LGI Homes, Inc.
Form 10-Q
May 10, 2016

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

FORM 10-Q

ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2016
OR
o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to .
Commission file number 001-36126

LGI HOMES, INC.
(Exact name of registrant as specified in its charter)

Delaware	46-3088013
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1450 Lake Robbins Drive, Suite 430, The Woodlands, Texas	77380
(Address of principal executive offices)	(Zip code)

(281) 362-8998
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý 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 ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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

As of May 6, 2016, there were 20,429,694 shares of the registrant’s common stock, par value $.01 per share, outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	March 31, 2016 (Unaudited)	December 31, 2015
ASSETS		
Cash and cash equivalents	$ 47,574	$ 37,568
Accounts receivable	13,769	17,325
Real estate inventory	561,010	531,228
Pre-acquisition costs and deposits	9,262	7,001
Property and equipment, net	1,991	2,108
Other assets	7,278	11,238
Goodwill and intangible assets, net	12,173	12,234
Total assets	$ 653,057	$ 618,702
LIABILITIES AND EQUITY		
Accounts payable	$ 20,480	$ 24,020
Accrued expenses and other liabilities	42,866	40,006
Deferred tax liabilities, net	3,120	2,726
Notes payable	323,102	304,561
Total liabilities	389,568	371,313
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Common stock, par value $0.01, 250,000,000 shares authorized, 21,429,694 shares issued and 20,429,694 shares outstanding as of March 31, 2016 and 21,270,389 shares issued and 20,270,389 shares outstanding as of December 31, 2015	214	213
Additional paid-in capital	179,974	175,575
Retained earnings	99,851	88,151
Treasury stock, at cost, 1,000,000 shares	(16,550)	(16,550)
Total equity	263,489	247,389
Total liabilities and equity	$ 653,057	$ 618,702

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended March 31,	
	2016	2015
Home sales revenues	$162,463	$120,690
Cost of sales	121,094	89,228
Selling expenses	14,091	11,582
General and administrative	9,952	8,205
Operating income	17,326	11,675
Other income, net	(503)	(46)
Net income before income taxes	17,829	11,721
Income tax provision	6,129	4,019
Net income	$11,700	$7,702
Earnings per share:		
Basic	$0.58	$0.39
Diluted	$0.57	$0.33
Weighted average shares outstanding:		
Basic	20,288,619	19,851,686
Diluted	20,461,073	23,808,813

See accompanying notes to the consolidated financial statements.

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

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock	Total Equity
	Shares	Amount				
BALANCE—December 31, 2015	21,270,389	$ 213	$ 175,575	$ 88,151	$ (16,550)	$ 247,389
Net income	—	—	—	11,700	—	11,700
Issuance of shares, net of offering costs	150,000	1	3,423	—	—	3,424
Issuance of restricted stock units in settlement of accrued bonuses	—	—	138	—	—	138
Compensation expense for equity awards	—	—	814	—	—	814
Stock issued under employee incentive plans	9,305	—	24	—	—	24
BALANCE—March 31, 2016	21,429,694	$ 214	$ 179,974	$ 99,851	$ (16,550)	$ 263,489

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended March 31,	
	2016	2015
Cash flows from operating activities:		
Net income	$11,700	$7,702
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	366	206
Excess tax benefits from stock based compensation	(24)	—
Compensation expense for equity awards	814	335
Deferred income taxes	394	245
Changes in assets and liabilities:		
Accounts receivable	3,556	(5,618)
Real estate inventory	(28,894)	(14,543)
Pre-acquisition costs and deposits	(2,261)	2,808
Other assets	3,956	1,257
Accounts payable	(3,291)	2,352
Accrued expenses and other liabilities	3,138	(152)
Net cash used in operating activities	(10,546)	(5,408)
Cash flows from investing activities:		
Purchases of property and equipment	(185)	(189)
Net cash used in investing activities	(185)	(189)
Cash flows from financing activities:		
Proceeds from notes payable	35,000	14,099
Payments on notes payable	(17,000)	(580)
Loan issuance costs	(464)	—
Payment for offering costs	(57)	—
Payment for earnout obligation	(252)	(284)
Excess tax deficiencies from equity awards	24	—
Proceeds from sale of stock, net of commissions	3,486	—
Net cash provided by financing activities	20,737	13,235
Net increase in cash and cash equivalents	10,006	7,638
Cash and cash equivalents, beginning of period	37,568	31,370
Cash and cash equivalents, end of period	$47,574	$39,008

See accompanying notes to the consolidated financial statements.

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

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization and Description of the Business

LGI Homes, Inc., a Delaware corporation (the "Company", "us," "we," or "our,"), is engaged in the development of communities and the design, construction, marketing and sale of new homes. At March 31, 2016, we had operations in Texas, Arizona, Florida, Georgia, New Mexico, Colorado, North Carolina, South Carolina, Washington and Tennessee.

Basis of Presentation

The unaudited consolidated financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. The accompanying unaudited consolidated financial statements include all adjustments that are of a normal recurring nature and necessary for the fair presentation of our results for the interim periods presented. Results for interim periods are not necessarily indicative of results to be expected for the full year.

The accompanying unaudited financial statements as of and for the three months ended March 31, 2016 and 2015, include the accounts of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and these differences could have a significant impact on the financial statements. The significant accounting estimates include real estate inventory and cost of sales, impairment of real estate inventory and property and equipment, goodwill, warranty reserves, our earnout liability, the fair value of the convertible debt, loss contingencies and our liability under our self-funded health benefit plan.

Recently Adopted Accounting Standards

Effective January 1, 2016, the Financial Accounting Standards Board (the "FASB") Accounting Standards Update ("ASU") No. 2015-03, "Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs" ("ASU 2015-03") requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The update is effective for interim and annual periods beginning after December 15, 2015. We adopted ASU 2015-03 retrospectively, and we reclassified $3.6 million of debt issuance costs to our recognized debt liabilities from other assets on our consolidated balance sheet at December 31, 2015.

Effective January 1, 2016, we adopted ASU No. 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis" ("ASU 2015-02"), which amends the consolidation requirements in ASC 810, primarily related to limited partnerships and variable interest entities (“VIEs”). The adoption of ASU 2015-02 did not change our presentation of consolidated financial statements and disclosures.

Recently Issued Accounting Pronouncements

In August 2014, the FASB issued ASU No. 2014-15, “Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern” (“ASU 2014-15”), which requires management to evaluate, at each reporting period, whether there are conditions or events that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the date the financial statements are issued and provide related disclosures. This ASU applies to all entities and is effective for periods ending after December 15, 2016. The adoption of ASU 2014-15 is not expected to have any effect on our consolidated financial statements or disclosures.

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In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”), which provides guidance for revenue recognition. ASU 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets and supersedes the revenue recognition requirements in Topic 605, “Revenue Recognition,” and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, “Revenue Recognition-Construction-Type and Production-Type Contracts.” ASU 2014-09’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under today’s guidance, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 is effective beginning January 1, 2018 and, at that time, we may adopt the new standard under the full retrospective approach or the modified retrospective approach. Early adoption of this ASU is not permitted. We are currently evaluating the method and impact the adoption of ASU 2014-09 will have on our consolidated financial statements and disclosures.

In February 2016, the FASB issued ASU No. 2016-02, “Leases,” (“ASU 2016-02”), which amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets in Topic 842 “Leases,”   will be effective for annual reporting periods beginning after December 15, 2018, and early adoption is permitted. ASU 2016-02 requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. We are currently evaluating the impact that the adoption of ASU 2016-02 will have on our consolidated financial statements and disclosures.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting,” (“ASU 2016-09”), which includes multiple amendments intended to simplify aspects of share-based payment accounting. ASU 2016-09 will be effective for annual reporting periods beginning after December 15, 2016, and early adoption is permitted. Amendments to the timing of when excess tax benefits are recognized, minimum statutory withholding requirements, and forfeitures will be applied using a modified retrospective transition method through a cumulative-effect adjustment to equity as of the beginning of the period of adoption. Amendments to the presentation of employee taxes paid on the statement of cash flows when an employer withholds shares to meet the minimum statutory withholding requirement will be applied retrospectively, and amendments requiring the recognition of excess tax benefits and tax deficiencies in the income statement are to be applied prospectively. We are currently evaluating the impact that the adoption of ASU 2016-09 will have on our consolidated financial statements and disclosures.

2. REAL ESTATE INVENTORY

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

	March 31, 2016	December 31, 2015
Land, land under development, and finished lots	$336,930	$320,320
Sales offices	9,597	8,083
Homes in progress	122,505	109,451
Completed homes	91,978	93,374
Total real estate inventory	$561,010	$531,228

Inventory consists of land, land under development, finished lots, sales offices, homes in progress, and completed homes. Inventory is stated at cost unless the carrying amount is determined not to be recoverable, in which case the affected inventory is written down to fair value.

Land, development and other project costs, including interest and property taxes incurred during development and home construction and net of expected reimbursements of development costs, are capitalized to real estate inventory. Land development and other common costs that benefit the entire community, including field construction supervision and related direct overhead, are allocated to individual lots or homes, as appropriate. The costs of lots are transferred to homes in progress when home construction begins. Home construction costs and related carrying charges are allocated to the cost of individual homes using the specific identification method. Costs that are not specifically identifiable to a home are allocated on a pro rata basis using either the lot size or relative sales value. Inventory costs for completed homes are expensed to cost of sales as homes are sold. Changes

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to estimated total development costs subsequent to initial home closings in a community are generally allocated to the remaining unsold lots and homes in the community on a pro rata basis.

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

Interest and financing costs incurred under our debt obligations, as more fully discussed in Note 4, are capitalized to qualifying real estate projects under development and homes in progress.

3. ACCRUED EXPENSES AND OTHER LIABILITIES

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

	March 31, 2016	December 31, 2015
Inventory related obligations	$17,272	$ 17,389
Retentions and development payable	5,742	3,748
Accrued compensation, bonuses and benefits	4,274	5,573
Earnout liability	1,109	1,425
Taxes payable	6,669	6,205
Warranty reserve	1,325	1,325
Accrued interest	2,292	1,249
Other	4,183	3,092
Total accrued expenses and other liabilities	$42,866	$ 40,006

Inventory Related Obligations

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

Earnout liability

The purchase price for the acquisition of certain assets and liabilities from Oakmont Home Builders, Inc. (“Oakmont”) and certain land positions of EST Properties, LLC, an affiliate of Oakmont (the “Oakmont Acquisition”) during October 2014 included contingent consideration to be paid based on homes closed through December 2017 attributable to Oakmont assets. The earnout liability is subject to adjustment based on revisions to the forecasted absorption rate and the actual number of homes closed during the earnout period.

Estimated Warranty Reserve

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

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

	Three Months Ended March 31,	
	2016	2015
Warranty reserves, beginning of period	$1,325	$900
Warranty provision	509	387
Warranty expenditures	(509)	(387)
Warranty reserves, end of period	$1,325	$900

4. NOTES PAYABLE

Revolving Credit Agreement

In May 2015, we entered into a Credit Agreement (the "Credit Agreement") with several financial institutions, and Wells Fargo Bank, National Association, as administrative agent. The Credit Agreement provides for a revolving credit facility up to $300.0 million. On January 6, 2016, the revolving credit facility was increased by $45.0 million to $300.0 million in accordance with the accordion feature of the Credit Agreement.

The Credit Agreement matures on May 26, 2018. Prior to each annual anniversary of the Credit Agreement, we may request a one-year extension of the maturity date. The Credit Agreement is guaranteed by each of our subsidiaries having gross assets equal to or greater than $0.5 million. Prior to the occurrence of a trigger event under the Credit Agreement, the revolving credit facility is unsecured except that the facility is secured by a first priority lien in certain land held for development, lots under development and/or finished lots with an aggregate land value of at least $35.0 million. As of March 31, 2016, the borrowing base under the Credit Agreement was $300.0 million, of which $248.0 million was outstanding, $7.6 million represents letter of credit assurances, and $44.4 million was available to borrow. Interest is paid monthly on borrowings under the Credit Agreement at LIBOR plus 3.50%. The Credit Agreement applicable margin for LIBOR loans ranges from 3.00% to 3.50% based on our leverage ratio. At March 31, 2016, LIBOR was 0.44%.

The Credit Agreement contains various financial covenants, including a tangible net worth ratio, a leverage ratio, a minimum liquidity amount, and an EBITDA to interest expense ratio. The Credit Agreement also prohibits us from making any investments except as permitted under the Credit Agreement. In addition, the Credit Agreement contains various covenants that, among other restrictions, limit the amount of our additional debt. At March 31, 2016, we were in compliance with all of the covenants contained in the Credit Agreement.

Convertible Notes

In November 2014, we issued $85.0 million aggregate principal amount of our 4.25% Convertible Notes due 2019 (the "Convertible Notes"). The Convertible Notes mature on November 15, 2019 and bear interest at a rate of 4.25%, payable semiannually in May and November. Prior to May 15, 2019, the Convertible Notes are convertible only upon satisfaction of any of the specified conversion events. On or after May 15, 2019, note holders can convert their Convertible Notes at any time at their option.

When issued, the conversion of the Convertible Notes could only be settled in shares of our common stock. On April 30, 2015 at our 2015 Annual Meeting of Stockholders, our stockholders approved the flexible settlement provisions of the Convertible Notes which allows us to settle the conversion of the Convertible Notes using any combination of cash and shares of our common stock. The initial conversion rate of the Convertible Notes is 46.4792 shares of our common stock for each $1,000 principal amount of Convertible Notes, which represents an initial conversion price of approximately $21.52 per share of our common stock. The conversion rate is subject to adjustments upon the occurrence of certain specified events.

When the Convertible Notes were issued, the fair value of $76.5 million was recorded to notes payable. $5.5 million of the remaining proceeds was recorded to additional paid in capital to reflect the equity component and the remaining

$3.0 million was recorded as a deferred tax liability. The carrying amount of the Convertible Notes is being accreted to face value over the term to maturity.

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Notes payable consist of the following (in thousands):

	March 31, 2016	December 31, 2015
LGI Homes, Inc.—Notes payable to Wells Fargo Bank, National Association and several financial institutions under the Credit Agreement ($300.0 million revolving credit facility) maturing on May 26, 2018; interest paid monthly at LIBOR plus 3.50%; net of approximately $1.5 million of debt issuance cost at March 31, 2016 and December 31, 2015; collateralized by certain land, land under development, and finished lots (carrying value of $56.2 million at March 31, 2016)	$246,486	$228,470
LGI Homes, Inc.— 4.25% Convertible Notes due November 15, 2019; interest paid semi-annually at 4.25%; net of debt issuance costs of approximately $2.0 million and $2.1 million at March 31, 2016 and December 31, 2015, respectively; and approximately $6.4 million and $6.8 million in unamortized discount at March 31, 2016 and December 31, 2015, respectively	76,616	76,091
Total notes payable	$323,102	$304,561

Capitalized Interest

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

	Three Months Ended March 31, 2016	2015
Interest incurred	$4,348	$3,360
Less: Amounts capitalized	(4,348)	(3,360)
Interest expense	$—	$—
Cash paid for interest	$2,263	$1,378

Included in interest incurred was amortization of deferred financing costs for notes payable and amortization of Convertible Notes discount of $1.0 million and $0.9 million for the three months ended March 31, 2016 and 2015, respectively.

5. INCOME TAXES

We utilize the liability method of accounting for income taxes. Under the liability method, deferred tax assets and liabilities are recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that some portion or all of the net deferred tax assets will not be realized. Our ability to realize deferred tax assets is assessed throughout the year and a valuation allowance is established, if required. We recognize the impact of a tax position only if it is more likely than not to be sustained upon examination based on the technical merits of the position. We recognize potential interest and penalties related to uncertain tax positions in income tax expense.

We file U.S. federal and state income tax returns. As of March 31, 2016, we have no unrecognized tax benefits. We are not presently under exam for income tax by any taxing jurisdiction and we are no longer subject to exam for years before 2011 (2010 for Texas).

Our effective tax rate of 34.4% is lower than the statutory rate primarily as a result of a decrease in the rate for the federal Domestic Production Activity Deduction offset by an increase in rate for state income taxes, net of the federal benefit.

Income taxes paid were $5.2 million and $4.0 million for the three months ended March 31, 2016 and 2015, respectively.

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6. EQUITY

Shelf Registration Statement and ATM Offering Program

We have an effective shelf registration statement on Form S-3 (the "Registration Statement") to offer and sell from time to time various securities with a maximum offering price of $300.0 million. Under the Registration Statement, we have established an at the market common stock offering program (the "ATM Program") to sell shares of our common stock having an aggregate offering price of up to $30.0 million. During March 2016, we issued and sold 150,000 shares of our common stock under the ATM Program and received net proceeds of approximately $3.5 million. At March 31, 2016, we have issued and sold 495,760 shares of our common stock under the ATM Program and, subject to the terms and conditions of the ATM Program, have the ability to sell an additional $16.7 million aggregate offering price of shares of our common stock under the ATM Program.

7. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share for the three months ended March 31, 2016 and 2015:

	Three months ended March 31,	
	2016	2015
Numerator (in thousands):		
Numerator for basic earnings per share	$11,700	$ 7,702
Effect of dilutive securities:		
Interest expense associated with Convertible Notes, net of taxes	—	151
Numerator for diluted earnings per share	$11,700	$ 7,853
Denominator:		
Basic weighted average shares outstanding	20,288,619	19,851,686
Effect of dilutive securities:		
Convertible Notes - treasury stock method	130,942	—
Convertible Notes - if-converted method	—	3,950,732
Restricted stock units	41,512	6,395
Diluted weighted average shares outstanding	20,461,073	23,808,813
Basic earnings per share	$0.58	$ 0.39
Diluted earnings per share	$0.57	$ 0.33
Antidilutive non-vested restricted stock units excluded from calculation of diluted earnings per share	22,985	120,452

In accordance with ASC 260-10, Earnings Per Share, we calculated the dilutive effect of the Convertible Notes using the "if-converted" method through April 30, 2015. The interest expense related to the Convertible Notes through March 31, 2015 was included in cost of sales. On April 30, 2015, our stockholders approved the flexible settlement provisions of the Convertible Notes at our 2015 Annual Meeting of Stockholders which allows us to settle the conversion of the Convertible Notes using any combination of cash and shares of our common stock. Therefore, during the three months ended March 31, 2016, the treasury stock method is used to calculate the dilutive effect of the Convertible Notes, since we have the intent and ability to settle the principal amount of the outstanding Convertible Notes in cash. Under the treasury stock method, the Convertible Notes have a dilutive impact on diluted earnings per share to the extent that the average market price of our common stock for a reporting period exceeds the conversion price of $21.52 per share.

During the three months ended March 31, 2016, the average market price of our common stock exceeded the conversion price of $21.52 per share, therefore the calculation of diluted earnings per share for the three months ended

March 31, 2016 includes the effect of approximately 0.1 million common shares related to the conversion spread of the Convertible Notes.

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8. STOCK-BASED COMPENSATION

Non-performance Based Restricted Stock Units

The following table summarizes the activity of our restricted stock units ("RSUs"):

	Three months ended March 31, 2016		2015	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Beginning balance	107,814	$ 16.48	102,786	$ 15.43
Granted	46,378	$ 21.78	58,723	$ 14.69
Vested	(9,305)	$ 14.78	(59,438)	$ 17.20
Forfeited	(1,731)	$ 16.24	(150)	$ 11.00
Ending balance	143,156	$ 18.31	101,921	$ 13.98

During the three months ended March 31, 2016, we issued 21,905 RSUs to senior management for the time based portion of our 2016 long-term incentive compensation program, 22,059 RSUs for 2015 bonuses to managers under the Annual Bonus Plan and 2,414 RSUs to other employees. The RSUs granted cliff vest on the third anniversary of the grant date and will be settled in shares of our common stock.

We recognized $0.2 million of stock-based compensation expense related to outstanding RSUs grants for the three months ended March 31, 2016 and 2015. At March 31, 2016, we had unrecognized compensation cost of $2.0 million related to unvested RSUs, which is expected to be recognized over a weighted average period of 2.5 years.

Performance Based Restricted Stock Units

The Compensation Committee of our Board of Directors has granted awards of Performance-Based RSUs ("PSUs") under the LGI Homes, Inc. Equity Incentive Plan to certain members of senior management for each of the three-year performance cycles: 2014 - 2016 , 2015 - 2017 and 2016 - 2018. The PSUs provide for shares of our common stock to be issued based on the attainment of certain performance metrics over the applicable three-year period. The number of shares of our common stock that may be issued to the recipients for the PSUs range from 0% to 200% of the target amount depending on actual results as compared to the target performance metrics. The PSUs vest upon the determination date for the actual results at the end of the three-year period and require that the recipients continue to be employed by us through the determination date. The PSUs will be settled in shares of our common stock.

The following table summarizes the activity of our PSUs:

Period Granted	Target PSUs Outstanding December 31, 2015	Target PSUs Granted	Target PSUs Vested	Target PSUs Forfeited	Target PSUs Outstanding at March 31, 2016	Weighted Average Grant Date Fair Value
2014	62,906	—	—	(2,926)	59,980	$ 17.09
2015	127,111	—	—	(6,140)	120,971	$ 13.34
2016	—	87,605	—	—	87,605	$ 21.79
Total	190,017	87,605	—	(9,066)	268,556	

At March 31, 2016, management estimates that the recipients will receive approximately 175%, 198% and 100% of the 2014, 2015 and 2016 target number of PSUs, respectively, at the end of the applicable three-year performance cycle based on projected performance compared to the target performance metrics. We recognized $0.6 million and $0.2 million of total stock-based compensation expense related to outstanding PSU grants for the three months ended March 31, 2016 and 2015, respectively. At March 31, 2016, we had unrecognized compensation cost of $4.4 million related to PSUs, which is expected to be recognized over a weighted average period of 1.6 years.

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9. FAIR VALUE DISCLOSURES

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

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

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

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

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

We utilize fair value measurements to account for certain items and account balances within our consolidated financial statements. Fair value measurements may also be utilized on a nonrecurring basis, such as for the impairment of long-lived assets. The fair value of financial instruments, including cash and cash equivalents and accounts receivable and accounts payable, approximate their carrying amounts due to the short term nature of these instruments. As of March 31, 2016, the revolving credit facility's carrying value approximates market value since it has a floating interest rate, which increases or decreases with market interest rates and our leverage ratio.

The Convertible Notes, as discussed in Note 4, were initially recorded at estimated fair value determined using Level 2 measurements. No significant changes occurred through March 31, 2016 and the recorded value of $74.4 million at December 31, 2015 approximated fair value. The fair value of the Convertible Notes was $75.3 million as of March 31, 2016 using Level 2 measurements compared to the carrying value of $76.6 million.

The fair value of the Oakmont Acquisition earnout, discussed in Note 3, is determined using Level 3 measurements based on the forecasted number of home closings adjusted to reflect probability weighted absorption scenarios and a 10% discount rate and has been estimated to be approximately $1.1 million and $1.4 million as of March 31, 2016 and December 31, 2015, respectively. Significant assumptions impacting our estimates of the fair value of the earnout include absorption rates, the timing of the completion of development activities and the discount rate.

The following table below shows the level and measurement of liabilities at March 31, 2016 and December 31, 2015 (in thousands):

		March 31, 2016		December 31, 2015	
	Fair Value Hierarchy	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Convertible Notes	Level 2	$76,616	$ 75,306	$76,091	$ 74,449
Earnout liability	Level 3	$1,109	$ 1,109	$1,425	$ 1,425

10. RELATED PARTY TRANSACTIONS

Magnolia Reserve

We have an option contract to purchase 106 finished lots in Montgomery County, Texas, from an affiliate of a family member of our chief executive officer for a total base purchase price of approximately $8.0 million. The lots will be purchased in takedowns of at least 21 lots during each 6 month period, subject to 5% annual price escalation and certain price protection terms. We had a $25,000 non-refundable deposit at March 31, 2016 related to this option contract. The first closing of 21 lots under this option contract occurred on April 29, 2016.

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Consulting Fees
We have a three year consulting agreement with a family member of our chief executive officer for $100,000 per year payable on a monthly basis, which expires November 2016. Consulting fees were $25,000 for each of the three month periods ended March 31, 2016 and 2015.

11. COMMITMENTS AND CONTINGENCIES

Contingencies
In the ordinary course of doing business, we become subject to claims or proceedings from time to time relating to our business activities including, but not limited to, the purchase, development, and sale of real estate. Management believes that these claims include usual obligations incurred by real estate developers and home builders in the normal course of business. In the opinion of management, these matters will not have a material effect on our consolidated financial position, results of operations or cash flows.
We have provided unsecured environmental indemnities to certain lenders. In each case, we have performed due diligence on the potential environmental risks including obtaining an independent environmental review from outside environmental consultants. These indemnities obligate us to reimburse the guaranteed parties for damages related to environmental matters. There is no term or damage limitation on these indemnities; however, if an environmental matter arises, we may have recourse against previous owners. Management is not aware of any environmental claims or occurrences and has recorded no reserves for environmental matters at March 31, 2016 and December 31, 2015.

Land Deposits
We have land purchase option contracts, generally through cash deposits, for the right to purchase land or lots at a future point in time with predetermined terms. Amounts paid for land options and deposits on land purchase contracts are capitalized and classified as deposits to purchase. Upon acquisition of the land, these deposits are applied to the acquisition price of the land and recorded as a cost component of the land in real estate inventory. To the extent that any deposits are nonrefundable and the associated land acquisition process is terminated or no longer determined probable, the deposit and related pre-acquisition costs are charged to general and administrative expense. Management reviews the likelihood of the acquisition of contracted lots in conjunction with its periodic real estate impairment analysis.
Under ASC Topic 810, Consolidation (“ASC 810”), a nonrefundable deposit paid to an entity is deemed to be a variable interest that will absorb some or all of the entity’s expected losses if they occur. Non-refundable land purchase and lot option deposits generally represent our maximum exposure if we elect not to purchase the optioned property. In most instances, we will also expend funds for due diligence, development and construction activities with respect to optioned land prior to close. Such costs are classified as preacquisition costs, which we would have to absorb should the option not be exercised. Therefore, whenever we enter into a land option or purchase contract with an entity and make a nonrefundable deposit, we may have a variable interest in a VIE. In accordance with ASC 810, we perform ongoing reassessments of whether we are the primary beneficiary of a VIE and would consolidate the VIE if we are deemed to be the primary beneficiary. As of March 31, 2016 and December 31, 2015, we determined we were not the primary beneficiary for any VIEs associated with non-refundable land deposit and option contracts.
The table below presents a summary of our lots under option or contract (in thousands, except for lot count):

	March 31, 2016	December 31, 2015
Land deposits and option payments	$8,964	$6,406
Commitments under the land purchase option and deposit contracts if the purchases are consummated	$204,505	$155,548
Lots under land options and land purchase contracts	7,722	6,318

As of March 31, 2016 and December 31, 2015, approximately $0.3 million of the land deposits are related to purchase contracts to deliver finished lots that are secured by mortgages on the related property and refundable under certain circumstances.

Bonding, Letters of Credit and Financial Guarantees

We are committed to perform certain development and construction activities and provide certain guarantees in the normal course of business. We have outstanding letters of credit, performance and surety bonds and financial guarantees totaling $25.0 million and $20.8 million at March 31, 2016 and December 31, 2015, respectively, related to our obligations for site improvements at various projects of which $7.6 million and $3.4 million, respectively, were issued under our revolving

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credit facility. Management does not believe that draws upon the letters of credit, bonds or financial guarantees if any, will have a material effect on our consolidated financial position, results of operations, or cash flows.

12. SEGMENT INFORMATION

We operate one principal homebuilding business which is organized and reports by division. We have five operating segments at March 31, 2016: our Texas, Southwest, Southeast, Florida and Northwest divisions. Our Texas division is our largest division and it comprised approximately 50% and 59% of total home sales revenues for the three months ended March 31, 2016, and 2015, respectively. As of March 31, 2016, the Northwest division had start-up activities and no revenues.

In accordance with ASC Topic 280, Segment Reporting ("ASC Topic 280"), operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision-maker ("CODM") in deciding how to allocate resources and in assessing performance. The CODM primarily evaluates performance based on the number of homes sold, gross margin and net income.

The operating segments qualify for aggregation as one reporting segment. In determining the reportable segment, we concluded that all operating segments have similar economic and other characteristics, including similar home floor plans, average selling prices, gross margin, production construction processes, suppliers, subcontractors, regulatory environments, customer type, and underlying demand and supply. Each operating segment follows the same accounting policies and is managed by our management team. We have no inter-segment sales, as all sales are to external customers.

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

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

Business Overview

We are one of the nation’s fastest growing public homebuilders in terms of percentage increase of home closings. We are engaged in the design, construction, marketing and sale of new homes in markets in Texas, Arizona, Florida, Georgia, New Mexico, South Carolina, North Carolina, Colorado, Washington and Tennessee. The markets where we have active communities at March 31, 2016, include Houston, San Antonio, Dallas/Fort Worth, Austin, Phoenix, Tucson, Tampa, Orlando, Fort Myers, Atlanta, Albuquerque, Charlotte, Denver, and Jacksonville.

Our management team has been in the residential land development business since the mid-1990s. Since commencing home building operations in 2003, we have constructed and closed over 13,000 homes. During the three months ended March 31, 2016, we had 844 home closings, compared to 671 home closings during the three months ended March 31, 2015.

We sell homes under the LGI Homes and Terrata Homes brands. Our 56 active communities at March 31, 2016 include two Terrata Homes communities. During March 2016, we also launched home sales at our third Terrata Homes community which is located in Denver, Colorado.

Recent Developments

During March 2016, we launched our home sales activities in Seattle, Washington and Colorado Springs, Colorado. We expect to have our first home closings in these markets and to begin home construction in the Nashville market during the second quarter of 2016.

Key Results

Key financial results as of and for the three months ended March 31, 2016, as compared to the three months ended March 31, 2015, were as follows:

- Home sales revenues increased 34.6% to $162.5 million from $120.7 million.
- Homes closed increased 25.8% to 844 homes from 671 homes.
- Average sales price of our homes increased 7.0% to $192,491 from $179,866.
- Gross margin as a percentage of home sales revenues decreased to 25.5% from 26.1%.
- Adjusted gross margin (non-GAAP) as a percentage of home sales revenues decreased to 26.7% from 27.8%.
- Net income before income taxes increased 52.1% to $17.8 million from $11.7 million.
- Adjusted EBITDA (non-GAAP) margin as a percentage of home sales revenues increased to 12.1% from 11.6%.
- Active communities increased to 56 from 44.

Total owned and controlled lots increased to 25,540 lots at March 31, 2016 from 23,915 lots at December 31, 2015.

For a reconciliation of certain non-GAAP measures to the most directly comparable GAAP measure, please see “—Non-GAAP Measures.”

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Results of Operations

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

	Three Months Ended March 31,	
	2016	2015
	(dollars in thousands, except per share data and average home sales price)	
Statement of Income Data:		
Home sales revenues	$162,463	$120,690
Expenses:		
Cost of sales	121,094	89,228
Selling expenses	14,091	11,582
General and administrative	9,952	8,205
Operating income	17,326	11,675
Other income, net	(503)	(46)
Net income before income taxes	17,829	11,721
Income tax provision	6,129	4,019
Net income	$11,700	$7,702
Basic earnings per share	$0.58	$0.39
Diluted earnings per share	$0.57	$0.33
Other Financial and Operating Data:		
Active communities at end of period	56	44
Home closings	844	671
Average sales price of homes closed	$192,491	$179,866
Gross margin (1)	$41,369	$31,462
Gross margin % (2)	25.5 %	26.1 %
Adjusted gross margin (3)	$43,321	$33,585
Adjusted gross margin % (2)(3)	26.7 %	27.8 %
Adjusted EBITDA (4)	$19,644	$14,004
Adjusted EBITDA margin % (2)(4)	12.1 %	11.6 %

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

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

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

most directly comparable.

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

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rates or effective tax rates, levels of depreciation or amortization and items considered to be non-recurring. Accordingly, our management believes that this measurement is useful for comparing general operating performance from period to period. Other companies may define adjusted EBITDA differently and, as a result, our measure of adjusted EBITDA may not be directly comparable to adjusted EBITDA of other companies. Although we use adjusted EBITDA as a financial measure to assess the performance of our business, the use of adjusted EBITDA is limited because it does not include certain costs, such as interest and taxes, necessary to operate our business. Adjusted EBITDA should be considered in addition to, and not as a substitute for, net income in accordance with GAAP as a measure of performance. Our presentation of adjusted EBITDA should not be construed as an indication that our future results will be unaffected by unusual or nonrecurring items. Our adjusted EBITDA is limited as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under GAAP. Please see "—Non-GAAP Measures—Adjusted EBITDA" for a reconciliation of adjusted EBITDA to net income, which is the GAAP financial measure that our management believes to be most directly comparable.

Three Months Ended March 31, 2016 Compared to Three Months Ended March 31, 2015

Homes Sales. Our home sales revenues and closings by division for the three months ended March 31, 2016 and 2015 were as follows (dollars in thousands):

	Three Months Ended March 31,			
	2016		2015	
	Revenues	Closings	Revenues	Closings
Texas	$			