 23, 2015 (File No. 1-7395), and incorporated herein by reference).

Edgar Filing: AV Homes, Inc. - Form 10-Q

- 4.4 * Senior Notes Indentures, dated May 18, 2017, among AV Homes, Inc., the Subsidiary Guarantors named therein, and Wilmington Trust, National Association, as trustee, relating to the 6.625% Senior Notes due 2022 (filed as Exhibit 4.1 to Form 8-K dated May 18, 2017 (File No. 1-7395), and incorporated herein by reference).
- 4.5 * Registration Rights Agreement dated as of May 18, 2017 among AV Homes, Inc., the guarantors named therein, and J.P. Morgan Securities LLC, as representative of the several initial purchasers named therein (filed as Exhibit 4.2 to Form 8-K dated May 18, 2017 (File No. 1-7395), and incorporated herein by reference).
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.1 Certification of Chief Executive Officer required by 18 U.S.C. Section 1350 (as adopted by Section 906 of the Sarbanes-Oxley Act of 2002) (furnished herewith).
- 32.2 Certification of Principal Financial Officer required by 18 U.S.C. Section 1350 (as adopted by Section 906 of the Sarbanes-Oxley Act of 2002) (furnished herewith).
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase.
- 101.LAB XBRL Taxonomy Extension Label Linkbase.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase.

*These exhibits are incorporated by reference and are on file with the Securities and Exchange Commission.

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.

AV HOMES, INC.

Date: October 27, 2017 By: /s/ Roger A. Cregg
Roger A. Cregg

President and Chief Executive Officer

(Principal Executive Officer)

Date: October 27, 2017 By: /s/ Michael S. Burnett
Michael S. Burnett

Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)